SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2008

Or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number: 000-49799

OVERSTOCK.COM, INC.

(Exact name of registrant as specified in its charter)

Delaware	**87-0634302**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

6350 South 3000 East

Salt Lake City, Utah 84121

(Address, including zip code, of

Registrant s principal executive offices)

Registrant s telephone number, including area code: **(801) 947-3100**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the act). Yes o No x

There were 22,812,317 shares of the Registrant s common stock, par value $0.0001, outstanding on August 1, 2008.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Overstock.com, Inc.

Consolidated Balance Sheets (unaudited)

(in thousands)

	December 31, 2007	June 30, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 101,394	$ 56,679
Marketable securities	46,000	30,020
Cash, cash equivalents and marketable securities	147,394	86,699
Accounts receivable, net	12,304	15,186
Notes receivable (Note 4)	1,506	250
Inventories, net	25,933	14,036
Prepaid inventory	3,572	2,648
Prepaid expenses	7,572	10,481
Total current assets	198,281	129,300
Property and equipment, net	27,197	21,318
Goodwill	2,784	2,784
Other long-term assets, net	86	30
Notes receivable (Note 4)	4,181	4,453
Total assets	$ 232,529	$ 157,885
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 70,648	$ 31,217
Accrued liabilities	35,241	24,248
Deferred revenue	17,357	15,417
Capital lease obligations	3,796	
Total current liabilities	127,042	70,882
Other long-term liabilities	3,034	2,975
Convertible senior notes	75,623	75,795
Total liabilities	205,699	149,652
Commitments and contingencies (Notes 7 and 8)		
Stockholders equity:		
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of December 31, 2007 and June 30, 2008		
Common stock, $0.0001 par value, 100,000 shares authorized, 25,423 and 25,496 shares issued as of December 31, 2007 and June 30, 2008, respectively	2	2
Additional paid-in capital	333,909	337,659
Accumulated deficit	(243,709)	(254,081)
Treasury stock, 1,605 and 2,713 shares at cost as of December 31, 2007 and June 30, 2008, respectively	(63,278)	(75,218)
Accumulated other comprehensive loss	(94)	(129)

Total stockholders equity		26,830		8,233
Total liabilities and stockholders equity	$	232,529	$	157,885

The accompanying notes are an integral part of these consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Operations (unaudited)

(in thousands, except per share data)

	Three months ended June 30, 2007	Three months ended June 30, 2008	Six months ended June 30, 2007	Six months ended June 30, 2008
Revenue				
Direct revenue	$ 43,578	$ 39,939	$ 89,279	$ 91,422
Fulfillment partner revenue	105,389	148,903	217,618	298,165
Total revenue	148,967	188,842	306,897	389,587
Cost of goods sold				
Direct(1)	36,321	34,752	75,641	79,066
Fulfillment partner	86,343	119,985	179,638	241,630
Total cost of goods sold	122,664	154,737	255,279	320,696
Gross profit	26,303	34,105	51,618	68,891
Operating expenses:				
Sales and marketing(1)	7,962	14,244	19,246	29,263
Technology(1)	15,237	15,311	30,210	29,827
General and administrative(1)	10,429	10,867	21,118	20,430
Restructuring	6,194		12,283	
Total operating expenses	39,822	40,422	82,857	79,520
Operating loss	(13,519)	(6,317)	(31,239)	(10,629)
Interest income	1,078	742	2,068	2,046
Interest expense	(1,027)	(888)	(2,056)	(1,789)
Loss from continuing operations	(13,468)	(6,463)	(31,227)	(10,372)
Loss from discontinued operations	(300)		(3,924)	
Net loss	$ (13,768)	$ (6,463)	$ (35,151)	$ (10,372)
Net loss per common share basic and diluted:				
Loss from continuing operations	$ (0.57)	$ (0.28)	$ (1.32)	$ (0.45)
Loss from discontinued operations	$ (0.01)	$	$ (0.17)	$
Net loss per common share basic and diluted	$ (0.58)	$ (0.28)	$ (1.49)	$ (0.45)
Weighted average common shares outstanding basic and diluted	23,689	22,750	23,642	23,048

(1) Includes stock-based compensation from stock based awards as follows (Note 11):

Cost of goods sold direct	$	114	$	50	$	221	$	99
Sales and marketing	$	85	$	86	$	163	$	170
Technology	$	188	$	220	$	365	$	434
General and administrative	$	750	$	862	$	1,461	$	1,849

The accompanying notes are an integral part of these consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Stockholders Equity

and Comprehensive Loss (unaudited)

(in thousands)

	Common stock		Additional Paid-in	Accumulated	Treasury stock		Accumulated Other Comprehensive	
	Shares	Amount	Capital	Deficit	Shares	Amount	Income (loss)	Total
Balance at December 31, 2007	25,423	$ 2	$ 333,909	$ (243,709)	(1,605)	$ (63,278)	$ (94)	$ 26,830
Exercise of stock options	73		924					924
Treasury stock issued for 401(k) matching contribution			(41)		2	60		19
Stock-based compensation to employees and directors			2,252					2,252
Stock-based compensation to consultants in exchange for services			315					315
Stock-based compensation for performance share plan			300					300
Purchase of treasury stock					(1,110)	(12,000)		(12,000)
Comprehensive loss:								
Net loss				(10,372)				(10,372)
Net unrealized loss on marketable securities							(3)	(3)
Cumulative translation adjustment							(32)	(32)
Total comprehensive loss								(10,407)
Balance at June 30, 2008	25,496	$ 2	$ 337,659	$ (254,081)	(2,713)	$ (75, 218)	$ (129)	$ 8,233

The accompanying notes are an integral part of these consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Cash Flows (unaudited)

(in thousands)

	Three months ended June 30,		Six months ended June 30,		Twelve months ended June 30,	
	2007	**2008**	**2007**	**2008**	**2007**	**2008**
Cash flows from operating activities of continuing operations:						
Net loss	$ (13,768)	$ (6,463)	$ (35,151)	$ (10,372)	$ (105,268)	$ (20,236)
Adjustments to reconcile net loss to cash provided by (used in) operating activities of continuing operations:						
Loss from discontinued operations	300		3,924		8,898	
Depreciation and amortization	7,974	5,887	15,745	12,384	35,046	26,134
Loss on disposition of property and equipment	1		1		1	
Stock-based compensation to employees and directors	1,137	1,068	2,210	2,252	4,284	4,564
Stock-based compensation to consultants for services	135	329	140	315	129	364
Stock-based compensation for performance share plan		150		300		(250)
Issuance of common stock from treasury for 401(k) matching contribution	113		715	19	890	(202)
Amortization of debt discount and deferred financing fees	86	85	172	172	311	344
Asset impairment and depreciation (other non cash restructuring)	2,169		2,169		2,960	
Restructuring charges	4,025		10,114		14,997	
Notes receivable accretion		(136)		(272)		(544)
Changes in operating assets and liabilities, net of effect of discontinued operations:						
Accounts receivable, net	(431)	(2,144)	3,396	(2,882)	5	(7,244)
Inventories, net	1,237	3,934	4,849	11,897	53,411	1,389
Prepaid inventory	477	(80)	117	924	1,119	(524)
Prepaid expenses	700	(363)	(1,262)	(2,909)	913	(1,746)
Other long-term assets, net	176		266		744	205
Accounts payable	5,467	(1,622)	(32,592)	(39,431)	(2,568)	(2,327)
Accrued liabilities	4,941	428	(18,768)	(10,993)	(6,033)	878
Deferred revenue	200	(771)	654	(1,940)	(427)	12,130
Other long-term liabilities		147		(59)		(252)
Net cash provided by (used in) operating activities of continuing operations	14,939	449	(43,301)	(40,595)	9,412	12,683
Cash flows from investing activities of continuing operations:						
Purchases marketable securities	(21,381)	(18,823)	(21,381)	(25,362)	(21,381)	(79,198)
Sales and maturities of marketable securities	3,400	18,428	3,400	41,339	3,400	67,197
Expenditures for property and equipment	(1,439)	(5,136)	(1,916)	(6,449)	(13,450)	(7,176)
	9,892		9,892		9,892	

Proceeds from the sale of discontinued operations, net of cash transferred						
Collection of note receivable	753	754	4,694	1,256	4,694	1,758
Decrease in cash resulting from de-consolidation of variable interest entity					(102)	
Net cash (used in) provided by investing activities of continuing operations	(8,775)	(4,777)	(5,311)	10,784	(16,947)	(17,419)
Cash flows from financing activities of continuing operations:						
Payments on capital lease obligations	(4)	(2)	(5,251)	(3,796)	(5,454)	(3,806)
Drawdown on line of credit		1,128	1,169	6,396	14,592	7,650
Payments on line of credit		(1,128)	(1,169)	(6,396)	(14,592)	(7,650)
Issuance of common stock in offerings, net of issuance costs					39,406	
Purchase of treasury stock				(12,000)		(12,000)
Exercise of stock options	768	924	1,921	924	2,994	2,233
Net provided by (used in) financing activities of continuing operations	764	922	(3,330)	(14,872)	36,946	(13,573)

The accompanying notes are an integral part of these consolidated financial statements.

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Effect of exchange rate changes on cash	36	(9)	21	(32)	84	(56)
Cash (used in) provided by operating activities from discontinued operations	(614)		(204)		1,307	
Cash used in investing activities of discontinued operations			(53)		(315)	
Net increase (decrease) in cash and cash equivalents	6,350	(3,415)	(52,178)	(44,715)	30,487	(18,365)
Change in cash and cash equivalents from discontinued operations	614		257		(993)	
Cash and cash equivalents, beginning of period	68,080	60,094	126,965	101,394	45,550	75,044
Cash and cash equivalents, end of period	$ 75,044	$ 56,679	$ 75,044	$ 56,679	$ 75,044	$ 56,679
Supplemental disclosure of cash flow information:						
Interest paid	$ 1,585	$ 1,524	$ 2,236	$ 2,163	$ 4,104	$ 3,809
Asset retirement obligation					450	
Deemed dividend on redeemable common stock					33	
Lapse of rescission right on redeemable common stock					2,431	
Promissory note received in exchange for deconsolidation of variable					6,702	
Promissory notes received as proceeds from sale of discontinued operations	6,000		6,000		6,000	
Prior year discretionary 401(k) contribution					408	

The accompanying notes are an integral part of these consolidated financial statements.

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Overstock.com, Inc.

Notes to Unaudited Consolidated Financial Statements

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared by Overstock.com, Inc. (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the audited annual consolidated financial statements and related notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2007. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of results for the interim periods presented. Preparing financial statements requires management to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management s best knowledge of current events and actions that the Company may undertake in the future, actual results may be different from the estimates. The results of operations for the three and six months ended June 30, 2008 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

2. ACCOUNTING POLICIES

Principles of consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. The consolidated financial statements include the accounts of the Company s OTravel subsidiary through April 25, 2007 (see Note 4 Sale of Discontinued Operations). All significant intercompany account balances and transactions have been eliminated in consolidation.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent liabilities in the consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, valuation of investments, receivables valuation, revenue recognition, sales returns, incentive discount offers, inventory valuation, depreciable lives of fixed assets, internally-developed software, valuation of acquired intangibles, income taxes, stock-based compensation, and contingencies. Actual results could differ materially from those estimates.

Revenue recognition

The Company derives revenue primarily from two sources: direct revenue and fulfillment partner revenue. Direct revenue consists of sale of merchandise to both individual consumers and businesses that are fulfilled directly from the Company s leased warehouses. Fulfillment partner revenue includes listing fees and commissions collected from products being listed and sold through the Auctions section of its Website, advertisement and lead generation revenue derived from its Cars listing site, and advertising revenue generated by its Real Estate site. The Company has organized its operations into two principal segments based on these primary sources of revenue (see Note 12 Business Segments).

Revenue is recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or the service has been provided; (3) the selling price or fee revenue earned is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured.

Revenue related to merchandise sales is recognized upon delivery to the Company s customers. As the Company ships high volumes of packages through multiple carriers, it is not practical for the Company to track the actual delivery date of each shipment. Therefore, the Company uses estimates to determine which shipments are delivered and therefore recognized as revenue at the end of the period. The delivery date estimates are based on average shipping transit times, which are calculated using the following factors: (i) the shipping carrier (as carriers differ in transit times); (ii) the fulfillment source (either the Company s warehouses or those of its fulfillment partners); (iii) the delivery destination; and (iv) actual transit time experience, which shows that delivery date is typically one to eight business days from the date of shipment.

The Company evaluates the criteria outlined in EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*, in determining whether it is appropriate to record the gross amount of product sales and related costs or the net amount earned as commissions. When the Company is the primary obligor in a transaction, is subject to inventory risk, has latitude in establishing prices and selecting suppliers, or has several but not all of these indicators, revenue is recorded gross. If the Company is not the primary obligor in the transaction and amounts earned are determined using a fixed percentage, revenue is recorded on a net basis. Currently, the majority of both direct revenue and fulfillment partner revenue is recorded on a gross basis, as the Company is the primary obligor.

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The Company periodically provides incentive offers to its customers to encourage purchases. Such offers include current discount offers, such as percentage discounts off current purchases and other similar offers. Current discount offers, when accepted by its customers, are treated as a reduction to the purchase price of the related transaction.

Direct revenue

Direct revenue consists of sales of merchandise to both individual consumers and businesses that are fulfilled directly from the Company s leased warehouses. Direct sales occur primarily through the Company s Website, but may also occur through other offline channels.

Fulfillment partner revenue

Fulfillment partner revenue consists of merchandise sold through the Company s Website and shipped by third parties directly to consumers and other businesses from warehouses maintained by the fulfillment partners, as well as revenue from the Auctions, Cars and Real Estate sections of its Website.

The auctions site (added to the Website in September 2004) allows sellers to list items for sale, buyers to bid on items of interest, and users to browse through listed items online. With limited exceptions, the Company is not considered the seller of the items sold on the auctions site and has no control over the pricing of those items. Therefore, for these sales, only the listing fees for items listed and commissions for items sold are recorded as revenue during the period items are listed or sold. Auctions revenues were insignificant during the three and six months ended June 30, 2007 and 2008, and are included in the fulfillment partner segment, as they are not large enough to separate out as its own segment.

The cars listing service (added to the Website in December 2006) allows dealers to list vehicles for sale and allows buyers to review vehicle descriptions, post offers to purchase, and provides the means for purchasers to contact sellers for further information and negotiations on the purchase of an advertised vehicle. Revenue from its cars listing business is included in the fulfillment partner segment, as it is not significant enough to separate out as its own segment.

The real estate listing service (added to the Website in May 2008) allows customers to search active listings across the country. Listing categories include foreclosures, live and on-line auctions, for sale by owner listings, broker/agent listings and numerous aggregated classified ad listings. Advertising revenue from the real estate business is included in the fulfillment partner segment, as it is not significant enough to separate out as its own segment.

Deferred revenue

Payment is generally required by credit card at the point of sale. Amounts received prior to delivery of products or services provided are recorded as deferred revenue. Amounts received in advance for Club O membership fees are recorded as deferred revenue and recognized ratably over the membership period. In addition, the Company sells gift cards and records related deferred revenue at the time of the sale. Revenue from a gift certificate is recognized when a customer redeems it. If a gift certificate is not redeemed, the Company recognizes revenue when the likelihood of its redemption becomes remote, generally two years from the date of issuance.

Internal-Use Software and Website Development

The Company includes in fixed assets the capitalized cost of internal-use software and website development, including software used to upgrade and enhance its Website and processes supporting the Company s business. As required by Statement of Position (SOP) 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,* the Company capitalizes costs incurred during the application development stage of internal-use software and amortizes these costs over the estimated useful life of two to three years. The Company expenses costs incurred related to design or maintenance of internal-use software as incurred.

During the three months ended June 30, 2007 and 2008, the Company capitalized $226,000 and $1.8 million, respectively, of costs associated with internal-use software and website development, which are partially offset by amortization of previously capitalized amounts of $3.7 million and $3.1 million for those respective periods. For the six months ended June 30, 2007 and 2008, the Company capitalized $1.5 million and $2.6 million of costs associated with internal-use software and website development, which are partially offset by amortization of previously capitalized amounts of $7.1 million and $6.2 million, respectively.

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Advertising expense

The Company recognizes advertising expenses in accordance with SOP 93-7, *Reporting on Advertising Costs*. As such, the Company expenses the costs of producing advertisements at the time production occurs or the first time the advertising takes place and expenses the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized as incurred based on the terms of the individual agreements, which are generally: (i) a commission for traffic driven to the Website that generates a sale, and (ii) based on the number of clicks on keywords or links to the Company s Website generated during a given period. Advertising expense included in sales and marketing expenses totaled $7.1 million and $13.1 million during the three months ended June 30, 2007 and 2008, respectively. For the six months ended June 30, 2007 and 2008, advertising expenses totaled $17.7 million and $27.0 million, respectively.

Restructuring

Restructuring expenses are primarily comprised of lease termination costs and the costs incurred for returning leased facilities back to their original condition in anticipation of subleasing current office space. Statement of Financial Accounting Standard (SFAS) No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS No. 146), requires that when an entity ceases using a property that is leased under an operating lease before the end of its term contract, the termination costs should be recognized and measured at fair value when the entity ceases using the facility. Key assumptions in determining the restructuring expenses include the terms that may be negotiated to exit certain contractual obligations (see Note 3 Restructuring Expense).

Fair Value of Financial Instruments

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements* (SFAS No.157), which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position, or FSP, FAS No. 157-2, *Effective Date of FASB Statement No. 157* (FSP FAS No. 157-2), which delayed the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company adopted SFAS No. 157 for fiscal 2008, except as it applies to those non-financial assets and non-financial liabilities as described in FSP FAS No. 157-2, and it did not have a material impact on its consolidated financial position, results of operations or cash flows.

On a quarterly basis, the Company measures at fair value certain financial assets, including cash equivalents and available-for-sale securities. SFAS No. 157 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company s market assumptions. These two types of inputs have created the following fair-value hierarchy:

- Level 1 Quoted prices for identical instruments in active markets;
-

Level 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

- Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the Company to minimize the use of unobservable inputs and to use observable market data, if available, when determining fair value. The fair value of these financial assets and liabilities was determined using the following levels of inputs as of June 30, 2008 (in thousands):

	Fair Value Measurements as of June 30, 2008:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents Money market mutual funds	$ 33,948	$ 33,948	$	$
Available-for-sale securities	30,020	30,020		
Total assets	$ 63,968	$ 63,968	$	$

Earnings (loss) per share

In accordance with SFAS No. 128, *Earnings per share*, basic earnings (loss) per share is computed by dividing net income (loss)

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attributable to common shares by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) for the period by the weighted average number of common and potential common shares outstanding during the period. Potential common shares, composed of incremental common shares issuable upon the exercise of stock options, restricted stock units, convertible senior notes and shares under the Performance Share Plan, are included in the calculation of diluted net earnings (loss) per share to the extent such shares are dilutive.

The following table sets forth the computation of basic and diluted earnings (loss) per share for the periods indicated (in thousands, except per share amounts):

	Three months ended June 30,		Six months ended June 30,	
	2007	**2008**	**2007**	**2008**
Loss from continuing operations	$ (13,468)	$ (6,463)	$ (31,227)	$ (10,372)
Loss from discontinued operations	(300)		(3,924)	
Net loss	$ (13,768)	$ (6,463)	$ (35,151)	$ (10,372)
Weighted average common shares outstanding basic	23,689	22,750	23,642	23,048
Effective of dilutive securities:				
Stock options				
Restricted stock units				
Convertible senior notes				
Shares under the Performance Share Plan				
Weighted average common shares outstanding diluted	23,689	22,750	23,642	23,048
Net loss per common share basic and diluted:				
Loss from continuing operations	$ (0.57)	$ (0.28)	$ (1.32)	$ (0.45)
Loss from discontinued operations	$ (0.01)	$	$ (0.17)	$
Net loss per common share basic and diluted	$ (0.58)	$ (0.28)	$ (1.49)	$ (0.45)

The stock options, restricted stock units, convertible senior notes outstanding and shares under the Performance Share Plan were not included in the computation of diluted earnings (loss) per share because to do so would have been antidilutive. The number of stock options outstanding at June 30, 2007 and 2008 was 1,290,000 and 1,031,000, respectively. In the first six months of 2008, the Compensation Committee of the Board of Directors approved grants of approximately 12,000 stock options and 485,000 restricted stock units to officers and employees of the Company. As of June 30, 2008, there were 457,000 restricted stock units outstanding (see Note 11 Stock Based Awards). As of June 30, 2008, the Company had $77.0 million of convertible senior notes outstanding, which could potentially convert into 1,010,000 shares of common stock in the aggregate.

Recent accounting pronouncements

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). Under SFAS No. 159, companies may elect to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company adopted SFAS No. 159 for fiscal 2008; however, it did not elect to apply the fair value option to any financial instruments or other items upon adoption of SFAS No. 159 during the six months ended June 30, 2008. Therefore, the adoption of SFAS No. 159 did not impact the Company s consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141 (R), *Business Combinations* (SFAS No. 141 (R)), and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS No. 160). SFAS No. 141 (R) requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquired entity at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. SFAS No. 160 clarifies that a noncontrolling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. SFAS No. 141 (R) and SFAS No. 160 are effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. The Company does not expect the adoption of SFAS No. 141 (R) or SFAS No. 160 to impact its financial position and results of operations or cash flows.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (SFAS No. 161). SFAS No. 161 requires enhanced disclosures about a company s derivative and hedging activities, in particular: 1) how and why derivative instruments are utilized; 2) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations; and 3) how derivative instruments and

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related hedged items affect a company s financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early adoption encouraged. The Company has no derivative instruments. Therefore, the Company does not expect the adoption of SFAS No. 161 to impact its financial position and results of operations or cash flows.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 162). The current GAAP hierarchy was established by the American Institute of Certified Public Accountants, and faced criticism because it was directed to auditors rather than entities. The issuance of this statement corrects this and makes some other hierarchy changes. This statement is effective 60 days following the Securities and Exchange Commission s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The FASB does not expect that this statement will result in a change to current practice.

3. RESTRUCTURING EXPENSE

During the fourth quarter of 2006, the Company began a facilities consolidation and restructuring program designed to reduce its overall expense structure in an effort to improve future operating performance, and incurred $5.7 million of restructuring charges related to the early termination of a data center lease.

During fiscal year 2007, the Company recorded $12.3 million of restructuring charges, of which $9.9 million related to the termination of a logistics services agreement, termination and settlement of a lease related to vacated warehouse facilities in Indiana, and abandonment and marketing for sub-lease office and data center space in the Company s current corporate office facilities. The Company also recorded an additional $2.2 million of restructuring charges related to accelerated depreciation of leasehold improvements located in the abandoned office and co-location data center space and $200,000 of other miscellaneous restructuring charges.

Restructuring liabilities along with charges to expense, cash payments or accelerated depreciation of leasehold improvements associated with the facilities consolidation and restructuring program were as follows (in thousands):

	Balance 12/31/2007	Charges to Expense	Cash payment	Balance 06/30/2008
Lease and contract termination costs	$ 4,035	$	$ (555)	$ 3,480
Total	$ 4,035	$	$ (555)	$ 3,480

Of the $3.5 million of restructuring liabilities, $3.0 million is classified in the balance sheet as Other long-term liabilities with the remainder in accrued liabilities.

Under the restructuring program, the Company recorded $18.0 million in restructuring charges through the end of the second quarter of 2007, including $5.7 million in fiscal year 2006 and $12.3 million in fiscal year 2007. There were no restructuring charges during the six months ended June 30, 2008. The costs incurred to date within each restructuring category approximate the costs that the Company had anticipated at the beginning of the program. In 2009, the Company intends to move its corporate office facilities into new warehouse space leased on April 8, 2008 (see Note 8 Commitments and Contingencies). The Company believes that, except for the additional lease and contract termination costs related to relocating its current office facilities to the new warehouse location, the restructuring program is substantially complete.

4. SALE OF DISCONTINUED OPERATIONS

On July 1, 2005, the Company acquired all the outstanding capital stock of Ski West, Inc. (Ski West) for an aggregate of $25.1 million (including $111,000 of capitalized acquisition related expenses).

Ski West was an on-line travel company whose proprietary technology provides consumer access to a large, fragmented, hard-to-find inventory of lodging, vacation, cruise and transportation bargains, primarily in popular ski areas in the U.S. and Canada. Effective upon the closing, Ski West became a wholly-owned subsidiary of the Company, and the Company integrated the Ski West travel offerings with the Company s existing travel offerings and changed its name to OTravel.com, Inc (OTravel).

