OVERSTOCK.COM, INC
Form 10-Q/A
March 15, 2006

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Mark One)

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

For the quarterly period ended September 30, 2005

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)

Former address:

6350 South 3000 East

Salt Lake City, Utah 84121

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 ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).

Yes ý No o

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2)

Yes o No ý

There were 19,306,046 shares of the Registrant s common stock, par value $0.0001, outstanding on November 7, 2005.

EXPLANATORY NOTE

On February 27, 2006, Overstock.com, Inc. (Company) filed its Current Report on Form 8-K with the Securities and Exchange Commission (SEC) in which it announced that it was restating previously reported financial statements to correct an error related to the accounting for freight costs incurred to deliver inventory to its warehouses. As more fully described in Note 2 of the financial statements, the Company has determined that the misstatements relate to the Company s historical practice of immediately expensing inbound freight costs in the period incurred rather than capitalizing such costs as a component of inventory and expensing such costs as the related inventory is sold. This Amendment No. 1 to Form 10-Q/A (Amendment) amends the Quarterly Report on Form 10-Q for the quarter end September 30, 2005 (Original Filing), as filed on November 9, 2005.

Except as required to reflect the effects of the restatement for the item above, no additional modifications or updates in this Amendment have been made to the Original Filing on Form 10-Q. Information not affected by the restatement remains unchanged and reflects the disclosures made at the time of the Original Filing. This amendment does not describe other events occurring after the original filing, including exhibits, or modify or update those disclosure affected by subsequent events. This Amendment should be read in conjunction with the Company s filings made with the SEC subsequent to the filing of the Original Filing, as information in such reports and documents may update or supersede certain information contained in this Amendment. Accordingly, this Amendment only amends and restates Items 1, 2 and 4 of Part I of the Original Filing, in each case, solely as a result of, and to reflect, the restatement, and no other information in the Original Filing is amended hereby. Additionally, pursuant to the rules of the SEC, Item 6 of Part II of the Original Filing has been amended to contain currently dated certifications of the President and Senior Vice President, Finance. As required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002, the certifications of our President and Senior Vice President, Finance are attached to this Amendment as Exhibits 31.1, 31.2 and 32.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Overstock.com, Inc.

Consolidated Balance Sheets

(in thousands)

(Unaudited)

	December 31, 2004 (Restated)	September 30, 2005 (Restated)
Assets		
Current assets:		
Cash and cash equivalents	$ 198,678	$ 2,575
Marketable securities	88,802	74,225
Cash, cash equivalents and marketable securities	287,480	76,800
Accounts receivable, net	5,715	7,551
Inventories, net	46,558	98,134
Prepaid inventory	12,322	12,606
Prepaid expenses and other assets	3,444	9,319
Total current assets	355,519	204,410
Restricted cash	1,602	633
Property and equipment, net	16,122	59,561
Goodwill	2,784	13,169
Other long-term assets, net	1,516	15,335
Total assets	$ 377,543	$ 293,108
Liabilities, Redeemable Securities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 64,060	$ 47,070
Accrued liabilities	22,917	45,278
Short-term borrowings		4,368
Capital lease obligations, current	595	6,638
Total current liabilities	87,572	103,354
Capital lease obligations, non-current	743	6,907
Convertible senior notes	116,251	84,596
Total liabilities	204,566	194,857
Commitments and contingencies (Note 14)		
	3,166	3,306

Redeemable common stock, $0.0001 par value, 460 shares issued and outstanding as of December 31, 2004 and September 30, 2005				
Stockholders equity:				
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of December 31, 2004 and September 30, 2005 respectively Common stock, $0.0001 par value, 100,000 shares authorized, 19,390 and 20,526 shares issued and 19,355 and 18,837 shares outstanding as of December 31, 2004 and September 30, 2005 respectively		2		2
Additional paid-in capital		243,131		250,863
Accumulated deficit		(71,726)		(90,501)
Unearned stock-based compensation		(1,301)		(493)
Treasury stock, 35 and 1,689 shares at cost as of December 31, 2004 and September 30, 2005, respectively		(100)		(65,333)
Accumulated other comprehensive income (loss)		(195)		407
Total stockholders equity		169,811		94,945
Total liabilities, redeemable securities and stockholders equity	$	377,543	$	293,108

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

Overstock.com, Inc.

Consolidated Statements of Operations (unaudited)

(in thousands, except per share data)

	Three months ended September 30, 2004 (Restated)	Three months ended September 30, 2005 (Restated)	Nine months ended September 30, 2004 (Restated)	Nine months ended September 30, 2005 (Restated)
Revenue				
Direct	$ 43,928	$ 68,449	$ 123,621	$ 196,397
Fulfillment partner	59,516	100,874	149,693	289,445
Total revenue	103,444	169,323	273,314	485,842
Cost of goods sold				
Direct	38,491	59,170	109,995	168,992
Fulfillment partner	51,103	83,589	131,010	242,821
Total cost of goods sold	89,594	142,759	241,005	411,813
Gross profit	13,850	26,564	32,309	74,029
Operating expenses:				
Sales and marketing	9,398	17,960	20,380	49,280
Technology	2,268	8,082	5,469	18,271
General and administrative	5,108	9,989	13,725	24,853
Amortization (reversal) of stock-based compensation	18	(8)	276	65
Total operating expenses	16,792	36,023	39,850	92,469
Operating loss	(2,942)	(9,459)	(7,541)	(18,440)
Interest income and other	168	(1,690)	393	(150)
Interest expense	(77)	(1,264)	(139)	(4,226)
Other income, net	3	11	5	4,181
Net loss	(2,848)	(12,402)	(7,282)	(18,635)
Deemed dividend related to redeemable common stock	(47)	(47)	(141)	(140)
Net loss attributable to common shares	$ (2,895)	$ (12,449)	$ (7,423)	$ (18,775)
Net loss per common share basic and diluted	$ (0.16)	$ (0.66)	$ (0.43)	$ (0.96)
Weighted average common shares outstanding basic and diluted	18,284	18,844	17,517	19,468

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

Overstock.com, Inc.
Consolidated Statements of Stockholders Equity
and Comprehensive Income (unaudited)

	Common stock Shares	Common stock Amount	Additional Paid-in Capital	Accumulated deficit	Unearned stock-based compensation	Treasury stock Shares	Treasury stock Amount	Accumulated Other Comprehensive Income (loss)	Total
				(amounts in thousands)					
Balance at December 31, 2004 (Restated)	19,390	$ 2	$ 243,131	$ (71,726)	$ (1,301)	(35)	$ (100)	$ (195)	$ 169,811
Exercise of stock options and warrants	1,136		6,881						6,881
Issuance of common stock from treasury			381			8	21		402
Purchase of treasury stock						(665)	(24,133)		(24,133)
Purchased call options for purchase of treasury stock			(47,507)						(47,507)
Settlement of purchased call options in exchange for cash			7,937						7,937
Settlement of purchased call options in exchange for treasury stock			41,121			(997)	(41,121)		
Forfeitures of unearned stock-based compensation from options issued to employees			(56)		56				
Amortization of stock-based compensation					65				65
Stock-based compensation to consultants in exchange for services			(1,025)		687				(338)
Deemed dividend related to redeemable common stock				(140)					(140)
Comprehensive income (loss):									
Net loss				(18,635)					(18,635)
Unrealized gain on marketable securities								491	491
Cumulative translation adjustment								111	111
Total comprehensive loss									(18,033)
Balance at September 30, 2005 (Restated)	20,526	$ 2	$ 250,863	$ (90,501)	$ (493)	(1,689)	$ (65,333)	$ 407	$ 94,945

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

Overstock.com, Inc.

Consolidated Statements of Cash Flows (unaudited)

(in thousands)

	Three months ended September 30, 2004 (Restated)	Three months ended September 30, 2005 (Restated)	Nine months ended September 30, 2004 (Restated)	Nine months ended September 30, 2005 (Restated)	Twelve months ended September 30, 2004 (Restated)	Twelve months ended September 30, 2005 (Restated)
Cash flows from operating activities:						
Net loss	$ (2,848)	$ (12,402)	$ (7,282)	$ (18,635)	$ (10,236)	$ (15,893)
Adjustments to reconcile net loss to cash provided by (used in) operating activities						
Depreciation and amortization	1,061	4,901	2,707	9,466	3,429	10,696
Realized (gain) loss from marketable securities	(1)	2,776	(1)	2,361	(2)	2,749
Loss on disposition of property and equipment						34
Amortization of unearned stock-based compensation	18	(8)	276	65	438	149
Stock options issued to consultants for services	25	(312)	594	(338)	701	(43)
Issuance of common stock from treasury		91		402		402
Amortization of debt discount and deferred financing fees		179		602		749
Gain from retirement of convertible senior notes				(4,170)		(4,170)
Changes in operating assets and liabilities:						
Accounts receivable	4,101	(968)	7,705	(965)	5,200	(4,201)
Inventories	(4,046)	(36,587)	(5,066)	(51,576)	(10,238)	(62,325)
Prepaid inventory	(5,137)	(2,196)	3,059	(284)	(1,584)	(284)
Prepaid expenses and other assets	(2,980)	(1,124)	(13,606)	(5,760)	(3,336)	(6,337)
Other long-term assets, net	102	(424)	(1,268)	(435)	(1,149)	(523)
Accounts payable	954	6,663	(7,887)	(17,911)	14,041	23,674
Accrued liabilities	7,824	19,503	8,419	21,997	12,268	27,177
Net cash provided by (used in) operating activities	(927)	(19,908)	(12,350)	(65,181)	9,532	(28,146)
Cash flows from investing activities:						
(Increase) decrease in restricted cash		200	(1,875)	969	(1,875)	1,242
Investments in marketable securities	(15,675)	(21,552)	(27,917)	(183,543)	(29,920)	(248,503)
Sales of marketable securities	1,470	34,062	3,944	196,250	12,206	207,679
Expenditures for property and equipment	(3,805)	(12,190)	(5,404)	(36,466)	(7,744)	(39,796)
Acquisition of Ski West (net of cash acquired)		(24,620)		(24,620)		(24,620)
Proceeds from the sale of property and equipment						20
Expenditures for other long-term assets					(172)	
Net cash used in investing activities	(18,010)	(24,100)	(31,252)	(47,410)	(27,505)	(103,978)
Cash flows from financing activities:						
Payments on capital lease obligations	(153)	(182)	(507)	(3,234)	(532)	(3,386)
Borrowings on line of credit		4,368	1,000	4,368	1,000	4,368
Payments on line of credit						(1,000)
Issuance of common stock, net of issuance costs			37,857		37,857	75,207
Issuance of convertible senior notes						116,251
Payments to retire convertible senior notes				(27,935)		(27,935)
Purchased call options for purchase of treasury stock				(47,507)		(47,507)
Settlement of call options for cash		7,937		7,937		7,937
Purchase of treasury stock				(24,133)		(24,133)
Exercise of stock options and warrants	596	2,973	3,555	6,881	3,848	7,615
Net provided by (used in) financing activities	443	15,096	41,905	(83,623)	42,173	107,417

Effect of exchange rate changes on cash		2		137		7		111		6		126
Net increase (decrease) in cash and cash equivalents		(18,492)		(28,775)		(1,690)		(196,103)		24,206		(24,581)
Cash and cash equivalents, beginning of period		45,648		31,350		28,846		198,678		2,950		27,156
Cash and cash equivalents, end of period	$	27,156	$	2,575	$	27,156	$	2,575	$	27,156	$	2,575
Supplemental cash flow information:												
Interest paid	$	77	$	76	$	139	$	2,569	$	146	$	2,595
Deemed dividend on redeemable common shares	$	47	$	47	$	141	$	140	$	190	$	187
Forfeitures on unearned stock-based compensation	$	105	$	10	$	192	$	56	$	267	$	64
Settlement of purchased call options for treasury stock	$		$		$		$	41,121	$		$	41,121
Equipment and software acquired under capital leases	$		$	193	$	1,835	$	15,390	$	120	$	15,390
Supplemental disclosure of non-cash activities:												
Fair value of assets acquired, net of cash acquired	$		$	25,956	$		$	25,956	$		$	25,956
Fair value of liabilities assumed				(1,336)				(1,336)				(1,336)
Cash paid to purchase businesses	$		$	24,620	$		$	24,620	$		$	24,620

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

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, 2004. 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 nine months ended September 30, 2005 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

As more fully described in Note 2, the Company determined that the financial statements and the disclosures in the notes thereto for the three month periods ended September 30, 2005 and 2004 contained in the Quarterly Report on Form 10-Q filed on November 9, 2005, require restatement. All amounts disclosed in the footnotes to the financial statements have been appropriately restated.

