

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

(MARK
ONE)

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

For the fiscal year ended December 31, 2003

OR

**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

(State or other jurisdiction of
incorporation or organization)

87-0634302

(I.R.S. Employer
Identification Number)

6322 South 3000 East, Suite 100

Salt Lake City, Utah 84121

(Address of principal executive offices including zip code)

(801) 947-3100

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$0.0001 par value (title of class)

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), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant as of the last business day of the registrant's most recently completed second quarter (June 30, 2003), was approximately \$150 million based upon the last sales price reported for such date on The NASDAQ Stock Market's National Market. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 5% of the outstanding shares of Common Stock and shares held by officers and directors of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination is not necessarily conclusive.

OVERSTOCK.COM,INC.
ANNUAL REPORT ON FORM 10-K

INDEX

Part I.

- Item [Special Note Regarding Forward-Looking Statements](#)
- Item [Business](#)
- 1.
- Item [Properties](#)
- 2.
- Item [Legal Proceedings](#)
- 3.
- Item [Submission of Matters to a Vote of Security Holders](#)
- 4.

Part II.

- Item [Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities](#)
- 5. [Purchases of Equity Securities](#)
- Item [Selected Financial Data](#)
- 6.
- Item [Management's Discussion and Analysis of Financial Condition and Results of Operation](#)
- 7.
- Item [Quantitative and Qualitative Disclosures About Market Risk](#)
- 7A.
- Item [Financial Statements and Supplementary Data](#)
- 8.
- Item [Changes in and Disagreements with Accountants on Accounting and Financial Disclosure](#)
- 9.
- Item [Controls and Procedures](#)
- 9A.

Part III.

- Item [Directors and Executive Officers of the Registrant](#)
- 10.
- Item [Executive Compensation](#)
- 11.
- Item [Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters](#)
- 12. [Matters](#)
- Item [Certain Relationships and Related Transactions](#)
- 13.
- Item [Principal Accountant Fees and Services](#)
- 14.

Part IV.

- Item [Exhibits, Financial Statement Schedules and Reports on Form 8-K](#)
- 15.
- [Signatures](#)
- [Exhibit Index](#)
- [Financial Statements](#)

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PART I
SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-K contains 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. 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. These statements include, but are not limited to, statements concerning:

- the anticipated benefits and risks of our business relationships;
- our ability to attract retail and business customers;
- the anticipated benefits and risks associated with our business strategy;
- our future operating results;
- the anticipated size or trends of the market segments in which we compete and the anticipated competition in those markets;
- potential government regulation;
- our future capital requirements and our ability to satisfy our capital needs;
- our expansion in international markets;
- the potential for additional issuances of our securities;
- our plans to devote substantial resources to our sales and marketing teams;
- the possibility of future acquisitions of businesses, products or technologies;
- our belief that we can attract customers in a cost-efficient manner;
- our strategy to develop strategic business relationships with additional wholesalers and distributors;
- our belief that current or future litigation will likely not have a material adverse effect on our business;
- our belief that certain of our stockholders are unlikely to exercise any rights of rescission or certain other remedies that they may possess;
- the anticipated anti-takeover effects of certain provisions of our charter documents;
- the ability of our online marketing campaigns to be a cost-effective method of attracting customers;

- possible technological improvements to existing inventory management systems, distribution and order fulfillment, network infrastructure and website features;
- our belief that manufacturers will recognize us as an efficient liquidation solution;
- our belief that the national television and radio branding campaign we began during 2003 will be effective and that the results of the campaign will justify its expense;
- our belief that the efforts we made during 2003 to improve the search function capabilities of our Websites will be effective and that we will be able to further improve those capabilities;
- our belief that the increases we made during 2003 in the scope of our Books, Music and Video department offerings will be attractive to customers and will result in increased sales of higher margin products;

- 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 belief that our information technology infrastructure, including the database cluster technology we implemented in late 2003, can and will support our operations and will not suffer significant downtime;
- our belief that the actions we took in late 2003 to improve the efficiency of our warehouse and to decrease our costs of providing customer service will be effective and will not have adverse effects on our business;
- our belief that the personnel adjustments we made in early 2004, which reduced our aggregate annual compensation by approximately \$1.5million, will not have adverse effects on our business;
- our belief that we can maintain inventory levels at appropriate levels despite the seasonal nature of our business; and
- our belief that we can successfully offer and sell a constantly changing mix of products and services, including those we recently introduced in our new travel department, ranging across a wide variety of price points.

Furthermore, in some cases, you can identify forward-looking statements by terminology such as may, will, could, should, expect, plan, intend, anticipate, believe, estimate, predict, potential or continue, the negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially. In evaluating these statements, you should specifically consider the risks outlined in this Form10-K, including those described in Item 1 under the caption "Risk Factors." These factors may cause our actual results to differ materially from those contemplated by any forward-looking statement. Except as otherwise required by law, we expressly disclaim any obligation to release publicly any update or revisions to any forward-looking statements to reflect any changes in our expectations or any change in events, conditions or circumstances on which any of our forward-looking statements are based. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

ITEM 1. BUSINESS

The following description of our business contains forward-looking statements relating to future events or our future financial or operating performance that involve risks and uncertainties, as set forth under "Special Note Regarding Forward-Looking Statements." Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under the heading "Risk Factors" and elsewhere in this Form10-K.

Overview

We are an online "closeout" retailer offering discount, brand-name merchandise for sale primarily over the Internet. Our merchandise offerings include bed-and-bath goods, kitchenware, watches, jewelry, electronics, sporting goods and designer accessories. We also sell books, magazines, CDs, DVDs, video cassettes and video games ("BMV"). We offer our customers an opportunity to shop for bargains conveniently, while offering our suppliers an alternative inventory liquidation distribution channel. We typically offer approximately 12,000 non-BMV products and approximately 500,000 BMV products in up to twelve departments on our Websites, www.overstock.com, www.overstockb2b.com and

www.worldstock.com. We also offer travel services, including airline tickets, hotel reservations and car rentals. We continually add new, limited inventory products to our Websites in order to create an atmosphere that encourages customers to visit frequently and purchase products before our inventory sells out.

Closeout merchandise is typically available in inconsistent quantities and prices and often is only available to consumers after it has been purchased and resold by disparate liquidation wholesalers. We believe that the traditional liquidation market is therefore characterized by fragmented supply and fragmented demand. Overstock utilizes the Internet to aggregate both supply and demand and create a more efficient market for liquidation merchandise.

We have a "direct" business, in which we buy and take possession of excess inventory for resale. We also have our "fulfillment partner" business, which we formerly called our "commission" business. In our "fulfillment partner" business, we sell merchandise of other retailers, cataloguers or manufacturers ("fulfillment partners") through our Websites. For both our direct and our fulfillment partner businesses we have a consumer and a business-to-business ("B2B") sales channel. Therefore, our business consists primarily of four combinations of these components: direct consumer, direct B2B, fulfillment partner consumer and fulfillment partner B2B.

Industry Overview

Manufacturers and retailers traditionally hold inventory to buffer against uncertain demand within their normal, "inline" sales channels. Inline sales channels are manufacturers' primary distribution channels, which are characterized by regularly placed orders by established retailers at or near wholesale prices. In recent years, several dynamics have shifted inventory risk from retailers to manufacturers, including:

- dominant retailers insist on just-in-time deliveries from manufacturers;
- dominant retailers often cancel orders mid-production and return unsold merchandise;
- style, color or model changes can quickly turn inventory into closeout merchandise;
- incorrect estimates of consumer demand which can lead to overproduction; and
- changes in a retailer's financial situation or strategy results in cancelled orders.

The disposal of excess, or overstock, inventory represents a substantial burden for many manufacturers, especially those who produce high-quality branded merchandise. Manufacturers seek to avoid liquidating through traditional retail channels where the manufacturer's discounted products may be sold alongside other full-price products. This can result in weaker pricing and decreased brand strength, and is known as channel conflict or sales channel pollution. As a result, many manufacturers turn to liquidation wholesalers and discount retailers. These liquidation channels provide manufacturers limited control of distribution and are, we believe, unreliable and expensive to manage when compared with their inline channels.

Despite the challenges encountered by manufacturers in the liquidation market, the proliferation of outlet malls, wholesale clubs and discount chains is evidence of the strong level of consumer demand for discount and closeout merchandise. However, consumers face several difficulties in shopping for closeout and overstock merchandise. For example, many traditional merchandise liquidation outlets are located in remote locations and have limited shopping hours, which we believe makes shopping burdensome and infrequent for many consumers. In addition, the space available in a traditional merchandise liquidation outlet constrains the number of products that a traditional merchandise liquidation outlet can offer at any given time.

However, we believe that the market for online liquidation is still early in its development and is characterized by only a limited number of competitors, some of which utilize an auction model to price their goods. Furthermore, we believe that there are no dominant companies in the online liquidation market, and many of the companies that do offer overstock or liquidation merchandise are focused on single product lines.

Lastly, small retailers are under competitive pressure from large national retailers. Small retailers generally do not have purchasing leverage with manufacturers; consequently, they are more likely to pay full wholesale prices and are more likely to receive inferior service. We believe that small retailers generally do not have access to the liquidation market because liquidation wholesalers are most often interested in liquidating large volumes of merchandise, rather than the small quantities appropriate for small, local retailers.

The Overstock Solution

Overstock utilizes the Internet to create a more efficient market for liquidation merchandise. We provide consumers and businesses with quick and convenient access to high-quality, brand-name merchandise at discount prices. We believe we are unlike other online liquidators because we focus on multiple product lines, offer a single price (as opposed to an auction format), and serve both businesses and consumers.

We have a "direct" business, in which we buy and take possession of inventory for resale. We also have our "fulfillment partner" business, which we formerly called our "commission" business. In our "fulfillment partner" business, we sell merchandise of other retailers, cataloguers or manufacturers ("fulfillment partners") through our Websites. We currently have fulfillment partner relationships with approximately 250 third parties which post over 6,000 non-BMV products on our Websites. Prior to July 1, 2003, we did not physically handle the merchandise we sold for our fulfillment partners, as the merchandise was shipped directly by them. They also handled all customer returns related to those sales. Beginning July 1, 2003, we took responsibility for all returned items relating to these sales and we now handle the possible resale of any returned items. We made the decision to change this policy to have more control over the Overstock customer shopping experience, as we believe that a seamless customer experience is key to creating loyal, long-term customers. By accepting returns at our warehouse, we can verify that fulfillment partner products are being packaged and shipped to our standards. Additionally, as customer returns are now all shipped to one location, the process is much more simple and convenient for our customers. As a result, beginning July 1, 2003, we are considered to be the primary obligor for these sales transactions, and we assume the risk of loss on the returned items. As a consequence, we now record revenue from sales transactions involving our fulfillment partners (excluding travel products) on a gross basis, rather than recording a commission on those sales as we did prior to July 1, 2003.

During the fourth quarter of 2003, we added a discount travel store to our Website. We use a fulfillment partner to supply the travel products (flights, hotels, rental cars, etc.) in our travel store. For the products sold in our travel store, we do not currently have inventory risk or pricing control, and do not directly provide customer service. Therefore, for these sales we are not considered to be the primary obligor, and record only our commission as revenue.

For both our direct and our fulfillment partner businesses we have a consumer and a business-to-business ("B2B") sales channel. Therefore, our business consists primarily of four combinations of these components: direct consumer, direct B2B, fulfillment partner consumer and fulfillment partner B2B. During 2003, we also operated a warehouse store from our Salt Lake City warehouse where we sold certain items that could not be economically sold on our Websites. Sales from the warehouse store in 2003 accounted for less than 1% of our total revenue, and in January 2004, we closed the warehouse store.

Overstock provides manufacturers with a one-stop liquidation channel to sell both large and small quantities of excess and closeout inventory without disrupting sales through traditional channels. Key advantages for manufacturers liquidating their excess inventory through Overstock include:

- *Resolution of channel conflict.* Channel conflicts arise when a manufacturer's excess inventory is sold through the same channel as their other product offerings. Since excess inventory is usually sold at a discount, sales of the manufacturer's other product offerings may be impacted as a consumer in a retail store may opt for the excess product or become confused by the pricing and model discrepancies. By using Overstock, manufacturers have an alternative and independent channel where they can sell excess inventory without the fear of hindering the sale of their other products.
- *Single point of distribution.* Manufacturers often use multiple liquidation sources to clear their excess inventory. Multiple sources create additional logistics issues that they would rather avoid. By using Overstock, manufacturers have a single source for the distribution of excess inventory.
- *Improved control of distribution.* By using Overstock, manufacturers can monitor what kind of customer, whether individual consumer or small retailer, ultimately purchases their merchandise. In addition, a manufacturer can request that its products be offered in only one of our sales channels in order to avoid sales channel pollution.
- *Improved transaction experience.* By having a reliable inventory clearing channel, manufacturers are able to more quickly and easily dispense of their excess merchandise.

Overstock also offers consumers a compelling alternative for bargain shopping. Key advantages for consumers include:

- *High quality and broad product selection.* Most of the merchandise offered on our Websites is from well-known, brand-name manufacturers. We typically have approximately 12,000 non-BMV products and approximately 500,000 BMV products (books, magazines, CDs, DVDs, video cassettes and video games) in up to twelve departments.
- *Convenient access on a secure site.* Our customers are able to access and purchase our products 24hours a day from the convenience of their home or office. Further, we do not sell any personal information about our customer base to third parties.
- *Responsive customer service and positive shopping experience.* Our team of customer service representatives (which includes employees, temporary employees and outsourced staff) assists customers by telephone and e-mail. Our customer service staff answers approximately 85% of phone calls within 30 seconds, and responds to approximately 98% of its e-mails within 12hours. For our consumer business, we include a return shipment label in our customer's shipment to facilitate product returns and, subject to certain conditions, we allow customers up to 15days to initiate the return of purchased merchandise. In addition, we continually update and monitor our Websites to enhance the shopping experience for our customers.

We also offer small businesses and retailers a compelling method for obtaining products for resale. We believe that small businesses and retailers can secure lower prices and better service through us than they typically receive from manufacturers or other distributors. We believe we are able to offer these advantages because, unlike many small businesses and retailers, we have the ability to access the liquidation market to buy merchandise in bulk quantities for which we often receive volume-based price discounts. Accordingly, we have designed our shipping and receiving operations with the flexibility to accommodate both the receipt of large shipments of inventory purchases, and the distribution of bulk loads to our small business customers.

Business Strategy

Our objective is to leverage the Internet to become the dominant closeout solution for holders of brand-name merchandise, allowing them to dispose of that merchandise discreetly and with high recovery values. We are pursuing this objective through the following key strategies:

- *Establish strong relationships with manufacturers.* With the growth in the scale of our operations, we believe we are becoming an efficient liquidation channel for manufacturers and distributors. With scale comes the ability to buy in volume, and we believe manufacturers appreciate our ability to liquidate their products without disturbing their traditional channels. Generally, manufacturers do not want their product offerings sold as heavily discounted, closeout products in brick-and-mortar retailers, as is common today. We believe that as manufacturers learn of our capabilities, they will increasingly recognize the attractiveness of Overstock as an efficient liquidation solution.
- *Optimize inventory management through the use of technology.* Our merchandise buyers are supported by proprietary software that provides nearly instantaneous information on product sales, margins and inventory levels. This technology enables us to make informed decisions and quickly change prices in an effort to maximize sales volume, gross profits and return on inventory capital.
- *Optimize marketing initiatives through the use of technology.* Our marketing team is supported by proprietary software that enhances the level of service provided to our customers and takes advantage of the unique characteristics of online distribution. Our software provides us immediate feedback on the effectiveness of various marketing campaigns, allowing us to optimize our marketing expenditures.
- *Maintain low customer acquisition costs.* We believe that by utilizing targeted online campaigns such as banner ad and e-mail campaigns, the results of which we are able to quantify, as well as our internally developed national television and radio branding campaign, we will be able to keep our per customer acquisition costs low.
- *Aggressively grow our B2B business.* We believe we offer our B2B customers a compelling opportunity for purchasing bulk inventory online at low prices with high-quality service. We believe that the small retail market is underserved by existing liquidators and we are working to take advantage of this significant opportunity. We have a dedicated B2B Website, as well as a dedicated B2B sales team, whose sole purpose is to further develop this business.
- *Provide responsive customer service.* Overstock maintains the infrastructure necessary to process and fulfill orders on an accurate, timely and reliable basis. We operate an approximately 354,000-square foot leased warehouse in Salt Lake City, Utah to help provide a high level of customer service. We strive continually to improve our product offerings, the look and feel of our Websites and the quality of our customers' shopping experience.

Key Relationships

Manufacturer, Supplier and Distribution Relationships. It is difficult to establish closeout buying relationships with manufacturers. Trust and experience gained through past interactions are important. We believe our business model reduces the risk to the manufacturer that its discounted products are sold alongside its full-priced products. Our supplier relationships provide us with recognized,

brand-name products. The table below identifies, for each of our product departments, the brand names that generate the largest revenues in each department.

AOL Time Warner	Krups	Random House
Bissell	Mai	RCA
Blue Ridge Home Fashions	Movado	Samsonite
Cuisinart	Nicole Miller	Seiko
Fuji	Novica	Simon & Schuster
Hewlett-Packard	Oriental Weavers	Sony
Jansport	Panasonic	Swiss Army
Kelty	Philips	Taylor Made
Kenneth Cole	Ralph Lauren	Vera Wang

To date, we have not entered into contracts with manufacturers or liquidation wholesalers that guarantee the availability of merchandise for a set duration. Our manufacturer and supplier relationships are based on historical experience with manufacturers and liquidation wholesalers and do not obligate or entitle us to receive merchandise on a long-term or short-term basis. In our direct business, we purchase the products from manufacturers or liquidation wholesalers using standard purchase orders. Generally, suppliers do not control any of the terms under which products are sold over our Websites.

In 2002, we entered into an agreement with SafewayInc. to provide discounted merchandise to be sold within their stores. SafewayInc. accounted for approximately \$21.0million, or approximately 9%, of our total revenues for the fiscal year ended December31, 2003. Currently, we are supplying certain stores in the western and midwestern regions of the United States. During the term of our agreement with Safeway, which ends on February26, 2004, we are prevented from selling the same or similar goods to any store that has more than 400 retail stores in the following categories: drug, mass merchandising, grocery, club or warehouse. We have notified Safeway that we do not intend to renew this agreement. In the future, we hope to develop relationships with other large retailers.

Fulfillment Partner Business. We have a "direct" business, in which we buy and take possession of inventory for resale. We also have our "fulfillment partner" business, which we formerly called our "commission" business. In our fulfillment partner business, we sell merchandise of other retailers, cataloguers or manufacturers ("fulfillment partners") through our Websites. We currently have fulfillment partner relationships with approximately 250 third parties which post over 6,000 non-BMV products on our Websites. Prior to July1, 2003, we did not physically handle the merchandise we sold for our fulfillment partners, as the merchandise was shipped directly by them. They also handled all customer returns related to those sales. Beginning July1, 2003, we took responsibility for all returned items relating to these sales, and we now handle the possible resale of any returned items. As a result, beginning July1, 2003, we are considered to be the primary obligor for these sales transactions, and we assume the risk of loss on the returned items. As a consequence, we now record revenue from sales transactions involving our fulfillment partners (excluding products from our travel store) on a gross basis, rather than recording a commission on those sales as we did prior to July1, 2003.