During the fourth quarter of 2006, in conjunction with the facilities consolidation and restructuring program described in Note 3, management decided to sell OTravel. The Company evaluated its plan to sell OTravel in accordance with SFAS No. 144, *Accounting for the Impairment of Long-Lived Assets* (SFAS No. 144), which requires that long-lived assets be classified as held for sale only when certain criteria are met. The Company classified the OTravel assets and liabilities as held for sale as it met these criteria as of December 31, 2006, which included: management s commitment to a plan to sell the assets; availability of the assets for immediate sale in their present condition; an active program to locate buyers and other actions to sell the assets has been initiated; sale of the assets is probable and their transfer is expected to qualify for recognition as a completed sale within one year; assets are being

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marketed at reasonable prices in relation to their fair value; and the unlikelihood that significant changes will be made to the plan. The travel business was not part of the Company s core business operations and was no longer part of its strategic focus. The results of operations for the subsidiary were included in the fulfillment partner segment prior to being classified as discontinued operations.

The Company also determined that the OTravel subsidiary met the definition of a component of an entity and accounted for it as a discontinued operation under SFAS No. 144. The results of operations for this subsidiary have been classified as discontinued operations in all periods presented. In conjunction with the discontinuance of OTravel, the Company performed an evaluation of the goodwill associated with the reporting unit pursuant to SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142) and SFAS No. 144 and determined that goodwill of approximately $4.5 million was impaired as of December 31, 2006, based on a non-binding letter of intent from a third party to purchase the business. During the quarter ended June 30, 2007, the Company received a revised offer from this third party to purchase its OTravel business and, in April 2007, the Company completed the sale of OTravel under these revised terms. Accordingly, the Company evaluated its goodwill as of June 30, 2007 and, based on the estimated fair value of the discounted cash flows of the net proceeds from the sale, determined that an additional $3.8 million of goodwill was impaired.

On April 25, 2007, the Company completed the sale of OTravel.com to Castles Travel, Inc., an affiliate of Kinderhook Industries, LLC, and Castles Media Company LLC, for $17.0 million. The Company received cash proceeds, net of cash transferred, of $9.9 million and two $3.0 million promissory notes. The $3.0 million senior note matures three years from the closing date and bears interest, payable quarterly, of 4.0%, 10.0% and 14.0% per year in the first, second and third years, respectively. The $3.0 million junior note matures five years from the closing date and bears interest of 8.0% per year, compounded annually, and is payable in full at maturity.

The following table is a summary of the Company s discontinued operations for the quarter-to-date period ended April 25, 2007 and the year-to-date period ended April 25, 2007 (in thousands):

	Quarter-to-date period ended April 25, 2007	Year-to-date period ended April 25, 2007
Sales	$ 145	$ 2,226
Cost of sales	(78)	(650)
Gross profit	67	1,576
Sales and marketing	(105)	(447)
Technology	(16)	(60)
General and administrative	(246)	(1,152)
Goodwill impairment		(3,841)
Loss from discontinued operations	$ (300)	$ (3,924)

5. MARKETABLE SECURITIES

The Company s marketable securities are reported at fair value with the related unrealized gains and losses included in accumulated other comprehensive income (loss), a component of shareholders equity, net of any tax effect. Realized gains or losses on the sale of marketable securities are determined using the specific-identification method.

The Company evaluates its investments periodically for possible other-than-temporary impairment by reviewing factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and the Company s ability and intent to hold the investment for a period of time which may be sufficient for anticipated recovery of market value. The Company records an impairment charge to the extent that the carrying value of its available-for-sale securities exceeds the estimated fair market value of the securities and the decline in value is determined to be other-than-temporary. The Company did not record any impairment charges related to other-than-temporary decline in value of its marketable securities during the three or six months ended June 30, 2007 or 2008.

As of June 30, 2008, the Company s marketable securities consisted of U.S. agency securities, commercial paper, and AAA-rated asset-backed securities collateralized by automobile loans/leases or credit card receivables. All marketable securities are classified as available-for-sale securities. The following table summarizes the Company s marketable security investments as of June 30, 2008 (in thousands):

	Cost	Net Unrealized Gains (Losses)	Estimated Fair Market Value
Marketable securities:			
U.S. Agency Securities	$ 16,747	$ 5	$ 16,752
Commercial Paper	10,455	1	10,456
Asset-Backed Securities	2,821	(9)	2,812
Total available-for-sale investments	$ 30,023	$ (3)	$ 30,020

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There were no realized gains and losses on sales of marketable securities during the three and six months ended June 30, 2007 and 2008.

6. OTHER COMPREHENSIVE LOSS

The Company follows SFAS No. 130, *Reporting Comprehensive Income.* This Statement establishes requirements for reporting comprehensive income (loss) and its components. The Company s comprehensive loss is as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2007	2008	2007	2008
Net loss	$ (13,768)	$ (6,463)	$ (35,151)	$ (10,372)
Net unrealized gain (loss) on marketable securities	1	(125)	1	(3)
Foreign currency translation adjustment	36	(9)	21	(32)
Comprehensive loss	$ (13,731)	$ (6,597)	$ (35,129)	$ (10,407)

7. BORROWINGS

Wells Fargo Operational Credit Agreement

The Company has a credit agreement (as amended to date, the Credit Agreement) with Wells Fargo Bank, National Association (Wells Fargo). The Credit Agreement provides a revolving line of credit to the Company of up to $30.0 million which the Company uses primarily to obtain letters of credit to support operations, namely, inventory purchases. Interest on borrowings is payable monthly and accrued at either (i) 1.0% above LIBOR in effect on the first day of an applicable fixed rate term, or (ii) at a fluctuating rate per annum determined by the bank to be one half a percent (0.50%) above daily LIBOR in effect on each business day a change in daily LIBOR is announced by the bank. The Credit Agreement expires on January 1, 2010, and requires the Company to comply with certain covenants, including restrictions on mergers, business combinations or transfer of assets.

Borrowings and outstanding letters of credit under the Credit Agreement are required to be completely collateralized by cash balances held at Wells Fargo Bank, N.A, and therefore the facility does not provide additional liquidity to the Company.

At June 30, 2008, no amounts were outstanding under the Credit Agreement, and letters of credit totaling $2.5 million were issued on behalf of the Company.

Wells Fargo Retail Finance Agreement

The Company is a party to a Loan and Security Agreement (the WFRF Agreement) with Wells Fargo Retail Finance, LLC and related security agreements and other agreements described in the WFRF Agreement.

The WFRF Agreement provides for advances to the Company and for the issuance of letters of credit for its account of up to an aggregate maximum of $40.0 million. The amount actually available to the Company may be less and may vary from time to time, depending on, among other factors, the amount of its eligible inventory and receivables. The Company s obligations under the WFRF Agreement and all related agreements are collateralized by all or substantially all of the Company s and its subsidiaries assets. The Company s obligations under the WFRF Agreement are cross-collateralized with its assets pledged under its $30.0 million credit facility with Wells Fargo Bank, N.A. The WFRF Agreement contains standard default provisions and expires on December 12, 2008. The conditions to the Company s use of the facility include a 45-day advance notice requirement.

Advances under the WFRF Agreement bear interest at either (i) the rate announced, from time to time, within Wells Fargo Bank, N.A. at its principal office in San Francisco as its prime rate or (ii) a rate based on LIBOR plus a varying percentage between 1.25% and 1.75%; however, the annual interest rate on advances under the WFRF Agreement will be at least 3.50%. The WFRF Agreement includes affirmative covenants as well as negative covenants that prohibit a variety of actions without the lender s approval, including covenants that limit the Company s ability to (a) incur or guarantee debt, (b) create liens, (c) enter into any merger, recapitalization or similar transaction or purchase all or substantially all of the assets or stock of another person, (d) sell assets, (e) change its name or the name of any of its subsidiaries, (f) make certain changes to its business, (g) optionally prepay, acquire or refinance indebtedness, (h) consign inventory, (i) pay dividends on, or purchase, acquire or redeem shares of, its capital stock,

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(j) change its method of accounting, (k) make investments, (l) enter into transactions with affiliates, or (m) store any of its inventory or equipment with third parties. At June 30, 2008, no amounts were outstanding and availability under the WFRF Agreement was $8.4 million.

Wells Fargo Commercial Card Agreement

The Company has a commercial card agreement (the Commercial Card) with Wells Fargo Bank, National Association (Wells Fargo). The Company uses the Commercial Card primarily for business purpose purchasing and must be paid in full each month. Outstanding amounts under the Commercial Card are collateralized by cash balances held at Wells Fargo Bank, N.A, and therefore the facility does not provide additional liquidity to the Company. At June 30, 2008, $1.5 million was outstanding and availability under the Commercial Card was $3.5 million.

Capital leases

The Company leased certain software and computer equipment under one non-cancelable capital lease that expired in June 2008.

Software and equipment relating to expired capital leases totaled $19.8 million at June 30, 2007 and 2008, with accumulated depreciation of $13.4 million and $18.5 million at those respective dates. Depreciation of assets recorded under expired capital leases was $1.4 million and $1.0 million during the three months ended June 30, 2007 and 2008, respectively. For the six months ended June 30, 2007 and 2008, depreciation of assets recorded under capital leases was $2.9 million and $2.4 million, respectively. As of June 30, 2008, the Company has no remaining capital leases.

3.75% Convertible senior notes

In November 2004, the Company completed an offering of $120.0 million of 3.75% Convertible Senior Notes (the Senior Notes). Proceeds to the Company were $116.2 million, net of $3.8 million of initial purchaser s discount and debt issuance costs. The discount and debt issuance costs are being amortized using the straight-line method which approximates the interest method. The Company recorded amortization of discount and debt issuance costs related to this offering totaling $86,000 and $85,000 during the three months ended June 30, 2007 and 2008, respectively. For the six months ended June 30, 2007 and 2008, amortization of discount and debt issuance costs totaled $172,000 for both periods. Interest on the Senior Notes is payable semi-annually on June 1 and December 1 of each year. The Senior Notes mature on December 1, 2011 and are unsecured and rank equally in right of payment with all existing and future unsecured, unsubordinated debt and senior in right of payment to any existing and future subordinated indebtedness.

The Senior Notes are convertible at any time prior to maturity into the Company s common stock at the option of the note holders at a conversion price of $76.23 per share or, approximately 1,010,000 shares in aggregate (subject to adjustment in certain events, including stock splits, dividends and other distributions and certain repurchases of the Company s stock, as well as certain fundamental changes in the ownership of the Company). Beginning December 1, 2009, the Company has the right to redeem the Senior Notes, in whole or in part, for cash at 100% of the principal amount plus accrued and unpaid interest. Upon the occurrence of a fundamental change (including the acquisition of a majority interest in the Company, certain changes in the Company s board of directors or the termination of trading of the Company s stock) meeting certain conditions, holders of the Senior Notes may require the Company to repurchase for cash all or part of their notes at 100% of the principal amount plus accrued and unpaid interest.

The indenture governing the Senior Notes requires the Company to comply with certain affirmative covenants, including making principal and interest payments when due, maintaining the Company s corporate existence and properties, and paying taxes and other claims in a timely manner.

At June 30, 2008, $77.0 million of the Senior Notes remained outstanding.

8. COMMITMENTS AND CONTINGENCIES

Commitments

Corporate office space

Through July 2005, the Company leased 43,000 square feet of office space at Old Mill Corporate Center I for its principal corporate offices under an operating lease which was originally scheduled to expire in January 2007. Beginning July 2005, this lease was terminated and replaced with a lease for approximately 154,000 rentable square feet in the Old Mill Corporate Center III in Salt Lake City, Utah for a term of ten years. The total lease obligation over the remaining term of this lease is $31.4 million, of which approximately $3.9 million is payable in the next twelve months. $8.2 million of the total lease obligation is offset by estimated

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sublease payments, of which $1.2 million is anticipated to be received in the next twelve months.

In 2006, the Company commenced implementation of a facilities consolidation and restructuring program. Under the program, the Company recorded $638,000 of accelerated amortization of leasehold improvements related to its current office facilities that it is attempting to sublease, and $450,000 of costs incurred to return its office facilities to their original condition as required by the lease agreement.

During fiscal year 2007, the Company recorded an additional $6.2 million of restructuring costs related to its marketing for sub-lease office and data center space in its current corporate office facilities. The Company also recorded an additional $2.2 million of restructuring charges related to accelerated depreciation of leasehold improvements located in the abandoned office and co-location data center space and $200,000 of other miscellaneous restructuring charges (see Note 3 Restructuring Expense).

Logistics and warehouse space

In July 2004, the Company entered into a logistics service agreement (the Logistics Agreement) wherein the handling, storage and distribution of some of its prepackaged products were performed by a third party. The Logistics Agreement and subsequent amendment set forth terms on which the Company paid various fixed fees based on square feet of storage and various variable costs based on product handling costs for a term of five years.

In December 2005, the Company entered into a warehouse facilities lease agreement (the License Agreement) to license approximately 400,000 square feet of warehouse space in Indiana. The License Agreement was subsequently amended, reducing the amount of lease space to approximately 300,000 square feet and extending the term to 2011.

In the first quarter of 2007, the Company terminated the Logistics Agreement and gave notice of intent to sublease the Indiana warehouse facilities under the License Agreement. During the second quarter of 2007, the Company reached an agreement to terminate the Indiana warehouse facilities lease effective August 15, 2007. As a result of the termination of the License agreement and warehouse lease, the Company incurred $3.7 million of related restructuring charges in 2007 (see Note 3 Restructuring Expense).

The Company currently leases 640,000 square feet for its warehouse facilities in Utah under operating leases which expire in August 2012.

On April, 8, 2008, the Company entered into a lease agreement with Natomas Meadows, LLC (Natomas Lease). The Natomas Lease is for a 686,865 square foot warehouse facility, now under construction in Salt Lake City, Utah (New Warehouse). The Natomas Lease provides that the Company will lease the New Warehouse in stages: beginning September 1, 2008, the Company will lease a total of 232,900 square feet of the New Warehouse; on February 1, 2009, the Company will lease a total of 435,400 square feet; and, on September 1, 2009, the Company will lease the remainder, for a total of 686,865 square feet. The Natomas Lease term is seven years, and specifies rent, exclusive of common area maintenance fees, at a variable rate over the course of the staged Lease term, ranging from $0.3300 per square foot for the first stage, to $0.3950 per square foot for the last year of the Natomas Lease term. The Company currently has warehouse operations in three facilities in Salt Lake City. Over the course of the staged Natomas Lease, the Company plans to consolidate to the New Warehouse its warehouse operations from two of its smaller leased warehouse facilities in Salt Lake City. Both of these smaller warehouse facilities are under common ownership with Natomas Meadows, LLC. The common owner has agreed to cancel the Company s leases of those facilities without any early termination penalty. The Natomas Lease anticipates that the Company may construct a corporate office facility within the New Warehouse. The Company intends to expand its customer service operations into the New Warehouse in 2008, and to move its corporate office facility to the New Warehouse in 2009.

Co-location data center

In July 2005, the Company entered into a Co-location Center Agreement (the Co-location Agreement) to build out and lease 11,289 square feet of space at Old Mill Corporate Center II for an IT co-location data center. The Co-location Agreement set forth the terms on which the Lessor would incur the costs to build out the IT co-location data center and the Company would commence to lease the space upon its completion for a term of ten years. In November 2006 however, the Company made the determination to consolidate its facilities and to not occupy the IT co-location data center, and the Co-location Agreement was terminated effective December 29, 2006, for which the Company incurred a $4.6 million restructuring charge (see Note 3 Restructuring Expense).

In December 2006, the Company entered into a Data Center Agreement (the OM I Agreement) to lease 3,999 square feet of space at Old Mill Corporate Center I for an IT data center to allow the Company to consolidate other IT data center facilities.

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Computer equipment operating leases

The Company has two operating leases for certain computer equipment that expire in the first and fourth quarters of 2010. It is expected that such leases will be renewed by exercising purchase options or replaced by leases of other computer equipment.

Summary of future minimum lease payments for all operating leases

Minimum future payments under all operating leases described above are as follows (in thousands):

Payments due by period		
2008	$	8,154
2009		8,480
2010		8,859
2011		9,148
2012		8,395
Thereafter		18,993
	$	62,029

Rental expense for operating leases totaled $3.5 million and $2.9 million for the three months ended June 30, 2007 and 2008, respectively. For the six months ended June 30, 2007 and 2008, rental expense totaled $7.4 million and $5.9 million, respectively.

Legal Proceedings

From time to time, the Company receives claims of and becomes subject to consumer protection, employment, intellectual property and other commercial litigation related to the conduct of the Company s business. Such litigation could be costly and time consuming and could divert its management and key personnel from its business operations. The uncertainty of litigation increases these risks. In connection with such litigation, the Company may be subject to significant damages or equitable remedies relating to the operation of its business and the sale of products on the Company s website. Any such litigation may materially harm its business, prospects, results of operations, financial condition or cash flows. However, the Company does not currently believe that any of its outstanding litigation will have a material adverse effect on its financial statements.

On August 11, 2005, along with a shareholder plaintiff, the Company filed a complaint against Gradient Analytics, Inc.; Rocker Partners, LP; Rocker Management, LLC; Rocker Offshore Management Company, Inc. and their respective principals in the Superior Court of California, County of Marin. On October 12, 2005, the Company filed an amended complaint against the same entities alleging libel, intentional interference with prospective economic advantage and violations of California s unfair business practices act. On March 7, 2006, the court denied the defendants demurrers to and motions to strike the amended complaint. The defendants each filed a motion to appeal the court s decision, the Company responded and the California Attorney General submitted an amicus brief supporting the Company s view; the court has ruled that this appeal stays discovery in the case. On May 30, 2007 the California Court of Appeals upheld the lower court s ruling in the Company s favor.

Defendants filed motions for rehearing, which the Court of Appeals summarily denied on June 27, 2007. Defendants filed Petitions for Review before the California Supreme Court which the California Supreme court denied on September 19, 2007. On October 1, 2007, the Court of Appeals remitted the case back to the Superior Court. On December 4, 2007, Matthew Kliber, a former principal of Gradient Analytics, filed a motion for judgment on the pleading which the court denied on February 8, 2008. The parties have begun discovery in this case. The Company intends to continue to pursue this action vigorously. The court has set an April 27, 2009 trial date.

On November 9, 2007, Copper River Partners, L.P. (formerly known as Rocker Partners, LP) filed a cross-complaint against the Company and certain of its current and former directors. The Copper River cross-complaint alleges cross-defendants have engaged in violations of California s state securities laws, violations of California s unfair business practices act, tortuous interference with contract and prospective business advantage, and deceit. In January 2008, each of the cross-defendants filed various motions in opposition of this cross-complaint. On April 23, 2008, the court dismissed Copper River s cross claims against former Company directors, John Byrne and Jason Lindsey, and current Company director Allison Abraham. In that same ruling, the court dismissed four of the six claims against former Company director John Fisher: securities fraud, unfair business practices, common law fraud and equitable indemnity. In a separate ruling on the same day relating to the Company and Patrick Byrne, the court dismissed the common law fraud claims and equitable indemnity claims and eliminated the possibility of money damages under Copper River s claims that Overstock and Byrne engaged in unfair business practices. In other portions of the court s rulings, the court declined to dismiss Copper River s securities fraud claims and its request for an injunction for unfair business practices against the Company and Patrick Byrne and the claims for tortious interference with contract and prospective business advantage against the Company, Patrick Byrne and John Fisher. On June 20, Copper River dismissed its complaints against Mr. Fisher. The parties have begun discovery in this case. The Company intends to defend the Copper River cross-complaint vigorously.

On January 30, 2008, Gradient Analytics, Inc. filed a motion for leave to file a cross-complaint against the Company and Patrick Byrne. Neither the Company nor Patrick Byrne opposed this motion. On April 14, 2008 the court granted this motion and Gradient

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Analytics filed a cross-complaint against the Company and Patrick Byrne. The Gradient Analytics cross-complaint alleges that the Company and Dr. Byrne engaged in violations of California s unfair business practices act, interference with prospective business advantage, and libel. On July 9, 2008, the court dismissed three of Gradient Analytics claims against Dr. Byrne based on statute of limitations grounds (but allowed for Gradient to amend its complaint) and restricted Gradient Analytics claim for unfair business practices, disallowing the possibility of money damages on that claim, and limiting it only to possible injunctive relief if Gradient Analytics proves the claim at trial. On July 25, 2008, Gradient Analytics filed a First Amended Cross-Complaint again alleging that the Company and Dr. Byrne engaged in violations of California s unfair business practices act, interference with prospective business advantage, and libel. The parties have begun discovery in this case. The Company intends to defend the Gradient Analytics cross-complaint vigorously.

On May 9, 2006 the Company received a notice of an investigation and subpoena from the Securities and Exchange Commission, Salt Lake City District Office. On May 17, 2006, Patrick Byrne also received a subpoena from the Securities and Exchange Commission, Salt Lake City District Office. These subpoenas requested a broad range of documents, including, among other documents, all documents relating to the Company s accounting policies, the Company s targets, projections or estimates related to financial performance, the Company s recent restatement of its financial statements, the filing of its complaint against Gradient Analytics, Inc., the development and implementation of certain new technology systems and disclosures of progress and problems with those systems, communications with and regarding investment analysts, communications regarding shareholders who did not receive the Company s proxy statement in April 2006, communications with certain shareholders, and communications regarding short selling, naked short selling, purchases and sales of Company stock, obtaining paper certificates, and stock loan or borrow of Company shares. The Company and Dr. Byrne responded to these subpoenas and cooperated with the Securities and Exchange Commission on this matter. On June 6, 2008, the Regional Director of the Salt Lake District Office of the Securities and Exchange Commission informed the Company that the office had completed its investigation of the Company and its officers and did not intend to recommend any enforcement action by the Securities and Exchange Commission against the Company or its officers.

On February 2, 2007, along with five shareholder plaintiffs, the Company filed a lawsuit in the Superior Court of California, County of San Francisco against Morgan Stanley & Co. Incorporated, Goldman Sachs & Co., Bear Stearns Companies, Inc., Bank of America Securities LLC, Bank of New York, Citigroup Inc., Credit Suisse (USA) Inc., Deutsche Bank Securities, Inc., Merrill Lynch, Pierce, Fenner & Smith, Inc., and UBS Financial Services, Inc. In September 2007, the Company filed an amended complaint adding two plaintiff shareholders, naming Lehman Brothers Holdings Inc. as a defendant, eliminating the previous claim of intentional interference with prospective economic advantage and clarifying various points of other claims in the original complaint. The suit alleges that the defendants, who control over 80% of the prime brokerage market, participated in an illegal stock market manipulation scheme and that the defendants had no intention of covering short sell orders with borrowed stock, as they are required to do, causing what are referred to as fails to deliver and that the defendants actions caused and continue to cause dramatic distortions with in the nature and amount of trading in the Company s stock as well as dramatic declines in the share price of the Company s stock. The suit asserts that a persistent large number of fails to deliver creates significant downward pressure on the price of a company s stock and that the amount of fails to deliver has exceeded the Company s entire supply of outstanding shares. The suit accuses the defendants of violations of California securities laws and common law, specifically, conversion, trespass to chattels, intentional interference with prospective economic advantage, and violations of California s Unfair Business Practices Act. The Company is seeking damages of $3.48 billion. In April 2007 defendants filed a demurrer and motion to strike the Company s complaint. The Company opposed the demurrer and motion to strike. In July 2007 the court substantially denied defendants demurrer and motion to strike. In November 2007, the defendants filed additional motions to strike. In February 2008, the court denied defendants motion to strike the Company s claims under California s Securities Anti-Fraud statute and defendants motion to strike the Company s common law punitive damages claims, but granted in part the defendants motion to strike Overstock s claims under California s Unfair Business Practices Act, while allowing the Company s claims for injunctive relief under California s Unfair Business Practices Act. The parties have begun discovery in this case. The Company intends to vigorously prosecute this action.

On March 29, 2007, the Company, along with other defendants, was sued in United States District Court for the Eastern District of Texas, Tyler Division, by Orion IP, LLC. The suit alleged that the Company and the other defendants infringe two patents owned by Orion that relate to the making and using supply chain methods, sales methods, sales systems, marketing methods, marketing systems, and inventory systems. On April 30, 2007, the Company filed an answer denying Orion s allegations and a counterclaim asserting that Orion s patent is invalid. The parties have reached a confidential agreement that settled the case and the case was dismissed on June 11, 2008.