2. RESTATEMENT OF FINANCIAL STATEMENTS

On February 27, 2006, Overstock.com, Inc. (Company) filed its Current Report on Form 8-K with the Securities and Exchange Commission (SEC) in which it announced that it was restating previously reported financial statements to correct an error related to the accounting for freight costs incurred to deliver inventory to its warehouses. The Company has determined that the misstatements relate to the Company s former practice of immediately expensing inbound freight costs in the period incurred rather than capitalizing such costs as a component of inventory and expensing such costs as the related inventory is sold.

With respect to capitalization of inbound freight costs, AICPA Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, Chapter 4, Inventory Pricing sets forth the general principles applicable to the pricing of inventories.

In late 2005, the Company reevaluated its prior accounting policy related to inbound freight charges. As a result, the Company concluded that inbound freight should have been capitalized as a component of inventory cost and expensed as a cost of goods sold as the inventory is sold.

Based upon this determination, the consolidated balance sheets as of December 31, 2004 and September 30, 2005 and the consolidated statements of operations for the quarters ended September 30, 2005 and 2004 contained herein have been restated. As the restatement adjustments decrease the net loss by $1.7 million and $103,000 for the quarters ended September 30, 2005 and 2004, respectively, and increase inventory by the corresponding amount, there has been no impact on net cash used in operating activities the consolidated statements of cash flows. The restated consolidated statements of operations and balance sheets have been restated as follows:

Consolidated Statements of Operations (unaudited)

(in thousands, except per share data)

	Three Months Ended September 30, 2005		
	As Previously Reported	Adjustment	As Restated
Revenue			
Direct	$ 68,449		$ 68,449
Fulfillment partner	100,874		100,874
Total revenue	169,323		169,323
Cost of goods sold			
Direct	60,939	(1,769)	59,170
Fulfillment partner	83,589		83,589
Total cost of goods sold	144,528	(1,769)	142,759
Gross profit	24,795	1,769	26,564
Operating expenses:			
Sales and marketing	17,960		17,960
Technology	8,082		8,082
General and administrative	9,989		9,989
Amortization of stock-based compensation	(8)		(8)
Total operating expenses	36,023		36,023
Operating loss	(11,228)	1,769	(9,459)
Interest income	(1,690)		(1,690)
Interest expense	(1,264)		(1,264)
Other income, net	11		11
Net loss	(14,171)	1,769	(12,402)
Deemed dividend related to redeemable common shares	(47)		(47)
Net loss attributable to common shares	$ (14,218)	$ 1,769	$ (12,449)
Net loss per common share basic and diluted	$ (0.75)	$ 0.09	$ (0.66)
Weighted average common shares outstanding basic and diluted	18,844		18,844

Consolidated Statements of Operations (unaudited)

(in thousands, except per share data)

	Three Months Ended September 30, 2004		
	As Previously Reported	Adjustment	As Restated
Revenue			
Direct	$ 43,928		$ 43,928
Fulfillment partner	59,516		59,516
Total revenue	103,444		103,444
Cost of goods sold			
Direct	38,594	(103)	38,491
Fulfillment partner	51,103		51,103
Total cost of goods sold	89,697	(103)	89,594
Gross profit	13,747	103	13,850
Operating expenses:			
Sales and marketing	9,398		9,398
Technology	2,268		2,268
General and administrative	5,108		5,108
Amortization of stock-based compensation	18		18
Total operating expenses	16,792		16,792
Operating loss	(3,045)	103	(2,942)
Interest income	168		168
Interest expense	(77)		(77)
Other income, net	3		3
Net loss	(2,951)	103	(2,848)
Deemed dividend related to redeemable common shares	(47)		(47)
Net loss attributable to common shares	$ (2,998)	$ 103	$ (2,895)
Net loss per common share basic and diluted	$ (0.16)	$ 0.00	$ (0.16)
Weighted average common shares outstanding basic and diluted	18,284		18,284

	Nine Months Ended September 30, 2005		
	As Previously Reported	Adjustment	As Restated
Revenue			
Direct	$ 196,397		$ 196,397
Fulfillment partner	289,445		289,445
Total revenue	485,842		485,842
Cost of goods sold			
Direct	171,246	(2,254)	168,992
Fulfillment partner	242,821		242,821
Total cost of goods sold	414,067	(2,254)	411,813
Gross profit	71,775	2,254	74,029
Operating expenses:			
Sales and marketing	49,280		49,280
Technology	18,271		18,271
General and administrative	24,853		24,853
Amortization of stock-based compensation	65		65
Total operating expenses	92,469		92,469
Operating loss	(20,694)	2,254	(18,440)
Interest income	(150)		(150)
Interest expense	(4,226)		(4,226)
Other income, net	4,181		4,181
Net loss	(20,889)	2,254	(18,635)
Deemed dividend related to redeemable common shares	(140)		(140)
Net loss attributable to common shares	$ (21,029)	$ 2,254	$ (18,775)
Net loss per common share basic and diluted	$ (1.08)	$ 0.12	$ (0.96)
Weighted average common shares outstanding basic and diluted	19,468		19,468

	Nine Months Ended September 30, 2004		
	As Previously Reported	Adjustment	As Restated
Revenue			
Direct	$ 123,621		$ 123,621
Fulfillment partner	149,693		149,693
Total revenue	273,314		273,314
Cost of goods sold			
Direct	110,196	(201)	109,995
Fulfillment partner	131,010		131,010
Total cost of goods sold	241,206	(201)	241,005
Gross profit	32,108	201	32,309
Operating expenses:			
Sales and marketing	20,380		20,380
Technology	5,469		5,469
General and administrative	13,725		13,725
Amortization of stock-based compensation	276		276
Total operating expenses	39,850		39,850
Operating loss	(7,742)	201	(7,541)
Interest income	393		393
Interest expense	(139)		(139)
Other income, net	5		5
Net loss	(7,483)	201	(7,282)
Deemed dividend related to redeemable common shares	(141)		(141)
Net loss attributable to common shares	$ (7,624)	$ 201	$ (7,423)
Net loss per common share basic and diluted	$ (0.44)	$ 0.01	$ (0.43)
Weighted average common shares outstanding basic and diluted	17,517		17,517

Consolidated Balance Sheets

(in thousands)

(Unaudited)

	As of September 30, 2005 As Previously Reported	As of September 30, 2005 As Restated
Assets		
Current assets:		
Cash and cash equivalents	$ 2,575	$ 2,575
Marketable securities	74,225	74,225
Cash, cash equivalents and marketable securities	76,800	76,800
Accounts receivable, net	7,551	7,551
Inventories, net	94,601	98,134
Prepaid inventory	12,606	12,606
Prepaid expenses	9,319	9,319
Total current assets	200,877	204,410
Restricted cash	633	633
Property and equipment, net	59,561	59,561
Goodwill	13,169	13,169
Other long-term assets, net	15,335	15,335
Total assets	$ 289,575	$ 293,108
Liabilities, Redeemable Securities and Stockholders Equity		
Current liabilities:		
Accounts payable	47,070	47,070
Accrued liabilities	45,278	45,278
Short-term borrowings	4,368	4,368
Capital lease obligations, current	6,638	6,638
Total current liabilities	103,354	103,354
Capital lease obligations, non-current	6,907	6,907
Convertible senior notes	84,596	84,596
Total liabilities	194,857	194,857
Redeemable common stock, $0.0001 par value, 460 shares issued and outstanding as of March 31, 2005	3,306	3,306
Stockholders equity:		
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of March 31, 2005		
Common stock, $0.0001 par value, 100,000 shares authorized, 19,491 shares issued as of March 31, 2005	2	2
Additional paid-in capital	250,863	250,863
Accumulated deficit	(94,034)	(90,501)
Unearned stock-based compensation	(493)	(493)
Treasury stock, 31 shares at cost as of March 31, 2005	(65,333)	(65,333)
Accumulated other comprehensive loss	407	407

Total stockholders equity		91,412		94,945
Total liabilities, redeemable securities and stockholders equity	$	289,575	$	293,108

Consolidated Balance Sheets

(in thousands)

	As of December 31, 2004 As Previously Reported	As of December 31, 2004 As Restated
Assets		
Current assets:		
Cash and cash equivalents	$ 198,678	$ 198,678
Marketable securities	88,802	88,802
Cash, cash equivalents and marketable securities	287,480	287,480
Accounts receivable, net	5,715	5,715
Inventories, net	45,279	46,558
Prepaid inventory	12,322	12,322
Prepaid expenses	3,444	3,444
Total current assets	354,240	355,519
Restricted cash	1,602	1,602
Property and equipment, net	16,122	16,122
Goodwill	2,784	2,784
Other long-term assets, net	1,516	1,516
Total assets	$ 376,264	$ 377,543
Liabilities, Redeemable Securities and Stockholders Equity		
Current liabilities:		
Accounts payable	64,060	64,060
Accrued liabilities	22,917	22,917
Capital lease obligations, current	595	595
Total current liabilities	87,572	87,572
Capital lease obligations, non-current	743	743
Convertible senior notes	116,251	116,251
Total liabilities	204,566	204,566
Redeemable common stock, $0.0001 par value, 460 shares issued and outstanding as of December 31, 2004	3,166	3,166
Stockholders equity:		
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of December 31, 2004		
Common stock, $0.0001 par value, 100,000 shares authorized, 19,390 shares issued as of December 31, 2004	2	2
Additional paid-in capital	243,131	243,131
Accumulated deficit	(73,005)	(71,726)
Unearned stock-based compensation	(1,301)	(1,301)
Treasury stock, 35 shares at cost as of December 31, 2004	(100)	(100)
Accumulated other comprehensive loss	(195)	(195)
Total stockholders equity	168,532	169,811
Total liabilities, redeemable securities and stockholders equity	$ 376,264	$ 377,543

3. ACCOUNTING POLICIES

Derivative instruments

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133) requires companies to recognize their derivative instruments, including certain derivative instruments embedded in other contracts, as either assets or liabilities in the balance sheet at fair value. The accounting for changes in the fair value of a derivative instrument depends on whether the instrument has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, a cash flow hedge or a hedge of a net investment in an international operation. For derivatives designated as hedges, the changes in fair value are recorded in the balance sheet as an item in other comprehensive income. Changes in the fair value of derivatives not designated as hedges are recorded in the statement of operations. As of September 30, 2005, the Company had not designated any derivative instruments as hedges.