During the fourth quarter of 2003, we added a discount travel store to our Website. We use a fulfillment partner to supply the travel products (flights, hotels, rental cars, etc.) in our travel store. For the products sold in our travel store, we do not currently have inventory risk or pricing control, and do not directly provide customer service. Therefore, for these sales we are not considered to be the primary obligor, and record only our commission as revenue.

Sales and Marketing

B2B. As of December 31, 2003, we had a dedicated sales force of 20 people who primarily interact with small, regional or local retailers by telephone or through e-mail to alert them to the opportunity they have to purchase merchandise at prices that are below wholesale, and which we believe are often lower than the prices paid by the larger retailers with whom they compete.

Consumer. We use cost-effective methods to target our consumer audience, including online campaigns, such as banner ad and e-mail campaigns, and we are able to monitor and evaluate the results of our online campaigns. We seek to identify and eliminate campaigns that do not meet our expectations. We also recently created and launched a national television and radio branding campaign. We developed the branding campaign internally, and we believe that we did so in a cost-effective manner.

Products

Online Products

Currently, our products are organized into eight different product departments on our consumer Website:

Apparel, Shoes & Accessories	Jewelry, Gifts & Watches
Books, Movies, CDs & Games	Sporting Goods & Events
Electronics & Computers	Travel
Home & Garden	Worldstock

Each of these departments has multiple categories that more specifically define the products offered within that department. For example, the following product categories are currently within the "Electronics & Computers" department:

Audio & Video	Office & Phones
Cameras & Optics	Computers & Printers

Each category has several subcategories that further detail the product contained within. For example, under the "Audio & Video" category, we have the subcategories of "Audio" and "TV & Video" and under the "Audio" subcategory we have the further sub-subcategories of "Car Audio & Video," "Clock Radios," "D.J. & Karaoke Equipment," "MP3/CD Players," "Other Audio," "Portable Stereo," and "Stereo Equipment."

Our B2B Website is organized into twelve different product departments, each of which contains multiple categories similar to those on our consumer Website.

Individual products can be accessed and viewed from the category or subcategory pages. These specific product pages include detailed product descriptions, a color picture and pricing information.

The number of total products we offer has grown from less than 100 in 1999, to more than 12,000 non-BMV products and approximately 500,000 BMV products (books, magazines, CDs, DVDs, video cassettes and video games) as of December 31, 2003. As the number of products and product categories change throughout the year, we periodically reorganize our departments and/or categories to better reflect our current product availability.

Our Worldstock Website, at www.worldstock.com, is our Internet marketplace through which artisans in the United States and around the world can sell their products and gain access to a broader market.

Fulfillment Operations

General. When customers place orders on our Websites, orders are fulfilled either by a third party "fulfillment partner" or directly from our Salt Lake City, Utah warehouse. We monitor both sources for accurate order fulfillment and timely shipment. We currently charge \$2.95 for basic ground shipping, but customers can choose from various expedited shipping services at their expense.

Payment Terms. As a general policy, we require verification of receipt of payment or credit card authorization before we ship products to consumers or B2B purchasers. From time to time we grant credit to our B2B purchasers with normal credit terms.

Direct Fulfillment. During 2003, we fulfilled approximately 41% of all orders through our leased Salt Lake City, Utah warehouse where we store approximately 6,000 non-BMV products offered on our Websites. We operate the warehouse with an automated warehouse management system that tracks the receipt of the inventory items, distributes order-fulfillment assignments to warehouse workers and obtains rates for various shipping options to ensure low-cost outbound shipping. Our Websites relay orders to the warehouse management system throughout each day, and the warehouse management system in turn confirms to our Websites shipment of each order. Customers track the shipping status of their packages through links we provide on our Websites. We advertise a standard of shipping within two business days of order placement, but most orders ship within one business day. The warehouse team generally ships between 4,000 and 5,000 orders per day, and up to approximately 10,000 orders per day during peak periods, using two overlapping daily shifts. We also process returns of direct and fulfillment partner merchandise in the Salt Lake City, Utah warehouse.

Fulfillment Partner Business. During 2003, approximately 59% of our orders were for inventory owned and shipped by third party fulfillment partners. We currently manage approximately 250 entities that collect their orders through our Websites. These third parties perform essentially the same operations as our warehouse: order picking and shipping; however, beginning July 1, 2003, we began handling returns for these sales. These third parties relay shipment confirmations to our Websites, where customers can review shipping and tracking information. From a customer's point of view, shipping from our warehouse or from the warehouse of one of these third parties is indistinguishable.

Customer Service

We are committed to superior customer service. We staff our customer service department with dedicated professionals who respond to phone and e-mail inquiries on products, ordering, shipping status, and returns. Our customer service representatives include Overstock employees, temporary employees and outsourced staff. Our customer service staff processes approximately 20,000 to 25,000 calls per week. The same staff processes approximately 20,000 to 40,000 e-mail messages each week, with less than a 24-hour turnaround time. We use automated e-mail and phone systems to route traffic to appropriate customer service representatives.

Technology

We use our internally developed Websites and a combination of proprietary technologies and commercially available licensed technologies and solutions to support our operations. We use the services of XO Communications, Inc., Qwest Communications International, Inc. and MCI, Inc. to obtain connectivity to the Internet over two OC3s and one DS3. We currently store our data on an Oracle 9i database cluster using Dell computer hardware, which is backed up by a high-speed redundant Network Appliance storage system. Currently, we use thirty-one Dell PowerEdge servers for our Websites, which are connected to the Oracle database and operate in a multi-processing Linux environment designed to accommodate large volumes of Internet traffic. During the 2003 holiday shopping season, our Internet systems operated at 30% of their capacity. We have added internal

"relief valve" technology and improved existing "relief valve" functionality with technology provided by Akamai Technologies, Inc. and Speedera, Inc. to provide a redundant solution to off-load transactions during extreme loads.

We are constantly working to enhance the reporting capabilities of our Websites to improve our understanding of our customers' needs and the operation of our Websites. Our Internet systems include redundant hardware on mission critical components and are located in our Salt Lake City, Utah facility.

Competition

The online liquidation services market is new, rapidly evolving, intensely competitive and has relatively low barriers to entry, as new competitors can launch new Websites at relatively low cost. We believe that competition in the online liquidation market is based predominantly on:

- price;
- product quality and selection;
- shopping convenience;
- customer service; and
- brand recognition.

Our liquidation services compete with other online retailers and traditional liquidation "brokers," some of which may specifically adopt our methods and target our customers. We currently or potentially compete with a variety of companies that can be divided into several broad categories:

- liquidation e-tailers such as SmartBargains;
- online retailers with discount departments such as Amazon.com, Inc., eBay, Inc. and Buy.com, Inc.; and
- traditional retailers and liquidators such as Ross Stores, Inc., Walmart Stores, Inc. and TJX Companies, Inc.

As the market for online liquidation grows, we believe that companies involved in online retail, as well as traditional retailers and liquidation brokers, will increase their efforts to develop services that compete with our online services. We also face potential competition from Internet companies not yet focused on the liquidation market, and from retail companies not yet operating online. We are unable to anticipate which other companies are likely to offer services in the future that will compete with the services we provide.

In addition, many of our current and potential competitors have greater brand recognition, longer operating histories, larger customer bases and significantly greater financial, marketing and other resources than us, and may enter into strategic or commercial relationships with larger, more established and well-financed companies. Some of our competitors could enter into exclusive distribution arrangements with our vendors and deny us access to their products, devote greater resources to marketing and promotional campaigns and devote substantially more resources to their Website and systems development than our company. New technologies and the continued enhancement of existing technologies also may increase competitive pressures on our company. We cannot assure you that we will be able to compete successfully against current and future competitors or address increased competitive pressures. See "Risk Factors."

Intellectual Property

We regard our domain names and similar intellectual property as critical to our success. We rely on a combination of laws and contractual restrictions with our employees, customers, suppliers,

affiliates and others to establish and protect our proprietary rights. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our intellectual property without authorization. In addition, we cannot assure you that others will not independently develop similar intellectual property. Although we are pursuing the registration of our key trademarks in the United States, some of our trade names are not eligible to receive trademark protection. In addition, effective trademark protection may not be available or may not be sought by us in every country in which our products and services are made available online, including the United States.

From time to time, we may be subject to legal proceedings and claims in the ordinary course of our business, including claims of alleged infringement of the trademarks and other intellectual property rights of third parties by our company. For example, in October 2003, Tiffany (NJ) Inc. and Tiffany and Company filed a complaint against us in the United States District Court for the Southern District of New York alleging that we have distributed counterfeit and otherwise unauthorized Tiffany product in violation of federal copyright and trademark law and related state laws. The complaint seeks statutory and other damages in an unspecified amount and injunctive relief. Although we have filed an answer and believe we have defenses to the allegations and intend to pursue them vigorously, the Tiffany lawsuit is in the early stages of discovery, and we do not have sufficient information to assess the validity of the claims or the amount of potential damages. These types of claims could result in increased costs of doing business through legal expenses, adverse judgments or settlements or require us to change our business practices in expensive ways. In addition, litigation could result in interpretations of the law that require us to change our business practices or otherwise increase our costs.

Third parties have in the past, and may in the future, recruit our employees who have had access to our proprietary technologies, processes and operations. These recruiting efforts expose us to the risk that such employees will misappropriate our intellectual property.

Additional litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Any litigation, regardless of outcome or merit, could result in substantial costs and diversion of management and technical resources, any of which could materially harm our business. See "Risk Factors."

Government Regulation

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

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

may be subject to significant fines or other payments for any past failures to comply with these requirements.

Employees

As of December 31, 2003, we had 326 full-time employees, including 62 in customer service, 125 in order fulfillment, 29 in information technology and Web store production, 19 in marketing, 41 in merchandising, 15 in finance, 20 in B2B sales and 15 in our executive and administrative department. We have never had a work stoppage, and none of our employees are represented by a labor union. We consider our employee relationships to be positive.

Risk Factors

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

Risks Relating to Overstock

Because we have a limited operating history, it is difficult to evaluate our business and future operating results.

We were originally organized in May 1997 and began posting a list of our merchandise on our Website in August 1998. In March 1999, we launched the first version of our Website through which customers could purchase products. Our limited operating history makes it difficult to evaluate our business and future operating results.

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

We have a history of losses and we may continue to incur operating and net losses for the foreseeable future. We incurred net losses attributable to common shares of \$11.6 million and \$12.1 million for the years ended December 31, 2002 and 2003, respectively. As of December 31, 2002, and 2003, our accumulated deficit was \$55.7 million and \$67.8 million, respectively. We will need to generate significant revenues to achieve profitability, and we may not be able to do so. Even if we do achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis in the future. If our revenues grow more slowly than we anticipate, or if our operating expenses exceed our expectations, our financial results would be harmed.

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

- enhance our distribution and order fulfillment capabilities;
- further improve our order processing systems and capabilities;
- develop enhanced technologies and features;
- expand our customer service capabilities to better serve our customers' needs;
- expand our product offerings;
- rent additional warehouse and office space;

- increase our general and administrative functions to support our operations; and
- increase our sales, branding and marketing activities, including maintaining existing or entering into new online marketing arrangements, and continuing or increasing our national television and radio branding campaign.

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

Our quarterly operating results are volatile and may adversely affect our stock price.

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

- increases in the cost of advertising;
- our inability to retain existing customers or encourage repeat purchases;
- difficulties developing our B2B operations;
- the extent to which our existing and future marketing agreements are successful;
- price competition that results in lower profit margins or losses;
- the amount and timing of operating costs and capital expenditures relating to the expansion of our business operations and infrastructure;
- the amount and timing of our purchases of inventory;
- our inability to manage distribution operations or provide adequate levels of customer service;
- our ability to successfully integrate operations and technologies from acquisitions or other business combinations;
- entering into new lines of products; and
- our inability to replace the loss of a significant customer.

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

Our limited operating history and the rapidly evolving nature of our industry make forecasting operating results difficult. We may not be able to quickly reduce spending if our revenues are lower than we project. Therefore, any significant shortfall in revenues would likely harm our business, operating results and financial condition and cause our results of operation to fall below the expectations of public market analysts and investors. If this occurs, the price of our common stock may decline.

We have grown quickly and if we fail to manage our growth, our business will suffer.

We have rapidly and significantly expanded our operations, and anticipate that further significant expansion will be required to address potential growth in our customer base and market opportunities. This expansion has placed, and is expected to continue to place, a significant strain on our management, operational and financial resources. Some of our officers have no prior senior management experience at public companies. Our new employees include a number of key managerial, technical and operations personnel who have not yet been fully integrated into our operations, and we expect to add additional key personnel in the near future. To manage the expected growth of our operations and personnel, we will be required to improve existing and implement new transaction-processing, operational and financial systems, procedures and controls, and to expand, train and manage our already growing employee base. If we are unable to manage growth effectively, our business, prospects, financial condition and results of operations will be harmed.

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

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

Further, many of the parties with which we may have online-advertising arrangements could provide advertising services for other online or traditional retailers and merchandise liquidators. As a result, these parties may be reluctant to enter into or maintain relationships with us. Failure to achieve sufficient traffic or generate sufficient revenue from purchases originating from third parties may result in termination of these relationships by these third parties. Without these relationships, our revenues, business, prospects, financial condition and results of operations could suffer.

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

Our performance is substantially dependent on the continued services and on the performance of our senior management and other key personnel, particularly Patrick M. Byrne, our President and Chairman of the Board. Our performance also depends on our ability to retain and motivate other officers and key employees. The loss of the services of any of our executive officers or other key employees for any unforeseen reason, including without limitation, illness or call to military service, could harm our business, prospects, financial condition and results of operations. We do not have employment agreements with any of our key personnel and we do not maintain "key person" life insurance policies. Our future success also depends on our ability to identify, attract, hire, train, retain and motivate other highly-skilled technical, managerial, editorial, merchandising, marketing and customer service personnel. Competition for such personnel is intense, and we cannot assure you that we will be able to successfully attract, assimilate or retain sufficiently qualified personnel. During 2003 individuals serving as our president and chief financial officer, our chief operating officer and our chief

technology officer each stepped down from those positions for unrelated reasons. Each of these three individuals remained an employee of the Company, and each continues to serve the Company at present. Our failure to retain and attract the necessary technical, managerial, editorial, merchandising, marketing and customer service personnel could harm our revenues, business, prospects, financial condition and results of operations.

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

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

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

During 2003, we had fulfillment partner relationships with approximately 250 third parties whose products we offer for sale on our Websites. At December 31, 2003, these products accounted for approximately 53% of the non-BMV products available on our Websites. We do not have any long-term agreements with any of these third parties. Our agreements with third parties are terminable at will by either party immediately upon notice. In general, we agree to offer the third parties' products on our Websites and these third parties agree to provide us with information about their products, honor our customer service policies and ship the products directly to the customer. If we do not maintain our existing or build new relationships with third parties on acceptable commercial terms, we may not be able to offer a broad selection of merchandise, and customers may refuse to shop at our Websites. In addition, manufacturers may decide not to offer particular products for sale on the Internet. If we are unable to maintain our existing or build new fulfillment partner relationships or if other product manufacturers refuse to allow their products to be sold via the Internet, our business would suffer severely.

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

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

dissatisfied with the services provided by these third parties, our reputation and the Overstock brand could suffer.

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

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

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

We have received in the past, and we anticipate we will receive in the future, communications alleging that certain items listed or sold through our Websites infringe third-party copyrights, trademarks and trade names or other intellectual property rights or that we have otherwise infringed third parties' past, current or future intellectual property rights. For example, in October 2003, Tiffany (NJ) Inc. and Tiffany and Company filed a complaint against us in the United States District Court for the Southern District of New York alleging that we have distributed counterfeit and otherwise unauthorized Tiffany product in violation of federal copyright and trademark law and related state laws. The complaint seeks statutory and other damages in an unspecified amount and injunctive relief. Although we have filed an answer and believe we have defenses to the allegations and intend to pursue them vigorously, the Tiffany lawsuit is in the early stages of discovery, and we do not have sufficient information to assess the validity of the claims or the amount of potential damages.

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

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

Our business may be harmed by fraudulent activities on our Websites.

We have received in the past, and anticipate that we will receive in the future, communications from customers who did not receive goods that they purchased. We also periodically receive complaints from our customers as to the quality of the goods purchased and services rendered. Negative publicity generated as a result of fraudulent or deceptive conduct by third parties could damage our reputation, harm our business and diminish the value of our brand name. We expect to continue to receive from customers requests for reimbursement or threats of legal action against us if no reimbursement is made.

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

We rely upon multiple third parties for the shipment of our products. Because we do not have a written long-term agreement with any of these third parties, we cannot be sure that these relationships will continue on terms favorable to us, if at all. Unexpected increases in shipping costs or delivery times, particularly during the holiday season, could harm our business, prospects, financial condition and results of operations. If our relationships with these third parties are terminated or impaired or if these third parties are unable to deliver products for us, whether through labor shortage, slow down or stoppage, deteriorating financial or business condition, responses to terrorist attacks or for any other reason, we would be required to use alternative carriers for the shipment of products to our customers. We may be unable to engage alternative carriers on a timely basis or upon terms favorable to us. Changing carriers would likely have a negative effect on our business, prospects, operating results and financial condition. Potential adverse consequences include:

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

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

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

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

Our transaction processing systems and network infrastructure may be unable to accommodate increases in traffic in the future. We may be unable to project accurately the rate or timing of traffic increases or successfully upgrade our systems and infrastructure to accommodate future traffic levels on our Websites. In addition, we may be unable to upgrade and expand our transaction processing systems in an effective and timely manner or to integrate any newly developed or purchased functionality with our existing systems. Any inability to do so may cause unanticipated system disruptions, slower response times, degradation in levels of customer service, impaired quality and speed of order fulfillment or delays in reporting accurate financial information.

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

Our long-term strategic plan involves expansion of our operations in the B2B merchandise liquidation market, entering into agreements to provide products and services to retail chains and other businesses, and possible expansion into additional markets. We cannot assure you that our efforts to expand our business in this manner will succeed or that we will be successful in managing agreements to provide products and services to retail chains and other businesses. To date, we have expended significant financial and management resources developing our B2B operations. Our failure to succeed in this market or other markets may harm our business, prospects, financial condition and results of operation. The exclusivity provisions of our Safeway agreement prevent us from providing similar products to stores having greater than 400 stores in the drug, mass merchandising, grocery, club or warehouse store categories, which may adversely affect our ability to grow and expand our B2B business. The Safeway agreement expires on February 26, 2004, and we do not intend to renew it. We may choose to expand our operations by developing new Websites, promoting new or complementary products or sales formats, such as our recent addition of travel product offerings, expanding the breadth and depth of products and services offered or expanding our market presence through relationships with third parties. In addition, we may pursue the acquisition of new or complementary businesses or technologies, although we have no present understandings, commitments or agreements with respect to any material acquisitions or investments. We cannot assure you that we would be able to expand our efforts and operations in a cost-effective or timely manner or that any such efforts would increase overall market acceptance. Furthermore, any new business or Website we launch that is not favorably received by consumers could damage our reputation or the Overstock brand. We may expand the number of categories of products we carry on our Websites, and these and any other expansions of our operations would also require significant additional expenses and development and would strain our management, financial and operational resources. The lack of market acceptance of such efforts or our inability to generate satisfactory revenues from such expanded services or products to offset their cost could harm our business, prospects, financial condition and results of operations.