On April 15, 2008, the Company received a letter from the Office of the District Attorney of Marin County, California, stating that the District Attorneys of Marin and four other counties in Northern California have begun an investigation into the way the Company advertises products for sale, together with an administrative subpoena seeking related information and documents. The subpoena requests a range of documents, including documents relating to pricing methodologies, definitions of core and partner product, as well as other site-defined terms, and the methods of internal and external pricing of products, as well as documents related to the pricing of a list of product items identified in the subpoena. The Company believes that it follows industry advertising practices and intends to cooperate with the investigation.

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On May 30, 2008 the Company filed a complaint in New York state court against the New York State Department of Taxation and Finance, its Commissioner, the State of New York and its governor, alleging that a recently enacted New York state tax law is unconstitutional. The effect of the New York law is to require internet sellers to collect and remit New York sales taxes on their New York sales, even though the seller has no New York tax nexus other than with New York based independent contractors who are internet advertising affiliates. The complaint asks for the court to declare the law unconstitutional and enjoin its application to the Company. New York has not answered the complaint, and the case is in its early phase.

On June 6, 2008, the Company along with other defendants was sued in the United States District Court for the Eastern District of Texas, Marshall Division, by Transauction, LLC. The suit alleges the Company and other defendants infringe on a patent owned by Transauction. The patent concerns processes by which an internet auction seller may become bonded for an internet auction sales transaction. The Company has not yet answered the Complaint. The Company intends to vigorously defend this action.

9. INDEMNIFICATIONS AND GUARANTEES

During its normal course of business, the Company has made certain indemnities, commitments, and guarantees under which it may be required to make payments in relation to certain transactions. These indemnities include, but are not limited to, indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease, and indemnities to directors and officers of the Company to the maximum extent permitted under the laws of the State of Delaware. The duration of these indemnities, commitments, and guarantees varies, and in certain cases, is indefinite. In addition, the majority of these indemnities, commitments, and guarantees do not provide for any limitation of the maximum potential future payments the Company could be obligated to make. As such, the Company is unable to estimate with any reasonableness its potential exposure under these items. The Company has not recorded any liability for these indemnities, commitments, and guarantees in the accompanying consolidated balance sheets. The Company does, however, accrue for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is both probable and reasonably estimable. The Company carries specific and general liability insurance policies that the Company believes would, in most circumstances, provide some, if not total recourse to any claims arising from these indemnifications.

10. STOCK REPURCHASE PROGRAM

On January 14, 2008, the Company s Board of Directors authorized a repurchase program that allows the Company to purchase up to $20.0 million of its common stock and / or its 3.75% Senior Convertible Senior Notes due 2011 through December 31, 2009. Under this repurchase program, the Company repurchased approximately 1.1 million shares of its common stock in open market purchases for $12.0 million during the six months ended June 30, 2008. During July 2008, the Company repurchased an additional 30,000 shares of its common stock in open market purchases for approximately $482,000.

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11. STOCK BASED AWARDS

The Company has equity incentive plans that provide for the grant to employees of stock-based awards, including stock options, restricted stock units and performance shares awards.

Stock-based compensation expense recognized under SFAS No. 123(R), *Share-Based Payment* (SFAS No.123(R)) for the three and six months ended June 30, 2007 and 2008 were as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2007	2008	2007	2008
Stock options	$ 1,137	$ 826	$ 2,210	$ 1,760
Restricted stock units		242		492
Performance shares		150		300
Total stock-based compensation expense	$ 1,137	$ 1,218	$ 2,210	$ 2,552

Stock Options

The exercise price of each stock option granted under the Company s employee equity incentive plans is equal to or greater than the market price of its common stock on the date of grant. Generally, option grants vest over four years, expire no later than ten years from the grant date and are subject to the employee s continuing service to the Company. The fair value of each option grant is estimated on the date of grant using the Black-Scholes-Merton (BSM) option pricing model. The weighted average grant date fair value of options granted and the weighted average assumptions used in the model for the three and six months ended June 30, 2007 and June 30, 2008 were as follows:

	Three Months Ended June 30,		Six Months Ended June 30.	
	2007	2008	2007	2008
Dividend yield	None	None	None	None
Expected volatility	64.3%	65.9%	65.3%	70.6%
Risk-free interest rate	4.65%	2.70%	4.7%	2.91%
Expected life (in years)	6.3	6.3	6.3	6.3
Weighted average fair value of options granted	$ 10.88	$ 13.27	$ 11.06	$ 9.18

The computation of the expected volatility assumption used in the BSM pricing model for new grants is based on implied volatility. The expected term represents the period that the Company s stock-based awards are expected to be outstanding and was determined on historical experience of similar awards, giving consideration to contractual terms and vesting provisions of the stock-based awards. For 2007 option grants, the Company elected to use the simplified method as discussed in Staff Accounting Bulletin (SAB) No. 107, *Share Based Payment* (SAB No. 107) to develop the estimate for expected term. On January 1, 2008, the Company adopted SAB No. 110, *Certain Assumptions Use in Valuation Methods Expected Term* (SAB No. 110). According to SAB No. 110, under certain circumstances the SEC staff will continue to accept the use of the simplified method as discussed in SAB No. 107, in developing an estimate of expected term of Plain Vanilla share options in accordance with SFAS No. 123(R), beyond December 31, 2007. The risk-free interest rate for the period within the expected term of the option is based on the yield of United States Treasury notes in effect at the time of grant. The Company has not historically paid dividends; thus the expected dividend yield used in the calculation is zero.

Restricted Stock Units

In the first quarter of 2008, the Compensation Committee of the Board of Directors approved grants of approximately 460,000 restricted stock units to officers and employees of the Company. During the second quarter of 2008, an additional 25,000 restricted stock units were granted. The restricted stock units vest over three years at 25% at the end of the first year, 25% at the end of the second year and 50% at the end of the third year and are subject to the employee s continuing service to the Company. At June 30, 2008, there were 457,000 restricted stock units that remained outstanding.

The cost of restricted stock units is determined using the fair value of the Company s common stock on the date of the grant and compensation expense is recognized in accordance with the vesting schedule. The weighted average grant date fair values of restricted stock units granted during the three and six months ended June 30, 2008 were as follows:

	Three Months Ended June 30, 2008	Six Months Ended June 30. 2008
Weighted average fair value of restricted stock units granted	$ 21.20	$ 12.65

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Performance Share Plan

In January 2006, the Board of Directors and Compensation Committee adopted the Overstock.com Performance Share Plan (the Plan) and approved grants to executive officers and certain employees of the Company. The Plan provides for a three-year period for the measurement of the Company s attainment of the performance goal described in the form of grant.

The performance goal is measured by growth in economic value, as defined in the Plan. The amount of payments due to participants under the Plan will be a function of the then current market price of a share of the Company s common stock, multiplied by a percentage dependent on the extent to which the performance goal has been attained, which will be between 0% and 200%. If the growth in economic value is 10% compounded annually or less, the percentage will be 0%. If the growth in economic value is 25% compounded annually, the percentage will be 100%. If the growth in economic value is 40% compounded annually or more, the percentage will be 200%. If the percentage growth is between these percentages, the payment percentage will be determined on the basis of straight line interpolation. Amounts payable under the Plan were originally payable in cash. During interim and annual periods prior to the third quarter of 2007, the Company recorded compensation expense based upon the period-end stock price and estimates regarding the ultimate growth in economic value that is expected to occur. These estimates included assumed future growth rates in revenues, gross margins and other factors. If the Company were to use different assumptions, the estimated compensation charges could be significantly different.

An amendment to the Plan to allow the Company to make payments in the form of common stock was approved by the shareholders on May 15, 2007. In the third quarter of 2007, the Company determined the fair value of the awards on the amendment date and determined to make the payments in the form of common stock, rather than cash. Therefore, the Company reclassified awards under the Plan from their current status as liability awards to equity awards in accordance with SFAS No. 123(R).

As of June 30, 2008, the Company has recognized $1,300,000 in total compensation expense under the Plan. The Company recognized $400,000 and $150,000 in compensation expense under the Plan during the three months ended June 30, 2007 and 2008, respectively. For the six months ended June 30, 2007 and 2008, the Company recognized $650,000 and $300,000, respectively, in compensation expense related to the Performance Share Plan.

12. BUSINESS SEGMENTS

Segment information has been prepared in accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. Segments were determined based on products and services provided by each segment. There were no inter-segment sales or transfers during the three or six months ended June 30, 2007 and 2008. The Company evaluates the performance of its segments and allocates resources to them based primarily on gross profit. The table below summarizes information about reportable segments for the three and six months ended June 30, 2007 and 2008 (in thousands):

	Three months ended June 30,			Six months ended June 30,		
	Direct	Fulfillment Partner	Consolidated	Direct	Fulfillment partner	Consolidated
2007						

Revenue	$ 43,578	$ 105,389	$ 148,967	$ 89,279	$ 217,618	$ 306,897
Cost of goods sold	36,321	86,343	122,664	75,641	179,638	255,279
Gross profit	$ 7,257	$ 19,046	26,303	$ 13,638	$ 37,980	51,618
Operating expenses			(39,822)			(82,857)
Other income (expense), net			51			12
Loss from continuing operations			$ (13,468)			$ (31,227)
2008						
Revenue	$ 39,939	$ 148,903	$ 188,842	$ 91,422	$ 298,165	$ 389,587
Cost of goods sold	34,752	119,985	154,737	79,066	241,630	320,696
Gross profit	$ 5,187	$ 28,918	34,105	$ 12,356	$ 56,535	68,891
Operating expenses			(40,422)			(79,520)
Other income (expense), net			(146)			257
Loss from continuing operations			$ (6,463)			$ (10,372)

The direct segment includes revenues, direct costs, and allocations associated with sales fulfilled from the Company s

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warehouses. Costs for this segment include product costs, inbound and outbound freight, warehousing and fulfillment costs, credit card fees and customer service costs.

The fulfillment partner segment includes revenues, direct costs and cost allocations associated with the Company s third party fulfillment partner sales and are earned from selling the merchandise of third parties over the Company s Website. The costs for this segment include product costs, partners warehousing and fulfillment costs, credit card fees and customer service costs.

Assets have not been allocated between the segments for management purposes and, as such, they are not presented here.

For the three and six months ended June 30, 2007 and 2008, over 99% of sales were made to customers in the United States of America. No individual geographical area accounted for more than 10% of net sales in any of the periods presented. At December 31, 2007 and June 30, 2008, all of the Company s fixed assets were located in the United States of America.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements. These statements relate to our, and in some cases our customers or other third parties , future plans, objectives, expectations, intentions and financial performance and the assumptions that underlie these statements. These forward-looking statements include, but are not limited to, statements regarding the following: our beliefs and expectations regarding the seasonality of our direct and fulfillment partner revenue; our beliefs regarding the sufficiency of our capital resources; planned distribution and order fulfillment capabilities; our beliefs, intentions and expectations regarding improvements of our order processing systems and capabilities; our intentions regarding the development of enhanced technologies and features; our intentions regarding the expansion of our customer service capabilities; our beliefs and intentions regarding enhancements to our sales and marketing activities; our beliefs regarding the potential for growth in our customer base; our beliefs and intentions regarding our expansion into new markets, including international markets; our belief regarding potential development of new Websites; our beliefs, intentions and expectations regarding promotion of new or complimentary product and sales formats; our belief, intentions and expectations regarding the expansion of our product and service offerings; our beliefs and intentions regarding expanding our market presence through relationships with third parties; our beliefs regarding the pursuit of complimentary businesses and technologies; our beliefs regarding the adequacy of our insurance coverage; our beliefs, intentions and expectations regarding litigation matters and legal proceedings, our defenses to such matters and our contesting of such matters; our beliefs and expectations regarding our existing cash and cash equivalents, cash requirements and sufficiency of capital; our beliefs and expectations regarding interest rate risk, our investment activities and the effect of changes in interest rates; our expectation that we will expand our customer service operations and move our corporate headquarters into our new warehouse location; our belief that we have completed the turnaround plan that we began well over a year ago; our intention to expand product selection and our fulfillment partner business; and our belief that our depreciation expense will decrease.

These forward-looking statements are subject to risks and uncertainties that could cause actual results and events to differ materially. For a detailed discussion of these risks and uncertainties please see Item 1A Risk Factors . These forward-looking statements speak only as of the date of this report and, except as required by law, we undertake no obligation to update forward-looking statements to reflect events or circumstances occurring after the date of this report.

Overview

We are an online closeout retailer offering discount brand name merchandise, including bed-and-bath goods, home décor, kitchenware, watches, jewelry, electronics and computers, sporting goods, apparel, and designer accessories, among other products. We also sell books, magazines, CDs, DVDs, videocassettes and video games (BMMG). We also operate as part of our Website an online auctions business a marketplace for the buying and selling of goods and services as well as an online site for dealers to list and customers to find cars for sale, and a real estate site that allows buyers to identify properties listed for sale.

We are based in Salt Lake City, Utah, and were founded in 1997. We launched our first Website through which customers could purchase products in March 1999. Our Website offers our customers an opportunity to shop for bargains conveniently, while offering our suppliers an alternative inventory liquidation distribution channel. We continually add new, limited inventory products to our Website in order to create an atmosphere that encourages customers to visit frequently and purchase products before our inventory sells out. We offer approximately 100,000 products under multiple departments under the shopping tab on our Website, and offer almost 720,000 media products in the Books etc. department on our Website.

Closeout merchandise is typically available in inconsistent quantities and often is only available to consumers after it has been purchased and resold by disparate liquidation wholesalers. We believe that the traditional liquidation market is therefore characterized by fragmented supply and fragmented demand. We utilize the Internet to aggregate both supply and demand and create a more efficient market for liquidation merchandise. Our objective is to provide a one-stop destination for discount shopping for

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products and services sold through the Internet.

Our Business

We utilize the Internet to create a more efficient market for liquidation, closeout and other discount merchandise. We provide consumers and businesses with quick and convenient access to high-quality, brand-name merchandise at discount prices. Our shopping business (sales of product offered through the Shopping section of our Website) includes both a direct business and a fulfillment partner business (see Item 1 of Part I, Financial Statements (Unaudited) Note 12 Business Segments). Products from our direct segment and fulfillment partner segments (including products from various industry verticals, such as florist, restaurant, and office supplies) are also available in bulk to both consumers and businesses through the Wholesale product category on our Website.

Direct business

Our direct business includes sales made to individual consumers and businesses, which are fulfilled from our leased warehouses in Salt Lake City, Utah. During the three and six months ended June 30, 2008, we fulfilled approximately 21% of all orders through our warehouses, which generally ship between 5,000 and 8,000 orders per day and up to approximately 34,000 orders per day during peak periods, using overlapping daily shifts.

Fulfillment partner business

For our fulfillment partner business, we sell merchandise of other retailers, cataloguers or manufacturers (fulfillment partners) through our Website. We are considered to be the primary obligor for the majority of these sales transactions and record revenue from the majority of these sales transactions on a gross basis. Our use of the term partner or fulfillment partner does not mean that we have formed any legal partnerships with any of our fulfillment partners. We currently have fulfillment partner relationships with approximately 870 third parties that post approximately 95,000 non-BMMG products, as well as most of the BMMG products (found in the Books etc. department) on our Website.

Our revenue from sales from both the direct and fulfillment partner businesses is recorded net of returns, coupons and other discounts. During the third quarter of 2007, we updated our returns policy. For products other than computers, electronics and mattresses, the returns policy provides for a full refund of the cost of the merchandise and all shipping charges if the product shipped is returned unopened within 30 days of delivery. If the product is returned after 30 days of delivery, is opened or shows signs of wear, the transaction may only be eligible for a partial refund. For items shipped from our Computers and Electronics department, returns must be initiated within 20 days of the purchase date and must be received in the original condition within 30 days of purchase. Computer and Electronics products returned opened or received at our warehouse after 30 days may only qualify for up to a 70 percent refund. Damaged or defective mattresses qualify for a full refund only if the items are refused at the time of delivery.

Both direct and fulfillment partner revenues are seasonal, with revenues historically being the highest in the fourth quarter, reflecting higher consumer holiday spending. We anticipate this will continue in the foreseeable future.

Unless otherwise indicated or required by the context, the discussion herein of our financial statements, accounting policies and related matters, pertains to the Shopping section of our Website and not necessarily to the Auctions, Cars, Real Estate or Community sections of our Website.

Auctions business

We operate an online auctions service as part of our Website. Our auctions service allows sellers to list items for sale, buyers to bid on items of interest, and users to browse through listed items online. We record only our listing fees and commissions for items sold as revenue. From time to time, we also sell items returned from our shopping business through our auctions service, and for these sales, we record the revenue on a gross basis. Revenue from our auctions business is included in the fulfillment partner segment, as it is not significant enough to separate out as its own segment.

Car listing business

We operate an online site for listing cars for sale as a part of our Website. The car listing service allows sellers to list vehicles for sale and allows buyers to review vehicle descriptions, post offers to purchase, and provides the means for purchasers to contact sellers for further information and negotiations on the purchase of an advertised vehicle. Revenue in the form of monthly listing fees paid by the sellers is recorded on a net basis and is included in the fulfillment partner segment, as it is not significant enough to separate out as its own segment.

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Real Estate listing business

During May 2008, we added an online site for listing real estate for sale as a part of our Website. The real estate listing service allows customers to search active listings across the country. Listing categories include foreclosures, live and on-line auctions, for sale by owner listings, broker/agent listings and numerous aggregated classified ad listings. Advertising revenue from the real estate business is included in the fulfillment partner segment, as it is not significant enough to separate out as its own segment.

Business Restructuring

During the fourth quarter of 2006, we began a facilities consolidation and restructuring program designed to reduce our overall expense structure in an effort to improve future operating performance (see Item 1 of Part I, Financial Statements (Unaudited) Note 3 Restructuring Expense).

Cost of goods sold

Cost of goods sold consists of the cost of the product, as well as inbound and outbound freight, warehousing and fulfillment costs (including payroll and related expenses and stock-based compensation), credit card fees and customer service costs.

Operating expenses

Sales and marketing expenses consist of advertising, public relations and promotional expenditures, as well as payroll and related expenses, including stock-based compensation, for personnel engaged in marketing and selling activities.

Advertising expense is the largest component of our sales and marketing expenses and is primarily attributable to expenditures related to online marketing activities and offline national radio, television and other advertising. Our advertising expenses totaled approximately $7.1 million and $13.1 million for the three months ended June 30, 2007 and 2008, respectively, representing 89% and 92% of sales and marketing expenses for those respective periods. For the six months ended June 30, 2007 and 2008, our advertising expense totaled approximately $17.7 million and $27.0 million, respectively, representing 92% of sales and marketing expenses for both periods.

Technology expenses consist of wages and benefits, including stock-based compensation, for technology personnel, rent, utilities and connectivity charges, as well as support and maintenance and depreciation and amortization related to software and computer equipment.

General and administrative expenses consist of wages and benefits, including stock-based compensation, for executive, legal, accounting, merchandising and administrative personnel, rent and utilities, travel and entertainment, depreciation and amortization of intangible assets and other general corporate expenses.

We have recorded no provision or benefit for federal and state income taxes as we have incurred net operating losses since inception. We have provided a full valuation allowance on the net deferred tax assets, consisting primarily of net operating loss carryforwards, because of uncertainty regarding their realizability.

Executive Commentary

This executive commentary is intended to provide investors with a view of our business through the eyes of our management. As an executive commentary, it necessarily focuses on selected aspects of our business. This executive commentary is intended as a supplement to, but not a substitute for, the more detailed discussion of our business included elsewhere herein. Investors are cautioned to read our entire Management s Discussion and Analysis of Financial Condition and Results of Operations , as well as our interim and audited financial statements, and the discussion of our business and risk factors and other information included elsewhere in this report. This executive commentary includes forward-looking statements, and investors are cautioned to read the Special Note Regarding Forward-Looking Statements included elsewhere in this report.

Commentary Revenue. Total revenue for Q2 2008 increased to $188.8 million, a 27% improvement over Q2 2007, and the same rate of growth we experienced in Q1 2008. Strong fulfillment partner revenue, which grew 41% and accounted for nearly 80% of total revenues, was the primary driver of growth this quarter. Our initiative to increase selection on our website continued throughout the second quarter, and we believe is a major reason for accelerating fulfillment partner revenue growth. We ended the quarter with approximately 100,000 SKUs on the site compared to 43,000 at the end of Q2 last year. We are adding products to existing and new categories, and these are coming from both existing and new fulfillment partners (we ended this quarter with 870 fulfillment partners, up from 550 a year ago). Direct revenue on the other hand, decreased 8% from last year due primarily to sales in some categories shifting from direct to fulfillment partners.

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Increases in traffic to our website, new and unique customers, customer orders, and average order value each contributed positively to revenue growth this quarter. See *Commentary Marketing* below for more information on our sales and marketing efforts.

Commentary Gross Profit and Gross Margin. Gross profit increased 30% to $34.1 million as a result of a shift in sales mix to higher margin categories. Fulfillment partner gross profit expanded 52% to $28.9 million, while direct gross profit contracted by 29% to $5.2 million. Like revenues, fulfillment partner margins benefited from a mix shift of higher-margin sales from direct to fulfillment partners.

Gross margin for the quarter improved 40 basis points (bps) to 18.1%, the highest in our history. Fulfillment partner gross margin expanded 130bps to 19.4%, while direct margin contracted 370 bps to 13.0%. The second quarter is traditionally our highest margin quarter of the year. This is due primarily to the mix of products typically sold during the period. Gross margins quarter also benefited in part by the continued shift from lower margin BMMG products, which decreased from 6.8% of total gross revenue last year to 4.3% this year. Fulfillment costs were down 100 bps, primarily the result of improved efficiencies in our warehousing and customer service operations. Gross margin for the past six quarterly periods and fiscal year ending 2007 was:

	Q1 2007	Q2 2007	Q3 2007	Q4 2007	FY 2007	Q1 2008	Q2 2008	YTD Q2 2008
Direct	14.0%	16.7%	15.9%	16.9%	16.0%	13.9%	13.0%	13.5%
Fulfillment Partner	16.9%	18.1%	17.9%	16.2%	17.1%	18.5%	19.4%	19.0%
Combined	16.0%	17.7%	17.5%	16.4%	16.8%	17.3%	18.1%	17.7%

Commentary Marketing. Sales and marketing expenses increased significantly over last year due in large part to our strategy to keep a consistent level of advertising this year (versus last year when this was significantly reduced), and also due to a new, exploratory marketing initiative we undertook during the quarter. As a result, marketing expenses increased 79% to $14.2 million compared to $8.0 million, and marketing expense as a percentage of revenue increased 220 bps from last year to 7.5%. We believe most of our marketing efforts during the quarter were effective, with many of the channels we operate running very efficiently. Visitors to our website increased, and new and unique customer growth increased by 31% and 19%, respectively. Additionally, we have recently reduced spending in exploratory areas, and expect to see improved marketing efficiency in the second half of the year.

Commentary Contribution and Contribution Margin. Contribution (gross profits less sales and marketing expense) increased 8%, from $18.3 million in Q2 2007 to $19.9 million in Q2 2008. However, as a result of increased marketing expense in Q2, contribution growth decreased sequentially and contribution margin was down from the previous year (10.5% in Q2 vs. 12.3% last year). For the first half of 2008, contribution increased 22% to $39.6 million, while contribution margin decreased 30 bps to 10.2%. The following table shows our calculation of contribution and contribution margin (in thousands):

	Three months ended June 30,	Six months ended June 30,

	2007	2008	2007	2008
Total revenue	$ 148,967	$ 188,842	$ 306,897	$ 389,587
Cost of goods sold	122,664	154,737	255,279	320,696
Gross profit	26,303	34,105	51,618	68,891
Less: Sales and marketing expense	7,962	14,244	19,246	29,263
Contribution	$ 18,341	$ 19,861	$ 32,372	$ 39,628
Contribution margin	12.3%	10.5%	10.5%	10.2%

Commentary Technology and G&A costs. G&A expenses rose 4% on increased personnel and stock compensation expenses. Technology costs were flat from last year as reduced depreciation expense offset higher costs from increases in technology personnel. Combined technology and G&A expenses rose 2% in Q2 to $26.2 million, but fell 2% over the first six months of the year compared to last year. Depreciation expense will continue to fall throughout this year and next, and as a result, we expect combined technology and G&A expenses to remain relatively flat in 2008 and 2009.

Commentary Operating expenses and operating loss. Total operating expenses increased 2%, from $39.8 million (including $6.2 million of restructuring costs) last year, to $40.4 million in Q2 2008. For the first six months of the year, operating expenses declined 4% from $82.9 million (including $12.3 million of restructuring costs) last year, to $79.5 million. The operating loss in Q2 2008 was $6.3 million, a 53% improvement down from $13.5 million (including $6.2 million of restructuring) during the same period in 2007.