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: 1) during the period customers are acquired; or 2) based on the number of clicks generated during a given period over the term of the contract. Advertising expense included in sales and marketing expenses totaled $9.0 million and $17.2 million during the three months ended September 30, 2004 and 2005, respectively, and $19.5 million and $47.7 million during the nine months ended September 30, 2004 and 2005, respectively.

Asset Retirement Obligation

In accordance with SFAS No. 143, Accounting for Asset Retirement Obligations, the Company establishes assets and liabilities for the present value of estimated future costs to return certain of our leased facilities to their original condition. Such assets are depreciated over the lease period into operating expense, and the recorded liabilities are accreted to the future value of the estimated restoration costs. At September 30, 2005, such amounts are not significant.

Accounting for merchant and agency revenues for Travel subsidiary

The determination of gross versus net revenue presentation is based principally on the Company s consideration of Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements and Emerging Issues Task Force Issue No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, including the weighing of the relevant qualitative factors regarding the Company s status as the primary obligor, and the extent of pricing latitude and inventory risk. The method of merchant revenue presentation by the Company does not impact operating profit, net income, or cash flows, but rather revenues and cost of sales.

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The principle factor in determining gross versus net presentation by the Company s travel subsidiary, OTravel.com, Inc. (OTravel.com see Note 5) is the consideration of who is the primary obligor in the relationship with the customer. Our Travel business provides extensive customer service and support for its customers; however, the supplier hotel is principally liable to its merchant hotel customers in all situations where the customer does not receive the hotel services booked through OTravel.com. In this case, OTravel.com provides customer service support to help resolve issues, even though such customer support could typically involve issues for which OTravel.com is not principally liable.

OTravel.com generates both merchant hotel revenues and agency air, hotel, car and cruise revenues. Merchant hotel revenues are recognized as net revenue at the time of booking since all transactions are billed directly to customers, are nonrefundable and generally noncancelable, and require no significant post-delivery obligations for OTravel.com. A reserve for chargebacks and cancellations is recorded at the time of the transaction based on historical experience.

Agency revenues are derived from airline ticket transactions, certain hotel transactions as well as cruise and car rental reservations. Agency revenues are recognized on a net basis on air transactions when the reservation is made and secured by a credit card. A cancellation allowance is recognized on these revenues based on historical experience. OTravel.com recognizes agency revenues on hotel reservations, cruise and car rental reservations, either on an accrual basis for payments from a commission clearinghouse or on receipt of commissions from an individual supplier.

Recent accounting pronouncements

In March 2005, the Financial Accounting Standards Board (FASB) issued FIN 47 which clarifies guidance provided by Statement No. 143, Accounting for Asset Retirement Obligations. FIN 47 is effective for the Company beginning the quarter ending March 31, 2006. The adoption of FIN 47 is not expected to have a significant impact on the Company s financial position, results of operations or cash flows.

In December 2004, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 123 (revised 2004) *Share-Based Payment* (Statement 123R). This standard requires companies to measure and recognize the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value. The effective date is the first annual reporting period beginning after June 15, 2005. The Company is currently evaluating pricing models and the transition provisions of this standard and will begin expensing all stock-based compensation in the first quarter of 2006.

On March 29, 2005, the SEC published Staff Accounting Bulletin (SAB) No. 107, which provides the Staffs views on a variety of matters relating to the interaction between Statement 123R and certain Securities and Exchange Commission Rules and regulations. The Company is currently evaluating the provisions of the SAB and will implement it when the Company begins expensing stock options under Statement 123R in the first quarter of 2006.

In March 2004, the FASB issued EITF Issue No. 03-1 (EITF 03-1), *The Meaning of Other-than-Temporary Impairments and its Application to Certain Investments,* which provides new guidance for assessing impairment losses on investments. Additionally, EITF 03-1 includes new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB delayed the accounting provisions of EITF 03-1; however, the disclosure requirements remain effective for annual periods ending after June 15, 2004. The Company will evaluate the impact of EITF 03-1 once final guidance is issued.

On June 7, 2005, the FASB issued Statement No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements (FAS 154). FAS 154 changes the requirements for the accounting and reporting of a change in accounting principle. Previously, most voluntary changes in accounting principles were required to be recognized by way of a cumulative effect adjustment within net income during the period of the change. FAS 154 requires retrospective application to prior periods financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. FAS 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, the Statement does not change the transition provisions of any existing accounting pronouncements. We do not believe adoption of FAS 154 will have a material effect on our consolidated financial position, results of operations or cash flows.

4. MARKETABLE SECURITIES

The Company s marketable securities consist of funds deposited into capital management accounts managed by two financial institutions at September 30, 2005 as follows (in thousands):

	Cost Basis	Recognized Loss On Derivative Securities	Unrealized Gains (Losses)	Fair Value
U.S. government and government agency securities	$ 23,997	$	$ (165)	23,832
Mortgage-backed securities	2,150		(4)	2,146
Foreign corporate securities	49,937	(2,350)	660	48,247
Total	$ 76,084	$ (2,350)	$ 491	$ 74,225

All marketable securities mature between 2005 and 2034 and are classified as available-for-sale securities. Available-for-sale securities are classified as current as they are deemed available for use, if needed for current operations.

Derivative instruments

During the first quarter of 2005, the Company purchased $49.9 million of Foreign Corporate Securities (Notes) which fully mature for $50.0 million in cash in November 2006. The Notes do not have a stated interest rate, but are structured to return the entire principal amount and a conditional coupon if held to maturity. The conditional coupon will provide a rate of return dependent on the performance of a basket of eight Asian currencies against the U.S. dollar. If the Company redeems the Notes prior to maturity, the Company may not realize the full amount of its initial investment. At September 30, 2005, the Notes had a fair value of $48.2 million.

Under SFAS No. 133, the Notes are considered to be derivative financial instruments and are marked to market quarterly. Any unrealized gain or loss related to the changes in value of the conditional coupon is recorded in the income statement as a component of interest income or expense. Any unrealized gain or loss related to the changes in the value of the Notes is recorded as a component of other comprehensive income (loss).

For the quarter and nine months ended September 30, 2005 changes in the value of the conditional coupon resulted in losses of $2.1 million and $2.4, respectively. The changes in the value of the Notes resulted in a gain of $660,000 which was recorded as a component of other comprehensive income (loss) for the quarter and nine months ended September 30, 2005.

The Company purchased the Notes to manage its foreign currency risks related to the strengthening of Asian currencies compared to the U.S. dollar, which would reduce the inventory purchasing power of the Company in Asia. However, the Company determined that the Notes did not qualify as hedging derivative instruments. Nevertheless, management believes that such instruments are useful in managing the Company s associated risk.

5. ACQUISITIONS

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). In addition, the Company may be subject to additional earn out payments (based on a percentage of operating profits for each of the next four years as follows: 50%, 33.3%, 20%, and 10%, respectively), subject to reduction under certain circumstances, pursuant to a Stock Purchase Agreement dated June 24, 2005 among the Company, Ski West, and all of the shareholders of Ski West.

Ski West is an on-line travel company whose proprietary technology provides easy consumer access to a large, fragmented, hard-to-find inventory of lodging, vacation, cruise and transportation bargains. The travel offerings are primarily in popular ski areas in the U.S. and Canada, with more recent expansion into the Caribbean and Mexico, as well as cruises.

Effective upon the closing, Ski West became a wholly-owned subsidiary of the Company, integrated the Ski West travel offerings with the Company s existing travel offerings and changed its name to OTravel.com, Inc.

Purchase Price Allocations

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed on July 1, 2005. The initial purchase price allocations may be adjusted within one year of the purchase date for changes in estimates of the fair value of assets acquired and liabilities assumed (in thousands):

		July 1, 2005
Cash	$	491
Current assets		986
Property and equipment		263
Goodwill		10,385
Intangible assets		14,313
Other assets		9
Assets acquired		26,447
Liabilities assumed		(1,336)
Net assets acquired	$	25,111

The excess of the purchase price over the fair values of assets acquired and liabilities assumed was allocated to goodwill. Any required earn out payments would further increase goodwill at the time the target operating results for the next four years are successfully achieved. Of the $10,385 recorded in goodwill, the full amount is expected to be deductible for tax purposes, to the extent the Company has sufficient taxable income in the future.

The amounts allocated to intangible assets, and their estimated useful lives, were based on independent appraisal and were attributed to the following categories (in thousands):

			Years
Enterprise information system	$	860	5
Customer list		2,339	4
Supplier contracts		6,271	12
Web sites and destination portal		2,887	5
Non-competition agreements		1,956	2
	$	14,313	

During the quarter ended September 30, 2005, the Company recorded amortization expense attributable to the above intangible assets of approximately $700,000.

Pro forma results of operations have not been presented because the effect of the acquisition was not material to the results of prior periods presented.

6. COMPREHENSIVE INCOME (LOSS)

The Company follows SFAS No. 130, *Reporting Comprehensive Income.* This Statement establishes requirements for reporting comprehensive income and its components. The Company s comprehensive loss for the three and nine months ended September 30, 2004 and 2005 is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2004 (Restated)	2005 (Restated)	2004 (Restated)	2005 (Restated)

Net loss	$ (2,848)	$ (12,402)	$ (7,282)	$ (18,635)
Net unrealized gain (loss) on marketable securities	6	312	(56)	(169)
Unrealized gain on foreign bonds		660		660
Foreign currency translation adjustment	2	137	7	111
Comprehensive loss	$ (2,840)	$ (11,293)	$ (7,331)	$ (18,033)

7. NET LOSS PER SHARE

Basic earnings (loss) per share is computed by dividing net income (loss) attributable to common shares for the period by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) attributable to common shares 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, warrants and convertible senior notes, are included in the calculation of diluted net loss per share to the extent such shares are dilutive. During the three- and nine-month periods ended September 30, 2004 and 2005, the effects of outstanding stock options, warrants and convertible senior notes were antidilutive and accordingly, have been excluded from diluted loss per share. There were 1.3 million options and no warrants outstanding at September 30, 2005. As of September 30, 2005, the Company had $87.0 million of convertible senior notes outstanding (Note 13), which could potentially convert into 1.2 million shares of common stock in the aggregate.

8. BUSINESS SEGMENTS

Segment information has been prepared in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 131, Disclosures about Segments of an Enterprise and Related Information. There were no inter-segment sales or transfers during the three- or nine-month periods ended September 30, 2004 or 2005. 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 nine months ended September 30, 2004 and 2005 (in thousands):

	Three months ended September 30,			Nine months ended September 30,		
	Direct operations	Fulfillment partner operations	Consolidated	Direct operations	Fulfillment partner operations	Consolidated
2004 (Restated)						
Revenue	$ 43,928	$ 59,516	$ 103,444	$ 123,621	$ 149,693	$ 273,314
Cost of goods sold	38,491	51,103	89,594	109,995	131,010	241,005
Gross profit	$ 5,437	$ 8,413	13,850	$ 13,626	$ 18,683	32,309
Operating expenses			(16,792)			(39,850)
Other income (expense), net			94			259
Net loss			$ (2,848)			$ (7,282)
2005 (Restated)						
Revenue	$ 68,449	$ 100,874	$ 169,323	$ 196,397	$ 289,445	$ 485,842
Cost of goods sold	59,170	83,589	142,759	168,992	242,821	411,813
Gross profit	$ 9,279	$ 17,285	26,564	$ 27,405	$ 46,624	74,029
Operating expenses			(36,023)			(92,469)
Other income, net			(2,943)			(195)
Net loss			$ (12,402)			$ (18,635)

The direct segment includes revenues, direct costs, and allocations associated with sales fulfilled from our 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 Websites. Costs for this segment include product costs, credit card fees and customer service costs. This segment also includes revenues and direct costs associated with our on-line auctions and travel businesses.