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

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

- other online liquidation e-tailers, such as SmartBargains;
- traditional retailers and liquidators, such as Ross Stores, Inc., Walmart Stores, Inc. and TJX Companies, Inc.; and
- online retailers and marketplaces such as Amazon.com, Inc., Buy.com, Inc. and eBay, Inc., which have discount departments.

Our B2B Website competes with liquidation "brokers" and retailers and online marketplaces such as eBay, Inc.

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

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

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

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

We allow our customers to return products and, beginning July 1, 2003, we started accepting returns of products sold through our fulfillment partners. Our ability to handle a large volume of returns is unproven. In addition, any policies intended to reduce the number of product returns may result in customer dissatisfaction and fewer return customers. If merchandise returns are significant, our business, financial condition and results of operations could be harmed.

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

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

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

Our success, and, in particular, our ability to successfully receive and fulfill orders and provide high-quality customer service, largely depends on the efficient and uninterrupted operation of our computer and communications hardware systems. Substantially all of our computer and communications

hardware is located at a single leased facility in Salt Lake City, Utah. Our systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunications failure, terrorist attacks, acts of war, break-ins, earthquake and similar events. We do not presently have redundant systems in multiple locations or a formal disaster recovery plan and our business interruption insurance may be insufficient to compensate us for losses that may occur. Despite the implementation of network security measures, our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays, loss of critical data or the inability to accept and fulfill customer orders. The occurrence of any of the foregoing risks could harm our business, prospects, financial condition and results of operations.

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

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

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

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

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

Issuances of our securities are subject to federal and state securities laws, and certain holders of common stock issued by us may be entitled to rescind their purchases.

Issuances of securities are subject to federal and state securities laws. From November 1999 through September 2000, we offered and sold common stock to investors in various states. Certain of those offerings may not have complied with various requirements of applicable state securities laws. In such situations a number of remedies may be available to regulatory authorities and the investors who purchased common stock in those offerings, including, without limitation, a right of rescission, civil penalties, seizure of our assets, a restraining order or injunction, and a court order to pay restitution and costs. As a result, certain investors in our common stock may be entitled to return their shares to Overstock and receive from us the full price they paid, plus interest, which we estimate to be an aggregate amount of approximately \$3.0 million at December 31, 2003.

We face risks relating to our inventory.

We directly purchase some of the merchandise that we sell on our Websites. We assume the inventory damage, theft and obsolescence risks, as well as price erosion risks for products that we purchase directly. These risks are especially significant because some of the merchandise we sell on our Websites are characterized by rapid technological change, obsolescence and price erosion (for example, computer hardware, software and consumer electronics), and because we sometimes make large purchases of particular types of inventory. In addition, we often do not receive warranties on the merchandise we purchase. Further, beginning July 1, 2003, we started accepting returns of products sold through our fulfillment partners, and we have the risk of reselling the returned products.

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

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

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

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

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

We have begun to expand into international markets, and in the future we may do so more aggressively. International sales and transactions are subject to inherent risks and challenges that could adversely affect our profitability, including:

- the need to develop new supplier and manufacturer relationships;

- unexpected changes in international regulatory requirements and tariffs;
- difficulties in staffing and managing foreign operations;
- longer payment cycles from credit card companies;
- greater difficulty in accounts receivable collection;
- potential adverse tax consequences;
- price controls or other restrictions on foreign currency; and
- difficulties in obtaining export and import licenses.

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

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

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

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

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

Risks Relating to the Internet Industry

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

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

- actual or perceived lack of security of information or privacy protection;
- possible disruptions, computer viruses or other damage to the Internet servers or to users' computers; and

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

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

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

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

Credit card fraud could adversely affect our business.

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

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

We do not currently collect sales or other similar taxes for physical shipments of goods into states other than Utah. One or more local, state or foreign jurisdictions may seek to impose sales tax collection obligations on us and other out-of-state companies that engage in online commerce. Our business could be adversely affected if one or more states or any foreign country successfully asserts that we should collect sales or other taxes on the sale of our merchandise.

Existing or future government regulation could harm our business.

We are subject to the same federal, state and local laws as other companies conducting business on the Internet. Today there are relatively few laws specifically directed towards conducting business on the Internet. However, due to the increasing popularity and use of the Internet, many laws and regulations relating to the Internet are being debated at the state and federal levels. These laws and regulations could cover issues such as user privacy, freedom of expression, pricing, fraud, quality of products and services, taxation, advertising, intellectual property rights and information security. Applicability to the Internet of existing laws governing issues such as property ownership, copyrights

and other intellectual property issues, taxation, libel, obscenity and personal privacy could also harm our business. For example, United States and foreign laws regulate our ability to use customer information and to develop, buy and sell mailing lists. The vast majority of these laws were adopted prior to the advent of the Internet, and do not contemplate or address the unique issues raised thereby. Those laws that do reference the Internet, such as the Digital Millennium Copyright Act and the CAN-SPAM Act of 2003, are only beginning to be interpreted by the courts and their applicability and reach are therefore uncertain. These current and future laws and regulations could harm our business, results of operation and financial condition.

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

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

Risks Relating to the Securities Markets and Ownership of Our Common Stock

Our stock price may be volatile and you may lose all or a part of your investment.

Our common stock has been publicly traded only since May30, 2002. The market price of our common stock has been subject to significant fluctuations since the date of our initial public offering. These fluctuations could continue. It is possible that in some future periods our results of operations may be below the expectations of public market analysts and investors. If this occurs, our stock price may decline. Among the factors that could affect our stock price are as follows:

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

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

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

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

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

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

Available Information

Our Internet website address is <http://www.overstock.com>. Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available through our Internet website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Our Internet website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.

ITEM 2. PROPERTIES

We lease approximately 33,000 square feet of office space for our corporate headquarters and customer service operations in Salt Lake City, Utah, and we lease an approximately 354,000 square foot warehouse and distribution facility also in Salt Lake City, Utah. We believe that these facilities will be sufficient for our needs for the next twelve months.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we receive claims of and become subject to consumer protection, employment, intellectual property and other commercial litigation related to the conduct of our business. Such litigation could be costly and time consuming and could divert our management and key personnel from our business operations. The uncertainty of litigation increases these risks. In connection with such litigation, we may be subject to significant damages or equitable remedies relating to the operation of our business and the sale of products on our websites. Any such litigation may materially harm our business, results of operations, financial condition and cash flows.

In October 2003, Tiffany (NJ) Inc. and Tiffany and Company filed a complaint against us in the United States District Court for the Southern District of New York alleging that we have distributed counterfeit and otherwise unauthorized Tiffany product in violation of federal copyright and trademark law and related state laws. The complaint seeks statutory and other damages in an unspecified amount and injunctive relief. Although we have filed an answer and believe we have defenses to the allegations and intend to pursue them vigorously, the Tiffany lawsuit is in the early stages of discovery, and we do not have sufficient information to assess the validity of the claims or the amount of potential damages.

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

No matters were submitted to a vote of security holders during the fourth quarter of 2003.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the Nasdaq National Market under the symbol "OSTK." Prior to May30, 2002, there was no public market for our common stock. The following table sets forth, for the periods indicated, the high and low closing prices per share for our common stock as reported on the Nasdaq National Market since May30, 2002.

	Common Stock Price	
	High	Low
Year Ended December 31, 2002		
Second Quarter (from May 30, 2002)	\$ 14.60	\$ 12.25
Third Quarter	14.55	5.40
Fourth Quarter	15.43	4.41
Year Ended December 31, 2003		
First Quarter	18.11	9.74
Second Quarter	14.69	8.00
Third Quarter	17.24	10.47
Fourth Quarter	20.92	12.84

As of December31, 2003, there were approximately 165 holders of record of our common stock. Because many of our shares of common stock are held by brokers and other institutions on behalf of shareholders, we are unable to estimate the total number of shareholders represented by these record holders.

We have never declared or paid any cash dividends on shares of our non-redeemable common stock. We currently intend to retain our earnings for future growth and do not anticipate paying any cash dividends in the foreseeable future. Any future determination to pay dividends will be at the discretion of our board of directors and will depend on our results of operations, financial conditions, contractual and legal restrictions and other factors the board deems relevant.

During the fourth quarter of 2003, there were no purchases of shares of the Company's common stock made by or on behalf of the Company or any "affiliated purchaser" as defined in Rule10b-18(a)(3) under the Exchange Act.

ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data as of December31, 2002 and 2003 and for each of the three years in the period ended December31, 2003, are derived from our consolidated financial statements and are included elsewhere in this Form10-K. The consolidated financial data as of December31, 1999, 2000 and 2001 and for the years ended December31, 1999 and 2000, are derived from consolidated financial statements, but are not contained herein. The historical results do not necessarily indicate results expected for any future period. This information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of

Operations" and the Consolidated Financial Statements and the related notes thereto included elsewhere in this Form10-K.

	Year ended December 31,				
	1999	2000	2001	2002	2003
	(in thousands, except per share data)				
Consolidated Statement of Operations Data:					
Direct revenue	\$ 1,835	\$ 21,762	\$ 35,243	\$ 77,943	\$ 136,592
Fulfillment partner revenue	—	867	3,965	12,379	100,811
Warehouse revenue	—	2,894	795	1,462	1,542
Total revenue	1,835	25,523	40,003	91,784	238,945
Cost of goods sold(1)	2,029	27,812	34,640	73,441	213,492
Gross profit (loss)	(194)	(2,289)	5,363	18,343	25,453
Operating expenses:					
Sales and marketing expenses(2)	4,948	11,376	5,784	8,669	20,173
General and administrative expenses(2)	3,230	7,556	9,441	10,825	16,911
Amortization of goodwill	—	226	3,056	—	—
Amortization of stock-based compensation	—	—	649	2,903	756
Total operating expenses	8,178	19,158	18,930	22,397	37,840
Operating loss	(8,372)	(21,447)	(13,567)	(4,054)	(12,387)
Interest income	52	241	461	403	461
Interest expense	(37)	(73)	(729)	(465)	(76)
Other income (expense), net	—	(33)	29	(444)	115
Net loss	(8,357)	(21,312)	(13,806)	(4,560)	(11,887)
Deemed dividend related to redeemable common stock	(4)	(210)	(404)	(406)	(262)
Deemed dividend related to beneficial conversion feature of preferred stock	—	—	—	(6,607)	—
Net loss attributable to common shares	\$ (8,361)	\$ (21,522)	\$ (14,210)	\$ (11,573)	\$ (12,149)
Net loss per common share—basic and diluted	\$ (4.63)	\$ (3.63)	\$ (1.29)	\$ (0.88)	\$ (0.75)
Weighted average common shares outstanding—basic and diluted	1,804	5,922	10,998	13,108	16,198
(1)Amounts include stock based compensation of	\$ —	\$ —	\$ 78	\$ 373	\$ 90
(2)Amounts exclude stock-based compensation as follows:					
Sales and marketing expenses	\$ —	\$ —	\$ 14	\$ 83	\$ 22
General and administrative expenses	—	—	635	2,820	734
	\$ —	\$ —	\$ 649	\$ 2,903	\$ 756

	As of December 31,				
	1999	2000	2001	2002	2003
	(in thousands)				
Balance Sheet Data:					
Cash and cash equivalents	\$ 2,563	\$ 8,348	\$ 3,729	\$ 11,059	\$ 28,846
Marketable securities	—	—	—	21,603	11,500
Working capital	1,253	6,440	3,071	35,679	45,284
Total assets	5,735	30,401	21,714	63,956	97,732
Total indebtedness	378	3,591	4,677	182	161
Redeemable common stock	505	4,930	5,284	4,363	2,978
Stockholders' equity	1,835	12,349	5,980	39,271	54,914

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following Management's Discussion and Analysis of Financial Condition and Results of Operation should be read in conjunction with our Consolidated Financial Statements and the related Notes thereto. This discussion contains forward-looking statements based upon current expectations that involve risks and uncertainties, such as our plans, objectives, expectations and intentions, as set forth under "Special Note Regarding Forward-Looking Statements." Our actual results and the timing of events could differ materially from those anticipated in these forward-looking statements as a result of several factors, including those set forth in the following discussion and under "Risk Factors" and elsewhere in this Form10-K.

Overview

We are an online "closeout" retailer offering discount brand name merchandise, including bed-and-bath goods, kitchenware, watches, jewelry, electronics, sporting goods, designer accessories and travel. Our company, based in Salt Lake City, Utah, was founded in 1997, and we launched our first Website through which customers could purchase products in March1999.

Our revenue is comprised of direct revenue, fulfillment partner revenue and warehouse revenue. During 2003 no single customer accounted for more than 1% of our total revenue other than Safeway, Inc., which accounted for 9% of our total revenue. Direct revenue includes sales made to individual consumers and businesses, which are fulfilled from our warehouse in Salt Lake City, Utah. We generate business-to-business (B2B) sales when we contact retailers by phone and e-mail and offer them our merchandise below wholesale prices, allowing them an opportunity to be more price-competitive in their local markets. After we establish a relationship with a B2B client, the client sometimes places subsequent orders directly through our B2B Website. Our B2B calling effort began in October2001, so our historical direct revenue has predominantly been based on individual consumer purchases made directly through our consumer Website.

Our fulfillment partner revenue is derived from two sources, consumer fulfillment partner revenue and B2B fulfillment partner revenue. Consumer fulfillment partner revenue is generated when we sell merchandise of other retailers, cataloguers or manufacturers ("fulfillment partners") through our consumer Websites. Prior to July1, 2003, we did not own or physically handle the merchandise we sold in these transactions, as the merchandise was shipped directly by a third party vendor, which also handled all customer returns related to those sales. Beginning July1, 2003, we took responsibility for all returned items relating to these sales and we now handle the resale of any returned items. As a result, beginning July1, 2003, we are considered to be the primary obligor for these sales transactions, and we assume the risk of loss on the returned items. As a consequence, we now record revenue from sales transactions involving our fulfillment partners (excluding travel products) on a gross basis, rather than recording a commission on sales as we did prior to July1, 2003. Similar to the manner in which we generate consumer fulfillment partner revenue, we generate B2B fulfillment partner revenue when

we sell the merchandise of third parties through our B2B Website. Our use of the term "partner" or "fulfillment partner" does not mean that we have formed any legal partnerships with any of our fulfillment partners.

During the fourth quarter of 2003, we added a discount travel store to our Website. We use fulfillment partners to supply the travel products (flights, hotels, rental cars, etc.) in our store. For the products sold in our travel store, we do not currently have inventory risk or pricing control, and do not provide customer service. Therefore, for these sales we are not considered to be the primary obligor, and record only our commission as revenue.

Our warehouse revenue is derived primarily from sales of products that cannot be economically sold on our Websites due to their low price points, bulk, irregular size or other factors. Historically, we held our warehouse sales in various physical locations. We held our first warehouse sale from November 2000 to January 2001, primarily to liquidate residual products from the purchase of the entire inventory of a distressed toy retailer. We initiated a second warehouse sale in February 2002, primarily to liquidate residual products from our acquisition of Gear.com. Sales from our warehouse store in 2003 accounted for less than 1% of total revenue. We closed the warehouse store in January 2004.

Our revenue is recorded net of returns, coupons and other discounts. In February 2002, we implemented a policy intended to reduce the number of returned products. This new policy provides for a \$4.95 restocking fee and the provision that we will not accept product returns initiated more than fifteen days after the shipment date. We charge a 15% restocking fee (instead of the \$4.95 handling fee) on all returned items from the Electronics & Computers department.

Cost of goods sold consists of the cost of the product, as well as inbound and outbound freight, fixed warehouse costs, warehouse handling costs, credit card fees, and customer service costs. B2B gross margins are typically less than individual consumer gross margins. Therefore, future overall gross margins will be impacted by the blend of net revenues from the consumer and B2B sales channels. Cost of goods sold also includes related stock-based compensation for each respective period.

Sales and marketing expenses consist primarily of advertising, public relations and promotional expenditures, as well as payroll and related expenses for personnel engaged in marketing and selling activities. Advertising expense is the largest component of our sales and marketing expenses and is primarily attributable to expenditures related to online marketing activities and our offline national radio and television branding campaign launched during the third quarter of 2003. For example, our advertising expenses totaled approximately \$4.8 million, \$7.0 million and \$18.6 million during the years ended December 31, 2001, 2002 and 2003, respectively. We expect our sales and marketing expenses to increase in future periods on an absolute dollar basis as we expect to continue to increase our online marketing efforts.

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

Amortization of goodwill during 2001 resulted from the acquisition of Gear.com, Inc. in November 2000. We adopted SFAS No. 142 for the fiscal year beginning January 1, 2002. Under this pronouncement, the remaining goodwill is not amortized, but is evaluated at least annually for impairment. There were no impairments of goodwill during the years ended December 31, 2002 and 2003.

We have recorded no provision or benefit for federal and state income taxes as we have incurred net operating losses since inception. As of December 31, 2002 and 2003, we had \$51.3 million and \$62.4 million, respectively, of net operating loss carryforwards, of which \$14.4 million is subject to limitation for those respective years. These net operating loss carryforwards will begin to expire in 2019. We have provided a full valuation allowance on the deferred tax asset, consisting primarily of net operating loss carryforwards, because of uncertainty regarding its realizability.

Both direct and fulfillment partner revenue are seasonal, with revenues historically being the highest in the fourth quarter, reflecting higher consumer holiday spending. We anticipate this will continue in the foreseeable future. With the exception of our acquisition of Gear.com, we have achieved our historical growth from internal operations.

Executive Commentary

The following executive commentary is intended to provide investors with a view of our business through the eyes of our management. As an executive commentary, it necessarily focuses on selected aspects of our business, including the following:

- The difference between our revenue reported under generally accepted accounting principles ("GAAP") and our gross merchandise sales;
- Changes we made to our merchandise returns policies during 2003 that affect our GAAP revenues;
- The increases in our gross merchandise sales and factors contributing to the increases;
- Certain issues relating to our operations;
- Certain issues relating to our expenses;
- Certain issues relating to our capital resources and liquidity; and
- The status of certain of our strategic projects.

This executive commentary is intended as a supplement to, but not a substitute for, the more detailed discussion of our business included elsewhere herein. Investors are cautioned to read our entire Management's Discussion and Analysis of Financial Condition and Results of Operation, as well as our audited financial statements, and the discussion of our business and risk factors and other information included elsewhere in this report. This executive commentary includes forward-looking statements, and investors are cautioned to read the Special Note Regarding Forward-Looking Statements included elsewhere in this report.

Commentary—Changes to our Returns Policies. At the beginning of the third quarter of 2003, we changed our merchandise return policies and procedures to permit our customers to return all items directly to us, rather than to the fulfillment partner who may have shipped the merchandise to the customer, and we are now considered the primary obligor. As a result, our GAAP revenue increased significantly and gross margins decreased significantly in the third and fourth quarters compared to previous reporting periods. Investors should understand that a significant portion of the increase in our GAAP revenues resulted solely from this change, and consequently, that gross merchandise sales comparisons year-over-year may be more informative than GAAP revenue comparisons for the affected periods. We also believe gross profit dollar comparisons year-over-year may be more informative than gross margin percentage comparisons.