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Commentary EBITDA (non-GAAP). We generated positive EBITDA for the fourth consecutive quarter, with $1.1 million this quarter, $4.6 million for the first six months of 2008, and $9.6 million over the trailing twelve months. This compares with $(4.2) million (including $6.2 million of restructuring), $(12.4) million (including $12.3 million of restructuring) and $(54.9) million (including $12.3 million of restructuring) over the same periods a year ago. We believe that, because our current capital expenditures are lower than our depreciation levels, discussing EBITDA at this stage of our business is useful to us and investors because it approximates cash used or cash generated by the continuing operations of the business.

Regulation G, *Conditions for Use of Non-GAAP Financial Measures,* and other SEC regulations regulate the disclosure of certain non-GAAP financial information. Our measure of EBITDA is a non-GAAP financial measure. EBITDA, which we reconcile to Operating loss in our income statement, is earnings before interest, taxes, depreciation, amortization and stock-based compensation. EBITDA is used in addition to and in conjunction with results presented in accordance with GAAP and should not be relied upon to the exclusion of GAAP financial measures. EBITDA reflects an additional way of viewing our results that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our results. You should review our financial statements and publicly-filed reports in their entirety and not rely on any single financial measure. Our discussion above and below (i) explains why management believes that presentation of EBITDA provides useful information to investors regarding our financial condition and results of operations, (ii) to the extent material, discloses the additional purposes, if any, for which management uses this non-GAAP measure, and (iii) provides a reconciliation of this measure to our operating losses. For further details on EBITDA, see the reconciliation of this non-GAAP measure to our GAAP operating loss below (in thousands):

	Three months ended June 30,		**Six months ended June 30,**		**Twelve months ended June 30,**	
	2007	**2008**	**2007**	**2008**	**2007**	**2008**
Operating loss	$ (13,519)	$ (6,317)	$ (31,239)	$ (10,629)	$ (95,276)	$ (20,989)
Add: Depreciation and amortization	7,974	5,887	15,745	12,384	35,046	26,134
Stock-based compensation expense to employees and directors	1,137	1,068	2,210	2,252	4,284	4,564
Stock-based compensation to consultants for services	135	329	140	315	129	364
Stock-based compensation for performance share plan		150		300		(250)
Treasury stock issued to employees as compensation	113		715	19	890	(202)
EBITDA	$ (4,160)	$ 1,117	$ (12,429)	$ 4,641	$ (54,927)	$ 9,621

Commentary Balance Sheet Items. We ended the quarter with $86.7 million in cash, cash equivalents and marketable securities, down from $89.8 million at the end of the previous quarter. Within the quarter cash decreased $3.2 million due to capital expenditures of $5.1 million, offset by cash provided by operating activities of $449,000, collection of a note receivable of $754,000 and exercise of stock options of $924,000 (see *Commentary Cash Flows* below).

Working capital went from $71.2 million at December 31, 2007 to $58.4 million, a $12.8 million decrease. This decrease in working capital is primarily the result of $12.0 million used to buy back our common stock and capital expenditures of $6.5 million, offset by $1.3 million collected on a note receivable, $924,000 from stock option exercises, and $4.6 million of positive EBITDA.

Commentary Cash Flows. Operating cash flows for Q2 2008 were $449,000 compared to $14.9 million for the same period in the prior year, a $14.5 million decline, primarily the result of positive changes to the balance sheet in receivables, inventory and payables/accruals last year. However, over the trailing twelve months, operating cash flows were $12.7 million (including $9.6 million of EBITDA) compared to $9.4 million for the prior year, a $3.3 million increase .. Free Cash Flow (a non-GAAP measure) for Q2 2008 was $(4.7) million versus $13.5 million last year. Over the last twelve months, free cash flow was $5.5 million, a $9.5 million increase over the $(4.0) million over the same period last year.

Regulation G, *Conditions for Use of Non-GAAP Financial Measures,* and other SEC regulations regulate the disclosure of certain non-GAAP financial information. Free cash flow reflects an additional way of viewing our cash flows and liquidity that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our cash flows. Free cash flow, which we reconcile to Net cash provided by (used in) operating activities , is cash flow from operations reduced by Expenditures for property and equipment . Although we believe that cash flow from operating activities is an important measure, we believe free cash flow is a useful measure to evaluate our business since purchases of fixed assets are a necessary component of ongoing operations. Therefore, we believe it is important to view free cash flow as a complement to our entire consolidated statements of cash flows. You should review our financial statements and publicly-filed reports in their entirety and not rely on any single financial measure. Our discussion above and below (i) explains why management believes that presentation of Free Cash Flow provides useful information to investors regarding our financial condition and results of operations, (ii) to the extent material, discloses the additional purposes, if any, for which management uses this non-GAAP measure, and (iii) provides a reconciliation of this measure to our operating cash flows as follows:

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	Three months ended June 30,		Twelve months ended June 30,	
	2007	2008	2007	2008
Net cash provided by operating activities	$ 14,939	$ 449	$ 9,412	$ 12,683
Expenditures for property and equipment	(1,439)	(5,136)	(13,450)	(7,176)
Free cash flow	$ 13,500	$ (4,687)	$ (4,038)	$ 5,507

The balance of our Management s Discussion and Analysis of Financial Condition and Results of Operations provides further information about the matters discussed above and other important matters affecting our business.

Critical Accounting Policies and Estimates

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Our critical accounting policies are as follows:

- revenue recognition;
- estimating valuation allowances and accrued liabilities (specifically, the reserve for returns, the allowance for doubtful accounts and the reserve for obsolete and damaged inventory);
- internal use software;
- accounting for income taxes;
- valuation of long-lived and intangible assets and goodwill; and
- stock based compensation and performance share plan.

Revenue recognition. We derive our revenue primarily from two sources: (i) direct revenue and (ii) fulfillment partner revenue, which includes listing fees and commissions collected from products being listed and sold through the Auctions section of our Website as well as advertisement and lead generation revenue derived from our cars and real estate listing businesses. We have organized our operations into two principal segments based on the primary source of revenue: Direct revenue and Fulfillment partner revenue (see Item 1 of Part I, Financial Statements (Unaudited) Note 12 Business Segments).

From our inception through the third quarter of 2007, we recorded revenue for the sale of merchandise through our direct and fulfillment partner segments based on product ship date. In the fourth quarter of 2007, we determined that we should not have recorded revenue until the delivery date. We performed a detailed analysis of this error and the impact of recording the cumulative effect of the error in the fourth quarter of 2007, and have determined that the impact of the correction was immaterial to the full year ended 2007 and fourth quarter of 2007 and to all prior periods.

We recorded the cumulative effect of this correction in the fourth quarter of 2007, resulting in a deferral of $13.7 million of revenue (including $3.7 million of direct revenue and $10.0 million of fulfillment partner revenue), and a decrease in cost of goods sold of $11.6 million ($3.1 million direct and $8.5 million fulfillment partner), which reduced gross profit and increased net loss by $2.1 million.

During the first quarter of 2008, we reversed this adjustment and recognized the $13.7 million of revenue and $2.1 million of gross profit that had been deferred at the end of the fourth quarter of 2007. At the end of the first quarter we performed the same analysis on orders that had been shipped but had not yet been delivered, and determined that $12.8 million of revenue and $2.2 million of gross profit should be deferred in the second quarter. The net effect of these adjustments on the first quarter results was an increase of $900,000 in revenue and a decrease of $100,000 in gross profit.

During the second quarter of 2008, we reversed the first quarter adjustment and recognized the $12.8 million of revenue and $2.2 million of gross profit that had been deferred at the end of the first quarter of 2008. At the end of the second quarter we performed the same analysis that we have performed in the previous reporting periods, and determined that $12.0 million of revenue and $2.1 million of gross profit should be deferred in the first quarter. The net effect of these adjustments on the second quarter results was an increase of $800,000 in revenue and an increase of $100,000 in gross profit.

The net effect of these adjustments on the six months results ended June 30, 2007 was an increase of $1.7 million in revenue and no change in gross profit. In the future, we will have similar deferral and reversals each quarter related to orders shipped but not

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delivered, and similar to this quarter, we do not anticipate that the net adjustment will have a material effect on total revenue or gross profit.

Revenue is recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or the service has been provided; (3) the selling price or fee revenue earned is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured.

Revenue related to merchandise sales is recognized upon delivery to our customers. As we ship high volumes of packages through multiple carriers, it is not practical for us to track the actual delivery date of each shipment. Therefore, we use estimates to determine which shipments are delivered and therefore recognized as revenue at the end of each period. Our delivery date estimates are based on average shipping transit times, which are calculated using the following factors: (i) the shipping carrier (as carriers differ in transit times); (ii) the fulfillment source (either our warehouses or those of our fulfillment partners); (iii) the delivery destination; and (iv) actual transit time experience, which shows that delivery date is typically one to eight business days from the date of shipment.

We review and update our estimate of delivery dates on a quarterly basis based on our actual transit time experience. However, actual shipping times may differ from our estimates. The following table shows the effect that hypothetical changes in the estimate of average shipping transit times would have had on the reported amount of revenue and net loss for the three months ended June 30, 2008 (in thousands):

Change in the Estimate of Average Transit Times (Days)	**Three months ended June 30, 2008**	
	Effect on Revenue	**Effect on Net Loss**
-2	$ 4,946	$ 878
-1	2,739	486
As reported	As reported	As reported
1	(2,879)	(518)
2	(5,581)	(1,004)

We evaluate the criteria outlined in EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*, in determining whether it is appropriate to record the gross amount of product sales and related costs or the net amount earned as commissions. When we are the primary obligor in a transaction, are subject to inventory risk, have latitude in establishing prices and selecting suppliers, or have several but not all of these indicators, revenue is recorded gross. If we are not the primary obligor in the transaction and amounts earned are determined using a fixed percentage, revenue is recorded on a net basis. Currently, the majority of both direct revenue and fulfillment partner revenue is recorded on a gross basis, as we are the primary obligor.

We periodically provide incentive offers to our customers to encourage purchases. Such offers include discount offers, such as percentage discounts off current purchases and other similar offers. Discount offers, when accepted by our customers, are treated as a reduction to the purchase price of the related transaction.

Direct revenue.

Direct revenue consists of sales of merchandise to both individual consumers and businesses that are fulfilled directly from our leased warehouses. Direct sales occur primarily through our Website, but may also occur through other offline channels.

Fulfillment partner revenue.

Fulfillment partner revenue consists of sales of merchandise through our Website to both consumers and businesses that are shipped directly to the customer from warehouses maintained by our fulfillment partners.

During September 2004, we added an online auction service to our Website. The Auctions site allows sellers to list items for sale, buyers to bid on items of interest, and users to browse through listed items online. With limited exceptions, we are not considered the seller of the items sold on the auction site and have no control over the pricing of those items. Therefore, for these sales, only the listing fees for items listed and commissions for items sold are recorded as revenue during the period items are listed or items are sold. Revenue from the auction business is not large enough to separate into its own segment, and therefore has been included within the fulfillment partner segment.

During December 2006, we added an online site for listing cars for sale as a part of our Website. The cars listing service allows dealers to list vehicles for sale and allows buyers to review vehicle descriptions, post offers to purchase, and provides the means for purchasers to contact sellers for further information and negotiations on the purchase of an advertised vehicle. Revenue

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from the cars listing business is not large enough to separate into its own segment, and therefore has been included within the fulfillment partner segment.

During May 2008, we added an online site for listing real estate for sale as a part of our Website. The real estate listing service allows customers to search active listings across the country. Listing categories include foreclosures, live and on-line auctions, for sale by owner listings, broker/agent listings and numerous aggregated classified ad listings. Revenue from the real estate listing business is not large enough to separate into its own segment, and therefore has been included within the fulfillment partner segment.

Deferred revenue. Payment is generally required by credit card at the point of sale. Amounts received prior to delivery of products or services provided are recorded as deferred revenue. Amounts received in advance for Club O membership fees are recorded as deferred revenue and recognized ratably over the membership period. In addition, we sell gift cards and record related deferred revenue at the time of the sale. Revenue from a gift certificate is recognized when a customer redeems it. If a gift certificate is not redeemed, we recognize revenue when the likelihood of its redemption becomes remote, generally two years from the date of issuance.

Reserve for returns. Total revenue is recorded net of estimated returns. For products other than computers, electronics and mattresses, the returns policy provides for a full refund if the item shipped is returned unopened within 30 days of delivery. If the item is returned after 30 days of delivery, opened or shows signs of wear, the transaction may only be eligible for a partial refund. For items shipped from our Computers and Electronics department, returns must be initiated within 20 days of the purchase date and must be received in the original condition within 30 days of purchase. Computer and Electronics items returned opened or received at our warehouse after 30 days may only qualify for up to a 70 percent refund. Damaged or defective mattresses qualify for a full refund only if the items are refused at the time of delivery.

We maintain a reserve for returns based on estimates of future product returns related to current period revenues and are estimated using historical experience. Management analyzes historical returns, current economic trends and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales returns reserve and other allowances in any accounting period. The reserve for returns was $2.8 million at June 30, 2008 and $5.0 million at December 31, 2007.

Allowance for doubtful accounts. From time to time, we grant credit to certain of our business customers on normal credit terms (typically 30 days). We perform ongoing credit evaluations of our customers financial condition and maintain an allowance for doubtful accounts receivable based upon our historical collection experience and expected collectibility of all accounts receivable. We maintained an allowance for doubtful accounts receivable of $2.6 million at June 30, 2008 and $2.5 million at December 31, 2007.

Reserve for obsolete and damaged inventory. We write down our inventory for estimated obsolescence or damage equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Once established, the original cost of the inventory less the related inventory reserve represents the new cost basis of such products. Reversal of these reserves is recognized only when the related inventory has been sold or scrapped. At June 30, 2008, our inventory balance was $14.0 million (including $1.8 million of inventory in-transit related to sales shipped but not yet delivered), net of allowance for obsolescence or damaged inventory of $1.5 million. At December 31, 2007, our inventory balance was $25.9 million (including $3.1 million of inventory in-transit related to sales shipped but not yet delivered), net of allowance for obsolescence or damaged inventory of $1.8 million.

Internal-Use Software and Website Development. Included in fixed assets is the capitalized cost of internal-use software and website development, including software used to upgrade and enhance our Website and processes supporting our business. As required by Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, we capitalize costs incurred during the application development stage of internal-use software and amortize these costs over the estimated useful life of two to three years. Costs incurred related to design or maintenance of internal-use software are expensed as incurred.

During the three months ended June 30, 2007 and 2008, we capitalized $226,000 and $1.8 million, respectively, of costs associated with internal-use software and website development, which are partially offset by amortization of previously capitalized amounts of $3.7 million and $3.1 million for those respective periods. For the six months ended June 30, 2007 and 2008, we capitalized $1.5 million and $2.6 million of costs associated with internal-use software and website development, which are partially offset by amortization of previously capitalized amounts of $7.1 million and $6.2 million, respectively.

Accounting for income taxes. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. As of December 31, 2007 and June 30, 2008, we have recorded a full valuation allowance of $82.7 million and $85.7 million, respectively, against our net deferred tax asset balance due to uncertainties related to our deferred tax assets as a result of our history of operating losses. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future

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periods, we may need to change the valuation allowance, which could materially impact our financial position and results of operations.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return.

We adopted the provisions of FIN 48 on January 1, 2007. As a result of a full valuation allowance, we do not have any unrecognized tax benefits and there is no effect on our financial condition or results of operations as a result of implementing FIN 48. We are subject to audit by the IRS and various states for periods since inception. We do not believe there will be any material changes in our unrecognized tax positions for periods since inception. Our policy is that we recognize interest and penalties accrued on any unrecognized tax positions as a component of income tax expense. As of the date of adoption of FIN 48, we did not have any accrued interest or penalties associated with any unrecognized tax positions, nor was any interest expense recognized during the year ended December 31, 2007. There have been no changes during the three and six months ended June 30, 2008.

Valuation of long-lived and intangible assets and goodwill. Under Statement of Financial Accounting Standard (SFAS) No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142), goodwill is not amortized, but must be tested for impairment at least annually. Other long-lived assets must also be evaluated for impairment when management believes that an asset has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the asset that may not be reflected in an asset s current carrying value, thereby possibly requiring an impairment charge in the future. Goodwill totaled $2.8 million as of December 31, 2007 and June 30, 2008.

In conjunction with the decision to sell OTravel, our travel subsidiary, we performed an evaluation of its goodwill, pursuant to SFAS No. 144, *Accounting for the Impairment Long-Lived Assets* , and SFAS No. 142, *Goodwill and Other Intangible Assets,* and determined that goodwill was subject to an impairment loss of approximately $3.8 million during the six months ended June 30, 2007 (see Item 1 of Part I, Financial Statements (Unaudited) Note 4 Sale of Discontinued Operations). These have been recorded as a component of the loss from discontinued operations.

Stock-based compensation. As of January 1, 2006, we adopted SFAS No. 123(R) *Share Based Payment* (SFAS No. 123(R)), which requires us to measure compensation cost for all outstanding unvested share-based awards at fair value and recognize compensation over the service period for awards expected to vest. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from our estimates, such amounts will be recorded as an adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results may differ substantially from these estimates. We have utilized a Black-Scholes-Merton (BSM) valuation model to estimate the value of stock options granted to employees. Several of the primary estimates used in measuring stock-based compensation are as follows:

Expected Volatility: The fair value of stock options were valued using a volatility factor based on our historical stock prices.

Expected Term: For 2005 and 2006 option grants, the expected term represents the period that our stock options are expected to be outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms and vesting provisions of the stock-based awards. For 2007 and 2008 option grants, we elected to use the simplified method as discussed in Staff Accounting Bulletin (SAB) No. 107, *Share Based Payment* (SAB No. 107) to develop an estimate of expected term. In December 2007, the SEC issued SAB No. 110, *Certain Assumptions Used in Valuation Methods Expected Term* (SAB No. 110). According to SAB No. 110, under certain circumstances the SEC staff will continue to accept the use of the simplified method as discussed in SAB No. 107, in developing an estimate of expected term of plain vanilla share options in accordance with SFAS No. 123(R), beyond December 31, 2007. We adopted SAB No. 110 effective January 1, 2008 and will continue to use the simplified method in developing the expected term used for our valuation of stock-based compensation.

Expected Dividend: We have not paid any dividends and do not anticipate paying dividends in the foreseeable future.

Risk-Free Interest Rate: We base the risk-free interest rate used on the implied yield currently available on U.S. Treasury zero-coupon issues with remaining term equivalent to the expected term of the options.

Estimated Pre-vesting Forfeitures: When estimating forfeitures, we consider voluntary and involuntary termination behavior.

Performance Share Plan. In January 2006 the Board and Compensation Committee adopted the Overstock.com Performance

Share Plan, and approved grants to executive officers and certain employees. The Plan provides for a three-year period for the measurement of our attainment of certain performance goals.

The performance goal is measured by growth in economic value, as defined in the Plan. The amount of payments due to participants under the Plan will be a function of the then current market price of a share of our common stock, multiplied by a percentage dependent on the extent to which the performance goal has been attained, which will be between 0% and 200%. If the growth in economic value is 10% compounded annually or less, the percentage will be 0%. If the growth in economic value is 25% compounded annually, the percentage will be 100%. If the growth in economic value is 40% compounded annually or more, the percentage will be 200%. If the percentage growth is between these percentages, the payment percentage will be determined on the basis of straight line interpolation. Amounts payable under the Plan were originally payable in cash. During interim and annual periods prior to the third quarter of 2007, we recorded compensation expense based upon the period-end stock price and estimates regarding the ultimate growth in economic value that is expected to occur. These estimates included assumed future growth rates in revenues, gross margins and other factors. If we were to use different assumptions, the estimated compensation charges could be significantly different.

An amendment to the Performance Share Plan to allow us to make payments in the form of common stock was approved by the shareholders on May 15, 2007. In the third quarter of 2007, we determined the fair value of the awards on the amendment date and determined to make the payments in the form of common stock, rather than cash. Therefore, we reclassified awards under the Plan from their current status as liability awards to equity awards in accordance with SFAS No. 123(R).

As of June 30, 2008, we had recognized $1,300,000 in total compensation expense under the Plan. During the three months ended June 30, 2007 and 2008, we recognized $400,000 and $150,000, respectively, in compensation expense under the Plan. For the six months ended June 30, 2007 and 2008, we recognized $650,000 and $300,000, respectively, in compensation expense under the Plan.

Restricted Stock Units. In the first quarter of 2008, the Compensation Committee of the Board of Directors approved grants of approximately 460,000 restricted stock units to officers and employees of the Company. During the second quarter of 2008, an additional 25,000 restricted stock units were granted. The restricted stock units vest over three years at 25% at the end of the first year, 25% at the end of the second year and 50% at the end of the third year and are subject to the employee s continuing service.

The cost of restricted stock units is determined using the fair value of our common stock on the date of the grant, and compensation expense is recognized over the vesting period (see Item 1 of Part I, Financial Statements (Unaudited) Note 11 Stock Based Awards).

Recent Accounting Pronouncements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position, or FSP, FAS No. 157-2, *Effective Date of FASB Statement No. 157* (FSP FAS No. 157-2), which delayed the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). We adopted SFAS No. 157 for fiscal 2008, except as it applies to those non-financial assets and non-financial liabilities as described in FSP FAS No. 157-2, and it did not have a material impact on our consolidated financial position, results of operations or cash flows. For information and related disclosures regarding our fair value measurements see Item 1 of Part I, Financial Statements (Unaudited) Note 2 Accounting Policies).

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). Under SFAS No. 159, companies may elect to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We adopted SFAS 159 for fiscal 2008; however, we did not elect to apply the fair value option to any financial instruments or other items upon adoption of SFAS 159 or during the period ended June 30, 2008. Therefore, the adoption of SFAS No. 159 did not impact our consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141 (R), *Business Combinations* (SFAS No. 141 (R)), and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS No. 160). SFAS 141 (R) requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquired entity at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. SFAS No. 160 clarifies that a noncontrolling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of

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earnings per share will continue to be based on income amounts attributable to the parent. SFAS No. 141 (R) and SFAS No. 160 are effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. The Company does not expect the adoption of SFAS No. 141 (R) or SFAS No. 160 to impact its financial position and results of operations or cash flows.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (SFAS No. 161). SFAS No. 161 requires enhanced disclosures about a company s derivative and hedging activities, in particular: 1) how and why derivative instruments are utilized; 2) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations; and 3) how derivative instruments and related hedged items affect a company s financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early adoption encouraged. We have no derivative instruments. Therefore, we do not expect the adoption of SFAS No. 161 to impact our financial position and results of operations or cash flows.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 162). The current GAAP hierarchy was established by the American Institute of Certified Public Accountants, and faced criticism because it was directed to auditors rather than entities. The issuance of this statement corrects this and makes some other hierarchy changes. This statement is effective 60 days following the Securities and Exchange Commission s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The FASB does not expect that this statement will result in a change to current practice.

Results of Operations

The following table sets forth our results of operations expressed as a percentage of total revenue for the three and six months ended June 30, 2007 and 2008:

	Three months ended June 30,		Six months ended June 30,	
	2007	**2008**	**2007**	**2008**
	(as a percentage of total revenue)			
Revenue				
Direct revenue	29.3%	21.1%	29.1%	23.5%
Fulfillment partner revenue	70.7	78.9	70.9	76.5
Total revenue	100.0	100.0	100.0	100.0
Cost of goods sold				
Direct	24.4	18.4	24.6	20.3
Fulfillment partner	57.9	63.5	58.6	62.0
Total cost of goods sold	82.3	81.9	83.2	82.3
Gross profit	17.7	18.1	16.8	17.7
Operating expenses:				
Sales and marketing	5.3	7.5	6.3	7.5
Technology	10.2	8.1	9.8	7.7
General and administrative	7.0	5.8	6.9	5.2
Restructuring	4.2		4.0	
Total operating expenses	26.7	21.4	27.0	20.4
Operating loss	(9.0)	(3.3)	(10.2)	(2.7)
Interest income	0.7	0.4	0.7	0.5

Interest expense	(0.7)	(0.5)	(0.7)	(0.5)
Other income, net				
Loss from continuing operations	(9.0)%	(3.4)%	(10.2)%	(2.7)%

Comparison of Three and Six Months Ended June 30, 2007 and 2008

Revenue

Total revenue increased 27%, from $149.0 million during the three months ended June 30, 2007 to $188.8 million during the same period in 2008. During that same period, direct revenue decreased 8%, from $43.6 million in 2007 to $39.9 million in 2008, while fulfillment partner revenue experienced 41% growth, from $105.4 million in 2007 to $148.9 million in 2008. For the six-month period ended June 30, 2008, total revenue increased 27% from $306.9 million in 2007 to $389.6 million in 2008. During that same six-month period, direct revenue increased 2%, from $89.3 million in 2007 to $91.4 million in 2008, while fulfillment partner revenue grew 37%, from $217.6 million in 2007 to $298.2 million in 2008.