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

For the three and nine-month periods ended September 30, 2004 and 2005, 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, 2004 and September 30, 2005, all of the Company s fixed assets were located in the United States of America.

9. PUBLIC OFFERINGS

In June 2004, the Company closed its second follow-on public offering, pursuant to which it sold 1.3 million shares of common stock, with proceeds to the Company of approximately $37.9 million, net of $405,000 of issuance costs.

In November 2004, the Company closed an additional follow-on public offering, pursuant to which it sold 1.4 million shares of common stock, with proceeds to the Company of approximately $75.2 million, net of $215,000 of issuance costs. Concurrently in November 2004, the Company issued convertible senior notes pursuant to which it received $116.2 million, net of $3.8 million of initial purchaser s discount and debt issuance costs.

10. STOCK-BASED COMPENSATION

The Company measures compensation expense to employees for its equity incentive plan using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* and provides pro forma disclosures of net income as if the fair value based method prescribed by Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation,* had been applied. The following table provides a reconciliation of net loss to pro forma net loss as if the fair value method had been applied to all awards (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2004 (Reported)	**2005 (Reported)**	**2004 (Reported)**	**2005 (Reported)**
Net loss, as reported	$ (2,848)	$ (12,402)	$ (7,282)	$ (18,635)
Add: Stock-based employee compensation expense included in reported net income	18	(8)	276	65
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(710)	(1,033)	(2,654)	(2,948)
Pro forma net loss	$ (3,540)	$ (13,443)	$ (9,660)	$ (21,518)
Net loss per common share				
Basic and diluted - as reported	$ (0.16)	$ (0.66)	$ (0.43)	$ (0.96)
Basic and diluted - pro forma	$ (0.20)	$ (0.71)	$ (0.55)	$ (1.11)

The fair value of options granted is estimated at the date of grant using the Black-Scholes option pricing model. The Black-Scholes option pricing model requires the input of highly subjective assumptions, including the expected stock price volatility. We use the historical stock price volatility of our common stock over the most recent period that is generally commensurate with the expected option life as the basis for estimating stock price volatility. For options granted during the three months ended September 2005, the historical stock price volatility used was based on a daily stock price observation, using the closing price, which resulted in an expected stock price volatility of 76.43%. For purpose of the above pro forma disclosure, the fair value of options granted is amortized to stock-based employee compensation cost over the period(s) in which the related employee services are rendered. Accordingly, the pro forma stock-based compensation cost for any period will typically relate to options granted in both the current period and prior periods. Effective January 1, 2006, the Company will record stock compensation expense in accordance with FAS 123R.

11. SHARE BUYBACK PROGRAM

During January 2005, the Company s Board of Directors authorized a stock repurchase program under which the Company was authorized to repurchase up to $50.0 million of its common stock through December 31, 2007. On April 26, 2005, the Board of Directors increased the amount of the stock buyback program to $100.0 million. Additionally, on June 14, 2005, the Board of Directors authorized an amendment of its three-year stock repurchase program to include the repurchase of its Convertible Senior Notes.

During 2005, the Company entered into several purchased call options, pursuant to which the Company could have been required to purchase up to 1.3 million shares of its common stock at certain settlement dates during the quarter ended June 30, 2005. In connection with these repurchase transactions; the Company paid approximately $47.5 million, which was recorded in shareholders equity in the consolidated balance sheet.

At the Company s option, the purchased call options were settled in cash or stock, based on the market price of our common stock on the date of the settlement. Upon settlement, the Company either had its capital investment returned with a premium or received shares of its common stock, depending, respectively, on whether the market price of its common stock was above or below a pre-determined price agreed in connection with each such transaction.

Under the buyback program, the Company repurchased approximately 665,000 shares of our common stock in open market transactions for $24.1 million during the nine months ended September 30, 2005. In addition, approximately 1.0 million shares of common stock were acquired as a result of the settlement of $41.1 million of structured stock repurchase transactions during the nine months ended September 30, 2005. The purchased call options that did not settle in stock settled in cash totaling $7.9 million, which the Company received in July 2005.

12. BORROWINGS

In December 2004, the Company entered into an amendment to a credit agreement (Amended Credit Agreement) with Wells Fargo Bank, National Association. The original credit agreement (originally executed in February 2004) provided the Company with a revolving line of credit for the purpose of issuing up to $10.0 million of letters of credit for the purchase of inventory. As amended to date, the Amended Credit Agreement provides a revolving line of credit to the Company of up to $30.0 million and expires December 31, 2005. The Company has the option to renew the Amended Credit Agreement annually. Included in the $30.0 million Amended Credit Agreement is a $15.0 million sub-limit for a revolving line of credit which the Company uses to obtain letters of credit to support inventory purchases.

At September 30, 2005 $4.4 million was outstanding on the line and letters of credit totaling $6.9 million were issued on our behalf under this facility.

Prior to October 18, 2005, interest on borrowings was payable monthly and accrued at either (i) one-half of one percentage point (0.50%) 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. Unpaid principal, together with accrued and unpaid interest was due on the maturity date. Borrowings under the facility were collateralized by the Company s cash and marketable securities deposited at Wells Fargo or its affiliates, and the Company was required to maintain balances with Wells Fargo or its affiliates of up to $21.1 million in order to have the full amount of the credit facility available.

The Amended Credit Agreement requires the Company to comply with certain covenants, including restrictions on mergers, business combinations or transfer of assets. The Company was in compliance with these covenants at September 30, 2005.

On October 18, 2005, we entered into a sixth amendment to the credit agreement (Sixth Amended Credit Agreement). The Sixth Amended Credit Agreement eliminated the requirement that the Company maintain specified cash balances with Wells Fargo as a condition to the availability of advances under the facility, and substituted collateral consisting of foreign bond securities owned by the Company in an aggregate principal amount of $50.0 million to secure the Company s obligations under the facility. The $15.0 million sub-limit used to obtain letters of credit to support inventory purchases remained the same. We have an option to renew the Sixth Amended Credit Agreement annually. The Sixth Amendment increased the interest rate on fixed rate advances under the credit facility to 1.35% above LIBOR on the first day of each fixed rate term.

Capital leases

The Company leases certain software and computer equipment under three non-cancelable capital leases that expire at various dates through 2008. The Company expects that in the normal course of business the leases will expire. Software and equipment acquired relating to the capital leases were $1.8 million and $16.3 million at December 31, 2004 and September 30, 2005, respectively, with accumulated depreciation and amortization of $395,000 and $2.9 million at those respective dates. Depreciation of assets recorded under capital leases was zero and $2.5 million for the nine months ended September 30, 2004 and 2005, respectively.

Future minimum lease payments under capital leases are as follows (in thousands):

Year Ending September 30,		
2006	$	7,202
2007		4,634
2008		2,996
2009		
2010		
Total minimum lease payments		14,832
Less: amount representing interest		(1,287)
Present value of capital lease obligations		13,545
Less: current portion		(6,638)
Capital lease obligations, non-current	$	6,907

13. 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). This includes $20.0 million of additional Senior Notes issued to the initial purchaser upon exercise of its 30-day purchase option to cover over-allotments. 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. During the three and nine months ended September 30, 2005, the Company recorded amortization of discount and debt issuance costs related to this offering totaling $128,000 and $384,000, respectively. Interest on the Senior Notes is payable semi-annually on June 1 and December 1 of each year, beginning June 1, 2005. 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 (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 our corporate existence and properties, and paying taxes and other claims in a timely manner. The

Company was in compliance with these covenants at September 30, 2005.

In June 2005, under the Share Buyback Program (see Note 11), the Company retired $33.0 million of its 3.75% Convertible Senior Notes (the Senior Notes), which were due on December 1, 2011 for $27.9 million in cash. As a result of the note retirement, the Company recognized a gain of $4.2 million, net of the associated unamortized discount of $960,000, in other income, in the consolidated statements of operations. As of September 30, 2005, $87.0 million of the Senior Notes remained outstanding. Pursuant to the Share Buyback Program, the Company had initiated the retirement of additional Convertible Senior Notes as of November 8, 2005.

14. COMMITMENTS AND CONTINGENCIES

Through July 2005, the Company leased 43,000 square feet of office space under an operating lease which was originally scheduled to expire in January 2007. However, effective July 2005 this lease was terminated and replaced with a lease for a new office building in the Old Mill Corporate Center III in Salt Lake City, Utah. Pursuant to this agreement, the Company began leasing approximately 143,000 rentable square feet for a term of ten years beginning July 2005. In February 2005, the Company and Old Mill Corporate Center III, LLC (the Lessor) entered into a Tenant Improvement Agreement (the OMIII Agreement) relating to the office building. The OMIII Agreement sets forth the terms on which the Company will pay the costs of certain improvements to the leased office space. The amount of the costs is estimated to be approximately $2.0 million. The OMIII Agreement requires the Company to reimburse the Lessor for the amount of the costs within thirty days after presentation of invoices or written requests for reimbursement. The OMIII Agreement also requires the Company to provide either a cash deposit or a letter of credit in the amount of $500,000 to the Lessor to provide funds for the removal of the improvements upon the termination of the lease. The Company issued a letter of credit for $500,000 to the Lessor.

The Company leases 480,000 square feet for its warehouse facilities in Utah under operating leases which expire in August 2012.

In June 2005, the Company entered into a non-cancelable operating lease for certain computer equipment expiring in the next three years. It is expected that such leases will be renewed by exercising purchase options or replaced by leases of other computer equipment.

Minimum future payments under these operating leases are as follows (in thousands):

Twelve Months Ending September 30,		
2006	$	5,488
2007		6,606
2008		7,143
2009		7,597
2010		7,810
Thereafter		38,152
	$	72,796

Rental expense for operating leases totaled $642,000 and $1.7 million for the three months ended September 30, 2004 and 2005, respectively, and $1.8 million and $3.7 million for the nine months ended September 30, 2004 and 2005, respectively.

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. Such litigation could be costly and time consuming and could divert our management and key personnel from our business operations. The uncertainty of litigation increases these risks. In connection with such litigation, we may be subject to significant damages or equitable remedies relating to the operation of our business and the sale of products on our websites. Any such litigation may materially harm the Company s, 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 impact on its financial statements.

In October 2003, Tiffany (NJ) Inc. and Tiffany & Co. filed a complaint against the Company in the United States District Court for the Southern District of New York alleging that the Company had distributed counterfeit and otherwise unauthorized Tiffany product in violation of federal copyright and trademark law and related state laws. The complaint seeks statutory and other damages in an unspecified amount and injunctive relief. In January and February 2005, Tiffany (NJ) Inc. and Tiffany & Co. filed five additional complaints against the Company in the United States District Court for the Southern District of New York alleging that the Company had distributed counterfeit and otherwise unauthorized Tiffany product in violation of federal copyright and trademark law and related state laws. These complaints also seek statutory and other damages in an unspecified amount and injunctive relief. Although the Company has filed answers to these complaints and the Company believes it has defenses to the allegations and intends to pursue them vigorously, the Company does not have sufficient information to assess the validity of the claims or the amount of potential damages alleged in these suits.

In September 2004, the Company received a letter from BTG International Inc. claiming that certain of its business practices and online marketing information technology systems infringe patents owned by BTG. On September 14, 2004, without engaging in any meaningful discussion or negotiation with the Company, BTG filed a complaint in the United States District Court of Delaware alleging that certain of the Company s business practices and online marketing information technology systems infringe a single patent owned by BTG. On October 21, 2004, the Company filed an answer denying the material allegations in BTG s claims. Although the Company has filed an answer and believes it has defenses to the allegations and intends to pursue them vigorously, the BTG lawsuit is in the discovery stage, and the Company does not have sufficient information to assess the validity of the claims or the amount of potential damages.

