OVERSTOCK.COM, INC
Form 10-Q
April 29, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2015

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	(801) 947-3100
(Address, including zip code, of Registrant's principal executive offices)	(Registrant's telephone number, including area code)

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

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

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

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

There were 24,276,099 shares of the Registrant's common stock, par value $0.0001, outstanding on April 20, 2015.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

Overstock.com, Inc.
Consolidated Balance Sheets (Unaudited)
(in thousands)

	March 31, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$124,322	$181,641
Restricted cash	505	580
Accounts receivable, net	15,651	18,963
Inventories, net	24,467	26,208
Prepaid inventories, net	4,174	3,214
Deferred tax assets, net	15,019	14,835
Prepaids and other current assets	10,928	12,621
Total current assets	195,066	258,062
Fixed assets, net	54,947	52,071
Precious metals	10,905	10,905
Deferred tax assets, net	48,887	50,331
Goodwill	2,784	2,784
Other long-term assets, net	7,809	2,712
Total assets	$320,398	$376,865
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$66,993	$112,787
Accrued liabilities	72,998	81,564
Deferred revenue	43,742	48,451
Total current liabilities	183,733	242,802
Other long-term liabilities	6,888	4,843
Total liabilities	190,621	247,645
Commitments and contingencies (Note 4)		
Stockholders' equity:		
Preferred stock, $0.0001 par value:		
Authorized shares - 5,000		
Issued and outstanding shares - none	—	—
Common stock, $0.0001 par value		
Authorized shares - 100,000		
Issued shares - 27,583 and 27,241		
Outstanding shares - 24,276 and 24,037	2	2
Additional paid-in capital	367,223	366,252
Accumulated deficit	(151,125)	(153,864)
Accumulated other comprehensive loss	(1,324)	(621)
Treasury stock:		
Shares at cost - 3,307 and 3,204	(84,885)	(82,531)
Equity attributable to stockholders of Overstock.com, Inc.	129,891	129,238
Equity attributable to noncontrolling interests	(114)	(18)

Total equity	129,777	129,220
Total liabilities and stockholders' equity	$320,398	$376,865

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.
Consolidated Statements of Income (Unaudited)
(in thousands, except per share data)

	Three months ended March 31, 2015	2014
Revenue, net		
Direct	$36,135	$38,047
Partner	362,209	303,160
Total net revenue	398,344	341,207
Cost of goods sold		
Direct(1)	32,527	33,097
Partner	290,380	244,114
Total cost of goods sold	322,907	277,211
Gross profit	75,437	63,996
Operating expenses:		
Sales and marketing(1)	27,972	23,392
Technology(1)	23,087	19,601
General and administrative(1)	20,534	15,296
Restructuring	—	(360)
Total operating expenses	71,593	57,929
Operating income	3,844	6,067
Interest income	43	41
Interest expense	(4)	(7)
Other income, net	605	459
Income before income taxes	4,488	6,560
Provision for income taxes	1,940	2,590
Consolidated net income	2,548	3,970
Less: Net loss attributable to noncontrolling interests	(191)	—
Net income attributable to stockholders of Overstock.com, Inc.	$2,739	$3,970
Net income per common share—basic:		
Net income attributable to common shares—basic	$0.11	$0.17
Weighted average common shares outstanding—basic	24,213	23,926
Net income per common share—diluted:		
Net income attributable to common shares—diluted	$0.11	$0.16
Weighted average common shares outstanding—diluted	24,390	24,339

(1) Includes stock-based compensation as follows (Note 6):

	2015	2014
Cost of goods sold — direct	$29	$40
Sales and marketing	59	81
Technology	120	170
General and administrative	570	632
Total	$778	$923

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.
Consolidated Statements of Comprehensive Income (Unaudited)
(in thousands)

	Three months ended March 31,	
	2015	2014
Consolidated net income	$2,548	$3,970
Other comprehensive loss:		
Unrealized loss on cash flow hedges, net of benefit for taxes of $438 and $0	(703)	—
Other comprehensive loss	(703)	—
Comprehensive income	1,845	3,970
Less: Comprehensive loss attributable to noncontrolling interests	(191)	—
Comprehensive income attributable to stockholders of Overstock.com, Inc.	$2,036	$3,970

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.
Consolidated Statements of Changes in Stockholders' Equity (Unaudited)
(in thousands)

	Three months ended March 31, 2015
Equity attributable to stockholders of Overstock.com, Inc.	
Number of common shares issued	
Balance at beginning of period	27,241
Common stock issued upon vesting of restricted stock	331
Exercise of stock options	11
Balance at end of period	27,583
Number of treasury stock shares	
Balance at beginning of period	3,204
Purchases of treasury stock	103
Balance at end of period	3,307
Total number of outstanding shares	24,276
Common stock	$2
Additional paid-in capital	
Balance at beginning of period	$366,252
Stock-based compensation to employees and directors	778
Exercise of stock options	193
Balance at end of period	$367,223
Accumulated deficit	
Balance at beginning of period	$(153,864)
Net income attributable to stockholders of Overstock.com, Inc.	2,739
Balance at end of period	$(151,125)
Accumulated other comprehensive loss	
Balance at beginning of period	$(621)
Net other comprehensive loss	(703)
Balance at end of period	$(1,324)
Treasury stock	
Balance at beginning of period	$(82,531)
Purchases of treasury stock	(2,354)
Balance at end of period	(84,885)
Total equity attributable to stockholders of Overstock.com, Inc.	$129,891
Equity attributable to noncontrolling interests	
Balance at beginning of period	$(18)
Net loss attributable to noncontrolling interests	(191)
Paid-in capital attributable to noncontrolling interests	95
Total equity attributable to noncontrolling interests	$(114)

Total equity	$129,777

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.
Consolidated Statements of Cash Flows (Unaudited)
(in thousands)

	Three months ended March 31,		Twelve months ended March 31,	
	2015	2014	2015	2014
Cash flows from operating activities:				
Consolidated net income	$2,548	$3,970	$7,379	$80,651
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Depreciation and amortization	5,376	3,795	19,645	14,454
Stock-based compensation to employees and directors	778	923	3,890	3,422
Deferred income taxes	1,698	2,317	3,122	(66,203)
Amortization of debt discount and deferred loan costs	39	—	39	13
Loss on investment in precious metals	—	—	1,269	1,457
Loss on investment in cryptocurrency	117	—	117	—
Restructuring reversals	—	(360)	—	(399)
Other	10	(5)	7	(26)
Changes in operating assets and liabilities:				
Restricted cash	—	—	1,000	75
Accounts receivable, net	3,312	211	185	15
Inventories, net	1,741	4,270	(1,694)	(1,238)
Prepaid inventories, net	(960)	139	(2,509)	323
Prepaids and other current assets	1,244	174	(385)	(1,824)
Other long-term assets, net	346	221	151	170
Accounts payable	(45,249)	(31,909)	8,312	12,000
Accrued liabilities	(10,359)	(13,718)	18,966	4,989
Deferred revenue	(4,709)	(478)	6,899	5,312
Other long-term liabilities	979	771	1,031	2,428
Net cash (used in) provided by operating activities	(43,089)	(29,679)	67,424	55,619
Cash flows from investing activities:				
Purchases of marketable securities	(3)	(12)	(14)	(69)
Sales of marketable securities	35	77	35	217
Purchases of intangible assets	(32)	(22)	(145)	(35)
Investment in precious metals	—	—	(2,496)	(8,080)
Investment in cryptocurrency	—	—	(300)	—
Equity method investment	(95)	—	(345)	—
Cost method investment	(5,000)	—	(5,000)	—
Expenditures for fixed assets, including internal-use software and website development	(6,612)	(6,195)	(41,763)	(18,200)
Proceeds from sale of fixed assets	—	—	43	—
Net cash used in investing activities	(11,707)	(6,152)	(49,985)	(26,167)
Cash flows from financing activities:				
Payments on capital lease obligations	(362)	—	(687)	—
Paydown on direct financing arrangement	(75)	(68)	(289)	(264)
Change in restricted cash	75	—	75	125
Proceeds from exercise of stock options	193	171	533	1,731
Purchase of treasury stock	(2,354)	(2,290)	(2,365)	(2,292)
Payment of debt issuance costs	—	—	(1,031)	—

Net cash used in financing activities	(2,523)	(2,187)	(3,764)	(700)
Net (decrease) increase in cash and cash equivalents	(57,319)	(38,018)	13,675	28,752
Cash and cash equivalents, beginning of period	181,641	148,665	110,647	81,895
Cash and cash equivalents, end of period	$124,322	$110,647	$124,322	$110,647

Continued on the following page

Overstock.com, Inc.
Consolidated Statements of Cash Flows (Unaudited)
(Continued)
(in thousands)

	Three months ended March 31,		Twelve months ended March 31,	
	2015	2014	2015	2014
Supplemental disclosures of cash flow information:				
Cash paid during the period:				
Interest paid	$8	$14	$41	$65
Taxes paid	72	—	148	263
Non-cash investing and financing activities:				
Fixed assets, including internal-use software and website development, costs financed through accounts payable and accrued liabilities	$2,659	$4,018	$2,659	$4,121
Equipment acquired under capital lease obligations	362	—	687	—
Capitalized interest cost	39	—	65	—
Change in value of cash flow hedge	1,141	—	2,149	—

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.
Notes to Unaudited Consolidated Financial Statements

1. BASIS OF PRESENTATION

As used herein, "Overstock," "Overstock.com," "O.co," "we," "our" and similar terms include Overstock.com, Inc. and our majority-owned subsidiaries, unless the context indicates otherwise. We have prepared the accompanying unaudited consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") 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 our audited annual consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2014. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are, in our opinion, necessary for a fair presentation of results for the interim periods presented. Preparing financial statements requires us 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 our best knowledge of current events and actions that we may undertake in the future, actual results may be different from the estimates. The results of operations for the three months ended March 31, 2015 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

2. ACCOUNTING POLICIES

Principles of consolidation

The accompanying consolidated financial statements include our accounts and the accounts of our wholly-owned and majority-owned subsidiaries. All intercompany account balances and transactions have been eliminated in consolidation.

Use of estimates

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

Cash equivalents

We classify all highly liquid instruments, including money market funds with a remaining maturity of three months or less at the time of purchase, as cash equivalents. Cash equivalents were $60.1 million and $135.1 million at March 31, 2015 and December 31, 2014, respectively.

Restricted cash

We consider cash that is legally restricted and cash that is held as a compensating balance for letter of credit arrangements as restricted cash.

Fair value of financial instruments

We account for our assets and liabilities using a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. These two types of inputs have created the fair-value hierarchy below. This hierarchy requires us to minimize the use of unobservable inputs and to use observable market data, if available, when determining fair value.

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

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- Level 2—Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and
- Level 3—Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

Under GAAP, certain assets and liabilities are required to be recorded at fair value on a recurring basis. Our assets and liabilities that are adjusted to fair value on a recurring basis are investments in money market mutual funds, trading securities, derivative instruments, and deferred compensation liabilities.

The fair values of our investments in money market mutual funds, trading securities, and deferred compensation liabilities are determined using quoted market prices from daily exchange traded markets on the closing price as of the balance sheet date and are classified as Level 1. The fair values of our derivative instruments are determined using standard valuation models. The significant inputs used in these models are readily available in public markets, or can be derived from observable market transactions, and therefore have been classified as Level 2. Inputs used in these standard valuation models for derivative instruments include the applicable forward rates, interest rates and discount rates. Included in the fair value of derivative instruments is an adjustment for nonperformance risk. The adjustment for nonperformance risk did not have a significant impact on the estimated fair value of our derivative instruments. For additional disclosures related to our derivative instruments, see Derivative financial instruments below.

The following tables summarize our assets and liabilities measured at fair value on a recurring basis using the following levels of inputs as of March 31, 2015 and December 31, 2014 as indicated (in thousands):

	Fair Value Measurements at March 31, 2015:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	$60,094	$60,094	$—	$—
Trading securities held in a “rabbi trust” (1)	59	59	—	—
Total assets	$60,153	$60,153	$—	$—
Liabilities:				
Derivatives (2)	$2,149	$—	$2,149	$—
Deferred compensation accrual “rabbi trust” (3)	63	63	—	—
Total liabilities	$2,212	$63	$2,149	$—

	Fair Value Measurements at December 31, 2014:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	$135,092	$135,092	$—	$—
Trading securities held in a “rabbi trust” (1)	90	90	—	—
Total assets	$135,182	$135,182	$—	$—
Liabilities:				
Derivatives (2)	$1,008	$—	$1,008	$—
Deferred compensation accrual “rabbi trust” (3)	94	94	—	—
Total liabilities	$1,102	$94	$1,008	$—

(1) — Trading securities held in a rabbi trust are included in Other current and Other long-term assets in the consolidated balance sheets.
(2) — Derivative financial instruments are included in Other long-term liabilities in the consolidated balance sheets.
(3) — Non qualified deferred compensation in a rabbi trust is included in Accrued liabilities and Other long-term liabilities in the consolidated balance sheets.

Our other financial instruments, including cash, restricted cash, accounts receivable, accounts payable and accrued liabilities are carried at cost, which approximates their fair value because of the short-term maturity of these instruments.