Commentary—GAAP revenue and Gross Merchandise Sales. Management believes that to understand our business and our financial statements, investors should understand the difference between our gross revenues as recorded under generally accepted accounting principles, and the non-GAAP measure we call gross merchandise sales. Gross merchandise sales ("GMS") represents the gross sales price of all sales transactions, including those for which the Company has recorded only a commission under generally accepted accounting principles, and therefore differs from GAAP revenue. Management believes that gross merchandise sales provides useful information to investors because it represents the total sales price of the merchandise sold via the Overstock websites or through our other business-to-business sales channels, regardless of the amount of GAAP revenue recorded by Overstock on those sales, which varies, depending on, among other things, the returns policies applicable to the

merchandise sold via the website. Management uses the measure of gross merchandise sales for internal planning purposes, including measuring the Company's growth, measuring the effectiveness of marketing expenditures, and capacity planning for information technology, customer service and logistics. In the future, our GAAP revenues are likely to constitute approximately 90-95% of our gross merchandise sales, and the difference between the two measures will be less significant than in the prior years.

The following table reconciles our gross merchandise sales to our GAAP revenues for the quarter and year ended December 31, 2003 (in millions).

	Three months ended		Year ended	
	December 31,		December 31,	
	2002	2003	2002	2003
Total revenue	\$ 41.5	\$ 123.2	\$ 91.8	\$ 238.9
Add: obligations payable to third parties upon sale of third-party merchandise	22.0	—	51.0	39.9
Add: sales returns and discounts	3.7	7.0	11.7	16.0
Gross merchandise sales	\$ 67.2	\$ 130.2	\$ 154.5	\$ 294.8

As mentioned above, we believe gross profit dollar comparisons year-over-year may be more informative than gross margin percentages comparisons. In the fourth quarter of 2003, our gross profits increased to \$11.8million from \$9.1million in the fourth quarter of 2002. Note that this increase is, on a percentage basis, much smaller than our GMS growth (gross profits increased 29%, while our GMS increased 94%). For the year ended December 31, 2003, gross profits increased to \$25.5million from \$18.3million (gross profits increased 39%, while our GMS increased 91%). The difference is accounted for partially by our decision to sell books, music, and videos at extremely slim margins, and also by some of the expense control issues discussed below.

Commentary—Increases in Gross Merchandise Sales. In 2003, the Company experienced year-over-year growth in GMS of almost 91%. In the first two quarters of 2003, our year-over-year growth in GMS was 138% and 94%, but dropped in the third quarter to 57%. In the fourth quarter of 2003, our GMS growth increased to 94% over the fourth quarter of 2002. This was due to several factors:

- **Customer Acquisition and Marketing**—We attracted 744,000 new customers during the fourth quarter of 2003, bringing the number of customers who have bought from us to just over three million. Our average cost per new customer, or customer acquisition cost ("CPA") as it is called in our industry, was \$13.19 for the fourth quarter, compared with \$14.06, \$8.69 and \$10.97 in the first three quarters of 2003, and \$11.20 in the previous year fourth quarter. CPA is calculated by taking our total marketing expenses, excluding only our B2B sales force compensation costs (which represented less than 1% of total marketing expenses), divided by the number of new business to consumer customers ("B2C"). Given that our CPA for the fourth quarter 2003 included a national branding effort that accounted for almost half of our total marketing expenses in the quarter, we consider this result very good.

Historically, we have acquired new customers almost exclusively through various online advertising channels. We try to generate at least a dollar of gross profit for every dollar we spend for online marketing, so that our online marketing pays for itself on the first purchase. We have difficulty finding sufficient advertising channels that meet our objective, and not all of our advertising channels always reach it. However, if we are able to locate channels that meet our standards, we may spend as much as \$50million on online advertising in 2004.

As mentioned above, we made a significant investment in a national television and radio branding effort in the fourth quarter of 2003. Based on independent surveys that we commissioned over the course of the quarter, the public's reported awareness of our Website increased significantly. According to the surveys, adult unprompted awareness of "Overstock.com" went from 4% to 14%, while adult prompted awareness went from 12% to 33% (for comparison, the same surveys show eBay and Amazon.com, with roughly 70% adult prompted awareness). In addition, we experienced significant increases in website traffic during the campaign, and based on our own statistical analysis of the traffic and resulting customers, we believe that we received approximately 50 to 70 cents in gross profits for every dollar we spent on television and radio advertising. This is below our online marketing standard. However, we believe that we realized other benefits from the national branding effort, including greater awareness with vendors and manufacturers. We also expect that the branding effort will increase the effectiveness of our online advertising as more people recognize our name and have a better understanding of our product selection and pricing. We intend to decrease our spending in this area in the first quarter of 2004, but expect to increase it again in the future.

- Conversion—Our marketing efforts are designed to attract visitors to our Website. After we attract a visitor, we attempt to convert the visitor into a purchaser. We are working to improve our conversion ratio by improving various aspects of our Website, including the improvements we made to the search function on our Website by installing an EasyAsk search engine during the third quarter of 2003. We believe that we still have room for significant improvement in our search function. In addition, we have begun to develop personalization and optimization algorithms that select products for customers and repeat visitors based on behavior and other factors. We are in the initial stages of this effort.

Commentary—Operations

- Warehouse—Approximately half of the product ordered from our Website is shipped from our Salt Lake City warehouse. Though we publicize a standard of shipping within two business days of receipt of order, under our internal standards, we try to ship orders received by 1:00p.m. Mountain time the same day. Two weeks before Thanksgiving, when the surge of Christmas orders first started, we slipped a day behind our internal standard, and then even further behind during the Thanksgiving weekend. However, we recognized the problem, devoted significant executive and key employee time and attention to it, and by December 4 we were generally shipping within 36 hours of receipt of orders; by December 9 we were shipping within 24 hours of order, and by December 13, we were shipping the same day of the order. By the end of December, we were again shipping 99% of orders within 24 hours, and 100% within 48 hours.
- Customer Service—During the fourth quarter of 2003, we answered emails within 12 hours 85% of the time, and answered phone calls within 30 seconds 85% of the time. We consider that good, but we consider some of our response times (hold times as long as three minutes, for example) unacceptable. We are addressing this issue aggressively.
- Information Technology—For our Website to handle the continued growth in 2003, we needed to expand our existing technology infrastructure. Rather than acquire a multi-million dollar Superdome or mainframe, we chose to implement a less-expensive, cutting edge, 8-node database cluster (a "cluster" is a database distributed across multiple interconnected servers). In October, our system was beginning to reach its capacity constraints, and we switched over to the new database cluster. Over the fourth quarter our information technology team refined this system with support from Oracle. In the process we experienced insignificant amounts of downtime, and we believe that we now have a more reliable and scalable system and Website.

Commentary—Expense discipline

- Warehouse—As discussed above, as a result of falling a few days behind in fulfillment at the warehouse, we incurred additional expenses in order to ship packages faster. We estimate that we incurred a few hundred thousand dollars in expenses in order to quickly increase our shipping capacity and fulfill customer orders on a timely basis.
- Customer Service—With the benefit of experience, we believe that we can reduce our costs of providing future customer service. We have now implemented changes, including the outsourcing of a portion of our customer service staff, that we believe will decrease our overall cost per customer contact, while maintaining the level of customer service that we have historically provided.
- Compensation—Our total compensation expense including benefits for 2003 was approximately \$10.0million. In early 2004 we reduced our staff, resulting in a reduction of our future compensation expense, on an annual basis, of approximately \$1.5million. Investors should note, however, that we will hire additional staff during 2004, and that we therefore may not realize a \$1.5million reduction in our 2004 compensation expense compared with 2003. Further, we do not expect to make similar cost reductions in future years.

Commentary—Inventory, Liquidity and Related Matters

- Inventory. We ended 2002 running low on inventory. An unexpectedly strong January 2003 depleted it further, and by February 2003 we believe that our low inventory levels choked sales. In an effort to avoid a repeat of this situation, we ended 2003 with inventory sufficient to support growth. We believe that our current inventory level and selection are appropriate, with the possible exception of our opportunistic purchase of over \$5million of Franck Muller watches in the closing weeks of 2003. We have limited experience selling these watches, which typically sell for over \$15,000 each. We believe that we now offer them at some of the lowest prices in the world.
- Cash and Marketable Securities. We ended 2003 with \$40.3million in cash and marketable securities, but at one point during the fourth quarter our cash was down to \$9.7million. There is an aspect of the cash flow of our business that is different than most other businesses. A typical business running at breakeven profitability absorbs cash as it grows to fund increased working capital needs, and releases cash as it shrinks as working capital declines, all else being equal. Overstock is different: about half of our business is our "fulfillment partner" business, where we sell a product through our website and collect the cash from a credit card transaction within a few days, but pay our fulfillment partner 15 to 30 days later. Because we collect cash for the sale before we pay our fulfillment partner, the fulfillment partner portion of our business generates temporary liquidity that we call float-cash. If we were running at break-even profitability but our fulfillment partner business were growing, our growth would generate float-cash. If we shrank, we would lose float-cash (again, all else being equal). This dynamic is the reverse of that displayed by the typical business. Investors should understand that a portion of the \$40.3million cash and marketable securities we held at December 31, 2003 was cash we owed to our fulfillment partners. Due to the seasonality of our business, our fulfillment partner business is expected to shrink in the first quarter of 2004, so we expect our cash balance to decrease during the first quarter of 2004 approximately proportionate with the decrease in sales by our fulfillment partners.
- Capital Needs. In addition to the other matters discussed below under Liquidity and Capital Resources, management periodically analyzes our capital resources, liquidity, and anticipated needs. One of the analyses our management performs periodically assumes that we will operate our business at break-even and grow 100% each year, and then assesses our need for capital

under those assumptions. As discussed above, since the fulfillment partner portion of our business generates float-cash as we grow, our need for additional capital may be less than the need of other businesses. However, as mentioned above, at our lowest point in the fourth quarter, our cash balance was as low as \$9.7million. That may be insufficient in the future. We are not yet at break-even, as our GAAP loss in the fourth quarter of 2003 was 2.5% of revenue. We will continue to look at our capital needs and try to position ourselves so that we will be able to raise capital if circumstances are appropriate. In addition, we are in the process of obtaining an inventory line of credit.

Commentary—Strategic projects

Following is a brief update on some of our recent strategic projects, some of which are also discussed above.

- Search Engine. As discussed above, we have implemented an "EasyAsk" search engine. We consider this superior to our old system, but believe that we can continue to improve our search function substantially.
- Branding Campaign. As discussed above, we launched our "Overstock.com—The Big O"-branding campaign through national television and radio ads, and we believe that we realized significant benefits from this campaign.
- Travel. We opened a travel department in the third quarter, which generated more than \$1,000,000 of bookings in the fourth quarter. In 2003 we included only the net commissions realized on travel bookings in our GAAP revenues and in our gross merchandise sales. In 2003 our net commissions from the travel department were insignificant.

Commentary—Worldstock

One additional project to report on is our Worldstock department, which sells handmade goods made primarily in underdeveloped countries throughout the world. While representing only a couple percentage points of our overall sales, Worldstock has generated about \$5million in revenue in the 27months it has been open, with approximately 15% gross profit margins. Based on assumptions management considers reasonable, we estimate that our Worldstock department has lost a little less than \$1million since its inception (and its inventory now ties up approximately another \$500,000 in cash). Worldstock purchases products from about 4,000 artisans in the developing world and has been growing quickly.

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

Critical Accounting Policies

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

- revenue recognition;

- estimating valuation allowances and accrued liabilities, specifically, the reserve for returns, the allowance for doubtful accounts and the allowance for obsolete and damaged inventory;
- accounting for income taxes; and
- valuation of long-lived and intangible assets and goodwill.

Revenue recognition. We derive our revenue from three sources: (i) direct revenue, which consists of merchandise sales made to consumers and businesses that are fulfilled from our warehouse; (ii) fulfillment partner revenue, which consists of revenue from the sale of merchandise shipped by fulfillment partners directly to consumers and other businesses; and (iii) warehouse revenue, which consists of sales of residual products from large bulk purchases of inventory. Both direct revenue and fulfillment partner revenue are recorded net of returns, coupons redeemed by customers, and other discounts.

With regards to our fulfillment partner revenue, prior to July 1, 2003, we did not own or physically handle the merchandise sold in these transactions, as the merchandise was shipped directly by a third party vendor, who also handled all customer returns related to those sales. Beginning July 1, 2003, we took responsibility for all returned items relating to these sales, and we now handle the resale of any returned items. As a result, beginning July 1, 2003, we are considered to be the primary obligor for these sales transactions, and we assume the risk of loss on the returned items. We now record revenue from sales transactions involving our fulfillment partners on a gross basis, rather than recording a commission on sales as we did prior to July 1, 2003. Similar to the manner in which we generate consumer fulfillment partner revenue, we generate B2B fulfillment partner revenue when we sell the merchandise of third parties through our B2B Website.

For sales transactions, we comply with the provisions of Staff Accounting Bulletin 101 "Revenue Recognition", as amended, which states that revenue should be recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) the product has been shipped and the customer takes ownership and assumes the risk of loss; (3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. We generally require payment by credit card at the point of sale. Any amounts received prior to when we ship the goods to customers are deferred.

Reserve for returns, allowance for doubtful accounts and the allowance for obsolete and damaged inventory. Our management must make estimates of potential future product returns related to current period revenue. Management analyzes historical returns, current economic trends and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales returns and other allowances in any accounting period. The reserve for returns was \$1.1 million as of December 31, 2003.

From time to time, we may grant credit to certain of our business customers on normal credit terms. We perform ongoing credit evaluations of our customers' financial condition and maintain an allowance for doubtful accounts receivable based upon our historical collection experience and expected collectibility of all accounts receivable. As of December 31, 2003, we recorded an allowance for doubtful accounts receivable of \$650,000.

Overstock writes down its inventory for estimated obsolescence or damage equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Our inventory balance was \$29.9 million, net of allowance for obsolescence or damaged inventory of \$1.1 million as of December 31, 2003.

Accounting for income taxes. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. As of December 31, 2003, we have recorded a full valuation allowance of \$25.7 million against our net deferred tax asset balance due to uncertainties related to our deferred tax assets as a result of our history of operating losses. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to change the valuation allowance, which could materially impact our financial position and results of operations.

Valuation of long-lived and intangible assets and goodwill. Effective January 1, 2002, we have adopted SFAS No. 142 Goodwill and Other Intangible Assets. Under this standard, goodwill is no longer amortized, but must be tested for impairment at least annually. Other long-lived assets must also be evaluated for impairment when management believes that an asset has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the asset that may not be reflected in an asset's current carrying value, thereby possibly requiring an impairment charge in the future. There were no impairments of goodwill or long-lived assets during 2001, 2002, or 2003. Net intangible assets and goodwill amounted to \$3.0 million as of December 31, 2003.

Results of Operations

The following table sets forth our results of operations expressed as a percentage of total revenue for 2001, 2002 and 2003.

	Year ended December 31,		
	2001	2002	2003
	(as a percentage of total revenue)		
Direct revenue	88.1 %	84.9 %	57.2 %
Fulfillment partner revenue	9.9	13.5	42.2
Warehouse revenue	2.0	1.6	0.6
Total revenue	100.0	100.0	100.0
Cost of goods sold(1)	86.6	80.0	89.3
Gross profit (loss)	13.4	20.0	10.7
Operating expenses:			
Sales and marketing expenses(2)	14.5	9.4	8.4
General and administrative expenses(2)	23.6	11.8	7.1
Amortization of goodwill	7.6	—	—
Amortization of stock-based compensation	1.6	3.2	0.3
Total operating expenses	47.3	24.4	15.8
Operating loss	(33.9)	(4.4)	(5.1)
Interest income	1.2	0.4	0.2
Interest expense	(1.8)	(0.5)	(0.0)
Other income (expense), net	0.1	(0.5)	0.0
Net loss	(34.4)%	(5.0)%	(4.9)%

Comparison of Years Ended December 31, 2002 and 2003

Revenue

Beginning July 1, 2003, customer returns from sales shipped by our fulfillment partners are returned directly to us and processed through our Salt Lake City warehouse, rather than returned to our fulfillment partners, as they previously were. We made the decision to change this policy to have more control over the Overstock customer shopping experience, as we believe that a seamless customer experience is key to creating loyal, long-term customers. By accepting returns at our warehouse, we can verify that fulfillment partner products are being packaged and shipped to our standards. Additionally, as customer returns are now all shipped to one location, the process is much more simple and convenient for our customers.

As a result of this change in business practices, we now record sales transactions shipped by our fulfillment partners on a gross basis instead of on a net basis, as we have historically done. Therefore, from the third quarter 2003 forward, revenue recorded in accordance with accounting principles generally accepted in the United States ("GAAP") will increase significantly from our results as reported in previous SEC filings. Additionally, as illustrated in the table above that sets forth our results of operations expressed as a percentage of total revenue for 2001, 2002 and 2003, direct revenue as a percentage of total revenue will decrease significantly while fulfillment partner revenue as a percentage of total revenue will increase. As a result, we believe that for year-over-year comparison purposes, gross merchandise sales (non-GAAP) comparisons may be more informative than GAAP revenue comparisons, as gross merchandise sales were not affected by the change in business practices.

Total revenue grew from \$91.8million in 2002, to \$238.9million in 2003, representing growth of 160%. During this same period, direct revenue increased from \$77.9million to \$136.6million, or a 75% growth, and fulfillment partner revenue grew from \$12.4million to \$100.8million representing growth of 714%. Warehouse revenue remained constant at \$1.5million for the years ended December 31, 2002 and 2003. The significant increase in total revenue was due primarily to the change in our business practices described above, coupled with an increase in the number of both direct and fulfillment partner orders and sales to other businesses. This increase was also a result of the growth of our B2C business due to increased marketing efforts, including the initiation of a nationwide television and radio advertising campaign that began in the third quarter of 2003 and continued through the fourth quarter. Gross merchandise sales totaled \$294.8million and \$154.5million for the years ended December 31, 2003 and 2002, respectively, representing an increase of 91%. Gross merchandise sales differ from GAAP revenue in that gross merchandise sales represent the gross sales price of goods sold by the Company before returns, sales discounts and before payments to fulfillment partners prior to July 1, 2003.

Cost of Goods Sold

As a result of the fulfillment partner returns policy change that occurred beginning the third quarter of 2003, we now record sales transactions shipped by our fulfillment partners on a gross basis instead of on a net basis as we have historically done. Therefore, GAAP revenue increased significantly beginning in the third quarter of 2003, which resulted in a significant increase in cost of goods sold and hence, a decrease in gross margins from previous quarters. These margins will now more closely resemble margins we receive from our direct revenue. As a result, we believe that for year-over-year comparison purposes, gross profit dollar comparisons may be more informative than gross margin percentage comparisons.

Cost of goods sold increased in absolute dollars, from \$73.4million in 2002 to \$213.5million in 2003, and as a percent of total revenue, from 80% to 89%, respectively. This increase in cost of goods sold, as a percent of total revenue, was primarily a result of the change in our business practices described above. In addition, cost of goods sold increased as a percentage of total revenue due to the

growth in sales of BMV products, which account for approximately 12% of total revenue in 2003, compared to less than 1% in 2002. These combined changes correlate to gross margins of 20% and 11% for the years ended December 31, 2002 and 2003, respectively. Cost of goods sold also includes stock-based compensation of \$373,000 and \$90,000 for the years ended December 31, 2002 and 2003, respectively.