In December 2003, the Company received a letter from Furnace Brook claiming that certain of the Company s business practices and the Company s on-line ordering system infringe a patent owned by Furnace Brook. After diligent efforts to show that the Company does not infringe these patents and Furnace Brook s continual assertions that it would vigorously protect its intellectual property rights if the Company did not agree to enter into licensing arrangements with respect to the asserted patents, on August 12, 2005, the Company filed a complaint in the United States District Court of Utah, Central Division, seeking declaratory judgment that the Company does not infringe any valid claim of the Furnace Brook patent. Furnace Brook filed a motion to dismiss the Company s complaint for lack of personal jurisdiction over Furnace Brook in Utah. On October 31, 2005, the United States District Court of Utah, Central Division, issued a decision to dismiss the Company s complaint for lack of personal jurisdiction over Furnace Brook. The Company is currently considering the benefits of motions for reconsideration or appeal of the Utah decision. On August 18, 2005, shortly after the Company filed the complaint in Utah, Furnace Brook filed a complaint in the United States District Court for the Southern District of New York, alleging that certain of the Company s business practices and the Company s on-line ordering system infringe a single patent owned by Furnace Brook. On September 12, 2005, the Company filed a motion to stay the proceedings in New York pending resolution of the issues related to the motion to dismiss in Utah. An answer to the New York complaint is not due until after resolution of the motion to stay. Although the Company believes to have defenses to the infringement allegations in the New York case, which the Company intends to pursue vigorously, the Furnace Brook lawsuit is not yet in the discovery stage, and the Company does not have sufficient information to assess the validity of the claims or the amount of potential damages.

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, as well as other, as yet unnamed, defendants. The Company, along with a second shareholder plaintiff, filed the complaint 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. The defendants have been served with, but have not yet answered, the amended complaint. The Company intends to pursue this action vigorously.

15. 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.

16. VARIABLE INTEREST ENTITY

In August 2004, the Company entered into an agreement which allows the Company to lend up to $10.0 million to an entity for the purpose of buying inventory, primarily to supply a new category within our jewelry store which allows customers purchasing diamond rings to select both a specific diamond and ring setting. In November 2004, the Company loaned the entity $8.4 million. The promissory note bears interest at 3.75% per annum. The Company is also entitled to receive fifty percent (50%) of any profits of the entity. Interest is due and payable quarterly on the fifteenth day of February, May, August and November, commencing on November 15, 2004 until the due date of November 30, 2006, on which all principal and interest accrued and unpaid thereon, shall be due and payable. The promissory note is collateralized by all of the assets of the entity.

The Company has a ten year option to purchase (Purchase Option) 50% of the ownership and voting interest of the entity. The exercise price of the Purchase Option is the sum of (a) one thousand dollars, and (b) $3.0 million, which may be paid, at the Company s election, in cash or by the forgiveness of $3.0 million of the entity s indebtedness to the Company.

The entity was evaluated in accordance with FASB Interpretation No. 46 (Revised), *Consolidation of Variable Interest Entities an Interpretation of ARB No. 51,* and it was determined to be a variable interest entity for which the Company was determined to be the primary beneficiary. As such, the financial statements of the entity are consolidated into the financial statements of the Company.

The carrying amount and classification of the consolidated assets that are collateral for the entity s obligations include (in thousands):

		September 30, 2005
Cash	$	257
Accounts receivable		53
Inventory		7,514
Prepaid expenses		11
Property and equipment		237
Total assets	$	8,072

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

Special Note Regarding Forward Looking Statements

In addition to historical information, this Quarterly Report on Form 10-Q/A 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 improvements to our general and administrative functions; 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 beliefs and intentions about entering into agreements to provide products and services to retail chains and other businesses; our belief regarding potential development of new Websites; our beliefs, intentions and expectations regarding promotion of new or complimentary products and sales formats; our beliefs, 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 other legal proceedings,and our defenses and responses to such matters; our beliefs and expectations regarding our existing cash and cash equivalents, cash requirements and sufficiency of capital; and our beliefs and expectations regarding interest rate risk, our investment activities and the effect of changes in interest rates.

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 the Factors That May Affect Future Results section of this report. 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.

Restatement

As discussed in Note 2 to the financial statements, the financial statements for the quarters ended September 30, 2004 and 2005 and the related notes thereto contained in this Amendment No. 1 to the Company s Quarterly Report on Form 10-Q/A for the quarters ended September 30, 2004 and 2005 have been restated in order to properly reflect the capitalization of inbound freight as a component of inventory rather than as a period cost. The cumulative effect of the adjustments for all fiscal years prior to 2002 is to reduce the reported accumulated deficit and to increase inventory by $239,000. The effect of the adjustments on the Consolidated Results of Operations for the years ended December 31, 2002, 2003 and 2004 is to reduce net loss by $241,000, $339,000 and $462,000, respectively. The effect of the adjustment on the consolidated results of operations for the three-month periods ended September 30, 2004 and 2005 is to decrease net loss by $103,000 and $1.8 million, respectively. All amounts in Management s Discussion and Analysis of Financial Condition and Results of Operation have been adjusted, as appropriate, for the effects of the restatement.

A more complete discussion of the restatement can be found in Item 4.02(a) of the Company s Current Report on Form 8-K filed with the Commission on February 27, 2006.

Overview

We are an online closeout retailer offering discount brand name merchandise, including bed-and-bath goods, home décor, kitchenware, watches, jewelry, electronics, sporting goods, apparel, designer accessories and travel, among other products. We also sell books, magazines, CD s, DVD s, videocassettes and video games (BMV). Our company, based in Salt Lake City, Utah, was founded in 1997, and we launched our first Website through which customers could purchase products in March 1999. In September 2004, we launched an online auction site as part of our Website an online marketplace for the buying and selling of goods between our customers.

Our revenue is comprised of direct revenue and fulfillment partner revenue. During the quarter ended September 30, 2005, no single customer accounted for more than 1% of our total revenue. Direct revenue includes sales made to individual consumers and businesses, which are fulfilled from our warehouse in Salt Lake City, Utah or our outsourced warehouse located in Plainfield, Indiana.

Our fulfillment partner revenue is generated when 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 we assume the risk of loss on the returned items. As a consequence, we record revenue from the majority of these sales transactions involving our fulfillment partners (excluding travel products) on a gross basis. Similar to our direct segment, fulfillment partner products are available to both consumers and businesses through our Club O frequent buyers club program and our Club O Gold bulk purchase program. 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.

During the fourth quarter of 2003, we added a discount travel store to our Website. We used fulfillment partners to supply the travel products and services (flights, hotels, rental cars, etc.). For the first and second quarters of 2004, our revenues from the Travel department were insignificant. During May of 2004, our travel store was closed so we could work to make improvements to the travel product offerings. In January 2005, we re-opened the travel store on our Website. We currently offer air, hotel and car reservation services as well as cruise and vacation packages.

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). In addition, the Company may be subject to additional earn out payments (based on a percentage of operating profits for each of the next four years as follows: 50%, 33.3%, 20%, and 10%, respectively), subject to reduction under certain circumstances, pursuant to a Stock Purchase Agreement dated June 24, 2005 among the Company, Ski West, and all of the shareholders of Ski West.

Ski West is an on-line travel company whose proprietary technology provides easy consumer access to a large, fragmented, hard-to-find inventory of lodging, vacation, cruise and transportation bargains. The travel offerings are primarily in popular ski areas in the U.S. and Canada, with more recent expansion into the Caribbean and Mexico, as well as cruises.

Effective upon the closing, Ski West became a wholly-owned subsidiary of the Company, integrated the Ski West travel offerings with the Company s existing travel offerings and changed its name to OTravel.com, Inc.

OTravel.com generates merchant hotel revenues. Merchant hotel revenues at OTravel.com are billed to customers and recognized on a net basis at the time of booking since all transactions are nonrefundable and generally noncancelable and OTravel.com has no significant post-delivery obligations. A reserve for chargebacks and cancellations is recorded at the time of the transaction based on historical experience.

All other revenues are considered agency revenues and relate to the Company s existing travel operations. Agency revenues are derived from airline ticket transactions, certain hotel transactions as well as cruise and car rental reservations. Agency revenues are recognized on a net basis on air transactions when the reservation is made and secured by a credit card. A cancellation allowance is recognized on these revenues based on historical experience. OTravel.com recognizes agency revenues on hotel reservations, cruise and car rental reservations, either on an accrual basis for payments from a commission clearinghouse or on receipt of commissions from an individual supplier.

During September 2004, we added an online auction service to our Website. Our auction tab allows sellers to list items for sale, buyers to bid on items of interest, and users to browse through listed items online. We are not the seller of the items sold on the auction site and we have no control over the pricing of those items. Therefore, for these sales we record only our listing fees and commissions for items sold as revenue. Unless otherwise indicated or required by the context, the discussion herein of our financial statements, accounting policies and related matters, pertains to our shopping site and not necessarily to our auction site. Revenue from our auction business is included in the fulfillment partner segment, as it is not significant enough to separate out as its own segment at this early stage of the business.

Our revenue from sales on our shopping site is recorded net of returns, coupons and other discounts. Our returns policy for all products other than those sold in our Electronics and Computers department provides for a $4.95 restocking fee and the provision that we will not accept product returns initiated more than twenty days after the shipment date. We charge a 15% restocking fee (instead of the $4.95 restocking fee) on all items returned for non-defective reasons from the Electronics and Computers department.

Cost of goods sold consists of the cost of the product, as well as inbound and outbound freight, fixed warehouse costs, warehouse handling costs, credit card fees, and customer service costs. Within the direct revenue channel, our gross margins on sales through our Club O frequent buyers club, our Club O Gold bulk purchases program and our BMV products tend to be lower than margins on our consumer sales, and our overall gross margins will be impacted by the blend of Club O, Club O Gold, and BMV sales as a percentage of our direct revenue.

Sales and marketing expenses consist primarily of advertising, public relations and promotional expenditures, as well as payroll and related expenses 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 our offline national radio and television advertising. For the three months ended September 30, 2004 and 2005, our advertising expenses totaled approximately $9.2 million and $17.2 million, respectively, representing 96% of sales and marketing expenses for both those respective periods. For the nine months ended September 30, 2004 and 2005, our advertising expenses totaled approximately $19.5 million and $47.7 million, respectively, representing 95% and 98% of sales and marketing expenses for those respective periods. We expect our sales and marketing expenses to increase in future periods on an absolute dollar basis as we expect to continue to increase our advertising efforts.

Technology expenses consist of wages and benefits for technology personnel, rents, utilities, connectivity charges and depreciation and amortization related to software and computer equipment.

General and administrative expenses consist of wages and benefits for executive, accounting, merchandising and administrative personnel, rents and utilities, travel and entertainment, depreciation and amortization of intangible assets and other general corporate expenses.

Goodwill is not amortized, but is evaluated at least annually for impairment. There was no impairment of goodwill during the nine months ended September 30, 2004 and 2005. The Company acquired $10.4 million of goodwill in conjunction with the acquisition of Ski West, Inc.

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.

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.

Restatement

As discussed in Note 2 to the financial statements, the financial statements and related notes thereto contained in the Company s Quarterly Report on Form 10-Q for the three month period September 30, 2005 and the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2004 have been restated. This document should be read in conjunction with the Management s Discussion and Analysis section of Amendment No. 1 to our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2004. All amounts in the Management s Discussion and Analysis of Financial Condition and Results of Operations have been adjusted, as appropriate, for the effects of this restatement.