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Restricted investments

We have a Non-Qualified Deferred Compensation Plan (the “NQDC Plan”) for senior management. Deferred compensation amounts are invested in mutual funds held in a “rabbi trust” and are restricted for payment to the participants of the NQDC Plan. We account for our investments held in the trust in accordance with Accounting Standards Codification (“ASC”) No. 320 “Investments — Debt and Equity Securities”. The investments held in the trust are classified as trading securities. The fair value of the investments held in the trust totaled $59,000 at March 31, 2015 and are included in Other current and Other long-term assets in the consolidated balance sheets. Our gains and losses on these investments were immaterial for the three months ended March 31, 2015 and 2014.

Accounts receivable

Accounts receivable consist primarily of trade amounts due from customers in the United States and from uncleared credit card transactions at period end. Accounts receivable are recorded at invoiced amounts and do not bear interest.

Allowance for doubtful accounts

From time to time, we grant credit to some of our business customers on normal credit terms (typically 30 days). We perform credit evaluations of our business customers’ financial condition and payment history and maintain an allowance for doubtful accounts receivable based upon our historical collection experience and expected collectability of accounts receivable. The allowance for doubtful accounts receivable was $572,000 and $511,000 at March 31, 2015 and December 31, 2014, respectively.

Concentration of credit risk

Cash equivalents include short-term, highly liquid instruments with maturities at date of purchase of three months or less. At March 31, 2015 and December 31, 2014, two banks held the majority of our cash and cash equivalents. We do not believe that, as a result of this concentration, we are subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships.

Financial instruments that potentially subject us to significant concentrations of credit risk consist primarily of cash equivalents and receivables. We invest our cash primarily in money market securities which are uninsured.

Valuation of inventories

Inventories, consisting of merchandise purchased for resale, are accounted for using a standard costing system which approximates the first-in-first-out (“FIFO”) method of accounting, and are valued at the lower of cost or market. We write down our inventory for estimated obsolescence and to lower of cost or market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Once established, the original cost of the inventory less the related inventory allowance represents the new cost basis of such products. Reversal of the allowance is recognized only when the related inventory has been sold or scrapped.

Prepaid inventories, net

Prepaid inventories, net represent inventories paid for in advance of receipt.

Prepaids and other current assets

Prepaids and other current assets represent expenses paid prior to receipt of the related goods or services, including advertising, license fees, maintenance, packaging, insurance, and other miscellaneous costs.

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Fixed assets

Fixed assets, which include assets such as technology infrastructure, internal-use software, website development, furniture and fixtures and leasehold improvements, are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the related assets or the term of the related capital lease, whichever is shorter, as follows:

	Life (years)
Computer software	2-4
Computer hardware	3-4
Furniture and equipment	3-5

Leasehold improvements are amortized over the shorter of the term of the related leases or estimated useful lives.

Depreciation and amortization expense is classified within the corresponding operating expense categories on the consolidated statements of income as follows (in thousands):

	Three months ended March 31,	
	2015	2014
Cost of goods sold - direct	$65	$87
Technology	4,999	3,437
General and administrative	312	271
Total depreciation and amortization, including internal-use software and website development	$5,376	$3,795

Internal-use software and website development

Included in fixed assets is the capitalized cost of internal-use software and website development, including software used to upgrade and enhance our Website and processes supporting our business. We capitalize costs incurred during the application development stage of internal-use software and amortize these costs over the estimated useful life of two to three years. Costs incurred related to design or maintenance of internal-use software are expensed as incurred.

During the three months ended March 31, 2015 and 2014, we capitalized $4.0 million and $4.0 million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally. Amortization of costs associated with internal-use software and website development was $3.2 million and $2.3 million for those respective periods.

Cost and equity method investments

In January 2015, in conjunction with our crypto-initiatives, we acquired a noncontrolling interest (less than 20%) in a privately held entity. The amount of the investment was $5 million and was recognized as a cost method investment included in Other long-term assets in our consolidated balance sheets. Earnings from the investment are recognized to the extent of dividends received, and we will recognize subsequent impairments to the investment if they are other than temporary. We have determined that it is not practicable to estimate the fair value of this investment. Consequently, we review this investment for impairment by evaluating if events or circumstances have occurred that may have a significant adverse effect on its fair value. If such events or circumstances have occurred, we will then estimate the fair value of the investment and determine if any decline in the fair value of the investment below its carrying value is other-than-temporary. At March 31, 2015, the carrying amount of the investment was $5 million. We recognized zero impairment losses during the three months ended March 31, 2015 and 2014.

During 2014, we acquired a 24.9% interest in a broker-dealer as part of our efforts to develop and license software to trade crypto-securities using crypto-technologies. The purchase price for the investment was $250,000 and is accounted for as an equity method investment included in Other long-term assets in our consolidated balance sheets. At March 31, 2015, the difference between the carrying value of this investment and the amount of underlying equity in net assets of the investee was not significant. Our proportionate share of the net income or loss of our equity method investee for three months ended March 31, 2015 and 2014 was not significant. When we record our proportionate share of net income, it increases income (or decreases loss) in our consolidated statements of income and our carrying value in that investment. Conversely, when we record

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our proportionate share of a net loss, it decreases income (or increases loss) in our consolidated statements of income and our carrying value in that investment. In conjunction with the agreement to purchase this investment we also formed an entity that is 75.1% owned by us and 24.9% owned by other parties. Although not significant, we intend to make additional contributions to this entity on behalf of these other parties. This entity is included in our consolidated financial statements. Intercompany transactions with the entity have been eliminated and the amounts of contributions and gains or losses that are attributable to noncontrolling interests are disclosed in our consolidated financial statements.

Leases

We account for lease agreements as either operating or capital leases depending on certain defined criteria. In certain of our lease agreements, we receive rent holidays and other incentives. We recognize lease costs on a straight-line basis without regard to deferred payment terms, such as rent holidays, that defer the commencement date of required payments. Additionally, tenant improvement allowances are amortized as a reduction in rent expense over the term of the lease. Leasehold improvements are capitalized at cost and amortized over the lesser of their expected useful life or the life of the lease, without assuming renewal features, if any, are exercised.

Treasury stock

We account for treasury stock under the cost method and include treasury stock as a component of stockholders' equity.

Precious Metals

Our precious metals consisted of $6.3 million in gold and $4.6 million in silver at March 31, 2015 and December 31, 2014. We store our precious metals at an off-site secure facility. Because these assets consist of actual precious metals, rather than financial instruments, we account for them as a cost method investment initially recorded at cost (including transaction fees) and then adjusted to the lower of cost or market based on an average unit cost. On an interim basis, we recognize decreases in the value of these assets caused by market declines. Subsequent increases in the value of these assets through market price recoveries during the same fiscal year are recognized in the later interim period, but may not exceed the total previously recognized decreases in value during the same year. Gains or losses resulting from changes in the value of our precious metal assets are recorded in Other income (expense), net in our consolidated statements of income. There were no recorded gains or losses on investments in precious metals for the three months ended March 31, 2015 and 2014.

Goodwill

Goodwill represents the excess of the purchase price paid over the fair value of the tangible net assets acquired in business combinations.

Goodwill is not amortized but is tested for impairment at least annually. When evaluating whether goodwill is impaired, we make a qualitative assessment to determine if it is more likely than not that its fair value is less than its carrying amount. If the qualitative assessment determines that it is more likely than not that its fair value is less than its carrying amount, we compare the fair value of the reporting unit to which the goodwill is assigned to its carrying amount. If the carrying amount exceeds its fair value, then the amount of the impairment loss must be measured. The impairment loss, if any, is calculated by comparing the implied fair value of the goodwill to its carrying amount. In calculating the implied fair value of goodwill, the fair value of the reporting unit is allocated to the other assets and liabilities within the reporting unit based on estimated fair value. The excess of the fair value of a reporting unit over the amount allocated to its other assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized when the carrying amount of goodwill exceeds its implied fair value.

In accordance with this guidance, we test for impairment of goodwill in the fourth quarter or when we deem that a triggering event has occurred. There were no impairments to goodwill recorded during the three months ended March 31, 2015 or the year ended December 31, 2014.

Cryptocurrency holdings

We hold cryptocurrency-denominated assets such as bitcoin and we include them in other current assets in our Consolidated Balance Sheets. Cryptocurrency-denominated assets were $233,000 and $340,000 at March 31, 2015 and December 31, 2014, respectively, and are recorded at the lower of cost or market based on an average unit cost. On an interim

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basis, we recognize decreases in the value of these assets caused by market declines. Subsequent increases in the value of these assets through market price recoveries during the same fiscal year are recognized in the later interim period, but may not exceed the total previously recognized decreases in value during the same year. Gains or losses resulting from changes in the value of our cryptocurrency assets are recorded in Other income (expense), net in our consolidated statements of income. Losses on cryptocurrency holdings were $117,000 and zero during the three months ended March 31, 2015 and 2014, respectively.

Other long-term assets

Other long-term assets consist primarily of cost and equity method investments (see Cost and equity method investments above) and long-term prepaid expenses.

Impairment of long-lived assets

We review property and equipment and other long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability is measured by comparison of the assets' carrying amount to future undiscounted net cash flows the asset group is expected to generate. Cash flow forecasts are based on trends of historical performance and management's estimate of future performance, giving consideration to existing and anticipated competitive and economic conditions. If such asset group is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair values. There were no impairments to long-lived assets recorded during the three months ended March 31, 2015 or the year ended December 31, 2014.

Derivative financial instruments

In 2014, we entered into a loan agreement in connection with the construction of our new corporate headquarters. We expect to borrow against the loan agreement in the second half of 2015. Because amounts borrowed on the loan will carry a variable LIBOR-based interest rate, we will be affected by changes in certain market conditions. These changes in market conditions may adversely impact our financial performance, and as such, we use derivatives as a risk management tool to mitigate the potential impact of these changes. We do not enter into derivatives for speculative or trading purposes. The primary market risk we manage through the use of derivative instruments is interest rate risk on the amounts we expect to borrow under the loan agreement relating to our new headquarters. To manage that risk, we use interest rate swap agreements. An interest rate swap agreement is a contract between two parties to exchange cash flows based on underlying notional amounts and indices. Our interest rate swaps entitle us to pay amounts based on a fixed rate in exchange for receipt of amounts based on variable rates. Because we have not yet borrowed against the loan agreement related to our cash flow hedges, the notional amounts under our hedges at March 31, 2015 were zero.

Our derivatives are carried at fair value in our consolidated balance sheets in Other long-term liabilities on a gross basis. The accounting for gains and losses that result from changes in the fair values of derivative instruments depends on whether the derivatives have been designated and qualify as hedging instruments under GAAP. Our derivatives have been designated and qualify as cash flow hedges. We formally designated and documented, at inception, the financial instruments as hedges of specific underlying exposures, the risk management objectives, and the strategy for undertaking the hedging transactions. In addition, we formally assess, both at the inception and at least quarterly thereafter, whether the financial instruments used in hedging transactions are effective at offsetting changes in the cash flows of the related underlying exposures. To the extent that the hedges are effective, the changes in fair values of our cash flow hedges are recorded in Accumulated other comprehensive income. Any ineffective portion is immediately recognized into earnings.

We determine the fair values of our derivatives based on quoted market prices or using standard valuation models (see Fair value of financial instruments above). The notional amounts of the derivative financial instruments do not necessarily represent amounts exchanged by the parties and, therefore, are not a direct measure of our exposure to the financial risks described above. The amounts exchanged are calculated by reference to the notional amounts and by other terms of the derivatives, such as interest rates.

The following table shows the effect of derivative financial instruments that were designated as accounting hedges for the period indicated (in thousands):

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Cash flow hedges (1)	Amount of gain (loss) recognized in OCI on derivative (effective portion) net of tax	Location of gain (loss) reclassified from Accumulated OCI into income (effective portion)	Amount of gain (loss) reclassified from Accumulated OCI into income (effective portion)	Location of gain (loss) recognized in income on derivative (ineffective portion)	Amount of gain (loss) recognized in income on derivative (ineffective portion)
Three months ended March 31, 2015					
Interest rate swap	$(703)	Interest expense	$—	Interest expense	$—

The following table provides the outstanding notional balances and fair values of derivative financial instruments that were designated as accounting hedges outstanding positions for the dates indicated, and recorded gains/(losses) during the periods indicated (in thousands):

Cash flow hedges (1)	Location in balance sheet	Expiration date	Outstanding notional	Fair value	Beginning gains (losses)	Gains (losses) recorded during period (2)	Ending gains (losses)
Three months ended March 31, 2015							
Interest rate swap	Other long-term liabilities	2023	$—	$(2,149)	$(1,008)	$(1,141)	$(2,149)

(1) — There were no outstanding derivative instruments for the three months ended March 31, 2014.
(2) — Gains (losses) recorded during the period are presented gross of the related tax impact.

Revenue recognition

We derive our revenue primarily from direct revenue and partner revenue from merchandise sales. We also earn revenue from advertising on our shopping and other pages. We have organized our operations into two principal segments based on the primary source of revenue: direct revenue and partner revenue (see Note 7—Business Segments).

Revenue is recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or the service has been provided; (3) the selling price or fee revenue earned is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. Revenue related to merchandise sales is recognized upon delivery to our customers. As we ship high volumes of packages through multiple carriers, it is not practical for us to track the actual delivery date of each shipment. Therefore, we use estimates to determine which shipments are delivered and, therefore, recognized as revenue at the end of the period. Our delivery date estimates are based on average shipping transit times, which are calculated using the following factors: (i) the type of shipping carrier (as carriers have different in-transit times); (ii) the fulfillment source (either our warehouses, those warehouses we control, or those of our partners); (iii) the delivery destination; and (iv) actual transit time experience, which shows that delivery date is typically one to eight business days from the date of shipment. We review and update our estimates on a quarterly basis based on our actual transit time experience. However, actual shipping times may differ from our estimates.