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We believe that the overall growth in our business is the result of improved marketing efforts (we had increases in traffic to our website, new and unique customers, customer orders, and average order value in the quarter) and increased product selection offered on our website. We ended the quarter with approximately 100,000 SKUs on the site compared to 43,000 at the end of Q2 last year. The increase in SKU s offered for sale are primarily through fulfillment partners in existing and new product categories, as well as from both existing and new fulfillment partners. As a result, fulfillment partner sales grew 41% in Q2 (and 37% for the first six months of 2008), while direct revenue decreased 8% in Q2 (up 2% for the six month period).

Gross profit and gross margin

Generally, our overall gross margin fluctuates based on several factors, including our product mix of sales; sales volumes mix between our direct and fulfillment partner businesses; changes in vendor and/or customer pricing, including competitive pricing and inventory management decisions within the direct business; warehouse management costs; customer service costs; and our discounted shipping offers. Discounted shipping offers reduce shipping revenue, and therefore reduce our gross margin on retail sales.

Gross margin for the three months ended June 30, 2008 increased 40 basis points, from 17.7% in Q2 2007 to 18.1% in Q2 2008. Gross profit for the three months ended June 30, 2007 and 2008 amounted to $26.3 million and $34.1 million, respectively, a 30% increase. For the six months ended June 30, gross margin increased from 16.8% in 2007 to 17.7% in 2008, an increase of 90 basis points. Gross profit totaled $51.6 million and $68.9 million for the six months ended June 30, 2007 and 2008, respectively, an increase of 33%. The increase in gross profit is the result of sales mix shifting to higher margin product categories, as well as a reduction in our fulfillment costs as a percentage of sales during both the three and six month periods (see the section below entitled Fulfillment costs).

Cost of goods sold includes stock-based compensation related to the adoption of SFAS No. 123(R) of $114,000 and $50,000 for the three months ended June 30, 2007 and 2008, respectively. Stock-based compensation totaled $221,000 and $99,000 for the six-month periods ended June 30, 2007 and 2008, respectively.

Direct Gross Profit and Gross Margin Gross profit for our direct business decreased 29% from $7.3 million during the three months ended June 30, 2007 to $5.2 million for the same period in 2008. Gross margin for our direct business decreased from 16.7% in Q2 2007 to 13.0% in Q2 2008. For the six months ended June 30, 2008, gross profit decreased 9% to $12.4 million from gross profit of $13.6 million for the six months ended June 30, 2007. For the same six-month periods, gross margin for our direct business decreased 180 basis points from 15.3% in 2007 to 13.5% in 2008. Gross margin improvements from the reduction of fulfillment costs (defined as warehousing costs, credit card fees and customer service costs see further discussion in the following section entitled Fulfillment Costs) to 5.5% of revenue (compared to 6.5% in Q2 2007) were offset by increases to product and freight costs as a percent of direct revenue, the result of shifts in product mix and increased costs.

Fulfillment Partner Gross Profit and Gross Margin Our fulfillment partner business generated gross profit of $19.0 million and $28.9 million for the three months ended June 30, 2007 and 2008, respectively, a 52% improvement. Gross margin for the fulfillment partner business also increased from 18.1% in Q2 2007 to 19.4% in Q2 2008 for those respective periods. Gross profit also increased 49% to $56.5 million during the six months ended June 30, 2008 when compared to the $38.0 million of gross profit generated during the six months ended June 30, 2007. For the same six-month periods, gross margin for our partner business increased 150 basis points from 17.5% in 2007 to 19.0% in 2008. The increase in gross margin is the result of 100 basis point reduction in fulfillment costs (warehousing costs, credit card fees and customer service costs) as a percentage of sales, and shifts in sales mix to higher margin products.

Fulfillment costs

Fulfillment costs include all warehousing costs, including fixed overhead and variable handling costs (excluding packaging costs), as well as credit card fees and customer service costs, all of which we include as costs in calculating gross margin. We believe that some companies in our industry, including some of our competitors, account for fulfillment costs within operating expenses, and therefore exclude fulfillment costs from gross margin. As a result, our gross margin may not be directly comparable to others in our industry.

The following table has been included to provide investors additional information regarding our classification of fulfillment costs and gross margin, thus enabling investors to better compare our gross margin with others in our industry (in thousands):

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	Three months ended June 30,						Six months ended June 30,					
		2007			2008			2007			2008	
Total revenue	$	148,967	100.0%	$	188,842	100.0%	$	306,897	100.0%	$	389,587	100.0%
Cost of goods sold:												
Product costs, freight costs and other cost of good sold		112,999	75.9%		144,317	76.4%		233,769	76.2%		298,293	76.5%
Fulfillment costs		9,665	6.5%		10,420	5.5%		21,510	7.0%		22,403	5.8%
Total cost of goods sold		122,664	82.4%		154,737	81.9%		255,279	83.2%		320,696	82.3%
Gross profit	$	26,303	17.7%	$	34,105	18.1%	$	51,618	16.8%	$	68,891	17.7%

As displayed in the above table, fulfillment costs during the three months ended June 30, 2007 and 2008 were $9.7 million and $10.4 million, representing 6.5% and 5.5% of total revenue for those respective periods. For the six months ended June 30, 2007 and 2008, fulfillment costs were $21.5 million and $22.4 million or 7.0% and 5.8% of total revenue. Fulfillment costs as a percentage of sales may vary due to several factors, such as our ability to manage costs at our warehouses, significant changes in the number of units received and fulfilled, the extent to which we utilize third party fulfillment services and warehouses, and our ability to effectively manage customer service costs and credit card fees. The decrease in fulfillment costs as a percent of revenue in both the second quarter and first six months of 2008 is the result of improved efficiencies in both our warehousing costs (including the reduction of warehouse space), and in our customer service operations.

Operating expenses

Sales and marketing. Sales and marketing expenses totaled $8.0 million and $14.2 million for the three months ended June 30, 2007 and 2008, representing 5.3% and 7.5% of total revenue for those respective periods. Comparing quarterly periods for 2007 and 2008, sales and marketing expenses increased 79%. For the six months ended June 30, 2007 and 2008, sales and marketing expenses increased 52% from $19.2 million in 2007 to $29.3 million in 2008, representing 6.3% and 7.5% of total revenue for those respective periods. We direct customers to our Website primarily through a number of targeted online marketing channels, such as paid search, affiliate marketing, portal advertising, e-mail campaigns, and other initiatives. We also utilize channels such as television, print and radio advertising.

Sales and marketing expenses also include stock-based compensation related to the adoption of SFAS No. 123(R) of $85,000 and $86,000 during the three months ended June 30, 2007 and 2008, respectively. For the six months ended June 30, 2007 and 2008, sales and marketing expenses included stock-based compensation of $163,000 and $170,000, respectively.

Costs associated with our discounted shipping promotions are not included in marketing expense. They are accounted for as a reduction of revenue and therefore affect sales growth and gross profit. We consider discounted shipping promotions as an effective marketing tool, and intend to continue to offer them as part of our overall marketing plan.

Technology expenses. Technology expenses totaled $15.2 million and $15.3 million for the three months ended June 30, 2007 and 2008, respectively, representing 10.2% of total revenue in 2007 and 8.1% in 2008. For the six months ended June 30, 2007 and 2008, technology expenses totaled $30.2 million and $29.8 million, respectively, representing 9.8% and 7.7% of total revenue for those respective periods.

Technology expenses also included stock-based compensation related to the adoption of SFAS No. 123(R) of $188,000 and $220,000 during the three months ended June 30, 2007 and 2008, respectively. For the six months ended June 30, 2007 and 2008, technology expenses included stock-based compensation of $365,000 and $434,000, respectively.

General and administrative expenses. General and administrative (G&A) expenses totaled $10.4 million and $10.9 million for the three months ended June 30, 2007 and 2008, respectively, representing approximately 7.0% and 5.8% of total revenue for those respective periods. For the six months ended June 30, 2007 and 2008, G&A expenses totaled $21.1 million and $20.4 million, a decrease of 3%, representing 6.9% and 5.2% of total revenue for both periods, respectively. The decrease in G&A expenses primarily relates to decreases in corporate facilities costs and stock-based compensation expense, offset by increases in payroll-related expenses.

We incurred stock-based compensation expense related to the adoption of SFAS No. 123(R) within general and administrative expenses of approximately $750,000, and $862,000 for the three months ended June 30, 2007 and 2008, respectively. For the six months ended June 30, 2007 and 2008, G&A included stock-based compensation expense of $1.5 million and $1.8 million, respectively.

A large portion of our technology and general and administrative expenses are non-cash expenses. These non-cash expenses (which include depreciation and amortization and stock-based compensation and exclude non-cash restructuring costs) for the three and six months ended June 30, 2007 were $8.4 million and $16.6 million, compared to similar non-cash expense of $6.4 million and $13.5 million during the three and six-month periods ended June 30, 2008. We estimate that these non-cash expenses will be approximately $27-$28 million for the full year 2008.

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Overall, our total operating expense increased 2% in Q2 over last year, while revenue increased 27% and gross profits expanded 30% for the same quarterly period. Comparing the six-month period ended June 30, 2008 to same period in 2007, total operating expenses decreased 4%, while total revenue increased 27% and gross profit increased 33%.

Restructuring expenses. During the fourth quarter of 2006, we commenced a facilities consolidation and restructuring program designed to reduce our overall expense structure in an effort to improve future operating performance. The facilities consolidation and restructuring program was substantially completed by the end of the second quarter of 2007, except for the additional lease and contract termination costs related to relocating its current office facilities to the new warehouse location in 2009. Restructuring expense totaled $12.3 million for the six months ended June 30, 2007, of which $6.2 million in restructuring expense was incurred in the second quarter of 2007. No restructuring expense was incurred during the three or six months ended June 30, 2008. There have been no restructuring expenses recorded since Q2 2007 (see Item 1 of Part I, Financial Statements (Unaudited) Note 3 Restructuring Expense).

Non-operating income (expense)

Interest income, interest expense and other income (expense). Interest income is derived primarily from the investment of our cash in short-term investments and from the interest earned notes receivable related to the sale of our travel business, OTravel. For the three months ended June 30, 2007 and 2008, interest income totaled $1.1 million and $740,000, respectively. For the six months ended June 30, 2007 and 2008, interest income totaled $2.1 million and $2.0 million, respectively.

Interest expense is largely related to interest incurred on our convertible notes, capital leases and our credit lines. Interest expense for the three months ended June 30, 2007 and 2008 totaled $1.0 million and $888,000, respectively. For the six months ended June 30, 2007 and 2008, interest expense totaled $2.0 million and $1.8 million, respectively.

During the fourth quarter of 2006, in conjunction with the facilities consolidation and restructuring program described in Item 1 of Part I, Financial Statements (Unaudited) Note 3 Restructuring Expense , management decided to sell OTravel, a wholly-owned travel offerings subsidiary. The travel business was not part of our core business operations and was no longer part of our strategic focus. We also determined that the OTravel subsidiary met the definition of a component of an entity and has been accounted for as a discontinued operation under SFAS No. 144. The results of operations for this subsidiary have been classified as discontinued operations for the three and six months ended June 30, 2007.

In conjunction with the discontinuance of OTravel, we performed an evaluation of the goodwill associated with the reporting unit pursuant to SFAS No. 142 and SFAS No. 144 and determined that goodwill of approximately $3.8 million was impaired as of June 30, 2007, based on the estimated fair value of the discounted cash flows of the net proceeds from the April 25, 2007 sale of OTravel.com for $17.0 million.

Income taxes

Income taxes. For the six months ended June 30, 2007 and 2008, we incurred net operating losses, and consequently paid insignificant amounts of federal, state and foreign income taxes. As of December 31, 2007 and June 30, 2008, we had net operating loss carryforwards of approximately $164.2 million and $175.5 million, respectively, which may be used to offset future taxable income. An additional $21.9 million of net operating losses are limited under Internal Revenue Code Section 382 to $799,000 a year. These net operating loss carryforwards will begin to expire in 2018.

Seasonality

Based upon our historical experience, increased revenues typically occur during the fourth quarter because of the holiday retail season. The actual quarterly results for each quarter could differ materially depending upon consumer preferences, availability of product and competition, among other risks and uncertainties. Accordingly, there can be no assurances that seasonal variations will not materially affect our results of operations in the future. The following table reflects our total revenues for each of the quarters since 2005 (in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2008	$ 200,745	$ 188,842		
2007	157,930	148,967	$ 161,930	$ 291,334
2006	178,044	159,192	156,885	294,029
2005	165,881	150,638	167,779	315,018

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Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that would be material to investors.

Liquidity and Capital Resources

At June 30, 2008, our cash and cash equivalents balance was $56.7 million and we had $30.0 million in marketable securities, for a total of $86.7 million of cash, cash equivalents and marketable securities.

We have payment terms with our fulfillment partners that extend beyond the amount of time necessary to collect proceeds from our customers. As a result, following our seasonally strong fourth quarter sales, at December 31 of each year, our cash, cash equivalents, marketable securities, accounts payable and accrued liabilities balances typically reach their highest level (other than as a result of cash flows provided by or used in investing and financing activities). However, our accounts payable and accrued liabilities balances normally decline during the first three months following year-end, which normally results in a decline in our cash, cash equivalents, and marketable securities balances from the year-end balance. The seasonality of our business causes accounts payable and accrued liabilities to grow significantly in the fourth quarter, and then decrease in the first quarter when they are paid.

Due to the strong effect of seasonality on our cash and marketable securities balance, we believe that the best measure of our operating cash flow is on a trailing twelve-month (TTM) basis. Over the TTM ended June 30, 2008, our operating activities resulted in net cash inflows of $12.7 million, versus net cash inflows of $9.4 million over the TTM ended June 30, 2007.

The $12.7 million of cash provided by operations for the TTM ended June 30, 2008 was comprised of inflows related to net losses of $20.2 million offset by $30.6 million of non-cash expenses, as well as a reduction of inventory of $1.4 million and increased accrued liabilities of $878,000. These were offset by operating cash outflows from an increase in accounts receivable of $7.2 million (due to an increase in the credit and account balances outstanding compared to June 30, 2007), and changes in combined prepaid inventory and prepaid expenses and accounts payable of $2.2 million and $2.3 million.

For the TTM ended June 30, 2007, cash provided by operating activities was $9.4 million and was comprised of outflows from net losses of $105.3 million, offset by restructuring charges of $18.5 million, loss from discontinued operations of $8.9 million and non-cash cash expenses of $40.4 million, as well as outflows from decreases in accounts payable and accrued liabilities of $2.6 million and $6.0 million, respectively. These cash outflows were offset primarily by the cash provided from the reduction of inventory (including prepaid inventory) of $55.0 million.

For the three months ended June 30, 2007 and 2008, our operating activities resulted in net cash inflows of $14.9 million and $449,000, respectively.

The $449,000 inflow of cash and cash equivalents provided by operating activities during the three months ended June 30, 2008 was comprised of inflows from net losses of $6.5 million offset by $7.4 million of net non-cash activity, as well as cash provided from changes in inventory and accrued liabilities of $3.9 million and $428,000 respectively. These were offset by cash outflows from changes in accounts receivable, accounts payable and deferred revenue of $2.1 million, $1.6 million and $771,000, respectively.

For the three months ended June 30, 2007, the $14.9 million inflow of cash and cash equivalents provided by operating activities was from net liabilities losses of $13.8 million offset by $300,000 of loss from discontinued operations, $6.2 million of non-cash restructuring costs and $9.4 million of other net non-cash activity, as well as changes in inventory, prepaid inventory, prepaid expenses, accounts payable, accrued liabilities and deferred revenue of $1.2 million, $477,000, $700,000, $5.5 million, $4.9 million and $200,000, respectively.

For the six months ended June 30, 2007 and 2008, operating activities resulted in net cash outflows of $43.3 million and $40.6 million, respectively.

For the six months ended June 30, 2008, the net cash used in operating activities of $40.6 million was mainly due to changes in receivables, prepaid expenses, accounts payable, accrued liabilities and deferred revenue of $2.9 million, $2.9 million, $39.4 million, $11.0 million and $1.9 million, respectively. This was offset by operating cash inflows from changes in inventories and prepaid inventory of $11.9 million and $924,000, respectively, as well as our net losses of $10.4 million offset by depreciation and amortization of $12.4 million and stock-based compensation of $2.9 million. Note that the significant decrease in accounts payables and accrued liabilities is due to the seasonality of our business, as payables and accruals grow significantly in the fourth quarter, and then decrease in the first quarter when they are paid. As stated earlier, this is why we believe that the best measure of our operating cash flow is on a trailing twelve-month basis.

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For the six months ended June 30, 2007, the net cash used in operating activities of $43.3 million was mainly due to changes in prepaid expenses, accounts payables and accrued liabilities of $1.3 million, $32.6 million and $18.8 million, respectively, in addition to net losses of $35.2 million offset by depreciation and amortization of $15.7 million, restructuring charges of $12.3 million, a loss from discontinued operations of $3.9 million and stock-based compensation of $2.4 million. This was offset by operating cash inflows from changes in accounts receivable, inventories and deferred revenue of $3.4 million, $4.8 million and $654,000, respectively.

Investing activities resulted in cash outflows of $8.8 million and $4.8 million for the three months ended June 30, 2007 and 2008, respectively. The cash outflows of $4.8 million during Q2 2008 resulted from purchases of marketable securities of $18.8 million and capital expenditures of $5.1 million, offset by cash inflows from investing activities from the sale and maturities of marketable securities of $18.4 million, and from cash received from $754,000 of payments received on a note receivable. Cash outflows from investing activities for the three months ended June 30, 2007 resulted from investments in marketable securities of $21.4 million, offset by cash received from the sale and maturity of marketable securities of $3.4 million and the net proceeds from the sale of OTravel of $9.9 million.

For the six months ended June 30, 2007 and 2008, investing activities resulted in cash outflows of $5.3 million and net cash inflows of $10.8 million, respectively. The $10.8 million of cash inflows during Q2 2008 resulted from the sales and maturities of marketable securities of $41.3 million and $1.3 million of payments received on a note receivable, offset by purchases of marketable securities of $25.4 million and capital expenditures of $6.4 million. For investing activities in 2007, cash outflows of $5.3 million were the result of investments in marketable securities and capital expenditures of $21.4 million and $1.9 million, respectively, offset by cash received from the sale and maturity of marketable securities of $3.4 million, payments received from a note receivable of $4.7 million and the net proceeds from the sale of OTravel of $9.9 million.

Financing activities resulted in cash inflows of $764,000 and $922,000 for the three months ended June 30, 2007 and 2008, respectively. The inflows for both three month periods related to proceeds from the exercise of stock options of $924,000 in 2008 and $768,000 in 2007.

For the six months ended June 30, 2007 and 2008, financing activities resulted in net cash outflows of $3.3 million and $14.9 million, respectively. For the six months ended June 30, 2008, cash used in financing activities was due to our stock repurchase of $12.0 million and payments for capital leases of $3.8 million. These outflows of cash were offset by proceeds from the exercise of stock options of $924,000. The cash used in 2007 was primarily from $1.9 million received from the exercise of stock options, offset by payments for capital leases of $5.3 million.

While we believe that the cash and marketable securities currently on hand, amounts available under our credit facility and expected cash flows from future operations will be sufficient to continue operations for at least the next twelve months, we may require additional financing. However, there can be no assurance that if additional financing is necessary it will be available, or, if available, that such financing can be obtained on satisfactory terms. Failure to generate sufficient revenues, profits or to raise additional capital could have a material adverse effect on our ability to continue as a going concern and to achieve our intended business objectives. Any projections of future cash needs and cash flows are subject to substantial uncertainty.

Contractual Obligations and Commitments. The following table summarizes our contractual obligations as of June 30, 2008 and the effect such obligations and commitments are expected to have on our liquidity and cash flow in future periods (in thousands):

Contractual Obligations	2008	2009	2010	2011	2012	Thereafter	Total
	Payments Due by Period						
Long-term debt arrangements	$	$	$	$ 77,000	$	$	$ 77,000
Interest on convertible senior notes	1,444	2,888	2,887	2,887			10,106
Operating leases	8,154	8,480	8,859	9,148	8,395	18,993	62,029
Purchase obligations	16,462						16,462
Line of credit							
Total contractual cash obligations	$ 26,060	$ 11,368	$ 11,746	$ 89,035	$ 8,395	$ 18,993	$ 165,597

Other Commercial Commitments	2008	2009	2010	2011	2012	Thereafter	Total
	Amounts of Commitment Expiration Per Period						
Letters of credit	$ 2,505	$	$	$	$	$	$ 2,505
Total commercial commitments	$ 2,505	$	$	$	$	$	$ 2,505

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3.75% Convertible Senior Notes

In November 2004, we completed an offering of $120.0 million of 3.75% Convertible Senior Notes (the Senior Notes). Interest on the Senior Notes is payable semi-annually on June 1 and December 1 of each year. The Senior Notes mature on December 1, 2011 and are unsecured and rank equally in right of payment with all existing and future unsecured, unsubordinated debt and senior in right of payment to any existing and future subordinated indebtedness. The Senior Notes are convertible at any time prior to maturity into our common stock at the option of the note holders at a conversion price of $76.23 per share (subject to adjustment in certain events, including stock splits, dividends and other distributions and certain repurchases of our stock, as well as certain fundamental changes in our ownership).

Beginning December 1, 2009, we have the right to redeem the Senior Notes, in whole or in part, for cash at 100% of the principal amount plus accrued and unpaid interest. Upon the occurrence of a fundamental change (including the acquisition of a majority interest in us, certain changes in our board of directors or the termination of trading of our stock) meeting certain conditions, holders of the Senior Notes may require us to repurchase for cash all or part of their notes at 100% of the principal amount plus accrued and unpaid interest.

The indenture governing the Senior Notes requires us to comply with certain affirmative covenants, including making principal and interest payments when due, maintaining our corporate existence and properties, and paying taxes and other claims in a timely manner. We were in compliance with these covenants at June 30, 2008.

In 2005, we retired $43.0 million of the Senior Notes for $35.7 million in cash. As a result of the note retirements, we recognized a gain of $6.2 million, net of the associated unamortized discount of $1.2 million for the year ended December 31, 2005. As of June 30, 2008, $77.0 million of Senior Notes and unamortized debt discount of $1.2 million remain outstanding.

Operating Leases

We have two non-cancelable operating leases for certain computer equipment that expire in first and fourth quarters of 2010. It is expected that such leases will be renewed by exercising purchase options or replaced by leases of other computer equipment. The lease obligations also include our obligations for corporate office space, logistics and warehouse space, co-location data center agreements and other operating leases.

Corporate office space

Through July 2005, we leased 43,000 square feet of office space at Old Mill Corporate Center I for our principal corporate offices under an operating lease which was originally scheduled to expire in January 2007. Beginning July 2005, this lease was terminated and replaced with a lease for approximately 154,000 rentable square feet in the Old Mill Corporate Center III in Salt Lake City, Utah for a term of ten years. The total lease obligation over the remaining term of the new lease is $32.3 million, of which approximately $3.9 million is payable in the next twelve months. $8.2 million of the total lease obligation is offset by estimated sublease payments, of which $1.2 million is anticipated to be received in the next twelve months.

In 2006, we commenced implementation of a facilities consolidation and restructuring program. Under the program, we recorded $638,000 of accelerated amortization of leasehold improvements related to our current office facilities that we sublet and $450,000 of costs incurred to return our office facilities to their original condition as required by the lease agreement.

During fiscal year 2007, we recorded an additional $6.2 million of restructuring costs related to our marketing for sub-lease office and data center space in our current corporate office facilities. We also recorded an additional $2.2 million of restructuring charges related to accelerated amortization of leasehold improvements located in the abandoned office and co-location data center space and $200,000 of other miscellaneous restructuring charges (see Item 1 of Part I, Financial Statements (Unaudited) Note 3 Restructuring Expense).

Logistics and warehouse space

In July 2004, we entered into a logistics service agreement (the Logistics Agreement) wherein the handling, storage and distribution of some of our prepackaged products were performed by a third party. The Logistics Agreement and subsequent amendment set forth terms on which we paid various fixed fees based on square feet of storage and various variable costs based on product handling costs for a term of five years.