Gross profits for our direct operations increased to \$13.5 million for the year ended December 31, 2003, from \$8.9 million recorded during the same period in 2002. For our direct operations, gross profit dollars increased 51% on a year-over-year basis while sales increased 75%. Gross profits for our direct operations, as a percentage of direct revenue decreased from 11% in 2002 to 10% in 2003. This was primarily due to increased costs related to capacity expansion at the warehouse, as well as an increase in warehouse handling expense as we ramped up staffing and packaging in anticipation of sales increases. Additionally, overall returns costs increased significantly as we increased capacity and staffing for increased returns volumes due to the returns policy change, and due to process inefficiencies that were identified and fixed during the third and fourth quarters.

Cost of goods sold on sales transactions from our fulfillment partners now includes the cost of the product, warehousing and fulfillment costs, credit card fees and customer service costs. Therefore, beginning in the third quarter of 2003, overall blended gross margins will be significantly lower than they have historically been. Now that the costs related to the initial implementation and process refinement of the fulfillment partner returns process have been absorbed in the third quarter, future gross profit dollars generated from these sales should not be significantly affected by this change.

Our fulfillment partner operations generated gross profits of \$11.6 million (12% margins) and \$9.6 million (78% margins) for the years ended December 31, 2003 and 2002, respectively. The increase in the gross profit dollars for our fulfillment partner operations was due to the general growth of the consumer business during the year, and an increase in the number of fulfillment partner products offered on our Websites. The decrease in gross margins for our fulfillment partner operations is largely due to the change in our business operations described above as well as an increase in BMV sales from 2% of fulfillment partner revenue in 2002 to 25% in 2003. Margins for BMV products have historically been much lower than those of other product categories.

Operating Expenses

Sales and marketing. Sales and marketing expenses totaled \$8.7 million and \$20.2 million for the years ended December 31, 2002 and 2003, representing 9% and 8% of total revenue, respectively. The increased marketing expense reflects increased online marketing efforts, particularly with the large portals (MSN, Yahoo & AOL), and with our affiliate marketing program. In addition, during 2003 we initiated our first national radio and television campaign, which added approximately \$5.5 million to the marketing expense in the current year over the previous year. We expect total marketing expenses to continue to increase in the future as a result of the expenses related to online marketing agreements that we have recently entered into and similar online or offline radio, television, or other similar agreements that we may enter into in the future. The decrease in sales and marketing as a percentage of total revenue was due to the increase in total revenue in 2003 which was a result of the fulfillment partner returns policy change that occurred beginning the third quarter of 2003.

General and administrative. General and administrative expenses increased from \$10.8 million in 2002 to \$16.9 million in 2003, representing 12% and 7% of total revenue, respectively. The increase in absolute dollars was primarily attributable to costs associated with building infrastructure, including expansion of corporate systems and additional personnel costs from increased corporate headcount. The decrease in general and administrative expenses as a percentage of total revenue was due to the increase in total revenue in 2003 which was a result of the fulfillment partner returns policy change that occurred beginning the third quarter of 2003.

Amortization of goodwill. Effective January 2002, we adopted SFAS No. 142, which requires that goodwill no longer be amortized. Hence, we did not record any goodwill amortization during the years ended December 31, 2002 and 2003.

Amortization of stock-based compensation. Prior to the Company's initial public offering in May 2002, the Company recorded unearned stock-based compensation related to stock options granted below the fair market value of the underlying stock. Since the initial public offering, the Company has not granted any additional stock options below fair market value. Amortization of stock-based compensation was approximately \$2.9 million and \$756,000 for the years ended December 31, 2002 and 2003, respectively.

Interest income, interest expense and other income (expense). The increase in interest income from \$403,000 in 2002 to \$461,000 in 2003 is due to the increase in our cash and marketable securities from our follow-on offering in the first quarter of 2003. Interest expense decreased from \$465,000 in 2002 to \$76,000 in 2003, primarily as a result of our termination of our inventory lines of credit in June 2002 and the reduction in our capital leases. Other income (expense) changed from expense of \$444,000 in 2002 to income of \$115,000 in 2003 primarily because the company paid \$439,000 of selling costs on behalf of a selling shareholder as part of the initial public offering in 2002.

Income taxes. We incurred net operating losses in 2002 and 2003, and consequently paid insignificant amounts of federal, state and foreign income taxes. As of December 31, 2003, we had \$62.4 million of net operating loss carryforwards, of which \$14.4 million is subject to limitation. These net operating loss carryforwards will begin to expire in 2019.

Comparison of Years Ended December 31, 2001 and 2002

Revenue. Total revenue grew from \$40.0 million in 2001, to \$91.8 million in 2002, representing growth of 129%. During this same period, direct revenue increased from \$35.2 million to \$77.9 million or a 121% growth, and fulfillment partner (formerly "commission") revenue grew from \$4.0 million to \$12.4 million representing growth of 212%. Warehouse revenue was \$795,000 in 2001 and \$1.5 million in 2002, representing growth of 84%. The increase in total revenue was due primarily to an increase in the number of both direct and commission orders and in the average order size. This increase was also a result of the growth of our B2C business due to increased marketing efforts and increased sales to other businesses, including Safeway, Inc. The increase in warehouse revenue from 2001 to 2002 was due primarily to an establishment of a permanent location for our warehouse store at our warehouse facility in July of 2002. For the warehouse sale in 2001, we liquidated part of a large inventory purchase from *Toytime.com* during January of that year. For the warehouse sale in 2002, we liquidated the remnants of the *Gear.com* inventory that occurred during the latter end of the first quarter and the first part of the second quarter of 2002. The gross merchandise sales of goods sold directly by us and on behalf of third parties were \$69.3 million in 2001 and \$154.5 million in 2002, an increase of 123%.

Cost of Goods Sold. Cost of goods sold increased in absolute dollars from \$34.6 million to \$73.4 million in 2002. This represents a decrease, as a percent of total revenue, from 87% in 2001 to 80% in 2002. The decrease in cost of goods sold as a percentage of total revenue in 2002 compared to 2001 was primarily a result of economies of scale achieved through an increased number of sales transactions and efficiencies in operations. These efficiencies include, but are not limited to, efficiencies in the actual costs paid to suppliers for goods, freight and handling costs, the costs of customer service and returns. The decrease is also attributable to an increase in fulfillment partner revenue as a percentage of total revenue (from 10% in 2001 to 13% in 2002), as fulfillment partner revenue has higher gross margins than direct revenue. Cost of goods sold also includes \$78,000 and \$373,000 of stock-based compensation for the years ended December 31, 2001 and 2002, respectively.

Operating Expenses

Sales and marketing. Sales and marketing expenses increased on an absolute dollar basis from \$5.8million in 2001, to \$8.7million in 2002 primarily as a result of our increased online marketing expenditures, including fixed payment arrangements in connection with online marketing relationships. However, this represents a decrease as a percent of total revenue from 15% to 9%. The decrease in marketing costs as a percentage of total revenue as compared to 2001 reflects an effort by our management to focus advertising expenditures on campaigns that it believes are the most cost-effective to increase net sales, such as targeted online advertising, as well as negotiating reduced rates charged to us for online marketing.

General and administrative. General and administrative expenses increased from \$9.4million in 2001, to \$10.8million in 2002 representing 24% and 12% of total revenue, respectively. The increase in absolute dollars was due primarily to new business development and the staffing necessary to manage and support our growth. General and administrative personnel increased from 65 employees at the end of 2001, to 84 employees at the end of 2002. The decrease in general and administrative expense as a percentage of total revenue was a result of economies of scale achieved through increased sales volume and the allocation of general and administrative expenses over a substantially larger revenue base.

Amortization of goodwill. Effective January 2002, we adopted SFAS No. 142, which requires that goodwill no longer be amortized. Hence, we did not record any goodwill amortization during fiscal year 2002. During 2001, \$3.1million was recorded as amortization of goodwill for the fiscal year ended December 31, 2001. Goodwill resulted from the acquisition of *Gear.com* in November 2000.

Amortization of stock-based compensation. Amortization of stock-based compensation was approximately \$649,000 and \$2.9million in 2001 and 2002, respectively. We attribute this increase primarily to amortization of non-cash deferred stock-based compensation recognized relating to options grants during the respective periods.

Interest income, interest expense and other income (expense). Interest income was \$461,000 in 2001 compared to \$403,000 in 2002. Interest expense decreased from \$729,000 in 2001 to \$465,000 in 2002, primarily as a result of the reduction in notes payable. Other income (expense) changed from income of \$29,000 in 2001 to expense of \$444,000 primarily because the company paid \$439,000 of selling costs on behalf of the selling shareholder as part of the initial public offering.

Income taxes. We incurred net operating losses in 2001 and 2002, and consequently paid insignificant amounts of federal, state and foreign income taxes. As of December 31, 2002, we had \$51.3million of net operating loss carryforwards, of which \$14.4million is subject to limitation. These net operating loss carryforwards will begin to expire in 2019.

Quarterly Results of Operations

The following tables set forth our unaudited quarterly results of operations data for the eight most recent quarters for the period ended December 31, 2003, as well as such data expressed as a percentage of our total revenue for the periods presented. The information in the table below should be read in conjunction with the Consolidated Financial Statements and the Notes thereto included elsewhere in this Form 10-K. We have prepared this information on the same basis as the Consolidated Financial Statements and the information includes all adjustments, consisting only of normal recurring adjustments, that we consider necessary for a fair statement of our financial position and operating results for the quarters presented. Our quarterly operating results have varied substantially in the past

and may vary substantially in the future. You should not draw any conclusions about our future results from the results of operations for any particular quarter.

	Three Months Ended							
	Mar. 31, 2002	June 30, 2002	Sept. 30, 2002	Dec. 31, 2002	Mar. 31, 2003	June 30, 2003	Sept. 30, 2003	Dec. 31, 2003
(in thousands, except per share data)								
Consolidated Statement of Operations Data:								
Direct revenue	\$ 10,029	\$ 11,853	\$ 20,759	\$ 35,302	\$ 24,962	\$ 25,159	\$ 29,011	\$ 57,460
Fulfillment revenue	1,659	2,230	2,857	5,633	3,966	3,431	28,504	64,910
Warehouse revenue	379	297	192	594	236	243	273	790
Total revenue	12,067	14,380	23,808	41,529	29,164	28,833	57,788	123,160
Cost of goods sold(1)	9,990	11,831	19,238	32,382	24,539	24,030	53,537	111,386
Gross profit	2,077	2,549	4,570	9,147	4,625	4,803	4,251	11,774
Operating expenses:								
Sales and marketing expenses(2)	1,219	1,313	2,083	4,054	3,848	2,572	3,855	9,898
General and administrative expenses(2)	2,802	2,195	2,372	3,456	4,545	3,367	4,059	4,940
Amortization of goodwill	—	—	—	—	—	—	—	—
Amortization of stock-based compensation	846	806	674	577	328	112	171	145
Total operating expenses	4,867	4,314	5,129	8,087	8,721	6,051	8,085	14,983
Operating income (loss)	(2,790)	(1,765)	(559)	1,060	(4,096)	(1,248)	(3,834)	(3,209)
Interest income	22	49	229	103	152	142	98	69
Interest expense	(240)	(208)	(7)	(10)	(7)	(55)	(8)	(6)
Other income (expense), net	1	(442)	63	(66)	10	25	79	1
Net income (loss)	(3,007)	(2,366)	(274)	1,087	(3,941)	(1,136)	(3,665)	(3,145)
Deemed dividend related to redeemable common stock	(111)	(106)	(97)	(92)	(77)	(78)	(58)	(49)
Deemed dividend related to beneficial conversion feature of preferred stock	(6,607)	—	—	—	—	—	—	—
Net income (loss) attributable to common shares	\$ (9,725)	\$ (2,472)	\$ (371)	\$ 995	\$ (4,018)	\$ (1,214)	\$ (3,723)	\$ (3,194)
Net income (loss) per common share								
—basic	\$ (0.87)	\$ (0.20)	\$ (0.03)	\$ 0.07	\$ (0.26)	\$ (0.07)	\$ (0.23)	\$ (0.19)
—diluted	\$ (0.87)	\$ (0.20)	\$ (0.03)	\$ 0.06	\$ (0.26)	\$ (0.07)	\$ (0.23)	\$ (0.19)
Weighted average common shares outstanding								
—basic	11,171	12,280	14,447	14,486	15,486	16,384	16,419	16,473
—diluted	11,171	12,280	14,447	15,696	15,486	16,384	16,419	16,473
(1)Amounts include stock based compensation of	\$ 102	\$ 96	\$ 93	\$ 82	\$ 39	\$ 13	\$ 20	\$ 18
(2)Amounts exclude stock-based compensation as follows:								
Sales and marketing expenses	\$ 22	\$ 21	\$ 21	\$ 19	\$ 11	\$ 3	\$ 5	\$ 3
General and administrative expenses	824	785	653	558	317	109	166	142
	\$ 846	\$ 806	\$ 674	\$ 577	\$ 328	\$ 112	\$ 171	\$ 145

	Three Months Ended							
	Mar. 31, 2002	June 30, 2002	Sept. 30, 2002	Dec. 31, 2002	Mar. 31, 2003	June 30, 2003	Sept. 30, 2003	Dec. 31, 2003
Additional Operating Data(1):								
Gross merchandise sales (in thousands)(2)	\$ 21,989	\$ 26,505	\$ 38,772	\$ 67,217	\$ 52,270	\$ 51,315	\$ 61,018	\$ 130,155
Number of orders(3)	177,339	212,383	290,649	578,839	490,507	521,846	643,402	1,375,506
Number of new B2C customers(4)	104,989	117,672	163,691	347,578	264,144	283,164	341,834	744,133
Average customer acquisition cost(5)	\$ 8.68	\$ 9.68	\$ 11.64	\$ 11.20	\$ 14.06	\$ 8.69	\$ 10.97	\$ 13.19

(1)

The additional operating data sets forth certain operating data relating to our business for the eight most recent quarters for the period ended December 31, 2003. While we believe that the information in the table above facilitates an understanding of our business and results of operations for the periods presented, such information is not in accordance with generally accepted accounting principles and should be read in conjunction with the quarterly results of operations data set forth above. We believe that gross merchandise sales is a metric widely used in our industry and by making this metric available to investors, we believe investors are able to compare our performance against others in our industry. We believe that investors may use the average customer acquisition cost metric to determine how efficiently we are able to achieve growth, if any. Again, we believe this metric is widely used in our industry, and providing these values to investors enables them to make more meaningful comparisons.

(2)

Gross merchandise sales represents the gross sales price of all sales transactions, including those for which we only record a commission under generally accepted accounting principles, and therefore differs from GAAP revenue. Beginning July 1, 2003 we changed our business practices regarding returns, which affected our fulfillment partner revenue. As a result, we believe that for year-over-year comparison purposes, gross merchandise sales (non-GAAP) comparisons may be more informative than GAAP revenue comparisons, as the gross merchandise sales were not affected by the change in business practices. The following table reconciles total revenue to gross merchandise sales (in thousands):

	Three Months Ended							
	Mar. 31, 2002	June 30, 2002	Sept. 30, 2002	Dec. 31, 2002	Mar. 31, 2003	June 30, 2003	Sept. 30, 2003	Dec. 31, 2003
	(in thousands)							
Total revenue	\$ 12,067	\$ 14,380	\$ 23,808	\$ 41,529	\$ 29,164	\$ 28,833	\$ 57,788	\$ 123,160
Add: Obligations payable to third parties upon sale of third-party merchandise	7,031	9,474	12,488	21,969	20,527	19,399	—	—
Add: Sales returns and discounts	2,891	2,651	2,476	3,719	2,579	3,083	3,230	6,995
Gross merchandise sales	\$ 21,989	\$ 26,505	\$ 38,772	\$ 67,217	\$ 52,270	\$ 51,315	\$ 61,018	\$ 130,155

(3)

Number of orders represents the number of individual orders for merchandise through our Websites excluding B2B orders.

(4)

Number of new B2C customers represents the number of valid new customer accounts. To establish a valid customer account, a person must provide us with the following information and purchase merchandise on our B2C Website: a unique e-mail address; a unique password; and a verified credit card account number.

(5)

Average customer acquisition cost represents total sales and marketing expense excluding B2B sales force compensation (including salary, bonus, commission and benefits costs) divided by the number of new customers for the period presented.

	Three Months Ended							
	Mar. 31, 2002	June 30, 2002	Sept. 30, 2002	Dec. 31, 2002	Mar. 31, 2003	June 30, 2003	Sept. 30, 2003	Dec. 31, 2003
	(as a percentage of total revenue)							
Direct revenue	83.2 %	82.4 %	87.2 %	85.0 %	85.6 %	87.3 %	50.2 %	46.7 %
Fulfillment partner revenue	13.7	15.5	12.0	13.6	13.6	11.9	49.3	52.7
Warehouse revenue	3.1	2.1	0.8	1.4	0.8	0.8	0.5	0.6
Total revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Cost of goods sold(1)	82.8	82.3	80.8	78.0	84.1	83.3	92.6	90.4
Gross profit	17.2	17.7	19.2	22.0	15.9	16.7	7.4	9.6
Operating expenses:								
Sales and marketing expenses(2)	10.1	9.1	8.7	9.8	13.2	8.9	6.7	8.0
General and administrative expenses(2)	23.2	15.3	10.0	8.3	15.6	11.7	7.0	4.0
Amortization of goodwill	—	—	—	—	—	—	—	—
Amortization of stock-based compensation	7.0	5.6	2.8	1.4	1.1	0.4	0.3	0.1
Total operating expenses	40.3	30.0	21.5	19.5	29.9	21.0	14.0	12.1
Operating income (loss)	(23.1)	(12.3)	(2.3)	2.5	(14.0)	(4.3)	(6.6)	(2.5)
Interest income	0.2	0.3	0.9	0.2	0.5	0.5	0.2	0.1
Interest expense	(2.0)	(1.4)	0.0	0.0	0.0	(0.2)	(0.0)	(0.0)
Other income (expense), net	0.0	(3.1)	0.2	(0.2)	0.0	(0.1)	0.1	0.0
Net income (loss)	(24.9)	(16.5)%	(1.2)	2.5 %	(13.5)%	(4.1)	(6.3)%	(2.4)
	%		%			%		%
(1)Amounts include stock-based compensation of	0.8 %	0.7 %	0.4 %	0.2 %	0.1 %	0.0 %	0.0 %	0.0 %
(2)Amounts exclude stock-based compensation as follows:								
Sales and marketing expenses	0.2 %	0.1 %	0.1 %	0.1 %	0.0 %	0.0 %	0.0 %	0.0 %
General and administrative expenses	6.8	5.5	2.7	1.3	1.1	0.4	0.3	0.1
	7.0 %	5.6 %	2.8 %	1.4 %	1.1 %	0.4 %	0.3 %	0.1 %

Our direct revenue and fulfillment partner revenue have increased in every quarter on a year-over-year basis. The general increase in total revenue is due to the expansion of our customer base as we attracted more visitors to our Websites, as well as repeat purchases from these customers. We have experienced significant seasonality in our business, reflecting a combination of seasonal fluctuations in Internet usage and traditional retail seasonality patterns. Internet usage and the rate of Internet growth may be expected to decline during the summer. Further, sales in the traditional retail industry are significantly higher in the fourth calendar quarter of each year than in the preceding three quarters. Fulfillment partner revenue increased significantly during the past two quarters due to the change in our business practices.