Executive Commentary

The following 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 Operation, as well as our audited financial statements included in our Annual Report on Form 10-K/A for the year ended December 31, 2004 and our unaudited financial statements included in this Quarterly Report on Form 10-Q/A as well as the discussion of our business and risk factors and other information included elsewhere in this Form 10-Q/A. This executive commentary includes forward-looking statements, and investors are cautioned to read the Special Note Regarding Forward-Looking Statements included in this Form 10-Q/A.

Commentary: ERP systems upgrade. During the quarter, we went live with a large systems upgrade. We anticipated that as part of the implantation, a small number of background processes would fail, but we experienced more issues than expected. As a result, we put our focus on resolving customer-facing issues (processing orders, shipping products and handling returns) versus internal issues. However, one internal issue was that we were unable to put new products on our site for a five-week period during the quarter, which gradually reduced the number of products on site, resulting in lower site conversion and sales. Once we were able to upload new products in mid-September, sales and site conversion moved back to previous levels.

In addition, other IT projects that were supposed to lift margins through improved efficiencies in logistics or customer service were either late or remain incomplete because the work required to address the ERP implementation eventually monopolized development resources. Other projects such as personalization of the website (Project Propeller) that were supposed to yield marketing gains also went unfinished. Our focus will continue to be the new ERP system through the end of 2005, but we anticipate having the resources necessary to address these additional projects during 2006.

Commentary Growth in Revenue. Total revenue was $169.3 million for the three-month period ended September 30, 2005, a 63.7% increase from the $103.4 million recorded during the same period in 2004. For the nine-month period ended September 30, 2005, total revenue grew 77.8% to $485.8 million from $273.3 million recorded in the same period in 2004.

Commentary Improved Gross Margins and Growth in Gross Profits. Gross margins increased from 13.4% in the third quarter of 2004 to 15.7% during the third quarter of 2005. For the nine-month periods ended September 30, 2004 and 2005, margins improved from 11.8% to 15.2%, respectively.

The improvements in gross margins are a result of the progress we achieved and efficiencies gained in several areas over the last six quarters. In particular, we believe our buying has become more effective as we continue to grow, allowing us to make larger inventory purchases and obtain more favorable pricing. Our total cost per package shipped has decreased due to better process management and lower packaging costs, and as a result of increased sales volumes. As a result of increased volumes and improved vendor relationships, we have obtained decreases in outbound shipping costs. Additionally, we have also made improvements to the cost of processing returns, customer service costs and credit card fees. Management continues to believe that additional improvements can be made in shopping gross margins; in particular as a result of technology projects currently being implemented. In addition, gross margins will increase as the auctions and travel businesses grow, as revenues are recorded net and therefore have much higher gross margins than the traditional shopping business.

Commentary Marketing. Sales and marketing expenses totaled $9.4 million and $17.9 million for the quarters ended September 30, 2004 and 2005, respectively, representing an increase of 91.5%. For those respective three-month periods sales and marketing expenses equaled 9.1% and 10.6% of total revenue. For the nine months ended September 30, 2004 and 2005, sales and marketing expenses increased 141.8%, from $20.4 million to $49.3 million, respectively. As a percentage of total revenue, sales and marketing expenses represent 7.5% and 10.1% for the nine months ended September 30, 2004 and 2005, respectively.

Management believes that our extensive marketing efforts directly resulted in a continued rapid growth in Website traffic (49% year over year for the third quarter, according to Nielsen Net Ratings). However, some of the increase has been in lower-converting traffic as well as traffic to our auctions and travel tabs. Additionally, as a result of a systems implementation that occurred during the third quarter, we were unable to load new products onto the website for five weeks. We believe this had a negative effect on overall site conversion, and therefore our marketing spend was less effective in the third quarter than we had expected. However, once we were able to get new products onto the site during the last two weeks of the quarter, we saw site conversion move back to previous levels.

Commentary Technology expenses . Technology costs increased 252.2%, from $2.3 million in the third quarter of 2004 to $8.1 million in third quarter of 2005. For the nine months ended September 30, 2004 and 2005, technology costs increased 234.1%, from $5.5 million to $18.3 million, respectively.

We have incurred a stair-step increase in technology costs during 2005 in an effort to prepare us for the next growth period of our lifecycle. The increase in absolute dollars was primarily attributable to the increase in hardware, software and personnel costs, and depreciation associated with the new infrastructure, including expansion of corporate systems, including a database site license and the related reimplementation and development of our overall system architecture. The increase in technology expenses also included the costs associated with the strategic projects of 2005, namely the development of an enterprise data warehouse and customer analytics system, completion of our auctions tab, reconstruction of our travel website, and development of our search engine and keyword management application.

As we have done throughout the current year, we intend to continue investing in technology; however, we do not expect the similar stair-step increases in technology expense seen in 2005 to continue, and we expect overall capital expenditures to decrease as a percentage of sales in the near future. However, we will continue to invest in additional functionality for our newly expanded infrastructure.

Commentary General and Administrative Expenses. General and administrative expenses increased 96% from $5.1 million in the third quarter of 2004 to $10.0 million during the third quarter of 2005, representing 4.9% and 5.9% of total revenue, respectively. General and administrative expenses increased 81.1% from $13.7 million during the nine month period ending September 30, 2004 to $24.9 million in the same period ended September 30, 2005, representing 5.0% and 5.1% of total revenue for each of those respective periods.

The increase in general and administrative expenses in the third quarter of 2005 and for the three quarters ended September 30, 2005 relate to the increase in payroll and related expenses and professional fees, primarily in merchandising and finance. In the third quarter of 2005, we relocated our corporate offices to larger facilities to allow for future growth. As a result we expect an additional rent expense of approximately $1 million quarterly.

On July 1, 2005, we completed our acquisition of Ski West and consolidated its operations into our travel business at that time. Ski West s operations contributed an additional $1.6 million of general and administrative expenses and an additional $700,000 of expense related to the amortization of the purchase price to intangible assets.

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 allowance for obsolete and damaged inventory;

accounting for income taxes

valuation of long-lived and intangible assets and goodwill; and

derivative instruments

Revenue recognition. We derive our revenue from four sources: (i) direct revenue, which consists of merchandise sales made to consumers and businesses that are fulfilled from our warehouse; (ii) fulfillment partner revenue, which consists of revenue from the sale of merchandise shipped by fulfillment partners directly to consumers and other businesses, as well as fee revenue collected from the products listed and sold through the auction tab of our Website; and (iii) merchant hotel revenues; and (iv) commission revenue from our auctions and agency travel operations. All sources of revenue are recorded net of returns, coupons redeemed by customers, and other discounts. Revenues from our auction and travel services were not material in 2004 or 2005 and therefore are included in fulfillment partner revenue.

We record revenue from the majority of these sales transactions involving our fulfillment partners (excluding auction and travel products) on a gross basis. Similar to our direct revenue segment, fulfillment partner products are available to both consumers and businesses through our Club O frequent buyers club and our Club O Gold bulk purchase program.

For sales transactions, we comply with the provisions of Staff Accounting Bulletin 104 Revenue Recognition , which states that revenue should be recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) the product has been shipped or the service provided and the customer takes ownership and assumes the risk of loss; (3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. We generally require payment by credit card at the point of sale. Amounts received prior to when we ship the goods or provide the services to customers are recorded as deferred revenue. In addition, amounts received in advance for Club O and Club O Gold membership fees are recorded as deferred revenue and recognized over the membership period.

Accounting for merchant and agency revenues for our Travel subsidiary

The determination of gross versus net presentation is based principally on the company s consideration of Staff Accounting Bulletin No. 101 Revenue Recognition in Financial Statements and Emerging Issues Task Force Issue No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, including the weighing of the relevant qualitative factors regarding the company s status as the primary obligor, and the extent of pricing latitude and inventory risk. The method of merchant revenue presentation by the Company does not impact operating profit, net income, or cash flows, but rather revenues and cost of sales.

The principle factor in determining gross versus net presentation was the consideration of who is the primary obligor in the relationship with the customer. Our Travel business provides extensive customer service and support for its customers; however, the supplier hotel is principally liable to its merchant hotel customers in all situations where the customer does not receive the hotel services booked through OTravel.com. In this case, OTravel.com provides customer service support to help resolve issues, even though such customer support could typically involve issues for which OTravel.com is not principally liable.

OTravel.com generates both merchant hotel revenues and agency air, hotel, car and cruise revenues. Merchant hotel revenues are recognized as net revenue at the time of booking since all transactions are billed directly to customers, are nonrefundable and generally non-cancelable, and require no significant post-delivery obligations for OTravel.com. A reserve for charge-backs and cancellations is recorded at the time of the transaction based on historical experience.

Agency revenues are derived from airline ticket transactions, certain hotel transactions as well as cruise and car rental reservations. Agency revenues are recognized on a net basis on air transactions when the reservation is made and secured by a credit card. A cancellation allowance is recognized on these revenues based on historical experience. OTravel.com recognizes agency revenues on hotel reservations, cruise and car rental reservations, either on an accrual basis for payments from a commission clearinghouse or on receipt of commissions from an individual supplier.

Reserve for returns, allowance for doubtful accounts and the allowance for obsolete and damaged inventory. Our management must make estimates of potential future product returns related to current period revenue. 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 and $1.7 million as of December 31, 2004 and September 30, 2005, respectively.

From time to time, we may grant credit to certain of our business customers on normal credit terms. 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 $750,000 and $1.1 million as of December 31, 2004 and September 30, 2005, respectively.

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. Our inventory balance was $46.6 million, net of allowance for obsolescence or damaged inventory of $1.3 million as of December 31, 2004. At September 30, 2005, our inventory balance was $98.1 million, net of reserve for obsolescence or damaged inventory of $2.1 million.

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, 2004 and September 30, 2005, we have recorded a full valuation allowance of $27.4 million and $34.6 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 periods, we may need to change the valuation allowance, which could materially impact our financial position and results of operations.

Valuation of long-lived and intangible assets and goodwill. Under SFAS 142, Goodwill and Other Intangible Assets, goodwill is no longer 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. There was no impairment of goodwill or long-lived assets during the nine months ended September 30, 2005. Goodwill totaled $2.8 million and $13.2 million as of December 31, 2004 and September 30, 2005. The Company added an additional $10.4 million in conjunction with the acquisition of Ski West, Inc. on July 1, 2005.

Derivative instruments. SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133), requires companies to recognize all of its derivative instruments, including certain derivative instruments embedded in other contracts, as either assets or liabilities in the balance sheet at fair value. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, a cash flow hedge or a hedge of a net investment in an international operation. For derivatives designated as hedges, the changes in fair value are recorded in the balance sheet as an item in other comprehensive income. Changes in the fair value of derivatives not designated as hedges are recorded in the statement of operations. As of September 30, 2005, we have not designated any derivative instruments as hedges.

Results of Operations 2004 compared to 2005

Revenue

Total revenue was $169.3 million for the three-month period ended September 30, 2005, a 63.7% increase from the $103.4 million recorded in the same period in 2004. During this same period, direct revenue increased from $43.9 million to $68.4 million, a 55.8% growth. Fulfillment partner revenue grew 69.5%, from $59.5 million in the third quarter of 2004 to $100.9 million in 2005. For the nine-month periods, total revenue grew 77.8% from $273.3 million in 2004 to $485.8 million recorded in 2005. During the same nine-month periods, direct revenue grew 58.9% from $123.6 million to $196.4 million in 2005 and fulfillment revenue grew 93.4% from $149.7 million to $289.4 million.