In December 2005, we entered into a warehouse facilities lease agreement (the License Agreement) to license approximately 400,000 square feet of warehouse space in Indiana. The License Agreement was subsequently amended, reducing the amount of lease space to approximately 300,000 and extending the term to 2011.

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In the first quarter of 2007, we terminated the Logistics Agreement and gave notice of intent to sublease the Indiana warehouse facilities under the License Agreement. During the second quarter of 2007, we reached an agreement to terminate the Indiana warehouse facilities lease effective August 15, 2007. As a result of the termination of the License agreement and warehouse lease, we incurred $3.7 million of related restructuring charges in 2007 (see Item 1 of Part I, Financial Statements (Unaudited) Note 3 Restructuring Expense).

We currently lease 640,000 square feet for our warehouse facilities in Utah under operating leases which expire in August 2012.

On April, 8, 2008, we entered into a lease agreement with Natomas Meadows, LLC (Natomas Lease). The Natomas Lease is for a 686,865 square foot warehouse facility, now under construction in Salt Lake City, Utah (New Warehouse). The Natomas Lease provides that construction of the New Warehouse is to be completed August 1, 2008 and that we will lease the New Warehouse in stages: beginning September 1, 2008, we will lease a total of 232,900 square feet of the New Warehouse; on February 1, 2009, we will lease a total of 435,400 square feet; and, on September 1, 2009, we will lease the remainder, for a total of 686,865 square feet. The Natomas Lease term is seven years, and specifies rent, exclusive of common area maintenance fees, at a variable rate over the course of the staged Natomas Lease term, ranging from $0.3300 per square foot for the first stage, to $0.3950 per square foot for the last year of the Natomas Lease term. We currently have warehouse operations in three facilities in Salt Lake City. Over the course of the staged Natomas Lease, we plan to consolidate to the New Warehouse our warehouse operations from two of our smaller leased warehouse facilities in Salt Lake City. Both of these smaller warehouse facilities are under common ownership with Natomas Meadows, LLC. The common owner has agreed to cancel our leases of those facilities without any early termination penalty. We intend to expand our customer service operations into the New Warehouse location in 2008, and to move our corporate office facility to the New Warehouse in 2009.

Co-location data center

In July 2005, we entered into a Co-location Center Agreement (the Co-location Agreement) to build out and lease 11,289 square feet of space at Old Mill Corporate Center II for an IT co-location data center. The Co-location Agreement set forth the terms on which the Lessor would incur the costs to build out the IT co-location data center and we would commence to lease the space upon its completion for a term of ten years. In November 2006 however, we made the determination to consolidate our facilities and to not occupy the IT co-location data center, and the Co-location Agreement was terminated effective December 29, 2006, for which we incurred a $4.6 million restructuring charge (see Item 1 of Part I, Financial Statements (Unaudited) Note 3 Restructuring Expense).

In December 2006, we entered into a Data Center Agreement (the OM I Agreement) to lease 3,999 square feet of space at Old Mill Corporate Center I for an IT data center to allow us to consolidate other IT data center facilities.

We believe that these facilities will be sufficient for our needs for the next twelve months, subject to seasonal requirements for additional warehouse space during the fourth quarter.

Purchase Obligations

The amount of purchase obligations shown is based on assumptions regarding the legal enforceability against us of purchase orders we had outstanding at June 30, 2008. Under different assumptions regarding our rights to cancel our purchase orders or different assumptions regarding the enforceability of the purchase orders under applicable law, the amount of purchase obligations shown in the table above would be less.

Borrowings

Wells Fargo Operational Credit Agreement

We have a credit agreement (as amended to date, the Credit Agreement) with Wells Fargo Bank, National Association (Wells Fargo). The Credit Agreement provides a revolving line of credit to us of up to $30.0 million which we use primarily to obtain letters of credit to support operations, namely, inventory purchases. Interest on borrowings is payable monthly and accrued at either (i) 1.0% above LIBOR in effect on the first day of an applicable fixed rate term, or (ii) at a fluctuating rate per annum determined by the bank to be one half a percent (0.50%) above daily LIBOR in effect on each business day a change in daily LIBOR is announced by the bank. The Credit Agreement expires on January 1, 2010, and requires us to comply with certain covenants, including restrictions on mergers, business combinations or transfer or assets. We were in compliance with these covenants at June 30, 2008.

Borrowings and outstanding letters of credit under the Credit Agreement are required to be completely collateralized by cash balances held at Wells Fargo Bank, N.A, and therefore the facility does not provide additional liquidity to us.

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At June 30, 2008, no amounts were outstanding under the Credit Agreement, and letters of credit totaling $2.5 million were issued on our behalf.

Wells Fargo Retail Finance Agreement

We are a party to a Loan and Security Agreement (as amended to date, the WFRF Agreement) with Wells Fargo Retail Finance, LLC and related security agreements and other agreements described in the WFRF Agreement.

The WFRF Agreement provides for advances to us and for the issuance of letters of credit for our account of up to an aggregate maximum of $40.0 million. The amount actually available to us may be less and may vary from time to time, depending on, among other factors, the amount of our eligible inventory and receivables. Our obligations under the WFRF Agreement and all related agreements are collateralized by all or substantially all of our and our subsidiaries assets. Our obligations under the WFRF Agreement are cross-collateralized with our assets pledged under our $30.0 million credit facility with Wells Fargo Bank, N.A. The WFRF Agreement contains standard default provisions and expires on December 12, 2008. The conditions to our use of the facility include a 45-day advance notice requirement.

Advances under the WFRF Agreement bear interest at either (i) the rate announced, from time to time, within Wells Fargo Bank, N.A. at its principal office in San Francisco as its prime rate or (ii) a rate based on LIBOR plus a varying percentage between 1.25% and 1.75%; however, the annual interest rate on advances under the WFRF Agreement will be at least 3.50%. The WFRF Agreement includes affirmative covenants as well as negative covenants that prohibit a variety of actions without the lender s approval, including covenants that limit our ability to (a) incur or guarantee debt, (b) create liens, (c) enter into any merger, recapitalization or similar transaction or purchase all or substantially all of the assets or stock of another person, (d) sell assets, (e) change our name or the name of any of our subsidiaries, (f) make certain changes to our business, (g) optionally prepay, acquire or refinance indebtedness, (h) consign inventory, (i) pay dividends on, or purchase, acquire or redeem shares of, our capital stock, (j) change our method of accounting, (k) make investments, (l) enter into transactions with affiliates, or (m) store any of our inventory or equipment with third parties. We were in compliance with these covenants as of June 30, 2008. At June 30, 2008, no amounts were outstanding under the WFRF Agreement. As of June 30, 2008, availability under the WFRF Agreement was $8.4 million.

Wells Fargo Commercial Card Agreement

The Company has a commercial card agreement (the Commercial Card) with Wells Fargo Bank, National Association (Wells Fargo). The Company uses the Commercial Card primarily for business purpose purchasing and must be paid in full each month. Outstanding amounts under the Commercial Card are collateralized by cash balances held at Wells Fargo Bank, N.A, and therefore the facility does not provide additional liquidity to the Company. At June 30, 2008, $1.5 million was outstanding and availability under the Commercial Card was $3.5 million.

Share Repurchase Program

On January 14, 2008, our Board of Directors authorized a repurchase program that authorizes us to purchase up to $20.0 million of our common stock and/or our 3.75% Senior Convertible Notes due 2011 through December 31, 2009. Under this repurchase program, we repurchased approximately 1.1 million shares of our common stock in open market transactions for $12.0 million during the six months ended June 3, 2008. During July 2008, we repurchased an additional 30,000 shares of its common stock in open market purchases for approximately $482,000.

Shelf Registration

In April 2005, we filed a registration statement with the Securities and Exchange Commission using a shelf registration or continuous offering process. Under this shelf process, we may, from time to time, sell any or all of the securities described in the prospectus in one or more offerings up to a total dollar amount of $500.0 million. On May 1, 2006, we issued approximately 1,042,000 shares of common stock for net proceeds of approximately $25.0 million. Additionally, on December 12, 2006, we issued approximately 2,734,000 shares for net proceeds of approximately $39.4 million. We did not issue any shares of common stock under the shelf registration statement during fiscal 2007 or the six months ended June 30, 2008.

Government Regulation

All of our services are subject to federal and state consumer protection laws including laws protecting the privacy of consumer non-public information and regulations prohibiting unfair and deceptive trade practices. In particular, under federal and state financial privacy laws and regulations, we must provide notice to consumers of our policies on sharing non-public information with third parties, must provide advance notice of any changes to our policies and, with limited exceptions, must give consumers the right to prevent sharing of their non-public personal information with unaffiliated third parties. Furthermore, the growth and demand for online commerce could result in more stringent consumer protection laws that impose additional compliance burdens on online companies. These consumer protection laws could result in substantial compliance costs and could interfere with the conduct of our business.

In many states, there is currently great uncertainty whether or how existing laws governing issues such as property ownership, sales and other taxes, libel and personal privacy apply to the Internet and commercial online services. These issues may take years to resolve. In addition, new state tax regulations may subject us to additional state sales and income taxes. New legislation or regulation, the application of laws and regulations from jurisdictions whose laws do not currently apply to our business or the application of existing laws and regulations to the Internet and commercial online services could result in significant additional taxes on our business. These taxes could have an adverse effect on our cash flows and results of operations. Furthermore, there is a possibility that we may be subject to significant fines or other payments for any past failures to comply with these requirements.

Factors that May Affect Future Results

Any investment in our securities involves a high degree of risk. Investors should consider carefully the risks and uncertainties described in this Form 10-Q, and all other information in this Form 10-Q and in our other filings with the SEC including those we file after we file this Form 10-Q, before deciding whether to purchase or hold our securities. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also become important factors that may harm our business. The occurrence of any of the risks described in under Risk Factors in our most recent Annual Report on Form 10-K or herein could harm our business. The trading price of our securities could decline due to any of these risks and uncertainties, and investors may lose part or all of their investment.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not use derivative financial instruments in our investment portfolio and have no foreign exchange contracts. Our financial instruments consist of cash and cash equivalents, marketable securities, trade accounts and contracts receivable, accounts payable and long-term obligations. We consider investments in highly-liquid instruments with a remaining maturity of 90 days or less at the date of purchase to be cash equivalents.

Our exposure to market risk for changes in interest rates relates primarily to our short-term investments and short-term obligations; thus, fluctuations in interest rates would not have a material impact on the fair value of these securities. However, the fair values of our investments may be subject to fluctuations due to volatility of the stock market in general, investment-specific circumstances, and changes in general economic conditions.

At June 30, 2008, we had $56.7 million in cash and cash equivalents and $30.0 million in marketable securities. Hypothetically, an increase or decrease in interest rates of one hundred basis points would have an estimated impact of $870,000 on our earnings or loss, or the fair market value or cash flows of these instruments. Our cash, cash equivalents and marketable securities consisted of U.S. agency securities, money market funds, commercial paper, and AAA-rated asset-backed securities collateralized by automobile loans/leases and credit card receivables.

At June 30, 2008, we had $77.0 million of convertible senior notes outstanding which bear interest at a fixed rate of 3.75%. At June 30, 2008, there were no borrowings outstanding under our lines of credit and letters of credit totaling $2.5 million were outstanding under our credit facilities.

The fair value of the convertible senior notes is sensitive to interest rate changes. Interest rate changes would result in increases or decreases in the fair value of the convertible senior notes, due to differences between market interest rates and rates in effect at the inception of the obligation. Unless we elect to repurchase our convertible senior notes in the open market, changes in the fair value of convertible senior notes have no impact on our cash flows or consolidated financial statements. The estimated fair value of our 3.75% Convertible Senior Notes as of June 30, 2008 was $53.9 million.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information relating to the Company and its consolidated subsidiaries required to be disclosed in the Company s periodic filings under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported in a timely manner in accordance with the requirements of the Exchange Act, and that such information is accumulated and communicated to management, including the Company s Chief Executive Officer (principal executive officer) and Senior Vice President, Finance (principal financial officer), as appropriate, to allow timely decisions regarding required disclosure. The Company carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer (principal executive officer) and Senior Vice President, Finance (principal financial officer), of the effectiveness of the design and operation of these disclosure controls and procedures, as such term is defined in Exchange Act Rule 13a-15(e), as of June 30, 2008. Based on this evaluation, the Chief

Executive Officer (principal executive officer) and Senior Vice President, Finance (principal financial officer) each concluded that the Company s disclosure controls and procedures were effective as of June 30, 2008.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company s internal control over financial reporting that occurred during the quarter ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth under Item 1 of Part I, Financial Statements (Unaudited) Note 8 Commitments and Contingencies, subheading Legal Proceedings, contained in the Notes to Unaudited Consolidated Financial Statements of this Quarterly Report on Form 10-Q is incorporated by reference in answer to this Item.

ITEM 1A. RISK FACTORS

Please consider the following risk factors carefully. Described below are what we believe to be the material risks that we face. If any of the events or circumstances described in the following risks actually occurs, our business, financial condition or results of operations could suffer. In addition, these are not the only risks we face. Our business faces many risks. The descriptions below include any material changes to and supersede the description of the risk factors as previously disclosed in Item 1A to Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, filed with the SEC on March 17, 2008.

Risks Relating to Overstock

We have a history of significant losses. If we do not achieve profitability, our financial condition and our stock price could suffer.

We have a history of losses and we may continue to incur operating and net losses for the foreseeable future. We incurred a net loss of $6.5 million and $10.4 million for the three and six months ended June 30, 2008. As of June 30, 2008, our accumulated deficit was $254.1 million. We will need to generate significant revenues to achieve profitability, and we may not be able to do so. Even if we do achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis in the future. If our revenues grow more slowly than we anticipate, or if our operating expenses exceed our expectations, our financial results would be harmed.

We will continue to incur significant operating expenses and some capital expenditures to:

- enhance our distribution and order fulfillment capabilities;
- further improve our order processing systems and capabilities;
- develop enhanced technologies and features;
- expand our customer service capabilities to better serve our customers needs;
- expand or modify our product offerings;
- rent or terminate warehouse and office space;
- increase our general and administrative functions to support our operations; and
- maintain or increase our sales, branding and marketing activities, including maintaining existing or entering into new online marketing or marketing analytics arrangements, and continuing or increasing our national television and radio advertising and direct mail campaigns.

Because we will incur many of these expenses before we receive any revenues from our efforts, our losses may be greater than the losses we would incur if we developed our business more slowly. Further, we base our expenses in large part on our operating plans and future revenue projections. Many of our expenses are fixed in the short term, and we may not be able to quickly reduce spending if our revenues are lower than we project. Therefore, any significant shortfall in revenues would likely harm our business, prospects, operating results and financial condition. In addition, we may find that these efforts are more expensive than we currently anticipate which would further increase our losses. Also, the timing of these expenses may contribute to fluctuations in our quarterly operating results.

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A downturn in general economic conditions may adversely affect our results of operations.

The success of our operations depends to a significant extent upon a number of factors relating to discretionary consumer spending, including economic conditions affecting disposable consumer income such as employment, business conditions, interest rates and taxation. There can be no assurance that consumer spending will not be adversely affected by economic conditions, thereby impacting our growth, financial condition and results of operations. Increases in the prices of fuel and gasoline, as well as increases in the prices of other energy products and commodities may also negatively affect our operating results.

The seasonality of our business places increased strain on our operations.

We expect a disproportionate amount of our net sales to occur during our fourth quarter. If we do not stock or restock popular products in sufficient amounts such that we fail to meet customer demand, it could significantly affect our revenue and our future growth. If we overstock products, we may be required to take significant inventory markdowns or write-offs, which could reduce gross profits. We may experience an increase in our net shipping cost due to complimentary upgrades, split-shipments, and additional long-zone shipments necessary to ensure timely delivery for the holiday season. If too many customers access our Website within a short period of time due to increased holiday demand, we may experience system interruptions that make our Website unavailable or prevent us from efficiently fulfilling orders, which may reduce the volume of goods we sell and the attractiveness of our products and services. In addition, we may be unable to adequately staff our fulfillment and customer service centers during these peak periods and delivery and other fulfillment companies and customer service co-sourcers may be unable to meet the seasonal demand.

If we fail to accurately forecast our expenses and revenues, our business, operating results and financial condition may suffer and the price of our securities may decline.

Our limited operating history and the rapidly evolving nature of our industry make forecasting operating results difficult. We have recently completed several large, complex and expensive infrastructure upgrades in order to increase our ability to handle larger volumes of sales and to develop or increase our ability to perform a variety of analytical procedures relating to our business, and we are continuing the work to upgrade and further expand these and other components of our infrastructure. We have experienced difficulties with the implementation of various aspects to the upgrades of our infrastructure, and have incurred increased expenses as a result of these difficulties. As a result of these expenditures, our ability to quickly reduce spending if our revenues are lower than we project is limited. Therefore, any significant shortfall in the revenues for which we have built and are continuing to build our infrastructure would likely harm our business, prospects, operating results and financial condition and cause our results of operation to fall below the expectations of public market analysts and investors. If this occurs, the price of our securities may decline.

We depend on our relationships with third party fulfillment partners for a large portion of the products that we offer for sale on our Website. If we fail to maintain these relationships, our business will suffer.

At June 30, 2008, we had fulfillment partner relationships with approximately 870 third parties whose products we offer for sale on our Website. We depend on our fulfillment partners to provide a large portion of the product selection we offer, as these products accounted for approximately 90% of the non-BMMG products available on our Website. We plan to continue to expand the number of fulfillment partner relationships and the number of products offered for sale by our fulfillment partners on our Website. We do not have any long-term agreements with any of these third parties. Our agreements with third parties are terminable at will by either party immediately upon notice. In general, we agree to offer the third parties products on our Website and these third parties agree to provide us with information about their products, honor our customer service policies and ship the products directly to the customer. If we do not maintain our existing relationships or build new relationships with third parties on acceptable commercial terms, we may not be able to offer a broad selection of merchandise, and customers may refuse to shop at our Website. In addition, manufacturers may decide not to offer particular products for sale on the Internet. If we are unable to maintain our existing or build new fulfillment partner relationships or if other product manufacturers refuse to allow their products to be sold via the Internet, our business and prospects would suffer severely.

We are partially dependent on third parties to fulfill a number of our fulfillment, distribution and other retail functions. If such parties are unwilling or unable to continue providing these services, our business could be seriously harmed.

In our fulfillment partner business, although we handle returned merchandise, we continue to rely on third parties to conduct a number of other traditional retail operations with respect to their respective products that we offer for sale on our Website, including maintaining inventory, preparing merchandise for shipment to individual customers and timely distribution of purchased merchandise. We have no effective means to ensure that these third parties will continue to perform these services to our satisfaction or on commercially reasonable terms. In addition, because we do not take possession of these third parties products, we are unable to fulfill these traditional retail operations ourselves. Our customers could become dissatisfied and cancel their orders or decline to make future purchases if these third parties are unable to deliver products on a timely basis. If our customers become dissatisfied with the services provided by these third parties, our reputation and the Overstock.com brand could suffer.

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We rely on our relationships with manufacturers, retailers and other suppliers to obtain sufficient quantities of quality merchandise on acceptable terms. If we fail to maintain our supplier relationships on acceptable terms, our sales and profitability could suffer.

To date, we have not entered into contracts with manufacturers or liquidation wholesalers that guarantee the availability of merchandise for a set duration. Our contracts or arrangements with suppliers do not provide for the continuation of particular pricing practices and may be terminated by either party at any time. Our current suppliers may not continue to sell their excess inventory to us on current terms or at all and we may not be able to establish new supply relationships. For example, it is difficult for us to maintain high levels of product quality and selection because none of the manufacturers, suppliers and liquidation wholesalers from whom we purchase products on a purchase order by purchase order basis have a continuing obligation to provide us with merchandise at historical levels or at all. In most cases, our relationships with our suppliers do not restrict the suppliers from selling their respective excess inventory to other traditional or online merchandise liquidators, which could in turn limit the selection of products available on our Website. If we are unable to develop and maintain relationships with suppliers that will allow us to obtain sufficient quantities of merchandise on acceptable commercial terms, such inability could harm our business, prospects, results of operation and financial condition.

We depend upon third-party delivery services to deliver our products to our customers on a timely and consistent basis. Deterioration in our relationship with any one of these third parties could decrease our ability to track shipments, cause shipment delays, and increase our shipping costs and the number of damaged products.

We rely upon multiple third parties for the shipment of our products. We cannot be sure that these relationships will continue on terms favorable to us, if at all. Unexpected increases in shipping costs or delivery times, particularly during the holiday season, could harm our business, prospects, financial condition and results of operations. If our relationships with these third parties are terminated or impaired or if these third parties are unable to deliver products for us, whether through labor shortage, slow down or stoppage, deteriorating financial or business condition, responses to terrorist attacks or for any other reason, we would be required to use alternative carriers for the shipment of products to our customers. In addition, conditions such as adverse weather can prevent any carriers from performing their delivery services, which can have an adverse effect on our customers satisfaction with us. In any of these circumstances, we may be unable to engage alternative carriers on a timely basis, upon terms favorable to us, or at all. Changing carriers would likely have a negative effect on our business, prospects, operating results and financial condition. Potential adverse consequences include:

- reduced visibility of order status and package tracking;
- delays in order processing and product delivery;
- increased cost of delivery, resulting in reduced gross margins; and
- reduced shipment quality, which may result in damaged products and customer dissatisfaction.

A significant number of merchandise returns could harm our business, financial condition and results of operations.

We allow our customers to return products. If merchandise returns are significant, our business, prospects, financial condition and results of operations could be harmed. We modify our policies relating to returns from time to time and any policies intended to reduce the number of product returns may result in customer dissatisfaction and fewer repeat customers.

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If the products that we offer on our Website do not reflect our customers tastes and preferences, our sales and profit margins would decrease.

Our success depends in part on our ability to offer products that reflect consumers tastes and preferences. Consumers tastes are subject to frequent, significant and sometimes unpredictable changes. Because some of the products that we sell consist of manufacturers and retailers excess inventory, we have limited control over some of the specific products that we are able to offer for sale. If our merchandise fails to satisfy customers tastes or respond to changes in customer preferences, our sales could suffer and we could be required to mark down unsold inventory which would depress our profit margins. In addition, any failure to offer products in line with customers preferences could allow our competitors to gain market share. This could have an adverse effect on our business, prospects, results of operations and financial condition.

We face risks relating to our inventory.

We directly purchase some of the merchandise that we sell on our Website. We assume the inventory damage, theft and obsolescence risks, as well as price erosion risks for products that we purchase directly. These risks are especially significant because some of the merchandise we sell on our Website is characterized by rapid technological change, obsolescence and price erosion (for example, computer hardware, software and consumer electronics) and because we sometimes make large purchases of particular types of inventory. In addition, we often do not receive warranties on the merchandise we purchase. We accept returns of products sold through our fulfillment partners and we have the risk of reselling the returned products.

In the recent past we have recorded charges for obsolete inventory and have had to sell certain merchandise at a discount or loss. It is impossible to determine with certainty whether an item will sell for more than the price we pay for it. To the extent that we rely on purchased inventory, our success will depend on our ability to liquidate our inventory rapidly, the ability of our buying staff to purchase inventory at attractive prices relative to its resale value and our ability to manage customer returns and the shrinkage resulting from theft, loss and misrecording of inventory. If we are unsuccessful in any of these areas, we may be forced to sell our inventory at a discount or loss.

We purchase some inventory from foreign markets and pay for inventory with U.S. dollars. If the dollar weakens with respect to foreign currencies, foreign vendors may require us to pay higher prices for products, which could negatively affect our gross margins.

If we do not successfully optimize and operate our warehouse and customer service operations, our business could be harmed.

If we do not successfully optimize and operate our warehouse and customer service operations, it could significantly limit our ability to meet customer demand. Because it is difficult to predict demand, we may not manage our facilities in an optimal way, which may result in excess or insufficient inventory or warehousing capacity. We may be unable to adequately staff our fulfillment and customer service centers. In addition, we rely on a limited number of companies to deliver inventory to us and to ship orders to our customers. If we are not able to negotiate acceptable terms with these companies, or they experience performance problems or other difficulties, it could negatively impact our operating results and customer experience.

The loss of key personnel or any inability to attract and retain additional personnel could affect our ability to successfully grow our business.