We evaluate the criteria outlined in ASC Topic 605-45, Principal Agent Considerations, in determining whether it is appropriate to record the gross amount of product sales and related costs or the net amount earned as commissions. When we are the primary obligor in a transaction, are subject to inventory risk, have latitude in establishing prices and selecting suppliers, or have several but not all of these indicators, revenue is recorded gross. If we are not the primary obligor in the transaction and amounts earned are determined using a fixed percentage, revenue is recorded on a net basis. Currently, the majority of both direct revenue and partner revenue is recorded on a gross basis, as we are the primary obligor. We present revenue net of sales taxes.

We periodically provide incentive offers to our customers to encourage purchases. Such offers include current discount offers, such as percentage discounts off current purchases and other similar offers, which, when used by customers, are treated as a reduction of revenue.

Based upon our historical experience, revenue typically increases during the fourth quarter because of the holiday retail season.

Direct revenue

Direct revenue is derived from merchandise sales of our owned inventory to individual consumers and businesses. Direct revenue comes from merchandise sales that occur primarily through our Website, but may also occur through offline and other channels.

Partner revenue

Partner revenue is derived from merchandise sales of inventory owned by our partners which they generally ship directly to our consumers and businesses. Partner revenue comes from merchandise sales that occur primarily through our Website, but may also occur through offline and other channels.

Club O loyalty program

We have a customer loyalty program called Club O for which we sell annual memberships ("standard Club O"). During 2014, we also introduced an introductory customer loyalty program called Club O Silver for customers who sign up to receive promotional emails. For standard Club O memberships, we record membership fees as deferred revenue and we recognize revenue ratably over the membership period. Both the standard Club O and Club O Silver loyalty programs allow members to earn reward dollars for qualifying purchases made on our Website. We also have a co-branded credit card program (see Co-branded credit card revenue below for more information). Co-branded cardholders are also standard Club O members and earn additional reward dollars for purchases made on our Website, and from other merchants.

Club O Reward dollars earned may be redeemed on future purchases made through our Website. Standard Club O membership reward dollars expire 90 days after the customer’s Club O membership expires. Club O Silver reward dollars expire 90 days after they are earned if no additional qualifying purchases are made during that period.

We account for these transactions as multiple element arrangements and allocate revenue to the elements using their relative fair values. We include the value of reward dollars earned in deferred revenue and we record it as a reduction of revenue at the time the reward dollars are earned.

We recognize revenue for Club O reward dollars when customers redeem their reward dollars as part of a purchase at our Website. We recognize other income when Club O Reward dollars expire or the likelihood of reward dollars being redeemed by a customer is remote (“reward dollar breakage”). Reward dollar breakage is currently recognized when the reward dollars expire as Other income in our consolidated statements of income. Because we recently introduced Club O Silver, and enrolled a significant number of Club O Silver members, reward dollars and resulting breakage may increase as compared to prior periods.

In instances where customers receive free Club O reward dollars not associated with any purchases, we account for these transactions as sales incentives such as coupons and record a reduction of revenue at the time the reward dollars are redeemed.

Co-branded credit card program

We have a co-branded credit card agreement with a commercial bank for the issuance of credit cards bearing the Overstock.com brand, under which the bank pays us fees for new accounts and for customer usage of the cards. The agreement also provides for a customer loyalty program offering reward points that customers will accrue from card usage and can use to make purchases on our Website (see Club O loyalty program above for more information). New account fees are recognized as revenue on a straight-line basis over the estimated expected life of co-branded credit card customers. Credit card usage fees are recognized as revenues as actual credit card usage occurs.

We also have a private label credit card agreement with another commercial bank for the issuance of credit cards bearing our brand, but that is only available for use on our Website. In connection with the agreement, we received upfront fees that we recognize as revenue on a straight line basis over the term of the agreement, which runs through February 2022. When customers make regular revolving purchases using the card, we receive fees, which are recognized as revenue. When we offer promotional financing for purchases made with the card (for example, 12 months same as cash), we pay a discount fee to the commercial bank, which we recognize as a reduction of revenue. The commercial bank owns all of the accounts under the program and performs all account administration, underwriting and servicing. Fees and royalties from new accounts, credit card usage fees, and fees from both of these cards were less than 1% of total net revenues for all periods presented.

Deferred revenue

Customer orders are recorded as deferred revenue prior to delivery of products or services ordered. We record amounts received for Club O membership fees as deferred revenue and we recognize it ratably over the membership period. We record Club O reward dollars earned from purchases as deferred revenue at the time they are earned and we recognize it as revenue upon redemption. If reward dollars are not redeemed, we recognize other income upon expiration. In addition, we sell gift cards and record related deferred revenue at the time of the sale. We sell gift cards without expiration dates and we recognize revenue from a gift card upon redemption of the gift card. If a gift card is not redeemed, we recognize other income when the likelihood of its redemption becomes remote based on our historical redemption experience. We consider the likelihood of redemption to be remote after 36 months.

We periodically enter into agreements with other parties to jointly market ancillary products or services on our website. As a result of those agreements, we sometimes receive payments in advance of performing our obligations under those agreements. Such payments received before we perform our obligations are recognized over our service period.

Sales returns allowance

We inspect returned items when they arrive at our processing facility. We refund the full cost of the merchandise returned and all original shipping charges if the returned item is defective or we or our partners have made an error, such as shipping the wrong product.

If the return is not a result of a product defect or a fulfillment error and the customer initiates a return of an unopened item within 30 days of delivery, for most products we refund the full cost of the merchandise minus the original shipping charge and actual return shipping fees. However, we reduce refunds for returns initiated more than 30 days after delivery or that are received at our returns processing facility more than 45 days after initial delivery.

If our customer returns an item that has been opened or shows signs of wear, we issue a partial refund minus the original shipping charge and actual return shipping fees.

Revenue is recorded net of estimated returns. We record an allowance for returns based on current period revenues and historical returns experience. We analyze actual historical returns, current economic trends and changes in order volume and acceptance of our products when evaluating the adequacy of the sales returns allowance in any accounting period.

The allowance for returns was $10.4 million and $15.5 million at March 31, 2015 and December 31, 2014 respectively. The decrease in allowance for returns at March 31, 2015 compared to December 31, 2014 is primarily due to decreased revenues mostly due to seasonality.

Credit card chargeback allowance

Revenue is recorded net of credit card chargebacks. We maintain an allowance for credit card chargebacks based on current period revenues and historical chargeback experience. The allowance for chargebacks was $105,000 and $129,000 at March 31, 2015 and December 31, 2014, respectively.

Cost of goods sold

Cost of goods sold includes product costs, warehousing costs, outbound shipping costs, handling and fulfillment costs, customer service costs and credit card fees, and is recorded in the same period in which related revenues have been recorded. Cost of goods sold, including product cost and other costs and fulfillment and related costs are as follows (in thousands):

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	Three months ended March 31,					
	2015			2014		
Total revenue, net	$398,344	100	%	$341,207	100	%
Cost of goods sold						
Product costs and other cost of goods sold	305,470	77	%	261,798	77	%
Fulfillment and related costs	17,437	4	%	15,413	5	%
Total cost of goods sold	322,907	81	%	277,211	81	%
Gross profit	$75,437	19	%	$63,996	19	%

Advertising expense

We expense the costs of producing advertisements the first time the advertising takes place and expense 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) a commission for traffic driven to the Website that generates a sale or 2) a referral fee based on the number of clicks on keywords or links to our Website generated during a given period. Advertising expense is included in sales and marketing expenses and totaled $25.8 million and $20.4 million during the three months ended March 31, 2015 and 2014, respectively. Prepaid advertising (included in Prepaids and other current assets in the accompanying consolidated balance sheets) was $1.4 million and $1.5 million at March 31, 2015 and December 31, 2014, respectively.

Stock-based compensation

We measure compensation expense for all outstanding unvested share-based awards at fair value on the date of grant and recognize compensation expense over the service period for awards expected to vest at the greater of a straight line basis or on an accelerated schedule when vesting of restricted stock awards exceeds a straight line basis. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from estimates, such amounts are recorded as an adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, and historical experience. Actual results may differ substantially from these estimates (see Note 6. Stock-Based Awards).

Loss contingencies

In the normal course of business, we are involved in legal proceedings and other potential loss contingencies. We accrue a liability for such matters when it is probable that a loss has been incurred and the amount can be reasonably estimated. When only a range of probable loss can be estimated, the most probable amount in the range is accrued. If no amount within this range is a better estimate than any other amount within the range, the minimum amount in the range is accrued. We expense legal fees as incurred (see Note 4. Commitments and Contingencies).

Income taxes

Our income tax provision for interim periods is determined using an estimate of our annual effective tax rate adjusted for discrete items, if any, for relevant interim periods. We update our estimate of the annual effective tax rate each quarter and make cumulative adjustments if our estimated annual effective tax rate changes.

Our quarterly tax provision and our quarterly estimate of our annual effective tax rate are subject to significant variations due to several factors including variability in predicting our pre-tax and taxable income and the mix of jurisdictions to which those items relate, relative changes of expenses or losses for which tax benefits are not recognized, how we do business, and changes in law, regulations, and administrative practices. Our effective tax rate can be volatile based on the amount of pre-tax income. For example, the impact of discrete items on our effective tax rate is greater when pre-tax income is lower. The tax provision does not include a benefit for the federal research credit, which expired at the end of 2014. If retroactively reinstated, the credit will be a discrete tax benefit in the period enacted.

We have not provided for U.S. income tax on certain foreign earnings because we intend to indefinitely reinvest these earnings outside the U.S. We have begun expansion of operations outside of the U.S. and have plans for additional expansion

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for which we have incurred and will continue to incur capital requirements. We have considered ongoing capital requirements of the parent company in the U.S.

We have tax deductions from stock-based compensation that exceed the stock-based compensation recorded for such instruments. To the extent such excess tax benefits are ultimately realized, they will increase shareholders' equity. We utilize the "with-and-without" approach in determining if and when such excess tax benefits are realized. Under this approach, excess tax benefits related to stock-based compensation are the last tax benefits to be realized.

Earnings per share

Basic earnings per share is computed by dividing net income attributable to common shares by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income 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, comprising incremental common shares issuable upon the exercise of stock options and restricted stock awards are included in the calculation of diluted earnings per common share to the extent such shares are dilutive.

The following table sets forth the computation of basic and diluted net income per common share for the periods indicated (in thousands, except per share data):

	Three months ended March 31,	
	2015	2014
Net income attributable to stockholders of Overstock.com, Inc.	$2,739	$3,970
Net income per common share—basic:		
Net income attributable to common shares—basic	0.11	0.17
Weighted average common shares outstanding—basic	24,213	23,926
Effect of dilutive securities:		
Stock options and restricted stock awards	177	413
Weighted average common shares outstanding—diluted	24,390	24,339
Net income attributable to common shares—diluted	$0.11	$0.16

The following shares were excluded from the calculation of diluted shares outstanding as their effect would have been anti-dilutive (in thousands):

	Three months ended March 31,	
	2015	2014
Stock options and restricted stock units	132	226

Recently issued accounting standards

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard becomes effective for us on January 1, 2017. Early adoption is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. Recent tentative decisions by the FASB may delay the effective date of this ASU and some of its other provisions. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

In April 2015, the FASB issued ASU No. 2015-03, Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The new standard becomes effective for us on January 1, 2016. Early adoption is permitted. The standard requires entities to apply this change on a retrospective basis for the periods presented. We are evaluating the effect that ASU 2015-03 will have in our consolidated financial statements and related disclosures.

In April 2015, the FASB issued ASU No. 2015-05, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement, provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The new standard becomes effective for us on January 1, 2016. Early adoption is permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect that ASU 2015-05 will have in our consolidated financial statements and related disclosures.

3. BORROWINGS

U.S. Bank term loan and revolving loan agreement

In October 2014, we entered into a syndicated senior secured credit facility (the "Facility") with U.S. Bank National Association ("U.S. Bank" or the "Administrative Bank") and certain other banks in connection with the construction of our new corporate headquarters (the "Project"). The Facility is governed by a Loan Agreement dated as of October 24, 2014 which provides for an aggregate credit amount of $55.8 million, consisting of (i) a senior secured real estate loan of $45.8 million (the "Real Estate Loan") to be used to finance a portion of the Project and (ii) a three-year $10.0 million senior secured revolving credit facility (the "Revolving Loan") for working capital and capital expenditures, but not for the Project. We must satisfy a number of conditions at least 60 days prior to any funding under the Facility, including making cash contributions of approximately $37.4 million toward the Project. We may also be required to make additional cash contributions if necessary to maintain a loan to value ratio of 80% or less. The Real Estate Loan and the Revolving Loan are both secured by the Project, our inventory and accounts receivable, substantially all of our deposit accounts and related assets. We expect to begin borrowing under the Facility in the second half of 2015.

On or about January 1, 2017, upon completion of the Project, the Real Estate Loan is designed to convert into an approximately 6.75-year term loan due October 1, 2023 (the "Term Loan"). The conditions to conversion of the Real Estate Loan to the Term Loan include, among others, requirements that the Project must have been completed in accordance with the applicable plans, paid for in full, and generally free of liens; completion must have been certified by the project architect and the inspecting architect; certificates of occupancy must have been issued; we must have paid all amounts then due to the lending banks and must be in compliance with the covenants under the Loan Agreement; the Real Estate Loan must be brought "in balance" as defined in the Loan Agreement, which may require us to contribute additional cash to the Project; we must have paid the final amount of our cash contribution as required by the Loan Agreement; and if required by the Administrative Bank, an updated appraisal must show that the Project is in compliance with an 80% loan to value ratio requirement. If the conditions to conversion are not satisfied in early 2017, all amounts outstanding under the Facility will become immediately due and payable.