Gross bookings totaled $114.4 million and $179.5 million for the quarters ended September 30, 2004 and 2005, respectively, representing an increase of 56.9%. For the nine-month periods ended September 30, 2004 and 2005, gross bookings totaled $304.4 million and $527.5 million, respectively, representing an increase of 73.3%. Gross bookings differ from GAAP revenue in that gross bookings represent the gross sales price of goods sold (excluding auctions and travel) by the Company before returns and sales discounts.

Our total revenue for the three and nine month periods ended September 30, 2005, increased as a result of our normal online marketing efforts as well as offline efforts through channels such as nation-wide television, print and radio advertising campaigns. In addition, total revenue benefited from extended discounted shipping promotions run during the months of March, May and six weeks of the third quarter of 2005. Although we experienced overall revenue growth, the rate of growth slowed due to decreased conversion rates during the last half of the quarter. We believe this was primarily the result of a five-week delay in adding new products to the site as a result of an upgrade to our information systems during the quarter

The increase in total revenue is also a reflection of our ability to acquire new customers from our marketing efforts, as evidenced by the addition of 703,000 new customers during the third quarter of 2005 compared to 514,000 new customers in the same quarter of 2004, an increase of 36.8%.

Gross Margins

Total Gross Margins - Cost of goods sold increased 59.3% in absolute dollars from $89.6 million during the third quarter of 2004 to $142.8 million during the same quarter of 2005. In comparing the third quarters of 2004 and 2005, total revenue increased 63.7%, from $103.4 million to $169.3 million, while gross profit dollars increased 91.8%, from $13.9 million to $26.6 million in those same periods. As a percent of total revenue, cost of goods sold decreased from 86.6% to 84.3% for those respective periods resulting in gross margins of 13.4% and 15.7% for the three months ended September 30, 2004 and 2005, respectively.

For the nine-month periods ended September 30, 2004 and 2005, cost of goods totaled $241.0 million and $411.8 million, respectively, representing an improvement in margins from 11.8% to 15.2%, respectively. In dollar terms, gross margins totaled $32.3 million and $74.0 million for the nine months ended September 30, 2004 and 2005, respectively, a 129.1% increase.

Direct Gross Margins - Gross profits for our direct business increased 41.1% from $5.4 million for the quarter ended September 30, 2004 to $9.3 million recorded during the same period in 2005. Direct revenue increased 55.8% from $43.9 million in the quarter ended September 30, 2004 to $68.4 million in the same quarter ended September 30, 2005. Gross profits as a percentage of direct revenue were 12.4% and 13.6% for the third quarters ended September 30, 2004 and 2005, respectively.

For the nine months ended September 30, 2004 and 2005, gross profit dollars for our direct business increased 101.1% from $13.6 million to $27.4 million, representing gross margins of 11.1% and 12.8%, respectively. Sales increased 58.9%, from $123.6 million to $196.4 million for those same comparative periods.

The improvements in direct gross margins year over year are a result of the progress and efficiencies gained in several areas. We believe our buying has become more effective as we continue to grow, allowing us to purchase at more favorable product pricing when compared to prior years. In addition, we have made improvements to our fulfillment costs in the current year, including warehouse handling costs and credit card fees.

We experienced a slight decrease in gross margins in the second and third quarters of 2005. Discounted shipping promotions in March and May and during six weeks of the third quarter of 2005 reduced shipping revenue, and we experienced inefficiencies in warehouse operations as a result of the third quarter systems upgrade.   These decreases in gross margins were offset by a 50 basis point increase in gross margins from the addition of Ski West to our existing travel operations.

Fulfillment Partner Gross Margins - Our fulfillment partner business generated gross profits of $8.4 million and $17.3 million for the quarters ended September 30, 2004 and 2005, respectively, an increase of 105.5%. Gross profits as a percentage of fulfillment partner revenue increased from 14.1% during the third quarter of 2004 to 17.1% during the same quarter of 2005. For the nine months ended September 30, 2004 and 2005, gross profits increased 149.6% from $18.7 million to $46.6 million, representing gross margins of 12.5% and 16.1%, respectively.

The increase in gross profit dollars for our fulfillment partner operations was due to the general growth of the consumer business during the year, and an increase in the number of fulfillment partner products offered on our Websites. The increase in gross margins is largely due to improvements in product costs and credit card fees, as well as a decrease in BMV gross bookings from 11.5% of total fulfillment partner bookings during the first three quarters of 2004, to 10.0% during the first three quarters of 2005.

Gross margins for BMV products have historically been much lower than those of other product categories; however, we have made improvements in BMV margins in 2005, which, in turn, increased the gross profit margin for the overall fulfillment partner operations.

Travel Gross Margins - Gross profit dollars for the travel operations were $1.2 million for the quarter ended September 30, 2005. The gross profit dollars generated by the travel business this quarter are primarily a result of merchant hotel revenue related to the operations of Ski West, which we acquired on July 1, 2005. Since revenues from these sales are recorded on a net basis, they result in lower revenue but higher gross margins (81% in the third quarter). If travel sales continue to increase, the higher gross margins will positively impact future gross margins for the overall business.

Fulfillment

Fulfillment costs during the third quarters of 2004 and 2005 were $7.7 million and $13.3 million, respectively, or 7.4% and 7.8% of total revenue for those respective periods. For the nine months ended September 30, 2004 and 2005, fulfillment costs were $20.9 million and $36.1 million, respectively, representing 7.6% and 7.4% of total revenue for those respective periods. Fulfillment costs include warehousing (excluding packaging costs), customer service costs and credit card fees.

Fulfillment costs as a percentage of sales may vary due to several factors, such as our level of productivity and accuracy, changes of units received and fulfilled, the extent we utilize third party fulfillment services and warehouses, and our ability to reduce customer service contacts per transaction by implementing improvements in our operations and customer service.

	Three months ended September 30,		Nine months ended September 30,	
	2004	2005	2004	2005
Total revenue	$ 103,444	$ 169,323	$ 273,314	$ 485,842
Cost of goods sold:				
Product costs, freight costs and other cost of good sold	81,927	129,469	220,113	375,691
Fulfillment costs	7,667	13,290	20,892	36,122
Total cost of goods sold	89,594	142,759	241,005	411,813
Gross profit	$ 13,850	$ 26,564	$ 32,309	$ 74,029

Operating expenses

Sales and marketing. Sales and marketing expenses totaled $9.4 million and $18.0 million for the quarters ended September 30, 2004 and 2005, respectively, representing an increase of 91.5%. For the three month periods ended September 30, 2004 and 2005, sales and marketing expenses equaled 9.1% and 10.6%, respectively, of quarterly total revenue. For the nine months ended September 30, 2004 and 2005, sales and marketing expenses increased 141.8%, from $20.4 million to $49.3 million, respectively. As a percentage of total revenue, sales and marketing expenses represent 7.5% and 10.1% for the nine months ended September 30, 2004 and 2005, respectively.

We direct customers to our websites primarily through a number of targeted online marketing channels, such as sponsored search, portal advertising, e-mail campaigns, and other initiatives. We also utilize channels such as nation-wide television, print and radio advertising campaigns. Our marketing expense is variable and is measured as a percentage of overall sales.

Overall online marketing spend has increased in absolute terms in the third quarter of 2005 and the three quarters ended September 30, 2005 compared to prior periods as a result of increased online marketing rates during 2004 and 2005, and an increase in our ongoing online marketing efforts, particularly with the large portals (MSN, Yahoo & AOL), and keyword search (Google). In addition, we continued our television, print and radio campaigns through the third quarter of 2005. Our marketing costs have also increased as a percentage of sales due to marketing efforts in our auctions and travel businesses. Since we record revenues in these businesses on a net basis, they typically have higher marketing expenses as a percent of revenue. These businesses currently account for 100 basis points of total marketing costs as a percent of sales.

While costs associated with our discounted shipping promotions are not included in marketing expense, we consider discounted shipping promotions as an effective marketing tool, and intend to continue to offer them as we deem appropriate.

Technology expenses. Technology expenses increased 256.3%, from $2.3 million in the third quarter of 2004 to $8.1 million in the third quarter of 2005. For the nine months ended September 30, 2004 and 2005, technology costs increased 234.1%, from $5.5 million to $18.3 million respectively.

We have incurred a stair-step increase in technology costs during 2005 in an effort to prepare us for the next growth period of our lifecycle. The increase in absolute dollars was primarily attributable to the increase in hardware, software and personnel costs, and depreciation associated with the new infrastructure, including expansion of corporate systems, such as a database site license and the related reimplementation and development of our overall system architecture. The increase in technology expenses also included the costs associated with the strategic projects of 2005, namely the development of an enterprise data warehouse and customer analytics system, completion of our auctions tab, reconstruction of our travel website, and development of our search engine and keyword management application.

As we have done throughout the current year, we intend to continue investing in technology; however, we do not expect the stair-step increases in technology expense seen in 2005, and we expect overall capital expenditures to decrease as a percentage of sales in the near future. However, we will continue to invest in additional functionality for our newly expanded infrastructure.

General and administrative expenses. General and administrative expenses increased 95.6% from $5.1 million in the third quarter of 2004 to $10.0 million during the third quarter of 2005, representing 4.9% and 5.9% of total revenue, respectively. For the nine-month periods, general and administrative expenses increased 81.1% from $13.7 million in 2004 to $24.9 million in 2005, representing 5.0% and 5.1% of total revenue for those respective periods.

The increase in general and administrative expenses in the third quarter of 2005 and for the three quarters ended September 30, 2005 relate to the increase in payroll and related expenses and professional fees, primarily in merchandising and finance. In the third quarter of 2005, we relocated our corporate offices to larger facilities to allow for future growth. As a result we expect an additional rent expense of approximately $1.0 million quarterly.

On July 1, 2005, we completed our acquisition of Ski West (and renamed it OTravel.com, Inc.) and consolidated its operations into our travel business. Ski West s operations contributed an additional $1.6 million of general and administrative expenses and an additional $700,000 of expense related to the amortization of intangible assets.

Amortization of stock-based compensation. Prior to the Company s initial public offering in May 2002, the Company recorded unearned stock-based compensation related to stock options granted below the fair market value of the underlying stock. Since the initial public offering, the Company has not granted any additional stock options below fair market value. Amortization of stock-based compensation was approximately $18,000 for the three months ended September 30, 2005 and a reversal of $8,000 for the same period in 2005. The reversal was a result of forfeitures of unvested options for which compensation expenses had been previously recorded. For the nine months ended September 30, 2004 and 2005, amortization of stock-based compensation totaled $276,000 and $65,000, respectively.

Non-operating income (expense)

Interest income, interest expense and other income (expense).

The primary component of our net interest income (expense) relates to the interest derived from the investment of our excess cash in marketable securities offset by interest expense related to the convertible debt, letters of credit, capital leases, and other related fees. Additionally, we incurred a large expense during the quarter related to the valuation of the conditional coupon of our foreign bonds. Interest income and other decreased from $168,000 in the third quarter of 2004 to $1.7 million negative interest income in the third quarter of 2005. For the nine months ended September 30, 2004 interest income (expense) decreased from $393,000 of interest income to negative interest income of $150,000 because of the valuation of our foreign bonds. For the quarter ended September 30, 2005 the valuation of the conditional coupon of our foreign bonds resulted in a loss of $2.1 million, and a loss of approximately $2.4 million for the nine months ended September 30, 2005. See Item 1 of Part 1, Financial Statements Note 4 Marketable Securities .