Cost of goods sold as a percentage of total revenue has fluctuated during the eight quarters ended December 31, 2003, ranging from 78% to 93%. The significant increases during the 3rd and 4th quarters of 2003 relate specifically to the change in business practices in our fulfillment partner operations and the resulting shift from recognizing revenue on a commission basis to a gross basis.

Total operating expenses as a percentage of total revenue have decreased on a year-over-year basis each quarter during 2003 as compared to 2002 as a result of economies of scale achieved through increased sales volume. In the near future, we expect to continue to devote substantial resources to the expansion of our sales and marketing efforts, and expect that total operating expenses may increase in absolute dollars in future periods. These expenses as a percentage of total revenue will vary depending on the level of revenue obtained.

Due to the foregoing factors, in one or more future quarters our operating results may fall below the expectations of securities analysts and investors. In such an event, the trading price of our common stock would likely be materially adversely affected.

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 the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Liquidity and Capital Resources

Prior to the second quarter of 2002, we financed our activities primarily through a series of private sales of equity securities, warrants to purchase our common stock and promissory notes. During the second quarter of 2002, we completed our initial public offering pursuant to which we received approximately \$26.1million in cash, net of underwriting discounts, commissions, and other related expenses. Additionally, in February2003, we completed a follow-on offering pursuant to which we received approximately \$24.0million in cash, net of underwriting discounts, commissions, and other related expenses. Our cash and cash equivalents balance was \$28.8million at December31, 2003. We also had marketable securities of \$11.5million at December31, 2003.

Our operating activities resulted in net cash outflows of \$10.4million for the year ended December31, 2003 and net cash inflows of \$2.5million for the year ended December31, 2002. The primary use of cash and cash equivalents during 2003 was to fund our normal operations, including net losses of \$11.9million, and changes in accounts receivable (\$3.2million), inventories (\$16.0million), and prepaid expenses and other assets (\$2.3million). This was offset by the change in accounts payable (\$16.6million) and accrued liabilities (\$2.9million).

Cash used in investing activities included \$6.7million in capital expenditures for property and equipment, including \$2.8million in the third quarter 2003 for expansion of our existing warehouse facility, a new customer service telephone system (\$800,000), and upgrades to the existing internal database (\$500,000). These expenditures were offset by a net increase of \$10.0million in cash and cash equivalents from the purchase and sales of marketable securities. For the year ended December31, 2003 and 2002, net cash provided by (used in) investing activities amounted to \$3.1million and \$(23.3million), respectively.

Net cash provided by financing activities during the year ended December31, 2003 was \$25.1million, consisting primarily of net proceeds of \$24.0million received from the follow-on public offering which occurred in February2003 and approximately \$1.2million received from the exercise of stock options and warrants, offset by \$141,000 of payments on capital leases. Net cash provided by financing activities for the year ended December31, 2002 was \$28.2million, consisting primarily of proceeds from our initial public offering in May2002 and the issuance of preferred stock in March2002, offset by the repayment of \$4.5million of notes payable.

On March4, 2002, we sold 958,612 shares of our SeriesA redeemable convertible preferred stock at \$6.89 per share for \$6.6million, net of issuance costs. As the fair value of the common stock to be

received upon conversion of the preferred stock was greater than the conversion price of the preferred stock at the date the preferred stock was issued, a beneficial conversion feature resulted in a non-cash charge of approximately \$6.6million which was recorded in the first quarter of 2002. This non-cash charge was recorded as a deemed dividend, of which \$3.7million is attributable to shares sold to the following related parties; JohnJ. ByrneJr., a former director of Overstock; Contex Limited, an entity controlled by Mark Byrne, a brother of PatrickM. Byrne; Haverford InternetLLC, an entity controlled by PatrickM. Byrne; The GordonS. Macklin Family Trust, a trust controlled by a director of Overstock; and Rope Ferry Associates,Ltd., an entity owned by JohnJ. ByrneIII and DorothyM. Byrne, the brother and mother of PatrickM. Byrne. The remaining purchasers of our SeriesA preferred stock are unrelated parties that are friends and acquaintances of our officers and directors.

Contractual Obligations and Commitments. The following table summarizes our contractual obligations as of December31, 2003 and the effect such obligations and commitments are expected to have on our liquidity and cash flow in future periods:

Contractual Obligations	Total	Payments Due by Period (in thousands)			
		Less than 1 Year	1-3Years	4-5Years	After 5 years
Long-term debt arrangements	\$ —	\$ —	\$ —	\$ —	\$ —
Capital lease obligations	177	85	85	7	—
Operating leases	3,748	1,575	2,108	65	—
Purchase obligations	8,038	8,038	—	—	—
Total contractual cash obligations	\$ 11,963	\$ 9,698	\$ 2,193	\$ 72	\$ —

Other Commercial Commitments	Total Amounts Committed	Amounts of Commitment Expiration Per Period (in thousands)			
		Less than Year 1	1-3Years	4-5Years	Over 5 years
Letters of credit	\$ 1,882	\$ 1,882	\$ —	\$ —	\$ —
Redeemable common stock	2,978	—	2,978	—	—
Total commercial commitments	\$ 4,860	\$ 1,882	\$ 2,978	\$ —	\$ —

The amount of purchase obligations shown is based on assumptions regarding the legal enforceability against us of purchase orders we had outstanding at December31, 2003. 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.

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

We have a \$3.5million revolving letter of credit facility, which expires June30, 2005, which we use to obtain letters of credit supporting our inventory purchases. At December31, 2003 the issuing bank or an affiliate of the bank had letters of credit totaling \$1.9million outstanding under this facility. However, we have no liability for this amount except to the extent, if any, that a beneficiary of any of the outstanding letters of credit draws upon a letter of credit. In evaluating our contractual obligations and commitments, investors should understand that the amount shown above under letters of credit is duplicative of a portion of the amount shown above under purchase obligations, because we have no

actual liability in connection with the letter of credit facility (other than for commitment fees and similar items) except to the extent that we fail to pay a similar amount included above in purchase obligations.

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

Seasonality

Financial results for Internet retailers are generally seasonal. Based upon the Company's historical experience, increased revenues typically occur during the fourth quarter because of the Christmas retail season. The actual quarterly results for each quarter could differ materially depending upon consumer preferences, availability of product and competition, among other risks and uncertainties. Accordingly, there can be no assurances that seasonal variations will not materially affect the Company's results of operations in the future. The following table reflects the Company's revenues for each of the quarters available since 2000 (in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2003	\$ 29,164	\$ 28,833	\$ 57,788 *	\$ 123,160 *
2002	12,067	14,380	23,808	41,529
2001	9,578	7,407	8,744	14,274
2000	2,257	3,795	4,339	15,132

*

Note that the revenue for the third and fourth quarters of 2003 reflect the change in Company policy in which sales by fulfillment partners are now recorded "gross" instead of "net" as in prior quarters.

Factors That May Affect Future Results

Any investment in our common stock involves a high degree of risk. Investors should consider carefully the risks and uncertainties, and all other information in this Form10-K before deciding whether to purchase or hold our common stock. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also become important factors that may harm our business.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not use derivative financial instruments in our investment portfolio and have no foreign exchange contracts. Our financial instruments consist of cash and cash equivalents, marketable securities, trade accounts and contracts receivable, accounts payable and long-term obligations. We consider investments in highly-liquid instruments purchased with a remaining maturity of 90days or less at the date of purchase to be cash equivalents. Our exposure to market risk for changes in interest rates relates primarily to our short-term investments and short-term obligations; thus, fluctuations in interest rates would not have a material impact on the fair value of these securities.

At December 31, 2003, we had \$28.8 million in cash and cash equivalents and \$11.5 million in marketable securities. A hypothetical 10% increase or decrease in interest rates would not have a material impact on our earnings or loss, or the fair market value or cash flows of these instruments.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements and supplementary data required by this item are included in Part IV, Item 15 of this Form 10-K and are presented beginning on page F-1.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

The Company's President (principal executive officer) and Vice President, Finance (principal financial officer), based on the evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, as of December 31, 2003, have concluded that the Company's disclosure controls and procedures were effective to ensure the timely collection, evaluation and disclosure of information relating to the Company that would potentially be subject to disclosure under the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder.

During the three-month period ended December 31, 2003, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

[Report of Independent Auditors](#)
[Consolidated Balance Sheets](#)
[Consolidated Statements of Operations](#)
[Consolidated Statement of Stockholders' Equity and Comprehensive Income](#)
[Consolidated Statements of Cash Flows](#)
[Notes to Consolidated Financial Statements](#)
[Schedule II Valuation and Qualifying Accounts](#)

F-1

Report of Independent Auditors

To the Board of Directors and
Stockholders of Overstock.com,Inc.

In our opinion, the consolidated financial statements listed in the index appearing on page F-1 present fairly, in all material respects, the financial position of Overstock.com,Inc. and its subsidiaries (the "Company") at December 31, 2002 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion the financial statement schedule listed in the index appearing on page F-1 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2002, the Company changed its method of accounting for goodwill in accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets.

/s/ PricewaterhouseCoopers LLP

Salt Lake City, Utah
February 20, 2004

F-2

Overstock.com, Inc.
Consolidated Balance Sheets

		December 31,	
		2002	2003
		(in thousands)	
Assets			
Current assets:			
Cash and cash equivalents	\$	11,059	\$ 28,846
Marketable securities		21,603	11,500
Accounts receivable, net		6,994	10,183
Inventories, net		13,954	29,926
Prepaid expenses and other assets		2,333	4,583
		Total current assets	55,943
Property and equipment, net		4,945	9,483
Goodwill		2,784	2,784
Other long-term assets, net		284	427
		Total assets	\$ 63,956
Liabilities, Redeemable Securities and Stockholders' Equity			
Current liabilities:			
Accounts payable	\$	13,731	\$ 30,363
Accrued liabilities		6,409	9,316
Capital lease obligations, current		124	75
		Total current liabilities	20,264
Capital lease obligations, non-current		58	86
		Total liabilities	20,322
Commitments and contingencies (notes 10, 11 and 12)			
Redeemable common stock, \$0.0001 par value, 683 and 460 shares issued and outstanding as of December 31, 2002 and 2003, respectively		4,363	2,978
Stockholders' equity:			
Common stock, \$0.0001 par value, 100,000 shares authorized, 13,866 and 16,060 shares issued as of December 31, 2002 and 2003, respectively		1	2
Additional paid-in capital		97,282	123,934
Accumulated deficit		(55,666)	(67,815)
Unearned stock-based compensation		(2,327)	(1,094)
Treasury stock, 35 shares at cost		(100)	(100)
Accumulated other comprehensive income (loss)		81	(13)
		Total stockholders' equity	39,271
		Total liabilities, redeemable securities and stockholders' equity	\$ 63,956

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

Overstock.com, Inc.
Consolidated Statements of Operations

	Year ended December 31,		
	2001	2002	2003
	(in thousands, except per share data)		
Direct revenue	\$ 35,243	\$ 77,943	\$ 136,592
Fulfillment partner revenue	3,965	12,379	100,811
Warehouse revenue	795	1,462	1,542
Total revenue	40,003	91,784	238,945
Cost of goods sold (includes amortization of stock-based compensation of \$78, \$373, and \$90, respectively)	34,640	73,441	213,492
Gross profit	5,363	18,343	25,453
Operating expenses:			
Sales and marketing expenses (excludes amortization of stock-based compensation of \$14, \$83, and \$22, respectively)	5,784	8,669	20,173
General and administrative expenses (excludes amortization of stock-based compensation of \$635, \$2,820, and \$734, respectively)	9,441	10,825	16,911
Amortization of goodwill	3,056	—	—
Amortization of stock-based compensation	649	2,903	756
Total operating expenses	18,930	22,397	37,840
Operating loss	(13,567)	(4,054)	(12,387)
Interest income	461	403	461
Interest expense	(729)	(465)	(76)
Other income (expense), net	29	(444)	115
Net loss	(13,806)	(4,560)	(11,887)
Deemed dividend related to redeemable common stock	(404)	(406)	(262)
Deemed dividend related to beneficial conversion feature of preferred stock	—	(6,607)	—
Net loss attributable to common shares	\$ (14,210)	\$ (11,573)	\$ (12,149)
Net loss per common share—basic and diluted	\$ (1.29)	\$ (0.88)	\$ (0.75)
Weighted average common shares outstanding—basic and diluted	10,998	13,108	16,198

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

Overstock.com, Inc.
Consolidated Statements of Stockholders' Equity
and Comprehensive Income

	Common stock		Additional Paid-in capital	Accumulated deficit	Unearned stock-based compensation	Treasury stock	Accumulated Other Comprehensive Income	Total
	Shares	Amount						
	(amounts in thousands)							
Balance at December 31, 2000	9,096	\$ 1	\$ 42,231	\$ (29,883)	\$ —	\$ —	\$ —	12,349
Issuance of common stock	1,210	—	6,915	—	—	—	—	6,915
Exercise of stock options	14	—	73	—	—	—	—	73
Purchase of treasury stock	—	—	—	—	—	(100)	—	(100)
Unearned stock-based compensation from options issued to employees	—	—	2,534	—	(2,534)	—	—	—
Amortization of stock-based compensation	—	—	—	—	727	—	—	727
Issuance of stock options to consultants in exchange for services	—	—	384	—	(208)	—	—	176
Lapse of rescission rights on redeemable common stock	7	—	50	—	—	—	—	50
Deemed dividend related to redeemable common stock	—	—	—	(404)	—	—	—	(404)
Net loss	—	—	—	(13,806)	—	—	—	(13,806)
Balance at December 31, 2001	10,327	1	52,187	(44,093)	(2,015)	(100)	—	5,980
Issuance of common stock	7	—	212	—	—	—	—	212
Exercise of stock options and warrants	149	—	615	—	—	—	—	615
Deemed dividend related to beneficial conversion feature of preferred stock	—	—	6,607	(6,607)	—	—	—	—
Conversion of Series A redeemable preferred stock to common stock	959	—	6,582	—	—	—	—	6,582
Issuance of common stock in IPO	2,256	—	26,140	—	—	—	—	26,140
Unearned stock-based compensation from options issued to employees	—	—	3,481	—	(3,481)	—	—	—
Amortization of stock-based compensation	—	—	—	—	3,276	—	—	3,276
Issuance of stock options to consultants in exchange for services	—	—	131	—	(107)	—	—	24
Lapse of rescission rights on redeemable common stock	168	—	1,327	—	—	—	—	1,327
Deemed dividend related to redeemable common stock	—	—	—	(406)	—	—	—	(406)
Net loss	—	—	—	(4,560)	—	—	—	(4,560)
Unrealized gain on marketable securities	—	—	—	—	—	—	81	81
Total comprehensive loss	—	—	—	—	—	—	—	(4,479)
Balance at December 31, 2002	13,866	1	97,282	(55,666)	(2,327)	(100)	81	39,271
Exercise of stock options and warrants	247	—	1,227	—	—	—	—	1,227
Issuance of common stock in Follow-on offering	1,725	1	23,967	—	—	—	—	23,968
Issuance of common stock	—	—	21	—	—	—	—	21
Forfeitures of unearned stock-based compensation from options issued to employees	—	—	(478)	—	478	—	—	—
Amortization of stock-based compensation	—	—	—	—	846	—	—	846
Issuance of stock options to consultants in exchange for services	—	—	268	—	(91)	—	—	177
Lapse of rescission rights on redeemable common stock	222	—	1,647	—	—	—	—	1,647
Deemed dividend related to redeemable common stock	—	—	—	(262)	—	—	—	(262)
Net loss	—	—	—	(11,887)	—	—	—	(11,887)

Realized gain on marketable securities	—	—	—	—	—	—	(15)	(15)
Unrealized loss on marketable securities	—	—	—	—	—	—	(78)	(78)
Cumulative translation adjustment	—	—	—	—	—	—	(1)	(1)
Total comprehensive loss								(11,981)
Balance at December 31, 2003	16,060	\$ 2	\$ 123,934	\$ (67,815)	\$ (1,094)	\$ (100)	(13)	\$ 54,914

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

F-5

Overstock.com, Inc.
Consolidated Statements of Cash Flows

	Year ended December 31,		
	2001	2002	2003
	(in thousands)		
Cash flows from operating activities:			
Net loss	\$ (13,806)	\$ (4,560)	\$ (11,887)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
Depreciation and amortization	1,735	1,873	2,325
Amortization of goodwill	3,056	—	—
Amortization of unearned stock-based compensation	727	3,276	846
Realized loss (gain) on marketable securities	—	55	(15)
Stock options issued to consultants for services	176	24	177
Stock issued to employees	63	181	21
Amortization of debt discount	291	242	—
Selling shareholder fees	—	439	—
Changes in operating assets and liabilities:			
Accounts receivable	(774)	(5,429)	(3,189)
Inventories, net	1,081	(6,368)	(15,972)
Prepaid expenses and other assets	920	(1,857)	(2,250)
Other long-term assets	(263)	246	(7)
Accounts payable	(1,532)	10,051	16,632
Accrued liabilities	(2,133)	4,316	2,907
Net cash (used in) provided by operating activities	(10,459)	2,489	(10,412)
Cash flows from investing activities:			
Purchases of marketable securities	—	(34,819)	(41,363)
Sales of marketable securities	—	13,243	51,388
Expenditures for property and equipment	(1,669)	(1,746)	(6,707)
Expenditures for other long-term assets	(35)	(5)	(172)
Net cash provided by (used in) investing activities	(1,704)	(23,327)	3,146
Cash flows from financing activities:			
Payments on capital lease obligations	(248)	(261)	(141)
Borrowings on related party note payables	4,500	1,160	—
Payments on related party note payables	(3,000)	(5,660)	—
Issuance of redeemable preferred stock	—	6,582	—
Issuance of common stock in offerings, net of issuance costs	—	26,140	23,968
Payment of selling shareholder fees	—	(439)	—
Issuance of common stock	6,319	31	—
Exercise of stock options and warrants	73	615	1,227
Purchase of treasury stock	(100)	—	—
Net cash provided by financing activities	7,544	28,168	25,054
Effect of exchange rate changes on cash	—	—	(1)
Net increase (decrease) in cash and cash equivalents	(4,619)	7,330	17,787

Cash and cash equivalents, beginning of year		8,348		3,729		11,059
Cash and cash equivalents, end of year	\$	3,729	\$	11,059	\$	28,846
Supplemental disclosures of cash flow information:						
Interest paid	\$	271	\$	222	\$	51
Equipment acquired under capital leases		75		25		120
Deemed dividend on redeemable common stock		404		406		262
Deemed dividend related to beneficial conversion feature of redeemable preferred stock		—		6,607		—
Conversion of Series A preferred stock to common stock		—		6,582		—
Unearned stock-based compensation (forfeitures)		2,534		3,481		(478)
Lapse of rescission rights on redeemable common stock		50		1,327		1,647

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

Overstock.com,Inc.
Notes to Consolidated Financial Statements
(all amounts in thousands, except per share data)

1. BUSINESS AND ORGANIZATION

Overstock.com,Inc. (the "Company") is an online "closeout" retailer offering discount, brand-name merchandise for sale primarily over the Internet. The Company's merchandise offerings include bed-and-bath goods, kitchenware, watches, jewelry, electronics, sporting goods and designer accessories. The Company also sells books, magazines, CDs, DVDs, videocassettes and video games ("BMV")

The Company was formed on May5, 1997 as D2—Discounts Direct, a limited liability company. On December30, 1998, the Company was reorganized as a C Corporation in the State of Utah and reincorporated in Delaware in May2002. On October25, 1999, the Company changed its name to Overstock.com,Inc. On November20, 2000, the Company acquired Gear.com,Inc. On July23, 2003, the Company formed Overstock Mexico, S. de R. L. de C.V., a wholly owned subsidiary to distribute its products in Mexico.