Amounts outstanding under the Real Estate Loan and the Term Loan will carry an interest rate based on one-month LIBOR plus 2.00% or an Alternate Base Rate plus 1.00%. However, we have entered into interest rate swap agreements designed to fix our interest rate on the Real Estate Loan and the Term Loan at approximately 4.6% annually (see Derivative financial instruments in Note 2. Accounting Policies). Monthly payments of interest only will be due and payable on the Real Estate Loan prior to conversion. Following conversion, we are required to make monthly payments of principal estimated to be $1.1 million annually plus interest, with a balloon payment of all unpaid principal (estimated to be $38.0 million) and interest on October 1, 2023. Amounts outstanding under the Revolving Loan will carry an interest rate based on LIBOR plus 2.00% or an Alternate Base Rate plus 1.00%.

We are required to maintain compliance as of the end of each calendar quarter beginning with the quarter ending December 31, 2014 with the following financial covenants:

- a fixed charge coverage ratio on a trailing 12-month basis of no less than 1.15 to 1.00;
- a cash flow leverage ratio on a trailing 12-month basis not greater than 3.00 to 1.00 during the Construction Phase (as defined in the Loan Agreement);
- a cash flow leverage ratio not greater than 2.50 to 1.00 following the Construction Phase; and
- minimum liquidity of at least $50.0 million.

At March 31, 2015 we were in compliance with the financial covenants. In addition to the financial covenants described above, we are required to comply with a number of covenants relating to the Project and our business, including covenants limiting certain indebtedness. Notwithstanding, the Loan Agreement permits us to incur up to $20.0 million of additional senior-secured indebtedness for equipment financing, and other senior-secured indebtedness provided that the aggregate principal amount of such other senior-secured indebtedness does not exceed ten percent of our consolidated assets. The Loan Agreement includes customary events of default in addition to events of default relating specifically to the Project. The Real Estate Loan and the Revolving Loan are cross-defaulted and cross-collateralized. In the event of a default, the default rate of interest would be 2.00% above the otherwise applicable rate.

Unless it terminates earlier or is extended with the consent of the Administrative Bank and all of the Banks, the Revolving Loan facility will terminate on October 24, 2017.

As of March 31, 2015 we had not borrowed any amounts under either the Real Estate Loan or the Revolving Loan.

U.S. Bank letters of credit

At March 31, 2015 and December 31, 2014, letters of credit totaling $505,000 and $580,000 respectively, were issued on our behalf collateralized by compensating cash balances held at U.S. Bank, which are included in Restricted cash in the accompanying consolidated balance sheets.

U.S. Bank commercial purchasing card agreement

We have a commercial purchasing card (the "Purchasing Card") agreement with U.S. Bank. We use the Purchasing Card for business purpose purchasing and must pay it in full each month. At March 31, 2015, $1.5 million was outstanding and $3.5 million was available under the Purchasing Card. At December 31, 2014, $803,000 was outstanding and $4.2 million was available under the Purchasing Card.

Capital leases

During the three months ended March 31, 2015, and the year ended December 31, 2014, we entered into capital lease arrangements of computer equipment for $362,000 and $325,000, respectively. These arrangements will expire in 2017. In order to obtain discounted pricing, we prepaid the entire $362,000 and $325,000 shortly after entering into the respective agreements. As such, we have no future payment obligations under capital leases at March 31, 2015 and December 31, 2014.

Fixed assets included assets under capital leases of $4.9 million and $4.7 million and accumulated depreciation related to assets under capital leases of $3.0 million and $2.8 million, respectively, at March 31, 2015 and December 31, 2014. Depreciation expense of assets recorded under capital leases was $195,000 and $160,000, for the three months ended March 31, 2015 and 2014, respectively.

4. COMMITMENTS AND CONTINGENCIES

Summary of future minimum lease payments for all operating leases

Minimum future payments under all operating leases as of March 31, 2015, are as follows (in thousands):

Payments due by period	
2015 (remainder)	$ 8,571

2016	9,342
2017	4,963
2018	4,585
2019	3,916
Thereafter	28,521
	$59,898

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Rental expense for operating leases totaled $3.1 million and $2.9 million for the three months ended March 31, 2015 and 2014, respectively.

Naming rights

During 2011, we entered into a six-year agreement with the Oakland-Alameda County Coliseum Authority ("OACCA") for the right to name the Oakland Alameda County Coliseum. Amounts shown below represent annual payments due OACCA for the naming rights. We have the right to terminate this agreement at our sole option, subject to payment of a termination fee.

Minimum future payments under the naming rights agreement as of March 31, 2015, are as follows (in thousands):

Payments due by period:	
2015 (remainder)	$1,351
2016	1,391
Thereafter	—
	$2,742

Technology

From time to time we enter into non-cancellable, long-term contractual agreements for technology services. Minimum future payments under these agreements as of March 31, 2015, are as follows (in thousands):

Payments due by period:	
2015 (remainder)	$2,292
2016	2,118
Thereafter	—
	$4,410

Legal Proceedings

From time to time, we are involved in litigation concerning consumer protection, employment, intellectual property and other commercial matters related to the conduct and operation of our business and the sale of products on our Website. In connection with such litigation, we may be subject to significant damages. In some instances other parties may have contractual indemnification obligations to us. However, such contractual obligations may prove unenforceable or non-collectible, and if we cannot enforce or collect on indemnification obligations, we may bear the full responsibility for damages, fees and costs resulting from such litigation. We may also be subject to penalties and equitable remedies that could force us to alter important business practices. Such litigation could be costly and time consuming and could divert or distract our management and key personnel from our business operations. Due to the uncertainty of litigation and depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect our business, results of operations, financial position, or cash flows.

On February 2, 2007, along with five shareholder plaintiffs, we filed a lawsuit in the Superior Court of California, County of San Francisco against Goldman Sachs & Co., Merrill Lynch, Pierce, Fenner & Smith, Inc., and also in the original complaint and by later amendment, against 8 other defendant banks. The suit alleged that the defendants, who controlled over 80% of the prime brokerage market, participated in an illegal stock market manipulation scheme and that the defendants had no intention of covering short sell orders with borrowed stock, as they are required to do, causing what are referred to as “fails to deliver” and that the defendants’ actions caused and continued to cause dramatic declines in the share price of our stock and that the amount of “fails to deliver” often exceeded our entire supply of outstanding shares. The suit accused the defendants of violations of California securities laws and common law and violations of California's Unfair Business Practices Act. Owing to its bankruptcy filing in 2008, we elected not to pursue our claims against one of the defendants. On July 23, 2009, the court sustained defendants' demurrer to our amended causes of action for conversion and trespass to chattels. On December 15, 2010, we and the other plaintiffs in the case entered into a settlement agreement with certain of the defendants requiring these defendants to pay in the aggregate $4.5 million to plaintiffs. Other terms of settlement are confidential. Following this settlement, remaining defendants in the suit were Goldman Sachs Group, Inc., Goldman Sachs & Co., Goldman Sachs

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Execution & Clearing L.P., ("Goldman Defendants") Merrill Lynch, Pierce, Fenner & Smith, Inc., Merrill Lynch Professional Clearing Corporation ("Merrill Lynch Defendants), and Bank of America Securities LLC. On December 15, 2010, we filed a motion to amend our complaint against the Goldman and Merrill Lynch Defendants to add a cause of action based on the New Jersey Racketeer Influenced and Corrupt Organization (RICO) Act. Defendants challenged the RICO claim by demurrer and eventually the court sustained the demurrer. We thereafter entered a settlement agreement with Bank of America Securities LLC, the terms of which are confidential, and dismissed the action as to that defendant. On August 19, 2011, the remaining defendants filed a motion for summary judgment. On January 10, 2012, the court granted the motion for summary judgment as to all remaining defendants and the judgment was entered. We appealed that decision and each side appealed the trial court's decisions regarding sealing of certain records in the case. The defendants applied to the court for reimbursement from us of their allowable court costs, and the court ordered costs in the amount of $689,471. The Court of Appeal issued its decision on November 13, 2014, reversing the trial court's dismissal and summary judgment in favor of Merrill Lynch Professional Clearing Corporation, but the court upheld the decision dismissing the Goldman Defendants. The Court of Appeal also upheld the trial court's decision denying the amendment of the complaint to include RICO claims, and in the matter of the sealing of the records, ordered that the relevant portions of the records be made public, subject to the trial court's determination of which documents were relevant and what third party, private financial information should be redacted. All parties petitioned the California Supreme Court for review of various parts the decision, and the court denied the petitions. The case has been remitted to the Court of Appeal, and subsequently to the trial court for final trial preparation and trial of our claims against Merrill Lynch Professional Clearing Corporation. The nature of the loss contingencies relating to any court costs ordered against us are described above.

On September 23, 2009, SpeedTrack, Inc. sued us along with 27 other defendants in the United States District Court in the Northern District of California. We are alleged to have infringed a patent covering search and categorization software. We believe that certain third party vendors of products and services sold to us are contractually obligated to indemnify us in this action. On November 11, 2009, the parties stipulated to stay all proceedings in the case until resolution of a reexamination of the patent in question, and also until a previously filed infringement action against Wal-Mart Stores, Inc. and other retailers resulted either in judgment or dismissal. Subsequently, the parties agreed to extend the time for defendants to answer until 21 days following a court order to lift the stay to which the parties stipulated. The United States Patent and Trademark Office resolved the reexamination of the patent in question in favor of SpeedTrack, Inc. The case remains stayed, pending the outcome and appeal of the infringement action against Wal-Mart Stores, Inc. and other retailers. On February 22, 2012, the court in the Wal-Mart Stores case granted Wal-Mart Stores' motion for summary judgment of non-infringement. The court also granted Speedtrack's motion for summary judgment on patent validity. Speedtrack appealed, and the ruling was upheld. It is not known whether the summary judgments granted in the Wal-Mart Stores case will have an effect on the Speedtrack case in which we are named as one of the defendants. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On September 29, 2010, a trustee in bankruptcy filed against us an adversary proceeding in the matter of In re: Petters Company, Inc., a case filed in United States Bankruptcy Court, in the District of Minnesota. The complaint alleges principal causes of action against us under various Bankruptcy Code sections and the Minnesota Fraudulent Transfer Act, to recover damages for alleged transfers of property from the Petters Company occurring prior to the filing of the case initially as a civil receivership in October 2008. The trustee's complaint alleges such transfers occurred in at least one note transaction whereby we transferred at least $2.3 million and received in return transfers totaling at least $2.5 million. The case is in its discovery stages. We filed a motion to dismiss on statute of limitations and other grounds. The court consolidated the issues in our motion with issues raised by motion in similar trustee-filed cases. The court issued legal rulings on these consolidated legal issues, and has allowed portions of the case to proceed to the discovery stage. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action.

On November 17, 2010, we were sued in the Superior Court of California, County of Alameda, by District Attorneys for the California Counties of Alameda, Marin, Monterey, Napa, Santa Clara, Shasta and Sonoma County, and the County of Santa Cruz later joined the suit. These district attorneys sought damages and an injunction under claims for violations of California consumer protection laws, alleging we made untrue or misleading statements concerning our pricing, price reductions, sources of products and shipping charges. The complaint asked for damages in the amount of not less than $15.0 million. We tried the case in September 2013 before the judge of the court and made final arguments in December 2013. On January 3, 2014, the court issued a tentative ruling in favor of the District Attorneys, which became a final Statement of Decision on February 5, 2014. The decision provides for an injunction that prescribes disclosures necessary for certain types of price advertising and price reductions and imposes civil penalties of $3,500 per day for practices from March 2006 through

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September 2008, and $2,000 per day for September 2008 through September 2013, totaling $6.8 million. The court issued a Final Judgment February 19, 2014 reflecting the Court's Statement of Decision. We have stipulated to Plaintiff's reimbursement of costs in the amount of $111,500. We have appealed the decision and have secured a bond as required in the ruling in the amount of 150% of the penalty imposed in the matter until the ruling on the appeal. The appeal is briefed. No date has been set for oral argument. The nature of the loss contingencies relating to claims that have been asserted against us are described above. We intend to continue to vigorously pursue the appeal and defend this action.