Our performance is substantially dependent on the continued services and on the performance of our senior management and other key personnel, including Patrick M. Byrne, our Chief Executive Officer. Our performance also depends on our ability to retain and motivate other officers and key employees. The loss of the services of any of our executive officers or other key employees for any unforeseen reason, including without limitation, illness or call to military service, could harm our business, prospects, financial condition and results of operations. We do not have employment agreements with any of our key personnel and we do not maintain key person life insurance policies. Our future success also depends on our ability to identify, attract, hire, train, retain and motivate other highly-skilled technical, managerial, editorial, merchandising, marketing and customer service personnel. Competition for such personnel is intense, and we cannot assure you that we will be able to successfully attract, assimilate or retain sufficiently qualified personnel. Our failure to retain and attract the necessary technical, managerial, editorial, merchandising, marketing and customer service personnel could harm our revenues, business, prospects, financial condition and results of operations.

We have a rapidly evolving business model.

Our business model has evolved and continues to do so. In the past we have added additional types of services and product offerings and in some cases, we have modified or discontinued those offerings. We may continue to try to offer additional types of products or services and we cannot offer any assurance that any of them will be successful. From time to time we have also modified aspects of our business model relating to our product mix and the mix of direct/fulfillment partner sourcing of the products we offer. We may continue to modify this aspect of our business as well as other significant aspects of our business. We cannot offer any assurance that these or any other modifications will be successful.

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We may be unable to manage expansion into new business areas which could harm our business operations and reputation.

Our long-term strategic plan involves expansion of our operations to offer additional types of products and services. We cannot assure you that our efforts to expand our business in this manner will succeed. Our failure to succeed in these markets or businesses or in other product or service offerings may harm our business, prospects, financial condition and results of operation. We cannot assure you that we will be able to expand our operations in a cost-effective or timely manner or that our efforts to expand will be successful. Furthermore, any new business or website we launch that is not favorably received by consumers could damage our reputation or the Overstock.com brand. We may expand the number of categories of products we carry on our Website and these and any other expansions of our operations would also require significant additional expenses and development and would strain our management, financial and operational resources. The lack of market acceptance of such efforts or our inability to generate satisfactory revenues from such expanded services or products to offset their cost could harm our business, prospects, financial condition and results of operations.

We may expand our international business, causing our business to become increasingly susceptible to numerous international business risks and challenges that could affect our profitability.

We plan to begin selling products in international markets, and in the future we may expand into these markets more aggressively. International sales and transactions are subject to inherent risks and challenges that could adversely affect our profitability, including:

- the need to develop new supplier and manufacturer relationships;
- the need to comply with additional U.S. and foreign laws and regulations to the extent applicable, including but not limited to, restrictions on advertising practices, regulations governing online services, restrictions on importation of specified or proscribed items, importation quotas, consumer protection laws, enforcement of intellectual property rights, laws dealing with consumer and data protection, privacy, encryption, and restrictions on pricing or discounts;
- unexpected changes in international regulatory requirements and tariffs, and geopolitical events such as war and terrorist attacks;
- difficulties in staffing and managing foreign operations, including, without limitation, differences in language, customs, and labor laws;
- longer payment cycles from credit card companies, increased payment risk;
- greater difficulty in accounts receivable collection;
- potential adverse tax consequences;
- price controls or other restrictions on foreign currency;
- difficulties in obtaining export and import licenses; and
- negative impact of returns.

To the extent we generate international sales and transactions in the future, any negative impact on our international operations could negatively impact our business. In particular, gains and losses on the conversion of foreign payments into United States dollars may contribute to fluctuations in our results of operations and fluctuating exchange rates could cause reduced gross revenues and/or gross margins from non-dollar-denominated international sales.

In order to obtain future revenue growth and achieve and sustain profitability, we will have to attract and retain customers on cost-effective terms.

Our success depends on our ability to attract and retain customers on cost-effective terms. We have relationships with online services, search engines, directories and other Website and e-commerce businesses to provide content, advertising banners and other links that direct customers to our Website. We rely on these relationships as significant sources of traffic to our Website and to generate new customers. If we are unable to develop or maintain these relationships on acceptable terms, our ability to attract new customers and our financial condition could be harmed. In addition, certain of our online marketing agreements may require us to pay upfront fees and make other payments prior to the realization of the sales, if any, associated with those payments. Accordingly, if these agreements or similar agreements that we may enter into in the future fail to produce the sales that we anticipate, our results of operations will be adversely affected. We cannot assure you that we will be able to increase our revenues, if at all, in a cost-effective manner. We periodically conduct national television and radio branding and advertising campaigns. Such campaigns are expensive and may not result in the cost effective acquisition of customers.

Further, many online advertisers on whom we may wish to or presently do rely on for services, may be reluctant to enter into or maintain relationships with us because our competitors may be more attractive advertising clients. Additionally, failure to achieve sufficient traffic or generate sufficient revenue from purchases originating from online advertisers may cause online advertisers to terminate their relationship with us. Without these relationships, our revenues, business, prospects, financial condition and results of operations could suffer.

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We may not be able to compete successfully against existing or future competitors.

The online liquidation services market is rapidly evolving and intensely competitive. Barriers to entry are minimal, and current and new competitors can launch new Websites at a relatively low cost. Our consumer Website currently competes with:

- liquidation e-tailers such as SmartBargains;
- online retailers with discount departments such as Amazon.com, Inc., eBay, Inc. and Buy.com, Inc.; and
- online specialty retailers such as BlueNile and BackCountry;
- traditional retailers and liquidators such as Ross Stores, Inc., Walmart Stores, Inc., TJX Companies, Inc., Costco Wholesale Corporation, Target Corporation, Best Buy Co., Inc., and Barnes and Noble, Inc., which may or may not also have an online presence.

Our Website competes with liquidation brokers and retailers and online marketplaces such as eBay, Inc.

We expect the online liquidation services market to become even more competitive as traditional liquidators and online retailers continue to develop services that compete with our services. In addition, manufacturers and retailers may decide to create their own Website to sell their own excess inventory and the excess inventory of third parties. Competitive pressures created by any one of our competitors, or by our competitors collectively, could harm our business, prospects, financial condition and results of operations.

Further, as a strategic response to changes in the competitive environment, we may from time to time make certain pricing, service or marketing decisions or acquisitions that could harm our business, prospects, financial condition and results of operations. For example, to the extent that we enter new lines of businesses such as third-party logistics, or discount brick and mortar retail, we would be competing with large established businesses such as APL Logistics, and Ltd., Ross Stores, Inc., respectively. We have recently entered the online auctions and car listing businesses in which we compete with large established businesses including eBay, Inc. and AutoTrader.com, Inc.

Many of our current and potential competitors described above have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing and other resources than we do. In addition, online retailers and liquidation e-tailers may be acquired by, receive investments from or enter into other commercial relationships with larger, well-established and well-financed companies. Some of our competitors may be able to secure merchandise from manufacturers on more favorable terms, devote greater resources to marketing and promotional campaigns, adopt more aggressive pricing or inventory availability policies and devote substantially more resources to Website and systems development than we do. Increased competition may result in reduced operating margins, loss of market share and a diminished brand franchise. We cannot assure you that we will be able to compete successfully against current and future competitors.

Our operating results depend on our Website, network infrastructure and transaction-processing systems. Capacity constraints or system failures would harm our business, prospects, results of operations and financial condition.

Any system interruptions that result in the unavailability of our Website or reduced performance of our transaction systems would reduce our transaction volume and the attractiveness of the services that we provide to suppliers and third parties and would harm our business, prospects, operating results and financial condition.

We use internally developed systems for our Website and certain aspects of transaction processing, including customer profiling and order verifications. We have experienced periodic systems interruptions due to server failure, which we believe will continue to occur from time to time. If the volume of traffic on our Website or the number of purchases made by customers substantially increases, we will need to further expand and upgrade our technology, transaction processing systems and network infrastructure. We have experienced and expect to continue to experience temporary capacity constraints due to sharply increased traffic during sales or other promotions and during the holiday shopping season. Capacity constraints can cause unanticipated system disruptions, slower response times, and degradation in levels of customer service, impaired quality and delays in reporting accurate financial information.

Our transaction processing systems and network infrastructure may be unable to accommodate increases in traffic in the future. We may be unable to project accurately the rate or timing of traffic increases or successfully upgrade our systems and infrastructure to accommodate future traffic levels on our Website. In addition, we may be unable to upgrade and expand our transaction processing systems in an effective and timely manner or to integrate any newly developed or purchased functionality with our existing systems. For example, in the third quarter 2005 we experienced difficulties with our implementation of infrastructure upgrades, which resulted in our inability to upload new products to our Website for a period of approximately five weeks. Any such difficulties with our transaction processing systems or other difficulties upgrading, expanding or integrating various aspects of our systems may cause unanticipated system disruptions, slower response times, and degradation in levels of customer service, additional expense, impaired quality and speed of order fulfillment or delays in reporting accurate financial information.

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If the facility where substantially all of our computer and communications hardware is located fails, our business, results of operations and financial condition will be harmed.

Our success, and in particular, our ability to successfully receive and fulfill orders and provide high-quality customer service, largely depends on the efficient and uninterrupted operation of our computer and communications systems. Substantially all of our computer and communications hardware is located at a single co-location facility in Salt Lake City, Utah, with a partially redundant back-up system located near our corporate headquarters in Salt Lake City. Although we have designed our back-up system in an effort to be able to provide limited back-up website functionality in the event of a failure of our main facility, our systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunications failure, terrorist attacks, acts of war, break-ins, earthquake and similar events, and our back-up systems are not designed to handle the volume of transactions normally handled by our primary systems. Our disaster recovery plan may be inadequate, and our business interruption insurance may be insufficient to compensate us for losses that may occur. Despite the implementation of network security measures, our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays, loss of critical data or the inability to accept and fulfill customer orders. The occurrence of any of the foregoing risks could harm our business, prospects, financial condition and results of operations.

We may be unable to protect our proprietary technology or keep up with that of our competitors.

Our success depends to a significant degree upon the protection of our software and other proprietary intellectual property rights. We may be unable to deter misappropriation of our proprietary information, detect unauthorized use and take appropriate steps to enforce our intellectual property rights. In addition, our competitors could, without violating our proprietary rights, develop technologies that are as good as or better than our technology.

Our failure to protect our software and other proprietary intellectual property rights or to develop technologies that are as good as our competitors could put us at a disadvantage to our competitors. In addition, the failure of the third parties whose products we offer for sale on our Website to protect their intellectual property rights, including their domain names, could impair our operations. These failures could harm our business, results of operations and financial condition.

We may be accused of infringing intellectual property rights of third parties.

Other parties also have claimed and may claim that we infringe their intellectual property rights. We have been subject to, and expect to continue to be subject to, legal claims of alleged infringement of the intellectual property rights of third parties. The ready availability of damages, royalties and the potential for injunctive relief has increased the defense litigation costs of patent infringement claims, especially those asserted by third parties whose sole or primary business is to assert such claims. Such claims, whether or not meritorious, may result in significant expenditure of financial and managerial resources, and the payment of damages or settlement amounts. Additionally, we may become subject to injunctions prohibiting us from using software or business processes we currently use or may need to use in the future, or requiring us to obtain licenses from third parties when such licenses may not be available on financially feasible terms or terms acceptable to us or at all. In addition, we may not be able to obtain on favorable terms, or at all, licenses or other rights with respect to intellectual property we do not own in providing e-commerce services to other businesses and individuals under commercial agreements.

If we do not respond to rapid technological changes, our services could become obsolete and we could lose customers.

To remain competitive, we must continue to enhance and improve the functionality and features of our e-commerce businesses. We may face material delays in introducing new services, products and enhancements. If this happens, our customers may forgo the use of our Website and use those of our competitors. The Internet and the online commerce industry are rapidly changing. If competitors introduce new products and services using new technologies or if new industry standards and practices emerge, our existing Website and our proprietary technology and systems may become obsolete. Our failure to respond to technological change or to adequately maintain, upgrade and develop our computer network and the systems used to process customers orders and payments could harm our business, prospects, financial condition and results of operations.

We may not be able to obtain trademark protection for our marks, which could impede our efforts to build brand identity.

We have filed trademark applications with the Patent and Trademark Office seeking registration of certain service marks and trademarks. There can be no assurance that our applications will be successful or that we will be able to secure significant protection for our service marks or trademarks in the United States or elsewhere as we expand internationally. Our competitors or others could adopt product or service marks similar to our marks, or try to prevent us from using our marks, thereby impeding our ability to build brand identity and possibly leading to customer confusion. Any claim by another party against us or customer confusion related to our trademarks, or our failure to obtain trademark registration, could negatively affect our business.

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We may not be able to enforce protection of our intellectual property rights under the laws of other countries.

As we begin to sell products internationally, we are subject to risks of doing business internationally as related to our intellectual property, including:

- legal uncertainty regarding liability for the listings and other content provided by our users, including uncertainty as a result of less Internet-friendly legal systems, unique local laws, and lack of clear precedent or applicable law; and
- differing intellectual property laws, which may provide insufficient protection for our intellectual property.

Our business and reputation may be harmed by the listing or sale of pirated, counterfeit or illegal items by third parties, and by intellectual property litigation.

We have received in the past, and we anticipate we will receive in the future, communications alleging that certain items listed or sold through our Website infringe third-party copyrights, trademarks and trade names or other intellectual property rights or that we have otherwise infringed third parties past, current or future intellectual property rights.

We may be unable to prevent third parties from listing unlawful goods, and we may be subject to allegations of civil or criminal liability for unlawful activities carried out by third parties through our Website. In the future, we may implement measures to protect against these potential liabilities that could require us to spend substantial resources and/or to reduce revenues by discontinuing certain service offerings. Any costs incurred as a result of liability or asserted liability relating to the sale of unlawful goods or the unlawful sale of goods could harm our revenues, business, prospects, financial condition and results of operations.

Resolving litigation or claims regarding patents or other intellectual property, whether meritorious or not, could be costly, time-consuming, cause service delays, divert our management and key personnel from our business operations, require expensive or unwanted changes in our methods of doing business or require us to enter into costly royalty or licensing agreements, if available. As a result, these claims could harm our business.

Negative publicity generated as a result of the foregoing could damage our reputation, harm our business and diminish the value of our brand name.

Our Gradient Analytics and Rocker Partners, L.P. litigation may have an adverse effect on our business and financial condition.

In August 2005 we filed an unfair business practice lawsuit against Gradient Analytics, Rocker Partners, LP and others, alleging that the defendants have conspired to denigrate Overstock s business for personal profit. In October 2005 we filed an amended complaint alleging additional causes of action and articulating in greater detail the allegations against the defendants. In November 2007, Copper River Partners, L.P. (formerly known as Rocker Partners, LP) filed a cross-complaint against us and some of our current and former directors. In July 2008, Gradient Analytics filed an amended cross-complaint against us and our Chief Executive Officer, Dr. Patrick Byrne. Dr. Byrne has appeared on nationally syndicated television programs and elsewhere to discuss the litigation. The use of management s time and attention and the company s resources in connection with the litigation and related matters may reduce the time and attention management is able to spend on or give to other aspects of our business, which may have adverse effects on other aspects of our business. In addition, the use of the company s resources in connection with the litigation and related matters may reduce the resources we are able to spend on or give to other aspects of our business, which may have adverse effects on other aspects of our business. To the extent that any such adverse effects exceed any benefits we may realize from pursuing the litigation, our business, prospects, financial condition and results of operation may suffer. Also, Gradient Analytics and Copper River Partners, L.P. have filed cross claims against the company and Dr. Byrne. If we are unsuccessful in defeating these claims, we may incur damages which may not be covered by existing insurance or may not be within policy limits which could adversely impact our financial condition.

Our Prime Broker litigation may have an adverse effect on our business and financial condition.

In February 2007, along with five shareholder plaintiffs, we filed a lawsuit in the Superior Court of California, County of San Francisco against Morgan Stanley & Co. Incorporated, Goldman Sachs & Co., Bear Stearns Companies, Inc., Bank of America Securities LLC, Bank of New York, Citigroup Inc., Credit Suisse (USA) Inc., Deutsche Bank Securities, Inc., Merrill Lynch, Pierce, Fenner & Smith, Inc., and UBS Financial Services, Inc. In September 2007, we filed an amended complaint adding Lehman Brothers, Inc. as an additional defendant and articulating in greater detail the allegations against the defendants. The use of management s time and attention in connection with the litigation and related matters may reduce the time management is able to spend on other aspects of our business, which may have adverse effects on other aspects of our business. In addition, the use of the company s resources in connection with the litigation and related matters may reduce the resources we are able to spend on or give to other aspects of our business, which may have adverse effects on other aspects of our business. To the extent that any such adverse effects exceed any benefits we may realize from pursuing the litigation, our business, prospects, financial condition and results of

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operation may suffer.

Existing or future government regulatory investigations could harm our business.

We are subject to federal, state and local regulatory laws governing our operations as a publicly traded company as well as governing the conduct of our business on the Internet, including compliance with various state and federal consumer protection laws. Government investigations into suspected violations of regulatory laws, whether or not such investigations result in civil or administrative actions against us, may have adverse effects on our business. The use of management s time and attention in connection with responding to government investigations or actions brought by regulatory agencies may reduce the time management is able to spend on other aspects of our business. Adverse administrative decisions by regulatory agencies or by courts in response to civil actions brought by regulatory agencies may result in our being ordered to pay civil fines or penalties, and may result in ordered payments of restitution to third parties, or cause expensive or unwanted changes in our methods of doing business, all of which also may harm or adversely effect our business. We are currently subject to an investigation by the Marin County District Attorney s Office and that of four other Northern California district attorney s offices relative to our compliance with various California consumer protection laws as they relates to our advertising and pricing policies. *See* Item 1 of Part I, Financial Statements (Unaudited) Note 8 Commitments and Contingencies, subheading Legal Proceedings, contained in the Notes to Unaudited Consolidated Financial Statements of this Quarterly Report on Form 10-Q. To the extent that these investigations become lengthy or result in adverse regulatory or court decisions, requiring payment of fine, penalty, restitution, or cause expensive or unwanted changes in our methods of doing business, our financial condition and results of operations may suffer.

We may be liable if third parties misappropriate our customers personal information.

If third parties are able to penetrate our network security or otherwise misappropriate our customers personal information or credit card information, or if we give third parties improper access to our customers personal information or credit card information, we could be subject to liability. This liability could include claims for unauthorized purchases with credit card information, impersonation or other similar fraud claims or damages for alleged violations of state or federal laws governing security protocols for the safekeeping of customers personal or credit card information. This liability could also include claims for other misuses of personal information, including unauthorized marketing purposes. These claims could result in litigation. Liability for misappropriation of this information could adversely affect our business. In addition, the Federal Trade Commission and state agencies have been investigating various Internet companies regarding their use of personal information. We could incur additional expenses if new regulations regarding the use of personal information are introduced or if government agencies investigate our privacy practices.

We rely on encryption and authentication technology licensed from third parties to provide the security and authentication necessary to effect secure transmission of confidential information such as customer credit card numbers. We cannot assure you that advances in computer capabilities, new discoveries in the field of cryptography or other events or developments will not result in a compromise or breach of the algorithms that we use to protect customer transaction data. If any such compromise of our security were to occur, it could harm our reputation, business, prospects, financial condition and results of operations. A party who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. We may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches. We cannot assure you that our security measures will prevent security breaches or that failure to prevent such security breaches will not harm our business, prospects, financial condition and results of operations.

We may be subject to product liability claims that could be costly and time consuming.

We sell products manufactured for us by third parties, some of which may be defective. If any product that we sell were to cause physical injury or injury to property, the injured party or parties could bring claims against us as the manufacturer and/or retailer of the product. Our insurance coverage may not be adequate to cover every claim that could be asserted. If a successful claim were brought against us in excess of our insurance coverage, it could adversely affect our business. Even unsuccessful claims could result in the expenditure of funds and management time and could have a negative impact on our business.

The promissory notes we hold in connection with the sale of our travel business may not be collectible.

As part of the sale of our travel business, we now hold senior and junior promissory notes issued by the purchaser. Both of these notes are in the principal amount of $3,000,000. The security on the senior note is the stock of the travel company we sold. There is no security on the junior note, which note also may be subordinated to all other debt of the travel company, and, according to the junior note terms, is not in default so long as the senior debt is outstanding. In the event of default on one or both of these notes, it is possible that stock held as security on the note will have lost some or all of its value. If the purchaser defaults on one or both of these notes, and we are unable to collect or realize comparable value by foreclosing on the stock held as security, the notes could have little or no value.

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We have significant indebtedness.

In connection with our sale of our 3.75% Convertible Senior Notes (the Senior Notes) in November 2004, we incurred $120.0 million of indebtedness, due December 1, 2011. Under the repurchase program approved by our Board of Directors in 2005, we retired $33.0 million and $10.0 million of the Senior Notes in June and November 2005. As of June 30, 2008, $77.0 million of the Senior Notes remained outstanding. As a result of this indebtedness, our principal and interest payment obligations increased substantially. The degree to which we are leveraged could materially and adversely affect our ability to obtain additional financing for working capital, acquisitions or other purposes and could make us more vulnerable to industry downturns and competitive pressures. Our ability to meet our debt service obligations is dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control.

We may be unable to generate sufficient cash flow to satisfy our debt service obligations.

Our ability to generate cash flow from operations to make payments on our debt obligations will depend on our future performance, which will be affected by a range of economic, competitive and business factors. We cannot control many of these factors, including general economic conditions and the health of the internet retail industry. If our operations do not generate sufficient cash flow from operations to satisfy our debt service obligations, we may need to borrow additional funds to make these payments or undertake alternative financing plans, such as refinancing or restructuring our debt, or reducing or delaying capital investments and acquisitions. Additional funds or alternative financing may not be available to us on favorable terms, or at all. Our inability to generate sufficient cash flow from operations or obtain additional funds or alternative financing on acceptable terms could have a material adverse effect on our business, prospects, financial condition and results of operations.

Risks Relating to our Auctions Site Business

Our auctions business is a new business.

Our auctions business began operation in September 2004. The online auctions business is a new business for us, and we cannot ensure that our expansion into the online auctions business will succeed. Our entry into the online auctions business will require us to devote substantial financial, technical, managerial and other resources to the business. It will also expose us to additional risks, including legal and regulatory risks, and it will require us to compete with established businesses having substantially greater experience in the online auctions business and substantially greater resources than we have.

Our auctions business may be subject to a variety of regulatory requirements.

Many states and other jurisdictions, including Utah, where our company is located, have regulations governing the conduct of traditional auctions and the liability of traditional auctioneers in conducting auctions. Although the vast majority of these regulations clearly contemplated only traditional auctions, not online auctions, the potential application of these types of regulations to online auction sites is not clear. We are aware that several states and some foreign jurisdictions have attempted to impose such regulations on other companies operating online auction sites or on the users of those sites. In addition, certain states have laws or regulations that do expressly apply to online auction site services. Although we do not expect these laws to have a significant effect on our auction site business, we will incur costs in complying with these laws, and we may from time to time be required to make changes in our business that may increase our costs, reduce our revenues, cause us to prohibit the listing of certain items in certain locations, or make other changes that may adversely affect our auctions business.

Current and future laws could affect our auctions business.

Like our shopping site business, our auction site business is subject to the same laws and regulations that apply to other companies conducting business on and off the Internet. In addition, our auction site business may be affected by other laws and regulations, such as those that expressly apply to online auction site services. Further, because of the wide range of items that users of our auctions service may choose to list on the site, a variety of additional laws and regulations may apply to transactions between users of our site, such as those requiring a license to sell or purchase certain items or mandating particular disclosures in connection with an offer or sale of an item. At least one state recently proposed legislation that sought to prohibit the sale of certain items through internet auction without similar application of the law to traditional retail establishments, online or printed classified advertising publications, or other types of sales list services. To the extent that such current or future laws or regulations prevent or inhibit users from selling items on our auction site, or to the extent these laws discriminate against internet auctions or apply in a discriminatory fashion, they could harm our business.

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Our business may be harmed if our auctions business is used for unlawful transactions.

The law regarding the potential liability of an online auction service for the activities of its users is not clear. We prohibit the listing of numerous categories of items in an effort to reduce the possibility that users of our auction site will engage in an unlawful transaction. However, we cannot assure that users of the site will comply with all laws and regulations applicable to them and their transactions, and we may be subject to allegations of civil or criminal liability for any unlawful activities conducted by them. Any costs we incur as a result of any such allegations, as a result of actual or alleged unlawful transactions utilizing our site, or in our efforts to prevent any such transactions, may harm our business. In addition, any negative publicity we receive regarding any such transactions or allegations may damage our reputation, our ability to attract new customers to our main shopping site, and the Overstock.com brand name generally.

Fraudulent activities using our auctions business and disputes between users of our auctions business may harm our business.