The Company is subject to risks common to rapidly growing Internet-based companies, including rapid technological change, growth and consumer acceptance of the Internet, dependence on principal products, new product development, new product introductions and other activities of competitors, and a limited operating history in Internet related e-commerce activities.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

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

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair value of financial instruments

Cash equivalents include short-term, highly liquid instruments with original maturities of 90days or less. At December31, 2002 and 2003, three banks held the Company's cash and cash equivalents. The Company does not believe that, as a result of this concentration, it is subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships. The Company's financial instruments, including cash, cash equivalents, accounts receivable, and accounts payable are carried at cost, which approximates their fair value because of the short-term maturity of these instruments.

Marketable securities consist of funds deposited into capital management accounts managed by two financial institutions. The financial institutions have invested these funds in municipal, government and corporate bonds which are classified as available-for-sale and reported at fair value using the specific identification method. Realized gains and losses are included in other income (expense), net in

the Statement of Operations. Unrealized gains and losses are excluded from earnings and reported as a component of other comprehensive income (loss), net of related estimated tax provisions or benefits.

Accounts receivable

Accounts receivable consist of amounts due from customers and from credit cards billed but not yet received at period end. The Company recorded an allowance for doubtful accounts of \$145 and \$650 at December 31, 2002 and 2003, respectively.

Concentration of credit risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash equivalents, investment securities, and receivables. The Company invests its cash primarily in money market, government and corporate securities which are uninsured.

The Company's accounts receivable are derived primarily from revenue earned from customers located in the United States. The Company maintains an allowance for doubtful accounts based upon the expected collectibility of accounts receivable. During the years ended December 31, 2002 and 2003, the Company recorded sales to its most significant customer totaling \$14,620 and \$21,044, respectively. There were no sales to this customer during 2001. At December 31, 2002 and 2003, the Company had a receivable of \$3,577 and \$5,345, respectively, from this customer. No other customer accounted for greater than 10% of revenues or receivables during 2001, 2002 or 2003.

Inventories

Inventories consist of merchandise purchased for resale and are stated at the lower of average cost or market. The Company establishes reserves for estimated obsolescence or damage equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions.

Property and equipment

Property and equipment, which includes capitalized leases, 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 lease, whichever is shorter, as follows:

	Years
Computer software	3
Computer hardware	5
Furniture and equipment	5

Leasehold improvements are amortized over the shorter of the term of the related leases or estimated service lives. Upon sale or retirement of assets, cost and related accumulated depreciation are removed from the balance sheet and the resulting gain or loss is reflected in operations.

Other long-term assets

Other long-term assets include deposits and the cost of acquiring the Overstock.com and other related domain names. The cost of the domain names is being amortized using the straight-line method over 5 years.

Goodwill

Goodwill represents the excess of the purchase price paid over the fair value of the tangible net assets acquired for the purchase of Gear.com. From November 28, 2000, the date of the Gear.com acquisition, through December 2001, the Company amortized its goodwill on a straight-line basis using a 2 year estimated life.

Effective January 1, 2002, Overstock.com adopted Statement of Financial Accounting Standards No. 142 *Goodwill and Other Intangible Assets*. SFAS 142 applies to all goodwill and identified intangible assets acquired in a business combination. Under this standard, all goodwill and long-lived intangible assets, including those acquired before initial application of the standard will not be amortized, but will be tested for impairment at least annually. Accordingly, the Company ceased amortization of its goodwill in January 2002. The Company evaluated the \$2,784 of unamortized goodwill during 2002 and 2003, and determined that no impairment charge should be recorded.

The following table shows what the Company's net loss and net loss per common share would have been for the years ended December 31, 2001, 2002 and 2003 exclusive of the amortization expense:

	Year ended December 31,		
	2001	2002	2003
Reported net loss	\$ (13,806)	\$ (4,560)	\$ (11,887)
Add back: Goodwill amortization	3,056	—	—
Adjusted net loss	\$ (10,750)	\$ (4,560)	\$ (11,887)
Basic and diluted loss per share:			
Reported net loss per common share	\$ (1.29)	\$ (0.88)	\$ (0.75)
Add back: Goodwill amortization	0.28	—	—
Adjusted net loss per common share	\$ (1.01)	\$ (0.88)	\$ (0.75)

Impairment of long-lived assets

The Company reviews property and equipment and other long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability is measured by comparison of the assets' carrying amount to future undiscounted net cash flows the assets are 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 assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the projected discounted future cash flows arising from the assets or their fair values, whichever is more determinable.

Revenue recognition

The Company derives its revenue from three sources: direct revenue, fulfillment partner revenue, and warehouse revenue. Revenue from all three sources is recognized when the following revenue recognition criteria are met: (1)persuasive evidence of an arrangement exists; (2)the product has been shipped and the customer takes ownership and assumes the risk of loss; (3)the selling price is fixed or determinable; and (4)collection of the resulting receivable is reasonably assured.

Direct revenue consists of merchandise sales made to individual consumers and businesses that are fulfilled from our warehouse. The Company generally requires payment by credit card at the point of sale. From time to time, the Company grants credit to its business customers on normal credit terms. Amounts received prior to shipment of goods to customers are recorded as deferred revenue. Direct revenue is recorded net of returns, chargebacks and coupons redeemed by customers and other discounts to obtain such sales.

Fulfillment partner revenue consists of sales of merchandise of third parties on the Company's Website, and is recognized when services have been rendered (generally when verification of the shipment of the product is communicated to the Company from the third party that shipped the product). Prior to July 1, 2003, the Company did not physically handle the merchandise sold in these transactions, as the merchandise was shipped directly by a third party vendor, who also handled all customer returns related to these fulfillment partner sales. During that period, the Company recognized as revenue only the commission portion of the price customers paid for the purchased products since the Company acted as an agent in such transactions. Beginning July 1, 2003, the Company took responsibility for all returned items relating to these sales and began accepting returned items relating to these sales into the Company's warehouse, and the Company now handles the possible resale of any returned items. As a result, beginning July 1, 2003, the Company is considered to be the primary obligor for these sales transactions, and assumes the risk of loss on the returned items. As a consequence, the Company now records revenue from sales transactions involving fulfillment partners on a gross basis, rather than recording a commission on sales as was recorded prior to July 1, 2003.

During the fourth quarter of 2003, the Company added a discount travel store to the Company's Website. Fulfillment partners are used to supply the travel products (flights, hotels, rental cars, etc.) in the store. For the products sold in the travel store, the Company does not currently have inventory risk or pricing control, and does not provide customer service. Therefore, for these sales the Company is not considered to be the primary obligor, and therefore, records only the commission as revenue.

Fulfillment partner revenue is reduced by the impact of returns, chargebacks and coupons redeemed by customers and other discounts to obtain such sales. The Company's total gross sales values for its fulfillment partner revenue were \$25,657, \$65,526 and \$156,624 during 2001, 2002, and 2003, respectively; however, it recognized \$3,965, \$12,379 and \$100,811 in related fulfillment partner revenue during 2001, 2002 and 2003, respectively.

Revenue from warehouse sales is recognized when the customer takes ownership, carries the products from the warehouse and assumes the risk of loss. For warehouse sales, the Company generally requires payment by cash or credit card at the point of sale. Gross sales are reduced by chargebacks and discounts to obtain such sales. The Company closed its warehouse store in January 2004.

Cost of goods sold

Cost of goods sold include product costs, warehousing costs, inbound and outbound shipping costs, handling and fulfillment costs, customer service costs and credit card fees, and are recorded in the same period in which related revenues have been recorded.

Income taxes

Income taxes are accounted for under the asset and liability method. Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be ultimately realized. Income tax expense (benefit) is the tax payable (receivable) for the period and the change during the period in the deferred tax assets and liabilities.

Stock-based compensation

The Company measures compensation expense to employees for its equity incentive plan using the intrinsic value method prescribed by Accounting Principles Board Opinion No.25 ("APB 25"), *Accounting for Stock Issued to Employees*, and provides pro forma disclosures of net income as if the fair value based method prescribed by Statement of Financial Accounting Standards ("SFAS") No.123, *Accounting for Stock-Based Compensation*, had been applied (Note 14). The following table provides a reconciliation of net loss to pro forma net loss as if the fair value method had been applied to all awards.

	Year ended December 31,		
	2001	2002	2003
Net loss, as reported	\$ (13,806)	\$ (4,560)	\$ (11,887)
Add: Stock-based employee compensation expense included in reported net income net of related tax effects	727	3,276	846
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(1,057)	(4,404)	(2,714)
Pro forma net loss	\$ (14,136)	\$ (5,688)	\$ (13,755)
Net loss per common share			
Basic and diluted—as reported	\$ (1.29)	\$ (0.88)	\$ (0.75)
Basic and diluted—pro forma	\$ (1.32)	\$ (0.97)	\$ (0.87)

The weighted average grant-date fair value of options granted during 2001, 2002 and 2003 was \$5.97, \$8.21 and \$8.27 per share, respectively, and was estimated using the assumptions discussed in Note 14.

Stock-based awards to non-employees are accounted for under the provisions of FAS123 and Emerging Issues Task Force Issue 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* .

Earnings (loss) per share

Earnings (loss) per share is computed by dividing net income (loss) attributable to common shares by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share assumes the exercise of all options and warrants which are dilutive, whether exercisable or not.

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

	Year ended December 31,		
	2001	2002	2003
Net loss attributable to common shares	\$ (14,210)	\$ (11,573)	\$ (12,149)
Weighted average common shares outstanding—basic	10,998	13,108	16,198
Effective of dilutive securities:			
Warrants	—	—	—
Employee stock options	—	—	—
Weighted average common shares outstanding—diluted	10,998	13,108	16,198
Earnings (loss) per common share—basic:	\$ (1.29)	\$ (0.88)	\$ (0.75)
Earnings (loss) per common share—diluted:	\$ (1.29)	\$ (0.88)	\$ (0.75)

The stock options and warrants outstanding were not included in the computation of diluted earnings per share because to do so would have been antidilutive. The number of shares of stock options and warrants outstanding at each year-end was 2,283 shares, 2,535 shares and 2,849 shares for 2001, 2002 and 2003, respectively.

Internal use software

The Company expenses all costs incurred for the development of internal use software that relate to the planning and post implementation phases of the development. Direct costs incurred in the development phase are capitalized and recognized over the software's estimated useful life of 3years. There were no website development costs or software costs capitalized in 2002 and 2003. Research and development costs and other computer software maintenance costs related to software development are expensed as incurred.

Advertising expense

The Company recognizes advertising expenses in accordance with SOP 93-7 *Reporting on Advertising Costs* . As such, the Company expenses the costs of producing advertisements at the time production occurs, and expenses the cost of communicating advertising in the period during which the

advertising space or airtime is used. Internet advertising expenses are recognized based on the terms of the individual agreements, which is generally: 1) during the period customers are acquired; or 2) based on the number of clicks generated during a given period over the term of the contract. Advertising expenses totaled \$4,802, \$7,043 and \$18,552 during the years ended December 31, 2001, 2002 and 2003, respectively.

Foreign currency translation

One of the Company's subsidiaries is located in Mexico where that subsidiary's local currency is considered its functional currency. All of that subsidiary's assets and liabilities are translated into U.S. dollars at exchange rates existing at the balance sheet dates, revenue and expenses are translated at weighted average exchange rates, and stockholders' equity is recorded at historical exchange rates. The resulting foreign currency translation adjustments are recorded as a separate component of stockholders' equity in the consolidated balance sheets as part of accumulated other comprehensive income (loss). Transaction gains and losses are included in other income (expense) in the consolidated financial statements and have not been significant for any periods presented.

Recently issued accounting pronouncements

The Financial Accounting Standards Board issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. SFAS 150 establishes standards on the classification and measurement of certain financial instruments with characteristics of both liabilities and equity. The provisions of SFAS 150 are effective for financial instruments entered into or modified after May 31, 2003 and to all other instruments that exist as of the beginning of the first interim financial reporting period beginning after June 15, 2003. The adoption of this standard did not have a material effect on the Company's financial statements.

3. PUBLIC OFFERINGS

On June 4, 2002, the Company closed its initial public offering, pursuant to which it sold 2,155 shares of its common stock, and a selling shareholder sold 845 shares of common stock at a price of \$13.00 per share. The offering resulted in proceeds to the Company of approximately \$24,880, net of \$2,014 of issuance costs. As part of the offering, the Company granted the underwriter the right to purchase up to 450 additional shares within thirty days after the offering to cover over-allotments. On June 27, 2002, the underwriter purchased an additional 101 shares of stock for \$1,260. At the closing of the offering, all issued and outstanding shares of the Company's redeemable convertible preferred stock were automatically converted into common stock on a 1:1 basis.

As part of the initial public offering, the Company paid \$439 of selling costs on behalf of the selling shareholder. This amount was recorded in other income (expense) in the statement of operations for the year ended December 31, 2002.

In February 2003, the Company closed its follow-on public offering, pursuant to which it sold 1,725 shares of common stock, with proceeds to the Company of approximately \$23,968, net of \$613 of issuance costs. The number of shares issued includes 225 additional shares that the Company granted the underwriter the right to purchase to cover any over-allotments.

4. MARKETABLE SECURITIES

The Company's marketable securities consist of funds deposited into capital management accounts managed by two financial institutions. The financial institutions invested these funds in municipal, government, and corporate bonds at December 31, 2002, as follows:

	Cost Basis	Unrealized Gains	Unrealized Losses	Estimated Market Value
U.S. government and government agency securities	\$ 18,114	\$ 72	\$ —	\$ 18,186
Asset backed and agency securities	386	—	(2)	384
Corporate securities	979	—	(1)	978
Money market securities	442	2	—	444
Mortgage based securities	1,601	10	—	1,611
	\$ 21,522	\$ 84	\$ (3)	\$ 21,603

The financial institutions have invested these funds in municipal, government, and corporate bonds at December 31, 2003, as follows:

	Cost Basis	Unrealized Gains	Unrealized Losses	Estimated Market Value
U.S. government and government agency securities	\$ 9,299	\$ 1	\$ (7)	\$ 9,293
Corporate securities	296	—	—	296
Money market securities	748	1	—	749
Mortgage based securities	1,169	—	(7)	1,162
	\$ 11,512	\$ 2	\$ (14)	\$ 11,500

All marketable securities mature between 2004 and 2006.

The components of gains and losses on sales of marketable securities for the years ended December 31, 2001, 2002 and 2003 were:

	Year ended December 31,		
	2001	2002	2003
Gross gains	\$ —	\$ —	\$ 19
Gross losses	—	—	(4)
Net realized gain on sales of marketable securities	\$ —	\$ —	\$ 15

5. INVENTORIES

Inventories consist of the following:

	December 31,	
	2002	2003
Product inventory	\$ 14,965	\$ 31,064
Less: allowance for obsolescence	(1,011)	(1,138)
	\$ 13,954	\$ 29,926

6. PREPAID EXPENSES AND OTHER ASSETS

Prepaid expenses and other assets consist of the following:

	December 31,	
	2002	2003
Inventory paid for in advance of receipt	\$ 1,362	\$ 2,946
Other prepaid expenses	971	1,637
	\$ 2,333	\$ 4,583

7. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	December 31,	
	2002	2003
Computer hardware and software	\$ 5,386	\$ 9,249
Furniture and equipment	3,908	6,738
Leasehold improvements	12	146
	9,306	16,133
Less: accumulated depreciation	(4,361)	(6,650)
	\$ 4,945	\$ 9,483

Depreciation of property and equipment totaled \$1,712, \$1,842, and \$2,289 for the years ended December 31, 2001, 2002 and 2003, respectively.

Property and equipment included assets under capital leases of \$856 and \$976 at December 31, 2002 and 2003, respectively and accumulated amortization related to assets under capital leases of \$691 and \$824, respectively.

8. OTHER LONG-TERM ASSETS

Other long-term assets consist of the following:

	December 31,	
	2002	2003
Domain names	\$ 151	\$ 323
Deposits	213	220
	364	543
Less: accumulated amortization	(80)	(116)
	\$ 284	\$ 427

Amortization for other long-term assets totaled \$23, \$31 and \$36 for the years ended December31, 2001, 2002 and 2003, respectively.

9. ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	December 31,	
	2002	2003
Inventory received but not invoiced	\$ 2,734	\$ 1,126
Reserve for returns	465	1,110
Accrued payroll and other related costs	673	850
Other accrued expenses	604	1,582
Accrued marketing expenses	1,233	2,674
Merchant processing accrual	444	1,313
Accrued freight	24	661
Deferred revenue	232	—
	\$ 6,409	\$ 9,316

10. BORROWINGS

On May22, 2002, the Company entered into a \$1,000 revolving credit agreement (the "Revolving Credit Facility") with Wells Fargo Bank, N.A. The proceeds are to be used for issuing standby and commercial letters of credit for the purchase of inventory. The Revolving Credit Facility was increased to \$2,000 on October9, 2003. The Revolving Credit Facility expires on June30, 2004. As of December31, 2003, there were no borrowings under this agreement; however, the Company has issued letters of credit totaling \$1,882 under this facility. Effective February23, 2004, the Company increased this Revolving Credit Facility to \$3,500.

Capital leases

Future minimum lease payments under capital leases are as follows:

Year Ending December 31,	
2004	\$ 85
2005	42
2006	23
2007	20
2008	7
Thereafter	—
Total minimum lease payments	177
Less: amount representing interest	(16)
Present value of capital lease obligations	161
Less: current portion	(75)
Capital lease obligations, non-current	\$ 86

11. COMMITMENTS AND CONTINGENCIES

The Company leases 33 square feet of office space and 354 square feet for its warehouse facility in Salt Lake City, Utah. The Company also has lease obligations under non-cancelable operating leases for computer equipment. Minimum future payments under these leases are as follows:

Year Ending December 31,	
2004	\$ 1,575
2005	1,327
2006	781
2007	65
Thereafter	—
	\$ 3,748

Rental expense for operating leases totaled \$1,180, \$1,639 and \$1,955 for the years ended December 31, 2001, 2002 and 2003, respectively.

The Company is involved in various legal matters arising in the normal course of business. In the opinion of management, the Company's liability, if any, arising from regulatory matters and legal proceedings related to these matters is not expected to have a material adverse impact on the Company's financial position, results of operations and cash flows. The outcomes of legal matters in which the Company is presently involved are not probable and reasonably estimable.

12. REDEEMABLE SECURITIES

In March 2002, the Company sold approximately 959 shares of mandatorily redeemable convertible preferred stock ("preferred stock") for approximately \$6,582, net of issuance costs. The preferred stock automatically converted to common stock on a 1:1 basis in connection with the initial public offering. As the fair value of the common stock to be received upon conversion was greater than the conversion price of the preferred stock at the date the preferred stock was issued, a beneficial conversion feature resulted in the amount of \$6,607, which was calculated in accordance with Emerging Issues Task Force No.98-5 *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios*. This beneficial conversion feature was reflected as a deemed dividend in the statement of operations during the year ended December 31, 2002.