On September 11, 2011, Droplets, Inc. filed suit against us and eight other defendants in the United States District Court in the Eastern District of Texas for infringement of a patent covering strings of programming code downloaded from a server to a client computer. The case was tried and on January 16, 2015 the jury rendered a verdict of infringement assessing damages in the amount of $4.0 million against us. Droplets has filed a motion for, and court may also order, injunctive relief, the payment of pre- and post-judgment interest, future royalties, attorney fees and costs. Droplets alleges future royalties in the amount of $305,000 per month. We have responded that we do not now infringe and that in any event, the amount requested is not legally justified. We have taken steps to avoid a future infringement finding. Droplets is also seeking reimbursement of its attorneys fees in an unspecified amount. Once judgment is final, we intend to appeal. The nature of the loss contingencies relating to claims that have been asserted against us are described above. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On February 11, 2013, RPost Holdings, Inc., RPost Communications Limited, and RMail Limited, filed suit against us in the United States District Court in Eastern District of Texas for infringement of patents covering products and services that verify the delivery and integrity of email messages. We tendered defense of the case to an indemnitor which accepted the defense. We answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On September 30, 2013, Altaf Nazerali filed suit against us in the Supreme Court of British Columbia for vicarious liability for defamation, libel and slander. The suit relates to alleged representations about Nazerali found on the website deepcapture.com. The suit alleges that the representations were made by our Chief Executive Officer, Patrick Byrne, and two other individuals on deepcapture.com. We are vigorously defending the action which is currently being tried in Canada. If Nazerali succeeds in the Canadian court, since we have no assets in Canada, Nazerali would have to domesticate his judgment in the United States before he could enforce any judgment against us. Canadian law and United States law regarding the prosecution of defamation, libel and slander cases are very different. As a result of the United States Constitutional protections of free speech, United States law affords a defendant in this type of case much greater procedural protections than does Canadian law. Before a foreign judgment for this kind of claim can be domesticated in the United States, a foreign judgment-holder must show that the judgment is not repugnant to the United States Constitution or alternatively, that affording the defendant these procedural protections would not have had a different result. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made.

In June 2013, William French filed suit against us and 46 other defendants under seal in the Superior Court of the State of Delaware. The filing was unsealed on March 24, 2014. French brought the action on Delaware's behalf for violations of Delaware's unclaimed property laws and for recovery of the unredeemed gift card value allegedly attributable to Delaware residents. French's complaint alleges that we, and other defendants, knowingly refused to fulfill obligations under Delaware's Abandoned Property Law by failing to report and deliver unclaimed gift card funds to the State of Delaware, and knowingly made, used or caused to be made or used, false statements and records to conceal, avoid or decrease an obligation to pay or transmit money to Delaware in violation of the Delaware False

Claims and Reporting Act. The complaint seeks an injunction, monetary damages (including treble damages) penalties, and attorneys' fees and costs. The case is in its discovery stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made.

We establish liabilities when a particular contingency is probable and estimable. At March 31, 2015, we have accrued $12.7 million in light of these probable and estimable liabilities. It is reasonably possible that the actual losses may exceed our accrued liabilities. We have other contingencies which are reasonably possible; however, the reasonably possible exposure to losses cannot currently be estimated.

5. INDEMNIFICATIONS AND GUARANTEES

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During our normal course of business, we have made certain indemnities, commitments, and guarantees under which we 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, the environmental indemnity we entered into in favor of the lenders under our Loan Agreement with U.S. Bank and other banks, and indemnities to our directors and officers 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 we could be obligated to make. As such, we are unable to estimate with any reasonableness our potential exposure under these items. We have not recorded any liability for these indemnities, commitments, and guarantees in the accompanying consolidated balance sheets. We do, 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.

6. STOCK-BASED AWARDS

We have equity incentive plans that provide for the grant to employees of stock-based awards, including stock options and restricted stock. During the three months ended March 31, 2015 and 2014, the Compensation Committee of the Board of Directors approved grants of 650 and 231,560 restricted stock awards, respectively, to our officers, board members and employees. The restricted stock awards vest over three years at 33.3% at the end of the first year, 33.3% at the end of the second year and 33.3% at the end of the third year and are subject to the employee’s continuing service to us. At March 31, 2015, there were 232,739 unvested restricted stock awards that remained outstanding.

The cost of restricted stock awards is determined using the fair value of our common stock on the date of the grant, and compensation expense is either recognized on a straight line basis over the three-year vesting schedule or on an accelerated schedule when vesting of restricted stock awards exceeds a straight-line basis. The cumulative amount of compensation expense recognized at any point in time is at least equal to the portion of the grant date fair value of the award that is vested at that date. The weighted average grant date fair value of restricted stock awards granted during the three months ended March 31, 2015 was $22.80.

Stock-based compensation expense related to restricted stock awards was $778,000 and $923,000 during the three months ended March 31, 2015 and 2014, respectively.

The following table summarizes restricted stock award activity during the three months ended March 31, 2015 (in thousands):

	Three months ended March 31, 2015	
	Units	Weighted Average Grant Date Fair Value
Outstanding—beginning of year	578	$16.70
Granted at fair value	1	22.80
Vested	(331)	12.52
Forfeited	(15)	23.70
Outstanding—end of period	233	$22.18

7. BUSINESS SEGMENTS

Segment information has been prepared in accordance with ASC Topic 280 Segment Reporting. Segments were determined based on how we manage the business. There were no inter-segment sales or transfers during the three months ended March 31, 2015 and 2014. We evaluate the performance of our segments and allocate resources to them based primarily on gross profit. The table below summarizes information about reportable segments for the three months ended March 31, 2015 and 2014 (in thousands):

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	Three months ended March 31,		
	Direct	Partner	Total
2015			
Revenue, net	$36,135	$362,209	$398,344
Cost of goods sold	32,527	290,380	322,907
Gross profit	$3,608	$71,829	$75,437
Operating expenses			71,593
Other income, net			644
Provision for income taxes			1,940
Consolidated net income			$2,548
2014			
Revenue, net	$38,047	$303,160	$341,207
Cost of goods sold	33,097	244,114	277,211
Gross profit	$4,950	$59,046	$63,996
Operating expenses			57,929
Other income, net			493
Provision for income taxes			2,590
Consolidated net income			$3,970

The direct segment includes revenues, direct costs, and cost allocations associated with sales of inventory we own. Costs for this segment include product costs, freight, warehousing and fulfillment costs, credit card fees and customer service costs.

The partner segment includes revenues, direct costs and cost allocations associated with sales of inventory owned by our partners. Costs for this segment include product costs, outbound freight and fulfillment costs, credit card fees and customer service costs.

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

For the three months ended March 31, 2015 and 2014, substantially all of our sales revenues were attributable to customers in the United States. At March 31, 2015 and December 31, 2014, substantially all of our fixed assets were located in the United States.

8. SUBSEQUENT EVENTS

In April 2015, we purchased a noncontrolling interest in a privately held entity. The amount of the investment totaled $1 million. We will recognize the investment as a cost method investment. Earnings from the investment will be recognized to the extent of dividends received, and we will recognize subsequent impairments to the investment if they are other than temporary.

In April 2015, the Compensation Committee of the Board of Directors approved grants of 234,250 restricted stock awards to our officers, board members and employees. The restricted stock awards vest over three years at 33.3% at the end of the first year, 33.3% at the end of the second year and 33.3% at the end of the third year and are subject to the employee's continuing service to us. The grant date fair value of these awards was $24.74. As of April 20, 2015, there were 466,989 unvested restricted stock awards that remained outstanding.

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

Special Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q and the documents incorporated herein by reference, as well as our other public documents and statements our officers and representatives may make from time to time, contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended. These statements are therefore entitled to the protection of the safe harbor provisions of these laws. These forward-looking statements involve risks and uncertainties, and relate to future events or our future financial or operating performance. The forward-looking statements include all statements other than statements of historical fact, including, without limitation, all statements regarding:

- the anticipated benefits and risks of our business and plans;
- our beliefs regarding our ability to attract and retain customers in a cost-efficient manner;
- the anticipated effectiveness of our marketing;
- our future operating and financial results, including any projections of revenue, profits or losses, contribution, technology expense, general and administrative ("G&A") expense, cash flow, capital expenditures or other financial measures or amounts or non-GAAP financial measures or amounts or anticipated changes in any of them;
- our plans and expectations regarding our design and construction of an office campus in Salt Lake City to serve as our corporate headquarters; our beliefs and expectations regarding the adequacy of our office and warehouse facilities and our anticipated transition from our current facilities to our anticipated new facilities;
- our expectations regarding the benefits and risks of the Construction Agreement and related agreements we recently entered into in connection with our construction of our planned corporate headquarters and of the credit facility we recently entered into for the purpose of, among other things, financing a portion of the costs of that construction;
- our expectations regarding our ability to secure the additional financing that we will need to complete our corporate headquarters;
- our future capital requirements and our ability to satisfy our capital needs;
- our expectations regarding the adequacy of our liquidity;
- our ability to retire or refinance any debt we may have or incur in the future;
- our decision to accept bitcoins as payment for the goods and services we sell and our expectations regarding the advantages and risks of doing so, and our expectations that any bitcoin or other transaction processing agents we utilize will perform in accordance with our expectations regardless of fluctuations in the value of bitcoin or other developments that may affect us or such processing agents;
- our decision to acquire and hold bitcoins and other cryptocurrencies and our expectations regarding the advantages and risks of doing so;
- the competition we currently face and will face in our business as the ecommerce business continues to evolve and to become more competitive, and as additional competitors, including competitors based in China or elsewhere, continue to increase their efforts in our primary markets;
- the effects of government regulation;
- our plans for international markets, our expectations for our international sales efforts and the anticipated results of our international operations;
- our plans and expectations regarding Overstock Fulfillment Services and Supplier Oasis and our efforts to provide multi-channel fulfillment services;
- our plans and expectations regarding our recently-announced launch of our Farmers Market offerings;
- our plans and expectations regarding our recently-announced launch of insurance product offerings and consumer finance offerings;
- our plans for further changes to our business;
-

our beliefs regarding current or future litigation or regulatory actions, including our expectations about our anticipated appeal of the Droplets verdict against us;

- our beliefs regarding the costs and benefits of our "spend and defend" policy under which we generally refuse to settle abusive patent suits brought against us;
- our beliefs and expectations regarding existing and future tax laws and related laws and the application of those laws to our business;

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- our beliefs regarding the adequacy of our insurance coverage;
- our beliefs regarding the adequacy and anticipated functionality of our infrastructure, including our backup facilities and beliefs regarding the adequacy of our disaster planning and our ability to recover from a disaster or other interruption of our ability to operate our website at its highest level of functionality;
- our beliefs regarding our cybersecurity efforts and measures and the costs we will incur in our ongoing efforts to avoid interruptions to our product offerings and other business processes from cyber attacks;
- our belief that we can meet our published product shipping standards even during periods of relatively high sales activity;
- our belief that we can maintain or improve upon customer service levels that we and our customers consider acceptable;
- our beliefs regarding the adequacy of our order processing systems and our fulfillment and distribution capabilities;
- our expectations regarding the costs and benefits of our other businesses, innovations and projects, including our new and used car listing service, our Worldstock Fair Trade offerings, our Main Street Revolution offerings, our consignment services, our ecommerce marketplace channel offerings, our projects involving bitcoin and our project to develop a decentralized facility for the trading of securities and other future businesses, innovations and projects and the anticipated functionality and results of operations of them;
- our expectations regarding the costs and benefits of various programs we offer, including Club O and programs pursuant to which we offer free or discounted participation in Club O or other programs we offer to members of the United States Armed Forces and/or to full-time, post-secondary students or others, and including our community site and our public service pet adoption program;
- our belief that we and our partners will be able to maintain inventory levels at appropriate levels despite the seasonal nature of our business;
- our belief that our sales through other ecommerce marketplace channels will be successful and will become an important part of our business; and
- our belief that we can successfully offer and sell a constantly changing mix of products and services.

Further, in some cases, you can identify forward-looking statements by terminology such as may, will, could, should, likely, expect, plan, seek, intend, anticipate, project, believe, estimate, predict, potential, goal, strategy, future or continue, the negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially from those contemplated by forward-looking statements for a variety of reasons, including among others:

- changes in U.S. and global economic conditions and consumer spending;
- any downturn in the U.S. housing industry;
- world events;
- the rate of growth of the Internet and online commerce, and the occurrence of any event that would discourage or prevent consumers from shopping or making payments online;
- any failure to maintain our existing relationships or build new relationships with partners on acceptable terms;
- any difficulties we may encounter maintaining optimal levels of product quality and selection or in attracting sufficient consumer interest in our product offerings;
- any difficulties we may have with the quality or safety of the products we offer;
- modifications we may make to our business model from time to time, including aspects relating to our product mix and the mix of direct/partner sourcing of the products we offer;
- the mix of products purchased by our customers;
- problems with cyber security or data breaches or Internet or other infrastructure or communications impairment problems or the costs of preventing or responding to any such problems;
- problems with or affecting our credit card processors, including cyber-attacks, Internet or other infrastructure or communications impairment or other events that could interrupt the normal operation of the credit card processors or any difficulties we may have maintaining compliance with the rules of the credit card processors;

- any problems we may encounter as a result of the anticipated implementation in the U.S of the EMV (Europay, MasterCard and Visa) standards for credit cards, which are scheduled to be implemented in the U.S. during 2015, including any problems that may result from any increase in online fraud as a result of the implementation or anticipated implementation of the EMV standards;

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- problems with or affecting the facility where substantially all of our computer and communications hardware is located or other problems that result in the unavailability of our Website or reduced performance of our transaction systems;
- difficulties we may have in responding to technological changes;
- problems with the large volume of fraudulent purchase orders we receive on a daily basis;
- problems we may encounter as a result of the listing or sale of pirated, counterfeit or illegal items by third parties;
- difficulties we may have financing our operations or our expansion with either internally generated funds or external sources of financing;
- any environmental or other difficulties we may encounter relating to the real estate we recently purchased, the design and construction of an office campus on that property to serve as our corporate headquarters, our financing of a substantial portion of the costs of designing and constructing the office campus and headquarters or of the interest rate swaps we entered into in connection with the financing, of financing it after construction, or the transition from our current facilities to new facilities;
- any difficulties we may encounter in connection with Overstock Fulfillment Services and Supplier Oasis and our efforts to provide multi-channel fulfillment services, our Farmers Market offerings, our insurance product offerings, our consumer finance offerings or other businesses or product or service offerings outside of our main shopping website offerings;
- any difficulties we may encounter as a result of our reliance on third parties that we do not control for the performance of critical functions material to our business;
- any difficulties we may encounter in connection with the rapid shift of ecommerce and online payments to mobile and multi-channel commerce and payments;
- the extent to which we owe income or sales taxes or are required to collect sales taxes or report sales or to modify our business model in order to avoid being required to collect sales taxes or report sales;
- any difficulties we may encounter as a consequence of accepting or holding bitcoins or other cryptocurrencies, whether as a result of regulatory, tax or other legal issues, technological issues, value fluctuations, lack of widespread adoption of bitcoins or other cryptocurrencies as an acceptable medium of exchange or otherwise;
- competition, including competition from well-established competitors including Amazon.com, and from others including competitors with business models that may include delivery capabilities that we may be unable to match;
- difficulties with the management of our growth and any periods in which we fail to grow in accordance with our plans;
- fluctuations in our operating results;
- difficulties we may encounter in connection with our efforts to expand internationally;
- difficulties we may encounter in connection with our efforts to offer additional types of services to our customers, including insurance products and consumer financing;
- difficulties we may encounter in connection with our efforts to develop code for the purposes of facilitating the creation of a decentralized facility for the trading of securities, and to create such a decentralized trading facility;
- the outcomes of legal proceedings, investigations and claims, including the outcome of our appeal of the judgment against us in the Droplets matter or the judgment obtained by the District Attorneys of a number of California counties as described in this report;
- our inability to optimize our warehouse operations;
- risks of inventory management and seasonality;
- the cost and availability of traditional and online advertising, the rapid changes in the online advertising business and the longer-term changes in the traditional advertising business, and the results of our various brand building and marketing campaigns; and
- the other risks described in this report or in our other public filings.