We are aware that other companies operating online auction services have periodically received complaints from users alleging that they have not received the purchase price or the goods they expected to receive and that, in some cases, users have been arrested and convicted for engaging in fraudulent activities using those companies auction sites. We may receive similar complaints. We do not have the ability to require users of our services to fulfill their obligations to make payments or to deliver items. We are aware that other companies periodically receive complaints from buyers about the quality of the items they purchase, requests for reimbursement of amounts paid, and communications threatening or commencing legal actions against them. We may receive similar complaints, requests and communications in connection with our auctions business.

We are subject to risks associated with information transmitted through our auctions service.

The law relating to the liability of online services companies for information carried on or disseminated through their services is currently unsettled. Claims could be made against online services companies under both U.S. and foreign law for defamation, libel, invasion of privacy, negligence, copyright or trademark infringement, or other theories based on the nature and content of the materials disseminated through their services. We are aware that private lawsuits seeking to impose liability under a number of these theories have been brought against other companies operating auction sites. In addition, domestic and foreign legislation has been proposed that would prohibit or impose liability for the transmission over the Internet of certain types of information. Our auctions service permits users to make comments regarding other users. Although all such comments are generated by users and not by us, we are aware that claims of defamation or other injury have been made against other companies operating auction services in the past and could be made in the future against us for comments made by users. Recent court decisions have narrowed the scope of the immunity provided to Internet service providers like us under the Communications Decency Act. This trend, if continued, may increase our potential liability to third parties for the user-provided content on our site.

Difficulties or negative publicity associated with our auctions business could affect our main shopping site business.

Any significant operational or other difficulties we encounter with our auctions business could damage our reputation, our ability to attract new customers to our main shopping site, and the Overstock.com brand name generally. Negative publicity resulting from actual or alleged fraudulent or deceptive conduct by users of our auctions business could also damage our reputation, our ability to attract new customers to our main shopping site, and the Overstock.com brand name generally.

Risks Relating to our Cars Site Business

Our cars site is a new business.

Our car listing site began operation in December 2006. The car listing site is a listing service for automobile sellers. The online car listing service is a new business for us. We cannot ensure that our expansion into the car listing business will succeed. Our entry into this business will require us to devote substantial financial, technical, managerial and other resources to this car listing site. It will also expose us to additional risks, including legal and regulatory risks, and it will require us to compete with established businesses having substantially greater experience in the online car listing service business and substantially greater resources than we have.

Our car listing business may be subject to a variety of regulatory requirements.

Many states and other jurisdictions, including Utah, where we are located, have regulations governing the conduct of car sellers and public advertisement for car sales. Generally, these regulations govern the conduct of those sellers advertising their automobiles for sale and are not directly applicable to those providing the medium through which the advertisement is made available to the public. Sellers are often subject to regulations in the nature of truth in advertising laws . The application of these regulations to online car listing service providers is not clear. Although we do not expect these laws to have a significant effect on our car listing business, we will incur costs in researching and complying with these laws, and we may from time to time be required to make changes in our business that may increase our costs, reduce our revenues, cause us to prohibit certain listing or advertising practices, or make other changes that may adversely affect our car listing business.

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Current and future laws could affect our car listing business.

Like our shopping business, our car listing business is subject to the same laws and regulations that apply to other companies conducting business on and off the Internet. In addition, our car listing business may be affected by other laws and regulations, such as those that expressly apply to advertising automobiles for sale. To the extent that such current or future laws or regulations prevent users from selling items on our car listing site, they could harm our business.

Our business may be harmed if our car listing site is used for unlawful transactions.

The law regarding the potential liability of an online listing service for automobile sales is not clear. The platform of the listing service will be accessible to those subscribers who will have the ability to feature their cars for sale and will supply the text descriptions of the vehicles, including the general condition of the vehicle and other important information. We will have no ability beforehand to know if the information sellers provide is correct. While our site terms and conditions of usage will prohibit unlawful acts, we cannot rule out the possibility that users of our car listing site will engage in unlawful transactions, or fail to comply with all laws and regulations applicable to them and their transactions. We may be subject to allegations of civil or criminal liability for any unlawful activities conducted by such users. Any costs we incur as a result of any such allegations, as a result of actual or alleged unlawful transactions utilizing our site, or in our efforts to prevent any such transactions, may harm our business. In addition, any negative publicity we receive regarding any such transactions or allegations may damage our reputation, our ability to attract new customers to our main shopping site, and the Overstock.com brand name generally.

Fraudulent activities using our car listing site and disputes between users of our car listing site may harm our business.

We are aware that other companies operating online car listing services have periodically received complaints from users alleging improprieties in connection with listings and occasionally these complaints may result in regulatory action. Particularly, with any online listing service there is the possibility that sellers may attempt to employ bait and switch techniques, attracting consumers with advertisements of low cost, good condition vehicles in hopes of switching buyer interest to another less favorable vehicle once a potential purchaser responds. Additionally, sellers may attempt to sell vehicles without accurate descriptions of the condition of the vehicles. We do not have the ability to require users of our services to fulfill their obligations to make accurate disclosures or comply with consumer laws prohibiting bait and switch or other prohibited seller tactics. We are aware that other companies providing similar services periodically receive complaints from vehicle purchasers about the quality of the vehicles they purchase, requesting reimbursement of amounts they have paid, threatening or commencing legal actions against the listing service for damages. We may receive similar complaints, requests and communications, and encounter similar legal actions in connection with our cars listing business, which may harm our business or reputation among consumers.

Risks Relating to our Real Estate Site Business

Our real estate site is a new business.

Our real estate listing site began operation in March 2008. The real estate listing site is a listing service for real estate sellers. The online real estate listing service is a new business for us. We cannot ensure that our expansion into the car listing business will succeed. Our entry into this business will require us to devote substantial financial, technical, managerial and other resources to this real estate listing site. It will also expose us to additional risks, including legal and regulatory risks, and it will require us to compete with established businesses having substantially greater experience in the online real estate listing service business and substantially greater resources than we have.

Our real estate listing business may be subject to a variety of regulatory requirements.

Many states and other jurisdictions, including Utah, where we are located, have regulations governing the conduct of real estate sellers and public advertisement for real estate sales, as well as licensing requirements for real estate sellers. Generally, these regulations govern the conduct of those sellers in selling and advertising their real estate for sale. Sellers are often subject to regulations in the nature of truth in advertising laws as well as the laws governing the conduct of licensed real estate agents and brokers. Although we do not expect these laws to have a significant effect on our real estate listing business, we will incur costs in researching and complying with these laws, and we may from time to time be required to make changes in our business that may increase our costs, reduce our revenues, cause us to prohibit certain listing or advertising practices, or make other changes that may adversely affect our real estate listing business.

Current and future laws could affect our real estate listing business.

Like our shopping business, our real estate listing business is subject to the same laws and regulations that apply to other companies conducting business on and off the Internet. In addition, our real estate listing business may be affected by other laws and

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regulations, such as those that expressly apply to advertising real estate for sale. To the extent that such current or future laws or regulations prevent users from selling items on our real estate listing site, they could harm our business.

Our business may be harmed if our real estate listing site is used for unlawful transactions.

The law regarding the potential liability of an online listing service for real estate sales is not clear. The platform of the listing service will be accessible to those subscribers who will have the ability to feature their real estate for sale and will supply the text descriptions of the real estate, including the general condition of the real estate and other important information. We will have no ability beforehand to know if the information sellers provide is correct. While our site terms and conditions of usage will prohibit unlawful acts, we cannot rule out the possibility that users of our real estate listing site will engage in unlawful transactions, or fail to comply with all laws and regulations applicable to them and their transactions. We may be subject to allegations of civil or criminal liability for any unlawful activities conducted by such sellers. Any costs we incur as a result of any such allegations, as a result of actual or alleged unlawful transactions utilizing our site, or in our efforts to prevent any such transactions, may harm our business. In addition, any negative publicity we receive regarding any such transactions or allegations may damage our reputation, our ability to attract new customers to our main shopping site, and the Overstock.com brand name generally.

Fraudulent activities using our real estate listing site and disputes between users of our real estate listing site may harm our business.

We are aware that other companies operating online real estate listing services have periodically received complaints from users alleging improprieties in connection with listings and occasionally these complaints may result in regulatory action. Particularly, with any online listing service there is the possibility that sellers may attempt to employ sales techniques that are not permitted by state or federal laws or regulations. We do not have the ability to require users of our services to refrain from employing sales techniques that are not permitted by state or federal laws or regulations or to make accurate disclosures or comply with consumer laws prohibiting these or other prohibited seller tactics. To the extent that real estate sellers using our listing services engage in practices proscribed by law, we may receive complaints, requests and communications, and encounter legal actions in connection with our real estate listing business, which may harm our business or reputation among consumers.

Risks Relating to our Community Site Business

Our Community site began operation in February 2006 with the introduction of Omuse, an Overstock supported, collaborative writing platform. Omuse allows Community site users to read about and or write guides about a universe of subjects in which they may have a particular expertise or interest. The Community site when fully deployed will also have services intended to establish user forum participation, provide customers access to recent news about Overstock and allow users the opportunity to participate in forum reading and writing, to create weblogs or post comments to the weblogs or blogs of other site users, or in our Omuse collaborative writing platform. Presently Omuse is the only operating platform on the Community site. The Community site is a new business for us. We cannot ensure that our expansion into this business will succeed. It is a business which allows persons to contribute content within certain guidelines and subject to terms and conditions. We cannot always be in a position to assure that our community users are abiding by these terms and conditions, or be in a position to interdict or remove inappropriate or infringing material. Our entry into this business will require us to devote substantial financial, technical, managerial and other resources to this site. It is uncertain whether the business will benefit financially from the Community site. The Community site will also expose us to additional risks, including legal and regulatory risks, including, but not limited to, legal actions for possible intellectual property infringement, and claims for libel.

Additionally, our entry into the Community site service will require us to compete with established businesses having substantially greater experience in the Community site service business and which have substantially greater resources than we have.

Risks Relating to the Internet Industry

Our success is tied to the continued use of the Internet and the adequacy of the Internet infrastructure.

Our future revenues and profits, if any, substantially depend upon the continued widespread use of the Internet as an effective medium of business and communication. Factors which could reduce the widespread use of the Internet include:

- actual or perceived lack of security of information or privacy protection;
- possible disruptions, computer viruses or other damage to the Internet servers or to users computers;
- significant increases in the costs of transportation of goods; and
- governmental regulation.

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Customers may be unwilling to use the Internet to purchase goods.

Our long-term future depends heavily upon the general public s willingness to use the Internet as a means to purchase goods. E-commerce remains a relatively new concept and large numbers of customers may not begin or continue to use the Internet to purchase goods. The demand for and acceptance of products sold over the Internet are highly uncertain and most e-commerce businesses have a short track record. If consumers are unwilling to use the Internet to conduct business, our business may not develop profitably.

The security risks or perception of risks of e-commerce may discourage customers from purchasing goods from us.

In order for the e-commerce market to develop successfully, we and other market participants must be able to transmit confidential information securely over public networks. Third parties may have the technology or know-how to breach the security of customer transaction data. Any breach could cause customers to lose confidence in the security of our Website and choose not to purchase from our Website. If someone is able to circumvent our security measures, he or she could destroy or steal valuable information or disrupt our operations. Concerns about the security and privacy of transactions over the Internet could inhibit the growth of the Internet and e-commerce. Our security measures may not effectively prohibit others from obtaining improper access to our information. Third parties may target our customers directly with fraudulent identity theft schemes designed to appear as legitimate communications from us. Any security breach or fraud perpetrated on our customers could expose us to increased costs and to risks of loss, litigation and liability and could seriously disrupt our operations.

Credit card fraud could adversely affect our business.

We do not carry insurance against the risk of credit card fraud, so the failure to adequately control fraudulent credit card transactions could reduce our net revenues and our gross margin. We have implemented technology to help us detect the fraudulent use of credit card information. However, we may in the future suffer losses as a result of orders placed with fraudulent credit card data even though the associated financial institution approved payment of the orders. Under current credit card practices, we may be liable for fraudulent credit card transactions because we do not obtain a cardholder s signature. If we are unable to detect or control credit card fraud, our liability for these transactions could harm our business, results of operation or financial condition.

If one or more states successfully assert that we should collect sales or other taxes on the sale of our merchandise or the merchandise of third parties that we offer for sale on our Website, our business could be harmed.

We do not currently collect sales or other similar taxes for physical shipments of goods into states other than Utah. One or more local, state or foreign jurisdictions may seek to impose sales tax collection obligations on us even though we are engaged in online commerce, and have no physical presence in those jurisdictions. The future location of our fulfillment centers and customer service center networks, or any other operation of the company, establishing a physical presence in states where we are not now present, may result in additional sales and other tax obligations. Our business could be adversely affected if one or more states or any foreign country successfully asserts that we should collect sales or other taxes on the sale of our merchandise.

Existing or future government regulation could harm our business.

We are subject to the same federal, state and local laws as other companies conducting business on the Internet. Today there are relatively few laws specifically directed towards conducting business on the Internet. However, due to the increasing popularity and use of the Internet, many laws and regulations relating to the Internet are being debated at the state and federal levels. These laws and regulations could cover issues such as user privacy, freedom of expression, pricing, fraud, quality of products and services, taxation, advertising, intellectual property rights and information security. Applicability to the Internet of existing laws governing issues such as property ownership, copyrights and other intellectual property issues, taxation, libel, obscenity and personal privacy could also harm our business. For example, United States and foreign laws regulate our ability to use customer information and to develop, buy and sell mailing lists. The vast majority of these laws was adopted prior to the advent of the Internet and do not contemplate or address the unique issues raised thereby. Those laws that do reference the Internet are only beginning to be interpreted by the courts and their applicability and reach are therefore uncertain. These current and future laws and regulations could harm our business, results of operation and financial condition. Recently, New York state enacted revenue legislation designed to tax retail sales to New York customers of any Internet retailer who used the advertising services of persons who reside in New York, and as a result, we terminated our agreements with all of our online marketing affiliates located in New York. In May 2008, we filed a lawsuit against the New York state asserting the unconstitutionality of the New York legislation. This and other changes in the state and federal regulatory structure governing permissible operations and taxation of Internet retail sales could harm our business, results of operation and financial condition.

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Laws or regulations relating to privacy and data protection may adversely affect the growth of our Internet business or our marketing efforts.

We are subject to increasing regulation at the federal, state and international levels relating to privacy and the use of personal user information. For example, we are subject to various telemarketing laws that regulate the manner in which we may solicit future suppliers and customers. Such regulations, along with increased governmental or private enforcement, may increase the cost of growing our business. In addition, many jurisdictions have laws that limit the uses of personal user information gathered online or offline or require companies to establish privacy policies. The Federal Trade Commission has adopted regulations regarding the collection and use of personal identifying information obtained from children under 13. Proposed legislation in this country and existing laws in foreign countries require companies to establish procedures to notify users of privacy and security policies, obtain consent from users for collection and use of personal information, and/or provide users with the ability to access, correct and delete personal information stored by us. Additional legislation regarding data security and privacy has been proposed in Congress. These data protection regulations may restrict our ability to collect demographic and personal information from users, which could be costly or harm our marketing efforts, and could require us to implement new and potentially costly processes, procedures and/or protective measures.

Risks Relating to the Securities Markets and Ownership of Our Securities

The price of our securities may be volatile and you may lose all or a part of your investment.

Our common stock has been publicly traded only since May 30, 2002. The market price of our common stock has been subject to significant fluctuations since the date of our initial public offering. These fluctuations could continue. It is possible that in some future periods our results of operations may be below the expectations of public market analysts and investors. If this occurs, the market price of our securities may decline. Some of the factors that could affect the market price of our securities are as follows:

- changes in securities analysts recommendations or estimates of our financial performance or publication of research reports by analysts;
- changes in market valuations of similar companies;
- announcements by us or our competitors of significant contracts, acquisitions, commercial relationships, joint ventures or capital commitments;
- general market conditions;
- actual or anticipated fluctuations in our operating results;
- intellectual property or litigation developments;
- changes in our management team;
- economic factors unrelated to our performance; and

- our issuance of additional shares of stock or other securities.

In addition, the securities markets have experienced significant price and trading volume fluctuations. These broad market fluctuations may adversely affect the trading price of our securities. In the past, following periods of volatility in the market price of a public company s securities, securities class action litigation has often been instituted against that company. Such litigation could result in substantial cost and a diversion of management s attention and resources.

Our quarterly operating results are volatile and may adversely affect the market price of our securities.

Our future revenues and operating results are likely to vary significantly from quarter to quarter due to a number of factors, many of which are outside our control, and any of which could harm our business. As a result, we believe that quarterly comparisons of our operating results are not necessarily meaningful and that you should not rely on the results of one quarter as an indication of our future performance. In addition to the other risk factors described in this report, additional factors that have caused and/or could cause our quarterly operating results to fluctuate and in turn affect the market price of our securities include:

- increases in the cost of advertising;
- our inability to retain existing customers or encourage repeat purchases;
- the extent to which our existing and future marketing agreements are successful;
- price competition that results in lower profit margins or losses;
- the amount and timing of operating costs and capital expenditures relating to the expansion of our business operations and infrastructure;
- the amount and timing of our purchases of inventory;
- our inability to manage distribution operations or provide adequate levels of customer service;
- our ability to successfully integrate operations and technologies from acquisitions or other business combinations;
- entering into new lines of products;

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- our ability to attract users to our new auctions and car listing sites; and
- our inability to replace the loss of significant customers.

Our operating results may fluctuate depending on the season, and such fluctuations may affect the market price of our securities.

We have experienced and expect to continue to experience fluctuations in our operating results because of seasonal fluctuations in traditional retail patterns. Sales in the retail and wholesale industry tend to be significantly higher in the fourth calendar quarter of each year than in the preceding three quarters due primarily to increased shopping activity during the holiday season. However, there can be no assurance that our sales in the fourth quarter will exceed those of the preceding quarters or, if the fourth quarter sales do exceed those of the preceding quarters, that we will be able to manage the increased sales effectively. Further, we generally increase our inventories substantially in anticipation of holiday season shopping activity, which has a negative effect on our cash flow. Securities analysts and investors may inaccurately estimate the effects of seasonality on our results of operations in one or more future quarters and, consequently, our operating results may fall below expectations, causing the market price of our securities to decline.

We do not intend to pay dividends on our common stock and you may lose the entire amount of your investment in our common stock.

We have never declared or paid any cash dividends on our common stock and do not intend to pay dividends on our common stock for the foreseeable future. We intend to invest our future earnings, if any, to fund our growth. Therefore, you will not receive any funds without selling your shares. We cannot assure that you will receive a positive return on your investment when you sell your shares or that you will not lose the entire amount of your investment.

Our Amended and Restated Certificate of Incorporation, Amended and Restated Bylaws and the Delaware General Corporation Law contain anti-takeover provisions which could discourage or prevent a takeover, even if an acquisition would be beneficial to our stockholders.

Several provisions of our Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws could discourage potential acquisition proposals and could delay or prevent a change in control of our company even if that change in control would be beneficial to our stockholders. For example, only one-third of our board of directors will be elected at each of our annual meetings of stockholders, which will make it more difficult for a potential acquirer to change the management of our company, even after acquiring a majority of the shares of our common stock. These provisions, which cannot be amended without the approval of two-thirds of our stockholders, could diminish the opportunities for a stockholder to participate in tender offers, including tender offers at a price above the then current market value of our common stock. In addition, our board of directors, without further stockholder approval, may issue preferred stock, with such terms as the board of directors may determine, that could have the effect of delaying or preventing a change in control of our company. The issuance of preferred stock could also adversely affect the voting powers of the holders of common stock, including the loss of voting control to others. We are also afforded the protections of Section 203 of the Delaware General Corporation Law, which could delay or prevent a change in control of our company or could impede a merger, consolidation, takeover or other business combination involving our company or discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of our company.

The price of our stock may be vulnerable to manipulation and volatility because of our fight against illegal naked short selling practices and associated regulatory change.

We have filed an unfair business practice lawsuit against Gradient Analytics, Rocker Partners, L.P. and others, alleging that the defendants have conspired to denigrate Overstock s business for personal profit, as well as an amended complaint alleging additional causes of action and articulating in greater detail the allegations against the defendants. We have also filed an unfair business practice lawsuit against Morgan Stanley & Co. Incorporated, Goldman Sachs & Co., Bear Stearns Companies, Inc., Bank of America Securities LLC, Bank of New York, Citigroup Inc., Credit Suisse (USA) Inc., Deutsche Bank Securities, Inc., Merrill Lynch, Pierce, Fenner & Smith, Inc., and UBS Financial Services, Inc. In September 2007, we filed an amended complaint adding Lehman Brothers Holdings Inc. as an additional defendant and articulating in greater detail the allegations against the defendants. We believe that the defendants in both of these lawsuits have engaged in unlawful actions and have caused substantial harm to Overstock, and that certain of the defendants have made efforts to drive the market price of Overstock s common stock down. To the extent that the defendants or other persons engage in any such actions or take any other actions to interfere with or destroy or harm Overstock s existing and/or prospective business relationships with its suppliers, bankers, customers, lenders, investors, prospective investors or others, our business, prospects, financial condition and results of operation may suffer, and the price of our common stock may be more volatile than it might otherwise be and/or may trade at prices below those that might prevail in the absence of any such efforts. Additionally, Dr. Patrick Byrne and the company have fostered and supported a national debate concerning illegal trading practices called naked short selling and have advocated regulatory changes and enforcement action designed to end these practices. The profile of the company and Dr. Byrne, and their positions on issues associated with the debate, may make the company and Dr. Byrne the target of criticism and derision in the financial markets and associated media, and this may prove to have an adverse effect on the company s

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stock price.

Our stock has consistently been on the Regulation SHO threshold list.

Regulation SHO requires the stock exchanges to publish daily a list of companies whose stock has failures-to-deliver above a certain threshold. It also requires mandatory close-outs for open fail-to-deliver positions in threshold securities persisting for over 13 days, with the aim that no security would appear on the threshold for any extended period. Despite that aim, we have consistently appeared on the Regulation SHO threshold list and have been on the list for more trading days than any other company.

Any investment in our securities involves a high degree of risk. Investors should consider carefully the risks and uncertainties described above, and all other information in this Form 10-Q and in any reports we file with the SEC after we file this Form 10-Q, before deciding whether to purchase or hold our securities. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also become important factors that may harm our business. The occurrence of any of the risks described in this Form 10-Q could harm our business. The trading price of our securities could decline due to any of these risks and uncertainties, and investors may lose part or all of their investment.

Available Information

Our Internet website address is http://www.overstock.com. Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge through our Internet website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. The address of that site is http://www.sec.gov. Our Internet website and the information contained therein or connected thereto are not a part of or incorporated into this Quarterly Report on Form 10-Q.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

During July 2008, we repurchased an additional 30,000 shares of its common stock in open market purchases for approximately $482,000.

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Our Annual Meeting of Stockholders (the Annual Meeting) was held on May 13, 2008. A total of 18,384,551 shares of common stock, par value $0.0001 per share (the Common Stock), were present at the Annual Meeting, either in person or by proxy, representing 80.9% of the votes that all stockholders of the Company are entitled to cast, constituting a quorum. The matters voted upon at the Annual Meeting by the stockholders consisted of the three proposals set forth in our definitive Proxy Statement dated March 28, 2008.

The first proposal related to the reelection of Allison H. Abraham and Joseph J. Tabacco as Class III directors of Overstock.com, Inc., to serve terms of three (3) years. Ms. Abraham and Mr. Tabacco were elected with the following votes:

Director	For	Withheld
Allison H. Abraham	18,130,192	254,359
Joseph J. Tabacco, Jr.	18,238,491	146,060

The second proposal was to approve an amendment of the Company s 2005 Equity Incentive Plan to increase the number of shares available there under by 1,000,000 shares. This proposal was approved with 13,871,508 shares of the Company s common stock voting in favor of, 1,243,225 shares voting against, 4,879 shares abstaining, and 3,264,939 broker non-votes.

The third proposal was to ratify the selection of PricewaterhouseCoopers LLP as the Company s independent registered public accounting firm for the fiscal year ending December 31, 2008. This proposal was approved with 18,344,228 shares of the Company s common stock that voted at the meeting voting in favor of, 23,575 shares voting against, and 16,748 shares abstaining.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits

31.1 & 31.2	Rule 13a-15(d)/15d-15(d) Certifications
32.1 & 32.2	Section 1350 Certifications

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

OVERSTOCK.COM, INC.

/s/ David K. Chidester
David K. Chidester
Senior Vice President, Finance

Date: August 4, 2008