Redeemable common stock relates to warrants and securities that are subject to rescission. Sales of 858 shares of the common stock and the issuance of 185 warrants to certain individuals did not fully comply with certain requirements under applicable State Blue Sky Laws. The offer and sale of these securities were not made pursuant to a registration statement and the Securities Act of 1933, nor were the offer and sale registered or qualified under any state security laws. Although the Company believed at the time that such offers, sales and conversion were exempt from such registration or qualification, they may not have been exempt in several states. As a result, purchasers of our common stock in some states have the right under federal or state securities laws to rescind their purchases for an amount equal to the purchase price paid for the shares, plus interest from the date of purchase until the rescission offer expires, at the annual rate mandated by the state in which such shares were purchased. These interest rates range from 8% to 10% per annum. The rescission rights lapse on various dates through September 2006.

At December 31, 2002 and 2003, the Company has classified \$4,363 and \$2,978, respectively, related to the rescission rights outside of shareholders' equity, because the redemption features are not within the control of the Company. However, management does not anticipate that holders of the redeemable common stock will exercise their rescission rights. Interest attributable to these securities is recorded as a deemed dividend and reflected as a deduction from net loss to arrive at net loss attributable to common shares in the Statements of Operations.

13. STOCKHOLDERS' EQUITY

Reverse stock split

On March 4, 2002, the Company's Board of Directors approved a proposal to amend the Company's certificate of incorporation to effect a reverse stock split. On April 15, 2002, the Company's Board of Directors approved a 1-for-28.34 reverse split. The authorized common shares have decreased from 450,000 to 100,000, effective May 20, 2002. All share amounts and per share data reflected in these consolidated financial statements are shown after giving retroactive effect to the 1-for-28.34 reverse stock split.

Reincorporation

In May 2002, the Company reincorporated in Delaware. As a result of the reincorporation, the Company is authorized to issue 100,000 shares of \$0.0001 par value common stock and 5,000 shares of

\$0.0001 par value preferred stock. The Board of Directors may issue the undesignated preferred stock in one or more series and determine preferences, privileges and restrictions thereof.

Common Stock

Each share of common stock has the right to one vote. The holders of common stock are also entitled to receive dividends whenever funds are legally available and when declared by the Board of Directors, subject to prior rights of holders of all classes of stock outstanding having priority rights as to dividends. No dividends have been declared or paid on the Company's common stock through December 31, 2003. In October 2001, the Company's Board of Directors authorized the purchase of 35 treasury shares from a former employee for \$100.

Warrants

In 2000, the Company issued warrants to certain shareholders in connection with the purchase of additional shares of common stock. At December 31, 2003, warrants to purchase 1,069 shares of common stock of the Company were outstanding, as follows:

Issuance Date	Exercise Price per Share	Warrants Outstanding	Expiration Date
May 1, 2000	\$ 7.09	237	April 30, 2005
May 15, 2000	\$ 7.09	258	May 14, 2005
June 22, 2000	\$ 7.09	7	June 21, 2005
September 21, 2000	\$ 4.26	567	September 20, 2005

No warrants were exercised in 2001, 3 warrants were exercised in 2002 and 50 warrants were exercised in 2003.

The Company has reserved sufficient shares of common stock to meet its stock option and warrant obligations. As stated in Note 12, 112 of these warrants are subject to rescission. At December 31, 2002 and 2003, related parties held 850 of the total warrants outstanding.

14. STOCK OPTION PLANS

The Company's board of directors adopted the Amended and Restated 1999 Stock Option Plan and the 2002 Stock Option Plan (collectively, the "Plans"), in May 1999 and April 2002, respectively. Under these Plans, the Board of Directors may issue incentive stock options to employees and directors of the Company and non-qualified stock options to consultants of the Company. Options granted under these Plans generally expire at the end of five years and vest in accordance with a vesting schedule determined by the Company's Board of Directors, usually over four years from the grant date. As of the initial public offering, the Amended and Restated 1999 Stock Option Plan was terminated. Future shares will be granted under the 2002 Stock Option Plan. As of December 31, 2003, 328 shares are available for future grants under these Plans.

The following is a summary of stock option activity:

	2001			2002			2003	
	Shares	Weighted Average Exercise Price	Weighted Average Fair Value	Shares	Weighted Average Exercise Price	Weighted Average Fair Value	Shares	Weighted Average Exercise Price
Outstanding—beginning of year	415	\$ 5.03		1,161	\$ 4.68		1,415	\$ 5.37
Granted at fair value	—	—		245	8.05		854	12.77
Granted at price below fair value	1,020	4.71	\$ 5.97	543	5.07	\$ 9.61	—	—
Exercised	(14)	5.06		(146)	4.22		(197)	4.69
Canceled/forfeited	(260)	4.82		(388)	5.15		(292)	9.12
Outstanding—end of year	1,161	4.68		1,415	5.37		1,780	8.39
Options exercisable at year-end	260	4.61		388	4.93		614	5.44

The following table summarizes information about stock options as of December 31, 2003:

Range of Exercise Prices	Options Outstanding at December 31, 2003			Options Exercisable at December 31, 2003		
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contract Life	Shares	Weighted Average Exercise Price	
\$2.00-\$4.99	240	\$ 3.95	2.7	125	\$ 3.78	
\$5.00-\$6.99	684	5.07	2.6	396	5.07	
\$7.00-\$9.99	170	8.09	3.2	56	7.25	
\$10.00-\$12.99	222	12.54	4.3	34	11.90	
\$13.00-\$22.68	464	13.69	4.4	3	15.46	
	1,780	8.39	3.3	614	5.44	

The weighted-average grant-date fair value of options granted during 2001, 2002 and 2003 was \$5.97, \$8.21 and \$8.27 per share, respectively (see Note 2). The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

	2001	2002	2003
Risk-free interest rate	5.17 %	3.31 %	2.63 %
Expected life (in years)	4	3	3
Expected volatility	100 %	100 %	104 %
Expected dividend yield	0 %	0 %	0 %

Stock-based compensation

In connection with certain stock option grants to employees during the years ended December 31, 2001 and 2002, the Company recognized approximately \$2,534 and \$3,481, respectively, of unearned stock-based compensation for the excess of deemed fair value of shares of common stock subject to such options over the exercise price of these options at the date of grant. In 2003, the company reversed \$478 of unearned stock-based compensation due to forfeitures of unvested options. Such amounts are included as a component of stockholders' equity and are being amortized over the vesting period in accordance with FASB Interpretation Number 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plan*. The Company recorded stock-based compensation expense of \$727, \$3,276 and \$846 during the years ended December 31, 2001, 2002 and 2003, respectively.

During the years ended December 31, 2001, 2002 and 2003, the Company granted 42, 177 and 18 options to consultants, respectively. The Company recorded unearned stock-based compensation of \$384, \$131 and \$268 related to these grants, of which \$176, \$24 and \$177 was recognized in operations in 2001, 2002 and 2003, respectively. The fair value for these options was measured at the grant date and is remeasured at the end of each quarter until vesting is complete. At December 31, 2002 and 2003, the fair value of these options was calculated using a Black-Scholes option pricing model using risk-free rates of 3.31% and 2.59% and an expected life of 3 years and 3 years, respectively, expected volatility of 100% and 105%, respectively, and a dividend yield of 0%.

15. EMPLOYEE STOCK PURCHASE PLAN

Effective January 24, 2001, the Company adopted an Employee Stock Purchase Plan (the "ESPP") to provide certain employees, directors and consultants an opportunity to purchase shares of its common stock annually, up to 5% of eligible compensation. During a specified open period as determined by the Board of Directors, participants can purchase shares of stock at a value determined by the Company's board of directors which approximates the deemed fair market value of the stock. As of the initial public offering, the ESPP was terminated. Future shares will be granted under the 2002 Stock Option Plan. There were 14 and 6 shares issued under the ESPP during 2001 and 2002, respectively. The Company recognized approximately \$63, \$51 and \$0 of stock-based compensation for the excess of the fair value of the shares of common stock over the purchase price during 2001, 2002 and 2003, respectively.

16. EMPLOYEE RETIREMENT PLAN

The Company has a 401(k) defined contribution plan which permits participating employees to defer up to a maximum of 15% of their compensation, subject to limitations established by the Internal Revenue Code. Employees who have completed a half-year of service and are 21 years of age or older are qualified to participate in the plan. The Company matches 50% of the first 6% of each participant's contributions to the plan. Participant contributions are immediately vested. Company contributions vest based on the participant's years of service at 20% per year over five years. The Company's cash contribution totaled \$68, \$88 and \$99 during 2001, 2002 and 2003, respectively.

17. INCOME TAXES

The components of the Company's deferred tax assets and liabilities as of December 31, 2002 and 2003 are as follows:

	December 31,	
	2002	2003
Deferred tax assets:		
Net operating loss carryforwards	\$ 19,771	\$ 24,072
Accrued expenses	1,193	1,371
Reserves and other	768	1,208
	21,732	26,651
Deferred tax liabilities:		
Depreciation	(163)	(986)
Valuation allowance	(21,569)	(25,665)
Net asset	\$ —	\$ —

As a result of the Company's history of losses, a valuation allowance has been provided for the full amount of the Company's net deferred tax assets. Based on the weight of available evidence, it is more likely than not that such benefits will not be realized.

At December 31, 2002 and 2003, the Company had net operating loss carryforwards of approximately \$36,869 and \$48,018, respectively, which may be used to offset future taxable income. An additional \$14,386 of net operating losses are limited under Internal Revenue Code Section 382 to \$799 a year. These carryforwards begin to expire in 2019.

The income tax benefit differs from the amount computed by applying the U.S. federal income tax rate of 35% to loss before income taxes for the following reasons:

	Year ended December 31,		
	2001	2002	2003
U.S. federal income tax benefit at statutory rate	\$ 4,832	\$ 1,596	\$ 4,166
State income tax benefit, net of federal expense	338	38	385
Nondeductible goodwill amortization	(1,070)	—	—
Stock compensation expense	(119)	(1,216)	(384)
Other	(336)	(611)	(71)
Unrecognized benefit due to valuation allowance	(3,645)	193	(4,096)
Income tax benefit	\$ —	\$ —	\$ —

18. RELATED PARTY TRANSACTIONS

In July 2001, the Company's Chief Executive Officer, who is also a significant shareholder in the Company, agreed to personally guarantee the Company's merchant account with a bank. The bank agreed to accept this personal guarantee in lieu of a demand deposit of \$1,000 with the bank. In exchange for his personal guarantee, the Company compensated the Chief Executive Officer with options to purchase 35 shares of the Company's common stock at an exercise price of \$5.07 per share.

These options vested over a three-year period based on the renewal of the guarantee. The Company recognized \$151 and \$39 of expense in 2001 and 2002, respectively, related to this arrangement. In 2003, the bank no longer required the guarantee. As a result, the Company cancelled the associated unvested options and reversed \$52 of expense which it had previously recorded.

As indicated in Note12, the Company sold shares of mandatorily redeemable convertible preferred stock in March2002, for which a deemed dividend was recorded as a result of the beneficial conversion feature. The total deemed dividend recorded for the year ended December31, 2002 was \$6,607, of which \$1,000 is attributable to preferred shares purchased by Haverford Internet, \$1,200 is attributable to preferred shares purchased by members of the board of directors, and \$1,500 is attributable to preferred shares purchased by family members of management.

On occasion, Haverford-Valley, L.C. (an entity owned by the Company's president) and certain affiliated entities make travel arrangements for our executives and pay the travel related expenses incurred by our executives on Company business. In 2001, 2002, and 2003 we reimbursed Haverford-Valley L.C. \$251, \$273, and \$236, respectively, for these expenses.

19. LEASE TERMINATION SETTLEMENT

In February2002, the Company relocated its corporate headquarters. At the time the Company relocated, it had 23months remaining under the facilities lease for the former headquarters location. In March2002, the Company settled its remaining obligation under the lease by paying the former landlord \$340 and relinquishing the right to sublease the facilities. The settlement payment is recorded in the statement of operations for the year ended December31, 2002 under general and administrative expenses.

20. BUSINESS SEGMENTS

Segment information has been prepared in accordance with SFAS No.131, *Disclosures about Segments of an Enterprise and Related Information* . Segments were determined based on products and services provided by each segment. Accounting policies of the segments are the same as those described in Note2. There were no intersegment sales or transfers during 2001, 2002 or 2003. The Company

evaluates the performance of its segments and allocates resources to them based primarily on gross profit. The table below summarizes information about reportable segments.

	Direct	Fulfillment partner	Warehouse	Consolidated
2001				
Revenue	\$ 35,243	\$ 3,965	\$ 795	\$ 40,003
Cost of goods sold	31,776	1,143	1,721	34,640
Gross profit (loss)	3,467	2,822	(926)	5,363
Operating expenses				(18,930)
Other income, net				(239)
Net loss				\$ (13,806)
2002				
Revenue	\$ 77,943	\$ 12,379	\$ 1,462	\$ 91,784
Cost of goods sold	69,004	2,755	1,682	73,441
Gross profit (loss)	8,939	9,624	(220)	18,343
Operating expenses				(22,397)
Other income, net				(506)
Net loss				\$ (4,560)
2003				
Revenue	\$ 136,592	\$ 100,811	\$ 1,542	\$ 238,945
Cost of goods sold	123,064	89,190	1,238	213,492
Gross profit	13,528	11,621	304	25,453
Operating expenses				(37,840)
Other income, net				500
Net loss				\$ (11,887)

The direct segment includes revenues, direct costs, and allocations associated with sales fulfilled from our warehouse. Costs for this segment include product costs, inbound freight, warehousing, and fulfillment costs, credit card fees and customer service costs.

The fulfillment partner segment includes revenues, direct costs and cost allocations associated with the Company's third party fulfillment partner sales and are earned from selling the merchandise of third parties over the Company's Websites. Prior to July 1, 2003, this was reported as the "commission revenue" segment, as only the commission portion of the sales transactions were recorded as revenue (i.e., recorded "net"). The costs for the previous commission segment only included credit card fees and customer service costs. From July 1, 2003 forward, due to a change in the company's business practices, including the partner sales return process, these sales transactions are now recorded gross. As a result, this segment's name has been changed to the "fulfillment partner" segment, and the costs for this segment include product costs, warehousing and fulfillment costs, credit card fees and customer service costs.

The warehouse segment includes revenues, direct costs, and cost allocations associated with sales made to individual consumers at the Company's warehouse store. Costs for this segment include product costs, warehousing and credit card fees. The Company closed the warehouse store in January 2004.

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

In 2001, 2002 and 2003, virtually all sales were made to customers in the United States of America. No individual geographical area accounted for more than 10% of net sales in any of the periods presented. At December 31, 2002 and 2003, all of the Company's fixed assets were located in the United States of America.

21. QUARTERLY RESULTS OF OPERATIONS (unaudited)

The following tables set forth our unaudited quarterly results of operations data for the eight most recent quarters for the period ended December 31, 2003. We have prepared this information on the same basis as the Consolidated Statements of Operations and the information includes all adjustments,

consisting only of normal recurring adjustments, that we consider necessary for a fair statement of our financial position and operating results for the quarters presented.

	Three Months Ended								
	Mar.31, 2002	June30, 2002	Sept.30, 2002	Dec.31, 2002	Mar.31, 2003	June30, 2003	Sept.30, 2003	Dec.31, 2003	(unaudited)
Consolidated Statement of Operations									
Data:									
Direct revenue	\$ 10,029	\$ 11,853	\$ 20,759	\$ 35,302	\$ 24,962	\$ 25,159	\$ 29,011	\$ 57,460	
Commission revenue	1,659	2,230	2,857	5,633	3,966	3,431	28,504	64,910	
Warehouse revenue	379	297	192	594	236	243	273	790	
Total revenue	12,067	14,380	23,808	41,529	29,164	28,833	57,788	123,160	
Cost of goods sold(1)	9,990	11,831	19,238	32,382	24,539	24,030	53,537	111,386	
Gross profit	2,077	2,549	4,570	9,147	4,625	4,803	4,251	11,774	
Operating expenses:									
Sales and marketing expenses(2)	1,219	1,313	2,083	4,054	3,848	2,572	3,855	9,898	
General and administrative expenses(2)	2,802	2,195	2,372	3,456	4,545	3,367	4,059	4,940	
Amortization of stock-based compensation	846	806	674	577	328	112	171	145	
Total operating expenses	4,867	4,314	5,129	8,087	8,721	6051	8,085	14,983	
Operating income (loss)	(2,790)	(1,765)	(559)	1,060	(4,096)	(1,248)	(3,834)	(3,209)	
Interest income	22	49	229	103	152	142	98	69	
Interest expense	(240)	(208)	(7)	(10)	(7)	(55)	(8)	(6)	
Other income (expense), net	1	(442)	63	(66)	10	25	79	1	
Net income (loss)	(3,007)	(2,366)	(274)	1,087	(3,941)	(1,136)	(3,665)	(3,145)	
Deemed dividend related to redeemable common stock	(111)	(106)	(97)	(92)	(77)	(78)	(58)	(49)	
Deemed dividend related to beneficial conversion feature of preferred stock	(6,607)	—	—	—	—	—	—	—	
Net income (loss) attributable to common shares	\$ (9,725)	\$ (2,472)	\$ (371)	\$ 995	\$ (4,018)	\$ (1,214)	\$ (3,723)	\$ (3,194)	
Net income (loss) per common share									
—basic	\$ (0.87)	\$ (0.20)	\$ (0.03)	\$ 0.07	\$ (0.26)	\$ (0.07)	\$ (0.23)	\$ (0.19)	
—diluted	\$ (0.87)	\$ (0.20)	\$ (0.03)	\$ 0.06	\$ (0.26)	\$ (0.07)	\$ (0.23)	\$ (0.19)	
Weighted average common shares outstanding									
—basic	11,171	12,280	14,447	14,486	15,486	16,384	16,419	16,473	
—diluted	11,171	12,280	14,447	15,696	15,486	16,384	16,419	16,473	

(1)Amounts include stock based compensation of \$102 \$ 96 \$ 93 \$ 82 \$ 39 \$ 13 \$ 20 \$ 18

(2)Amounts exclude stock-based compensation as follows:

Sales and marketing expenses \$ 22 \$ 21 \$ 21 \$ 19 \$ 11 \$ 3 \$ 5 \$ 3

General and administrative expenses 824 78 653 558 31 109 16 142
5 7 6
\$846 \$ 80 \$674 \$577 \$ 32 \$112 \$ 17 \$145
6 8 1

Schedule II
Valuation and Qualifying Accounts
(dollars in thousands)

	Balance at Beginning of Year	Charged to Expense	Deductions	Balance at End of Year
Year ended December 31, 2001				
Deferred tax valuation allowance	\$ 18,117	\$ 3,645	\$ —	21,762
Reserve for sales returns	350	6,121	5,975	496
Allowance for inventory obsolescence	1,750	1,135	1,942	943
Year ended December 31, 2002				
Deferred tax valuation allowance	\$ 21,762	\$ —	\$ 193	21,569
Reserve for sales returns	496	3,994	4,025	465
Allowance for inventory obsolescence	943	164	96	1,011
Allowance for doubtful accounts	—	145	—	145
Year ended December 31, 2003				
Deferred tax valuation allowance	\$ 21,569	\$ 4,096	\$ —	25,665
Reserve for sales returns	465	11,463	10,818	1,110
Allowance for inventory obsolescence	1,011	1,763	1,636	1,138
Allowance for doubtful accounts	145	529	24	650

F-27