In evaluating all forward-looking statements, you should specifically consider the risks outlined above and in this Quarterly Report on Form 10-Q in Part II, Item 1A under the caption “Risk Factors” in Part I, Item 2 under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere in this report.

These factors may cause our actual results to differ materially from those contemplated by any forward-looking statement. Although we believe that our expectations reflected in the forward-looking statements are reasonable, we cannot guarantee or offer any assurance of future results, levels of activity, performance or achievements or other future events.

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Our forward-looking statements contained in this report 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 or any changes in our expectations or any change in any events, conditions or circumstances on which any of our forward-looking statements are based.

Available Information

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge through the Investors Relations section of our main website www.overstock.com as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Our Internet Website and the information contained therein or connected thereto are not a part of or incorporated into this Quarterly Report on Form 10-Q.

Overview

We are an online retailer offering price-competitive brand name, non-brand name and closeout merchandise, including furniture, home decor, bedding and bath, housewares, jewelry and watches, apparel and designer accessories, electronics and computers, and sporting goods, among other products. We also sell hundreds of thousands of best seller and current run books, magazines, CDs, DVDs and video games (“BMMG”). We sell these products and services through our Internet websites located at www.overstock.com, www.o.co and www.o.biz (referred to collectively as the “Website”). Although our three websites are located at different domain addresses, the technology and equipment and processes supporting the Website and the process of order fulfillment described herein are the same for all three websites.

Our company, based in Salt Lake City, Utah, was founded in 1997. We launched our initial website in March 1999 and were re-incorporated in Delaware in 2002. Our Website offers our customers an opportunity to shop for bargains conveniently, while offering our suppliers an alternative inventory liquidation or sales channel. We continually add new, and sometimes limited, inventory to our Website in order to create an atmosphere that encourages customers to visit frequently and purchase products before our inventory sells out. We sell products primarily in the United States.

We have two operating segments, direct and partner. Our direct business includes sales made to individual consumers and businesses, from our owned inventory and that are fulfilled primarily from our warehouse in Salt Lake City, Utah. For our partner business, we sell merchandise of other retailers, cataloguers or manufacturers ("partners") primarily through our Website. We are considered to be the primary obligor for the majority of these sales transactions and we record revenue from the majority of these sales transactions on a gross basis. Our use of the term "partner" does not mean that we have formed any legal partnerships with any of our partners.

As used herein, “Overstock,” “Overstock.com,”, “O.co,” “we,” “our” and similar terms include Overstock.com, Inc. and its subsidiaries, unless the context indicates otherwise.

Executive Commentary

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

This executive commentary includes forward-looking statements, and investors are cautioned to read “Special Cautionary Note Regarding Forward-Looking Statements.”

Revenues in Q1 2015 increased 17% compared to Q1 2014. The growth in revenue was primarily due to a 12% increase in orders, coupled with a 5% increase in average order size, from $165 to $174. In addition, the percentage of revenue we defer from orders taken but not delivered was less due to the timing of quarter end. These increases in revenue were partially offset by increased promotional activities including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions, and by an increase in returns. Although our average order size has increased in recent years, we expect the rate of increase to lessen as our sales mix shift into home and garden products tapers.

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Gross profit in Q1 2015 increased 18% compared to Q1 2014 primarily as a result of revenue growth. Gross margin increased to 18.9% in Q1 2015 compared to 18.8% in Q1 2014. The increase in gross margin was largely due to a continued shift in sales mix into higher margin home and garden products, partially offset by increased promotional activities including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions.

Sales and marketing expenses as a percentage of revenue increased from 6.9% to 7.0% during Q1 2015 as compared to the same period in 2014, primarily due to increased spending in the display ad and offline advertising marketing channels, partially offset by decreased staff-related costs and decreased spending in the email marketing channel.

As a result of these factors, we had a 17% increase in Contribution in Q1 2015 compared to Q1 2014 (see Non-GAAP Financial Measures below for a reconciliation of Contribution to Gross Profit). Contribution margin remained flat at 11.9% for both periods.

Technology expenses in Q1 2015 increased $3.5 million compared to Q1 2014, primarily due to an increase in depreciation of $1.6 million, an increase in staff-related costs of $1.5 million, and increased licensing and support costs of $441,000.

General and administrative expense in Q1 2015 increased $5.2 million compared to Q1 2014 primarily due to an increase of $1.9 million in staff and travel related costs, an increase in legal costs of $1.5 million, and a $1.3 million increase in management consulting services.

We continue to seek opportunities for growth by expanding our international sales and distribution footprint, through our crypto-initiatives, and through other means. As a result of these initiatives, we expect to continue to incur additional technology and G&A expenses, and may make investments in other technology companies. These expenses or investments may be material, and, coupled with the seasonality of our business, may lead to reduced income as compared to prior periods or to losses in some periods.

We are continuing the construction of our new corporate headquarters in Salt Lake City, Utah and we expect to complete the project in 2016. We estimate that the total project will cost approximately $95.4 million and as of March 31, 2015 have spent approximately $19.7 million toward the project. In connection with this project, we entered in to a loan agreement in 2014 which provides for an aggregate $55.8 million credit facility consisting of a term loan and revolving loan facility. We expect to begin borrowing under the facility in the second half of 2015. The construction project and related financing is discussed in further detail in the Liquidity and Capital Resources, Borrowings section below.

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

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Results of Operations

The following table sets forth our results of operations expressed as a percentage of total net revenue:

	Three months ended March 31,	
	2015	2014
	(as a percentage of total net revenue)	
Revenue, net		
Direct	9.1 %	11.2 %
Partner	90.9	88.8
Total net revenue	100.0	100.0
Cost of goods sold		
Direct	8.2	9.7
Partner	72.9	71.5
Total cost of goods sold	81.1	81.2
Gross profit	18.9	18.8
Operating expenses:		
Sales and marketing	7.0	6.9
Technology	5.8	5.7
General and administrative	5.2	4.5
Restructuring	—	(0.1)
Total operating expenses	18.0	17.0
Operating income	0.9	1.8
Interest income	—	—
Interest expense	—	—
Other income, net	0.2	0.1
Income before income taxes	1.1	1.9
Provision for income taxes	0.5	0.8
Consolidated net income	0.6 %	1.2 %

Comparison of Three Months Ended March 31, 2015 to Three Months Ended March 31, 2014

Revenue

The following table reflects our net revenues for the three months ended March 31, 2015 and 2014 (in thousands):

	Three months ended March 31,			
	2015	2014	$ Change	% Change
Revenue, net				
Direct	$36,135	$38,047	$(1,912)	(5.0)%
Partner	362,209	303,160	59,049	19.5
Total revenue, net	$398,344	$341,207	$57,137	16.7 %

The primary reason for increased total net revenue for the three months ended March 31, 2015, as compared to the same period in 2014, was a 12% increase in orders, coupled with a 5% increase in average order size, from $165 to $174. In addition, the percentage of revenue we defer from orders taken but not delivered was less due to the timing of quarter end. These increases in revenue were partially offset by increased promotional activities including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions, and by an increase in returns. Although our average order size has increased in recent years, we expect the rate of increase to lessen as our sales mix shift into home and garden products tapers.

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The primary reason for decreased direct revenue for the three months ended March 31, 2015, as compared to the same period in 2014, was an increase in gross returns and promotional activities including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions.

The increase in partner revenue for the three months ended March 31, 2015, as compared to the same period in 2014, was primarily due to an increase in sales of home and garden products, partially offset by an increase in gross returns and promotional activities including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions. Notwithstanding this increase, we do not expect the sales mix shift to home and garden products to continue at the same rate in the future as in recent years.

The shift of business from direct to partner (or vice versa) is an economic decision based on the economics of each particular product offering at the time and we generally do not have particular goals for an “appropriate” mix or percentage for the size of either. We believe that the mix of the business between direct and partner is consistent with our strategic objectives for our business model in the current economic environment and we do not currently foresee any material shifts in mix.

The product lines we offer, and their respective percentages of our revenue, are based on many factors including customer demand, our marketing efforts, promotional pricing and joint-marketing offered by our suppliers, and the types of liquidation inventory we are able to obtain. These factors change frequently and affect the mix of the product lines we sell. While we have experienced a trend toward our home and garden category in recent years, our business model is to deal primarily in price-competitive replenishable and closeout merchandise, which includes a wide variety of product offerings. While we do not currently expect any material shifts in our product line mix, the amount of the product lines we sell is an economic result of the factors described above, which may change from time to time.

We continue to seek increased participation in our Club O loyalty program. We also intend to increase Club O Rewards to our Club O members in lieu of coupons we offer to all customers. This may adversely impact our revenues if the incremental sales from our Club O members as a result of this change are less than any decrease in the sales from our current coupon program. For additional information regarding our Club O loyalty program see Item 1 of Part I, "Financial Statements (Unaudited)"—Note 2. Accounting Policies, Club O loyalty program.

International sales were less than 2% of total net revenues for the three months ended March 31, 2015 and 2014.

Change in estimate of average transit times (days)

Revenue related to merchandise sales is recognized upon delivery to our customers. As we ship high volumes of packages through multiple carriers, it is not practical for us to track the actual delivery date of each shipment. Therefore, we use estimates to determine which shipments are delivered and, therefore, recognized as revenue at the end of the period. Our delivery date estimates are based on average shipping transit times. We review and update our estimates on a quarterly basis based on our actual transit time experience. However, actual shipping times may differ from our estimates.

The following table shows the effect that hypothetical changes in the estimate of average shipping transit times would have had on the reported amount of revenue and income before taxes for the three months ended March 31, 2015 (in thousands):

	Three Months Ended March 31, 2015	
Change in the	Increase	Increase

Estimate of Average Transit Times (Days)	(Decrease) Revenue	(Decrease) Net Income
2	$(8,924)	$(1,357)
1	$(4,245)	$(644)
As reported	As reported	As reported
-1	$4,082	$615
-2	$13,139	$1,999

See "Executive Commentary" above for additional discussion regarding revenue.

Gross profit and gross margin

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Our overall gross margins fluctuate based on our sales volume mix between our direct business and partner business; changes in supplier cost and / or sales price, including competitive pricing; inventory management decisions within the direct business; sales coupons and promotions; product mix of sales; and operational and fulfillment costs.

The following table reflects our net revenues, cost of goods sold and gross profit for the three months ended March 31, 2015 and 2014 (in thousands):

	Three months ended March 31,			
	2015	2014	$ Change	% Change
Revenue, net				
Direct	$36,135	$38,047	$(1,912)	(5.0)%
Partner	362,209	303,160	59,049	19.5
Total net revenue	$398,344	$341,207	$57,137	16.7 %
Cost of goods sold				
Direct	$32,527	$33,097	$(570)	(1.7)%
Partner	290,380	244,114	46,266	19.0
Total cost of goods sold	$322,907	$277,211	$45,696	16.5 %
Gross Profit				
Direct	$3,608	$4,950	$(1,342)	(27.1)%
Partner	71,829	59,046	12,783	21.6
Total gross profit	$75,437	$63,996	$11,441	17.9 %

Gross margins for the past five quarterly periods and fiscal year ending 2014 were:

	Q1 2014	Q2 2014	Q3 2014	Q4 2014	FY 2014	Q1 2015
Direct	13.0 %	11.3 %	12.5 %	12.5 %	12.3 %	10.0 %
Partner	19.5 %	19.7 %	19.7 %	18.7 %	19.3 %	19.8 %
Combined	18.8 %	18.8 %	19.0 %	18.2 %	18.6 %	18.9 %

Total gross profit for the three months ended March 31, 2015 increased 18% as compared to the same period in 2014 primarily as a result of revenue growth. Total gross margin for the three months ended March 31, 2015 increased to 18.9% as compared to 18.8% during the same period in 2014. The increase in gross margin was largely due to a continued shift in sales mix into higher margin home and garden products, partially offset by increased promotional activities including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions. We do not expect the sales mix shift to home and garden products to continue at the same rate in the future as in recent years.