Interest expense is comprised largely of interest expense related to our convertible notes, capital leases and our line of credit. Interest expense increased from $77,000 during the third quarter of 2004 to $1.3 million during the third quarter of 2005, primarily as a result of the interest expense from our convertible senior notes issued in November 2004. For the nine months ended September 30, 2004 and 2005, interest expense totaled $139,000 and $4.2 million, respectively.

We recorded other income, net of $3,000 and $11,000 during the third quarters of 2004 and 2005, respectively. For the nine months ended September 30, 2004 and 2005, other income totaled $5,000 and $4.2 million, respectively. The $4.2 million gain incurred in the nine months ended September 30, 2005 relates the retirement of $33.0 million of the 3.75% Convertible Senior Notes which occurred during the second quarter of 2005. See Item 1 of Part 1, Financial Statements Note 13 3.75% Convertible Senior Notes .

Income taxes

Income taxes. For the three and nine months ended September 30, 2004 and 2005, we incurred net operating losses, and consequently paid insignificant amounts of federal, state and foreign income taxes. As of December 31, 2004 and September 30, 2005, we had $73.1 million and $91.3 million, respectively, of net operating loss carryforwards, of which $21.9 million is subject to limitation. These net operating loss carryforwards will begin to expire in 2019.

Recent Accounting Pronouncements

In March 2005, the Financial Accounting Standards Board (FASB) issued FIN 47 which clarifies guidance provided by Statement No. 143, Accounting for Asset Retirement Obligations. FIN 47 is effective for the Company no later than March 31, 2006. The adoption of FIN 47 is not expected to have a significant impact on our financial position, results of operations or cash flows.

In December 2004, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 123 (revised 2004) *Share-Based Payment* (Statement FAS 123R). This standard requires companies to measure and recognize the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value. The effective date is the first annual reporting period beginning after June 15, 2005. We are currently evaluating pricing models and the transition provisions of this standard and will begin expensing all stock-based compensation in the first quarter of 2006.

On March 29, 2005, the SEC published Staff Accounting Bulletin (SAB) No. 107, which provides the Staffs views on a variety of matters relating to the interaction between Statement 123R and certain Securities and Exchange Commission Rules and regulations. We are currently evaluating the provisions of the SAB and will implement it when we begin expensing stock options under Statement 123R in the first quarter of 2006.

In March 2004, the FASB issued EITF Issue No. 03-1 (EITF 03-1), *The Meaning of Other-than-Temporary Impairments and its Application to Certain Investments,* which provides new guidance for assessing impairment losses on investments. Additionally, EITF 03-1 includes new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB delayed the accounting provisions of EITF 03-1; however, the disclosure requirements remain effective for annual periods ending after June 15, 2004. We will evaluate the impact of EITF 03-1 once final guidance is issued.

On June 7, 2005, the FASB issued Statement No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements (FAS 154). FAS 154 changes the requirements for the accounting for, and reporting of, a change in accounting principle. Previously, most voluntary changes in accounting principles were required to be recognized by way of a cumulative effect adjustment within net income during the period of the change. FAS 154 requires retrospective application to prior periods financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. FAS 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, the Statement does not change the transition provisions of any existing accounting pronouncements. We do not believe adoption of FAS 154 will have a material effect on our consolidated financial position, results of operations or cash flows.

Seasonality

Financial results for Internet retailers are generally seasonal. Based upon the Company s historical experience, increased revenues typically occur during the fourth quarter because of the Christmas 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 the Company s results of operations in the future. The following table reflects the Company s revenues for each of the quarters available since 2002 (in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2005	$ 165,881	$ 150,638	$ 169,323	
2004	82,078	87,792	103,444	$ 221,321
2003	29,164	28,833	57,788*	123,160
2002	12,067	14,380	23,808	41,529

* Note that beginning in the third quarter of 2003, total revenue reflects the change in the Company s returns policy, as a result of which sales by fulfillment partners are now recorded gross instead of net as in prior quarters.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Liquidity and Capital Resources

Prior to the third quarter of 2002, we financed our activities primarily through a series of private sales of equity securities, warrants to purchase our common stock and promissory notes. During the second quarter of 2002, we completed our initial public offering pursuant to which we received approximately $26.1 million in cash, net of underwriting discounts, commissions, and other related expenses. Additionally, we completed follow-on offerings in February 2003, May 2004 and November 2004, pursuant to which we received approximately $24.0 million, $37.9 million and $75.2 million, respectively, in cash, net of underwriting discounts, commissions, and other related costs. In November 2004, we also received $116.2 million in proceeds from the issuance of our convertible senior notes. At September 30, 2005, our cash and cash equivalents balance was $2.6 million and our marketable securities totaled $74.2 million.

Our operating activities resulted in cash outflows of $927,000 and $19.9 million for the quarters ended September 30, 2004 and 2005, respectively. For the nine months ended September 30, 2004 and 2005, operating activities resulted in cash outflows of $12.4 million and $65.2 million, respectively. The primary operating uses of cash and cash equivalents during the first nine months of 2005 was to fund our operations, including net losses of $18.6 million, increases in inventory of $51.6 million as we prepare for the fourth quarter holiday sales season, prepaid expenses of $5.8 million and the change in accounts payable of $17.9 million. This was offset by the change in accounts receivable and accrued liabilities of $7.0 million and $22.0 million, respectively.

Cash used in investing activities totaled $31.3 million and $47.4 million for the nine months ended September 30, 2004 and 2005, respectively. The cash outflow for investing activities was attributed to capital expenditures for property and equipment of $36.5 million and the acquisition of Ski West, Inc. for $24.6 million. Cash flows used in investing activities was offset by a net increase of $12.7 million from the purchases and sales of marketable securities.

Our financing activities resulted in net cash inflows of $41.9 million during the nine months ended September 30, 2004 and net cash outflows of $83.6 million for the same period in 2005. The cash outflows for financing activities for 2005 were due to $3.2 million in capital lease obligations, purchased call options totaling $47.5 million, payments on early extinguishment of debt of $27.9 million and purchase of treasury stock of $24.1 million. During that same period, we received proceeds from the exercise of stock options and warrants of $6.9 million and borrowed $4.4 million from our line of credit.

Contractual Obligations and Commitments

The following table summarizes our contractual obligations as of September 30, 2005 and the effect such obligations and commitments are expected to have on our liquidity and cash flow in future periods:

	Payments Due by Period (in thousands)				
Contractual Obligations	**Total**	**Less than 1 Year**	**1-3 Years**	**4-5 Years**	**After 5 years**
Long-term debt arrangements	$ 87,000	$	$	$	$ 87,000
Interest on convertible senior notes	21,469	1,894	6,525	6,525	6,525
Capital lease obligations	14,832	7,202	7,630		
Operating leases	72,796	5,488	13,749	15,407	38,152
Purchase obligations	52,500	52,500			
Total contractual cash obligations	$ 248,597	$ 67,084	$ 27,904	$ 21,932	$ 131,677

		Amounts of Commitment Expiration Per Period (in thousands)			
Other Commercial Commitments	**Total Amounts Committed**	**Less than 1 Year**	**1-3 Years**	**4-5 Years**	**Over 5 years**
Letters of credit	$ 6,918	$ 6,918	$	$	$
Redeemable common stock	3,306		3,306		
Total commercial commitments	$ 10,224	$ 6,918	$ 3,306	$	$

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, beginning June 1, 2005. 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 the ownership of the Company).

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 the Company, certain changes in the Company s 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.

In June 2005, under the Share Buyback Program (Note 11), the Company retired $33.0 million of 3.75% Convertible Senior Notes (the Senior Notes), which were due on December 1, 2011 for $27.9 million in cash. Interest on the notes was payable on June 1 and December 1 of each year. As a result of the note retirement, we recognized a gain of $4.2 million, net of the associated unamortized discount of $960,000. As of September 30, 2005, $87.0 million of Senior Notes remain outstanding.

The lease obligations include our obligations under a ten-year lease agreement we entered in December 2004 for approximately 143,000 square feet of office space in Salt Lake City. We took possession of the new office space in July of 2005, and terminated our lease obligations under our previous office lease agreements at the same time. The total lease obligation over the ten-year term of the new lease is $39.6 million, of which approximately $1.9 million will be payable in 2005. In connection with the preparation of the new office space, we have agreed to provide a letter of credit for $500,000 to provide funds for the removal of the improvements upon termination of the new sublease and have also agreed to pay approximately $2.0 million for leasehold improvements. We expect to pay this entire amount for leasehold improvements during 2005.

The amount of purchase obligations shown is based on assumptions regarding the legal enforceability against us of purchase orders we had outstanding at September 30, 2005. 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.

In December 2004, we replaced our senior secured credit facility by amending a facility we had with Wells Fargo Bank, National Association. On October 18, 2005 we entered into a Sixth Amendment (the Sixth Amendment) which increased the aggregate amount available under the credit facility from $20 million to $30 million. The Sixth Amendment also eliminated the requirement that the Company maintain specified cash balances with Wells Fargo as a condition to the availability of advances under the facility, and substituted collateral consisting of foreign bond securities owned by the Company in an aggregate principal amount of $50.0 million to secure the Company s obligations under the facility. The Sixth Amendment includes a $15.0 million sub-limit which we use to obtain letters of credit to support inventory purchases. At September 30, 2005 the issuing bank or an affiliate of the bank had letters of credit totaling $6.9 million issued on our behalf under this facility. We have an option to renew the Amended Credit Agreement annually. The Sixth Amendment increased the interest rate on fixed rate advances under the credit facility to 1.35% above LIBOR on the first day of each fixed rate term under the credit facility the interest rate.

The agreement governing the facility requires us to comply with certain covenants, including restrictions on mergers, business combinations or transfers of assets. We were in compliance with these covenants at September 30, 2005. At September 30, 2005, $4.4 million was outstanding under the facility and $6.9 million in letters of credit was outstanding.

The estimated amount of redeemable common stock is based solely on the statutes of limitations of the various states in which stockholders may have rescission rights and may not reflect the actual results. The stock is not redeemable by its terms. We do not have any unconditional purchase obligations, other long-term obligations, guarantees, standby repurchase obligations or other commercial commitments.

In January 2005, the Company s Board of Directors authorized a stock buyback program under which we may repurchase up to $50.0 million of our common stock through December 31, 2007. In April 2005, the Company s Board of Directors authorized an increase to the stock buyback program from $50.0 million to a total of $100.0 million. Additionally, on June 14, 2005, the Board of Directors amended the stock repurchase program to authorize the repurchase of our Convertible Senior Notes.

Under the buyback program, we repurchased approximately 665,000 shares of our common stock in open market transactions for $24.1 million during the nine months ended September 30, 2005. In addition, approximately 1.0 million shares of common stock were acquired as a result of the settlement of $41.1 million of structured stock repurchase transactions during the nine months ended September 30, 2005. The structured stock repurchase transactions not settled in stock were settled in cash totaling $7.9 million which we received in July 2005. These transactions are recorded in shareholder s equity in the accompanying consolidated balance sheets.

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. While we anticipate that, beyond the next twelve months, our expected cash flows from future operations will be sufficient to fund our operational requirements, 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, generate profitability or 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. See Factors that May Affect Future Results.

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 January 2005, we received an initial inquiry from the Federal Trade Commission (FTC) regarding our shipping policies, procedures, and practices and other matters. We responded to the initial inquiry, and we continue to cooperate with the FTC in providing additional information the FTC has requested in follow-up inquiries. We are currently unable to determine the potential outcome of this inquiry.

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 below, and all other information in this Form 10-Q/A and in our other filings with the SEC including those we file after we file this Form 10-Q/A, 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 following risks 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.

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.

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