The 302 basis point decrease in direct gross margin for the three months ended March 31, 2015, as compared to the same period in 2014, was primarily due to increased promotional activities including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to driving a higher proportion of our sales using such promotions, increased warehousing costs, and increased returns costs.

The 35 basis point increase in partner gross margin for the three months ended March 31, 2015, as compared to the same period in 2014 was primarily due to a continued shift in sales mix into higher margin home and garden products, partially offset by increased promotional activities including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to driving a higher proportion of our sales using such promotions.

Cost of goods sold includes stock-based compensation expense of $29,000 and $40,000 for the three months ended March 31, 2015 and 2014, respectively.

See “Executive Commentary” above for additional discussion.

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Fulfillment costs

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

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

	Three months ended March 31,			
	2015		2014	
Total revenue, net	$398,344	100%	$341,207	100%
Cost of goods sold				
Product costs and other cost of goods sold	305,470	77%	261,798	77%
Fulfillment and related costs	17,437	4%	15,413	5%
Total cost of goods sold	322,907	81%	277,211	81%
Gross profit	$75,437	19%	$63,996	19%

Fulfillment costs as a percentage of sales may vary due to several factors, such as our ability to manage costs at our warehouses, significant changes in the number of units received and fulfilled, the extent to which we use third party fulfillment services and warehouses, and our ability to effectively manage customer service costs and credit card fees. Fulfillment and related costs remained relatively flat during the three months ended March 31, 2015 as compared to the same periods in 2014.

See “Gross profit” above for additional discussion.

Operating expenses

Sales and marketing expenses

We use a variety of methods to target our consumer audience, including online campaigns, such as advertising through keywords, product listing ads, display ads, search engines, affiliate marketing programs, social coupon websites, portals, banners, e-mail, direct mail and viral and social media campaigns. We also do brand advertising through television, radio, print ads, and event sponsorships.

The following table reflects our sales and marketing expenses for the three months ended March 31, 2015 and 2014 (in thousands):

	Three months ended March 31,			
	2015	2014	$ Change	% Change
Sales and marketing expenses	$27,972	$23,392	$4,580	19.6 %
Sales and marketing expenses as a percent of net revenues	7.0 %	6.9 %		

The 17 basis point increase in sales and marketing expenses as a percentage of revenue for the three months ended March 31, 2015, as compared to the same period in 2014, was primarily due to increased spending in the display ad and offline advertising marketing channels, partially offset by decreased staff-related costs and decreased spending in the email marketing channel.

Sales and marketing expenses include stock-based compensation expense of $59,000 and $81,000 for the three months ended March 31, 2015 and 2014, respectively.

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Costs associated with our discounted shipping and other promotions, such as coupons, are not included in marketing expense. Rather, they are accounted for as a reduction of revenue and therefore affect sales and gross margin. We consider discounted shipping and other promotions, such as our policy of free shipping on orders over $50, as an effective marketing tool, and intend to continue to offer them as we deem appropriate as part of our overall marketing plan.

Technology expenses

We seek to invest efficiently in technology, including web services, customer support solutions, website search, expansion of new and existing product categories, and in investments in technology to enhance the customer experience, improve our process efficiency and support and expand our logistics infrastructure. We expect to continue to increase our technology expenses to support these initiatives and these increases may be material.

We have experienced an increase in the frequency and variety of cyber attacks on our Website. The impact of these attacks, their costs, and the costs incurred to protect our Website against future attacks have not been material. However, we consider the threat from cyber attacks to be serious and will continue to incur costs relating to them.

The following table reflects our technology expenses for the three months ended March 31, 2015 and 2014 (in thousands):

	Three months ended March 31,			
	2015	2014	$ Change	% Change
Technology expenses	$23,087	$19,601	$3,486	17.8 %
Technology expenses as a percent of net revenues	5.8 %	5.7 %		

The $3.5 million increase in technology costs for the three months ended March 31, 2015, as compared to the same period in 2014, was primarily due to an increase in depreciation of $1.6 million, an increase in staff-related costs of $1.5 million, and increased licensing and support costs of $441,000.

We continue to seek opportunities for growth by expanding our international sales and distribution footprint, through our crypto-initiatives, and through other means. As a result of these initiatives, we expect to continue to incur additional technology and G&A expenses, and may make investments in other technology companies. These expenses or investments may be material, and, coupled with the seasonality of our business, may lead to reduced income as compared to prior periods or to losses in some periods.

Technology expenses include stock-based compensation expense of $120,000 and $170,000 for the three months ended March 31, 2015 and 2014, respectively.

General and administrative expenses

The following table reflects our general and administrative expenses ("G&A") for the three months ended March 31, 2015 and 2014 (in thousands):

	Three months ended March 31,			
	2015	2014	$ Change	% Change
General and administrative expenses	$20,534	$15,296	$5,238	34.2 %
General and administrative expenses as a percent of net revenues	5.2 %	4.5 %		

The $5.2 million increase in general and administrative expenses (“G&A”) for the three months ended March 31, 2015, as compared to the same period in 2014, was primarily due to an increase of $1.9 million in staff and travel related costs, an increase in legal costs of $1.5 million, and a $1.3 million increase in management consulting services.

G&A expenses include stock-based compensation expense of approximately $570,000 and $632,000 for the three months ended March 31, 2015 and 2014, respectively.

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Depreciation expense

Depreciation expense is classified within the corresponding operating expense categories on the consolidated statements of operations as follows (in thousands):

	Three months ended March 31,	
	2015	2014
Cost of goods sold - direct	$65	$87
Technology	4,999	3,437
General and administrative	312	271
Total depreciation and amortization, including internal-use software and website development	$5,376	$3,795

Other income

Other income, net for the three months ended March 31, 2015 was $605,000 as compared to $459,000 in 2014. The change is primarily due to increased Club O Rewards breakage of $336,000 due to increased participation in the Club O Rewards program, including our recently introduced Club O Silver program, partially offset by losses on crypto-currency of $117,000 and a decrease in gift card breakage of $95,000.

Income taxes

Our provision for income taxes for the three months ended March 31, 2015 and 2014 was $1.9 million and $2.6 million, respectively. The decrease in the 2015 provision relative to the 2014 provision is primarily due to a decrease in pre-tax income in the same quarter. The effective tax rate for the three months ended March 31, 2015 and 2014 was 43.2% and 39.5%, respectively. The increase in the effective tax rate is attributable to an increase in the valuation allowance related to the deferred tax asset for unrealized capital losses and losses in certain jurisdictions where no benefit can be recognized. We have indefinitely reinvested foreign earnings of $171,000 at March 31, 2015. We would need to accrue and pay U.S. income tax on this amount if repatriated. We do not intend to repatriate these earnings.

Seasonality

Based upon our historical experience, revenue typically increases during the fourth quarter because of the holiday retail season and gross margin decreases due to increased sales of certain lower margin products, such as electronics. The actual quarterly results for each quarter could differ materially depending upon consumer preferences, availability of product and competition, among other risks and uncertainties. Accordingly, there can be no assurances that seasonal variations will not materially affect our results of operations in the future.

The following table reflects our total net revenues for each of the quarters in 2015, 2014 and 2013 (in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2015	$ 398,344	$ N/A	$ N/A	$ N/A
2014	341,207	332,545	352,991	470,360
2013	311,994	293,204	301,426	397,593

Liquidity and Capital Resources

Current sources of liquidity

Subject to our need for additional financing for a portion of the anticipated costs of completing our new corporate headquarters as described below, we believe that the cash and cash equivalents currently on hand and expected cash flows from future operations will be sufficient to continue operations for at least the next twelve months. However, we may require additional financing for the completion of the new corporate headquarters and related equipment and furniture. Although we are attempting to obtain additional financing, there can be no assurance that we will be able to do so, or that any financing available will be available on satisfactory terms. Our failure to generate sufficient revenues or profits or to obtain additional financing or raise additional capital could have a material adverse effect on our operations and on our ability to achieve our intended business objectives. Any projections of future cash needs and cash flows are subject to substantial uncertainty.

As we have previously announced, we plan to build a new corporate headquarters in Salt Lake City, Utah. We currently estimate the total cost of the headquarters, including the cost of the land and related equipment and furniture, at approximately $95.4 million. We have spent approximately $19.7 million toward the project as of March 31, 2015. In 2014, we entered into a syndicated senior secured credit facility with U.S. Bank National Association, and other banks which provides for an approximately 27-month construction loan of $45.8 million (which is designed to subsequently convert into an approximately 6.75-year term loan following completion of the construction of the headquarters), and a three-year $10.0 million revolving loan facility that terminates on October 24, 2017 but may be renewed with the consent of all lenders.

The actual amount of financing to be available under the construction loan facility will be limited by a loan-to-value limit of 80% based on periodic appraisals. The loan agreement requires us to fund a substantial portion of the project costs ($37.4 million) prior to any draws on either the term loan facility or the revolving facility. We have the right to prepay either loan without penalty at any time.

If the conditions to the conversion of the construction loan into the term loan are not satisfied in early 2017, both the construction loan and the revolver would become due immediately. This would have a material adverse effect on our liquidity.

The $10.0 million in financing to be available under the revolving loan facility may be used for working capital, capital expenditures and other corporate purposes, but may not be used for the construction of the headquarters. In order to draw on either the construction loan or the revolving loan we are required to satisfy a number of conditions set forth in the loan agreement. Based on these conditions (primarily the requirement to fund a substantial portion of the project costs) we do not expect to draw on the construction loan until the second half of 2015 (see Borrowings - U.S. Bank term loan and revolving loan agreement below).

We expect to continue discussions with the bank regarding additional financing for equipment and furniture for our new corporate headquarters, when we are nearer to completion of construction.

Our principal sources of liquidity are cash flows generated from operations, and our existing cash and cash equivalents. At March 31, 2015, we had cash and cash equivalents of $124.3 million.

Cash flow information is as follows (in thousands):

	Three months ended March 31,		Twelve months ended March 31,	
	2015	2014	2015	2014
Cash provided by (used in):				
Operating activities	$(43,089)	$(29,679)	$67,424	$55,619
Investing activities	(11,707)	(6,152)	(49,985)	(26,167)
Financing activities	(2,523)	(2,187)	(3,764)	(700)

Free cash flow

“Free Cash Flow” (a non-GAAP measure) for the three months ended March 31, 2015 and 2014, was $(49.7) million and $(35.9) million, respectively, and $25.7 million and $37.4 million for the twelve months ended March 31, 2015 and 2014, respectively. See Non-GAAP Financial Measures below for a reconciliation of Free Cash Flow to net cash provided by (used in) operating activities.

Cash flows from operating activities

For the three months ended March 31, 2015 and 2014, our operating activities resulted in net cash outflows of $43.1 million and $29.7 million, respectively.

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Cash received from customers generally corresponds to our net revenues as our customers primarily use credit cards to buy from us causing our receivables from these sales transactions to settle quickly. We have payment terms with our partners that generally extend beyond the amount of time necessary to collect proceeds from our customers. As a result, following our typically seasonally strong fourth quarter sales, at December 31 of each year, our cash, cash equivalents, accounts payable and accrued liability balances normally reach their highest level (other than as a result of cash flows provided by or used in investing and financing activities). However, our accounts payable and accrued liability balances normally decline during the first three months following year-end, which normally results in a decline in our cash and cash equivalents balances from the year-end balance. The seasonality of our business causes payables and accruals to grow significantly in the fourth quarter, and then decrease in the first quarter when they are typically paid.

The $43.1 million of net cash used by operating activities during the three months ended March 31, 2015 was primarily due to decreases in accounts payable of $45.2 million, accrued liabilities of $10.4 million, and deferred revenue of $4.7 million. Accounts payable and deferred revenue decreased due to seasonality which caused high balances at year-end 2014 and a significant decline during 2015. The decrease in accrued liabilities was primarily attributable to decreases in our returns allowance due to seasonality. The net cash used by operating activities during the three months ended March 31, 2015 was partially offset by non-cash depreciation and amortization expense of $5.4 million, a decrease in accounts receivable of $3.3 million and net income of $2.5 million.

The $29.7 million of net cash used by operating activities during the three months ended March 31, 2014 was primarily due to decreases in accounts payable of $31.9 million and accrued liabilities of $13.7 million. Accounts payable increased in Q4 2013 due to increased sales and in part due to the timing of key holiday sales. In 2013, the holiday sales season began later than in previous years, and as a result some of our payments to our suppliers for holiday sales were due in January 2014 rather than in December 2013. This caused a significant increase in accounts payable during Q4 2013 and a significant decrease in accounts payable during Q1 2014. Accrued liabilities increased during Q4 2013 due to the timing of some invoices related to marketing expenses and legal matters which were paid in Q1 2014. The net cash used by operating activities during the three months ended March 31, 2014 was partially offset by a reduction in inventory of $4.3 million, net income of $4.0 million, and non-cash depreciation, amortization and stock compensation expense of $4.7 million.

Cash flows from investing activities

For the three months ended March 31, 2015 investing activities resulted in net cash outflows of $11.7 million primarily due to $6.6 million of expenditures for fixed assets and a $5.0 million cost method investment.

For the three months ended March 31, 2014, investing activities resulted in net cash outflows of $6.2 million, primarily from expenditures for fixed assets.

Cash flows from financing activities

For the three months ended March 31, 2015 and 2014, financing activities resulted in net cash outflows of $2.5 million and $2.2 million, respectively.

The $2.5 million used in financing activities during the three months ended March 31, 2015 and the $2.2 million used during the same period in 2014 resulted primarily from the purchase of shares of our common stock withheld for minimum tax withholdings upon the vesting of a portion of certain restricted stock award grants.

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Contractual Obligations and Commitments

The following table summarizes our contractual obligations as of March 31, 2015 and the effect such obligations and commitments are expected to have on our liquidity and cash flow in future periods (in thousands):

	Payments Due by Period						
Contractual Obligations	Remainder of 2015	2016	2017	2018	2019	Thereafter	Total
Operating leases	$8,571	$9,342	$4,963	$4,585	$3,916	$28,521	$59,898
Naming rights	1,351	1,391	—	—	—	—	2,742
Purchase obligations	22,814	—	—	—	—	—	22,814
Technology, marketing and other services	2,292	2,118	—	—	—	—	4,410
Headquarters construction costs	36,316	39,236	208	—	—	—	75,760
U.S. Bank term loan payments	186	1,801	3,110	3,158	3,106	49,604	60,965
Total contractual cash obligations (1)	$71,530	$53,888	$8,281	$7,743	$7,022	$78,125	$226,589

(1) As described below under "U.S. Bank Term Loan Payments," $45.8 million of the payments shown here is duplicative. See U.S. Bank term loan payments below.

	Amounts of Commitment Expiration Per Period						
Other Commercial Commitments	2015	2016	2017	2018	2019	Thereafter	Total
Letters of credit	$505	$—	$—	$—	$—	$—	$505

Operating leases

From time to time we enter into operating leases for facilities and equipment for use in our operations.

Naming rights

During 2011, we entered into a six-year agreement with the Oakland-Alameda County Coliseum Authority (“OACCA”) for the right to name Oakland Alameda County Coliseum (now known as “O.co Coliseum”). Amounts represent annual payments due OACCA for the naming rights. We have the right to terminate this agreement at our sole option, subject to payment of a termination fee.

Purchase obligations

The amount of purchase obligations shown above is based on assumptions regarding the legal enforceability against us of inventory purchase orders we had outstanding at March 31, 2015. 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.

Technology, marketing and other services

From time to time we enter into long-term contractual agreements for technology, marketing or other services.

Headquarters construction costs

We have entered into various agreements under which we have incurred obligations relating to our plans to build an approximately 225,000 square foot building in Salt Lake City, Utah, to serve as our corporate headquarters, together with related facilities and improvements (collectively, the “Project”). We expect the total Project costs to be approximately $95.4 million. Under the financing agreement described below we are required to fund the first $37.4 million of project costs before we can draw on the loan. At March 31, 2015 we had funded approximately $19.7 million toward the project, including approximately $11.0 million we paid to purchase the land. Our obligations include payments to become due under the

Construction Agreement described below, and under engineering, architectural, project management and consulting agreements, as well as anticipated expenditures for fixed assets and various other anticipated obligations related to the Project. These costs are based on our current estimates; however, the costs we actually incur, the amounts we actually pay and the timing of the actual payments could vary significantly from these estimates.

U.S. Bank term loan payments

We have entered into a financing agreement related to the Project (see Borrowings below). The amounts presented reflect our estimated payments of principal and interest based on our anticipated draws on the loan. The timing and amount of our draws on the loan could vary significantly from these estimates. Further, $45.8 million of the amounts shown in the row titled "U.S. Bank term loan payments" reflect the scheduled repayment of the financing of $45.8 million of costs shown in the row titled "Headquarters construction costs."

Construction agreement

We estimate the total cost of building our corporate headquarters, including the land and related equipment and furniture, at approximately $95.4 million over approximately the next two years. Our wholly owned subsidiary O.com Land is party to a construction agreement (the “Construction Agreement”) with Okland Construction Company Inc. (“Okland”) regarding preconstruction and construction services to be provided by Okland in connection with the construction of the Project.

In accordance with the Project Milestones as described in the Construction Agreement, Okland is required to Substantially Complete the Work (as such term is defined in the Construction Agreement) within 100 weeks following the commencement of the Construction Phase (as defined in the Construction Agreement) subject to modification under certain circumstances. Pursuant to the Construction Agreement, O.Com Land agreed to make progress payments to Okland for construction services as set forth in the Construction Agreement, and subject to a 5% retention on progress payments for the Work.

Tax contingencies

As of March 31, 2015 and December 31, 2014, tax contingencies were $780,000 and $709,000, respectively. We expect the total amount of tax contingencies to increase in the future. In addition, changes in state, federal, and foreign tax laws may increase our tax contingencies. The timing of the resolution of income tax examinations is highly uncertain, and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ from the amounts accrued. While it is reasonably possible that within the next 12 months we will receive additional assessments by various tax authorities or reach resolution of income tax examinations in one or more jurisdictions, we do not anticipate that we will make any payments to such authorities during that period. These assessments or settlements may or may not result in changes to our contingencies related to positions on prior years’ tax filings.

Borrowings

U.S. Bank term loan and revolving loan agreement

On October 24, 2014, we entered into a syndicated senior secured credit facility (the “Facility”) with U.S. Bank National Association ("U.S. Bank" or the "Administrative Bank") and certain other banks. The Facility is governed by a Loan Agreement dated as of October 24, 2014 and collateral and other agreements. The Loan Agreement provides for an aggregate credit amount of $55.8 million, consisting of (i) a senior secured real estate loan of $45.8 million (the “Real Estate Loan”) to be used to finance a portion of the development and construction of the Project described above, and

(ii) a three-year $10.0 million senior secured revolving credit facility (the “Revolving Loan”) for working capital and capital expenditures, but not construction of the Project. We must satisfy a number of conditions at least 60 days prior to any funding under the Facility, including making cash contributions totaling approximately $37.4 million toward the Project. We may also be required to make additional cash contributions if necessary to maintain a loan to value ratio of 80% or less. The Real Estate Loan and the Revolving Loan are both secured by the Project, our inventory and accounts receivable, substantially all of our deposit accounts and related assets. We expect to satisfy the conditions to funding under the Facility in the second half of 2015.

The Real Estate Loan is intended initially to provide financing for a portion of the construction of the Project. On or about January 1, 2017 (subject to one potential extension of up to three months, and subject to potential additional extensions of up to 30 days for force majeure), upon completion of the Project, the Real Estate Loan is designed to convert into an approximately 6.75-year term loan due October 1, 2023 (the "Term Loan"). The conditions to conversion of the Real Estate Loan to the Term Loan include, among others, requirements that the Project must have been completed in accordance with the applicable plans, paid for in full, and be generally free of liens; completion must have been certified by the project architect and the inspecting architect; certificates of occupancy must have been issued; we must have paid all amounts then due to the Banks and must be in compliance with the covenants under the Loan Agreement; the Real Estate Loan must be or must be brought "in balance" as defined in the Loan Agreement, which may require us to contribute additional cash to the Project; we must have paid the final amount of our cash contribution as required by the Loan Agreement; and if required by the Administrative Bank, an updated appraisal must show that the Project is in compliance with an 80% loan to value ratio requirement (or we must pay down the principal balance and/or agree to reduce the amount of the Term Loan commitment to reach the required ratio). If the conditions to conversion are not satisfied in early 2017, all amounts outstanding under the Facility will become immediately due and payable.

Amounts outstanding under the Real Estate Loan and the Term Loan will carry an interest rate based on LIBOR plus 2.00% or an Alternate Base Rate plus 1.00%. However, we have entered into interest rate swap agreements with U.S. Bank and Compass Bank designed to fix our interest rate on the Real Estate Loan and the Term Loan at approximately 4.6% annually. Monthly payments of interest only will be due and payable on the Real Estate Loan prior to conversion, after which monthly payments of principal in the amount of $1.1 million annually plus interest will be due and payable, with a balloon payment of all then unpaid principal (estimated to be $38.0 million), interest and other amounts due and payable on the Term Loan due on October 1, 2023. Amounts outstanding under the Revolving Loan will carry an interest rate based on LIBOR plus 2.00% or an Alternate Base Rate plus 1.00%.

We are required to maintain compliance as of the end of each calendar quarter beginning with the quarter ending December 31, 2014 with the following financial covenants:

- a fixed charge coverage ratio on a trailing 12-month basis of no less than 1.15 to 1.00;
- a cash flow leverage ratio on a trailing 12-month basis not greater than 3.00 to 1.00 during the Construction Phase (as defined in the Loan Agreement);
- a cash flow leverage ratio not greater than 2.50 to 1.00 following the Construction Phase; and
- minimum liquidity of at least $50.0 million.

At March 31, 2015, we were in compliance with the financial covenants. In addition to the financial covenants described above, we are required to comply with a number of covenants relating to the Project and our business, including covenants limiting certain indebtedness, including senior-secured indebtedness consisting of interest-bearing debt for borrowed money or for financed assets. However, the Loan Agreement permits us to incur up to $20.0 million principal amount of additional senior-secured indebtedness for equipment financing, and other senior-secured indebtedness provided that the aggregate principal amount of such other senior-secured indebtedness does not exceed ten percent of our consolidated assets. The Loan Agreement includes customary events of default in addition to events of default relating specifically to the Project. The Real Estate Loan and the Revolving Loan are cross-defaulted and cross-collateralized. In the event of a default, the default rate of interest would be 2.00% above the otherwise applicable rate.

Unless it terminates earlier or is extended with the consent of the Administrative Bank and all of the Banks, the Revolving Loan facility will terminate on October 24, 2017.

As of March 31, 2015 and as of April 20, 2015, we had not borrowed any amounts under either the Real Estate Loan or the Revolving Loan.

U.S. Bank letters of credit

As of March 31, 2015 and December 31, 2014, letters of credit totaling $505,000 and $580,000 respectively, were issued on our behalf collateralized by compensating cash balances held at U.S. Bank, which are included in restricted cash in the accompanying consolidated balance sheets.

U.S. Bank commercial purchasing card agreement

We have a commercial purchasing card (the “Purchasing Card”) agreement with U.S. Bank. We use the Purchasing Card for business purpose purchasing and must pay it in full each month. At March 31, 2015, $1.5 million was outstanding and

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$3.5 million was available under the Purchasing Card. At December 31, 2014, $803,000 was outstanding and $4.2 million was available under the Purchasing Card.

Off-Balance Sheet Arrangements

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

Critical Accounting Policies and Estimates

The preparation of our financial statements requires that we make estimates and judgments. We base these on historical experience and on other assumptions that we believe to be reasonable. Our critical accounting policies are discussed in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of our Annual Report on Form 10-K for the year ended December 31, 2014, and our accounting policies and use of estimates are further discussed in Note 2 to the financial statements included in this Form 10-Q and elsewhere in this Management's Discussion and Analysis of Financial Condition and Results of Operations. There have been no material changes to the critical accounting policies previously disclosed in that report.

Non-GAAP Financial Measures

Regulation G, Conditions for Use of Non-GAAP Financial Measures, and other SEC regulations regulate the disclosure of certain non-GAAP financial information.

Contribution and Contribution Margin

Contribution (a non-GAAP financial measure which we reconcile to "Gross profit" in our consolidated statements of income and comprehensive income) consists of gross profit less sales and marketing expense and reflects an additional way of viewing our results. Contribution Margin is Contribution as a percentage of revenues. When viewed together with our GAAP results, we believe Contribution and Contribution Margin provide management and users of the financial statements information about our ability to cover our operating costs, such as technology and general and administrative expenses. Contribution and Contribution Margin are used in addition to and in conjunction with results presented in accordance with GAAP and should not be relied upon to the exclusion of GAAP financial measures. You should review our financial statements and publicly-filed reports in their entirety and not rely on any single financial measure. The material limitation associated with the use of Contribution is that it is an incomplete measure of profitability as it does not include all operating expenses or non-operating income and expenses. Management compensates for these limitations when using this measure by looking at other GAAP measures, such as operating income and net income.

For further details on Contribution and Contribution Margin, see the calculation of these non-GAAP financial measures below (in thousands):

	Three months ended March 31,			
	2015		2014	
Total net revenue	$398,344	100%	$341,207	100%
Cost of goods sold	322,907	81.1	277,211	81.2
Gross profit	75,437	18.9	63,996	18.8
Less: Sales and marketing expense	27,972	7.0	23,392	6.9
Contribution and contribution margin	$47,465	11.9%	$40,604	11.9%

Free cash flow

Free cash flow (a non-GAAP financial measure) reflects an additional way of viewing our cash flows and liquidity that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our cash flows and liquidity. Free cash flow, which we reconcile to “Net cash provided by (used in) operating activities,” is net cash provided by operating activities reduced by “Expenditures for fixed assets, including internal-use software and website

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development." We believe that net cash provided by operating activities is an important measure, since it includes both the cash impact of the continuing operations of the business and changes in the balance sheet that impact cash. However, we believe free cash flow is a useful measure to evaluate our business since purchases of fixed assets are a necessary component of ongoing operations and free cash flow measures the amount of cash we have available for mandatory debt service and financing obligations, changes in our capital structure, and future investments after purchases of fixed assets. Therefore, we believe it is important to view free cash flow as a complement to our entire consolidated statements of cash flows as calculated below (in thousands):

	Three months ended March 31,	Twelve months ended March 31,