

Event Transcript

Overstock Com Inc [OSTK]

Q4 2005 Overstock Com Inc Earnings Conference Call
07 Feb 2006 11:00 (ET)

Corporate Participants

David Chidester - Overstock.com - SVP, Finance
Patrick Byrne - Overstock.com - President

Conference Call Participants

Aaron Kessler - Piper Jaffray - Analyst
Scott Devitt - Stifel Nicolaus - Analyst
Frank Gristina - Avondale Partners - Analyst
Rebecca Kujawa - Stanford Financial Group - Analyst
Paul Cohen - CIBC World Markets - Analyst
Justin Post - Merrill Lynch - Analyst

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Operator

Good morning, everyone. My name is Jamie and I will be your conference moderator today. I would like to welcome each of you to Overstock.com's 2005 financial results conference call. At this time, all lines are in a listen-only mode. Later, we will announce the opportunity for questions and instructions will be given at that time. A Web-based slide presentation will be used during this call and is available for download or viewing over the Internet on the Company Web site, www.shareholder.com/Overstock.

If you are listening via the telephone and want to see the presentation via the Internet, please ensure that you select the "no audio, slides only" option. If you select the regular webcast, you will experience up to a 25-second delay.

(OPERATOR INSTRUCTIONS). This call is being recorded and will be available for replay beginning today at 3 PM Eastern Time through 11.59 PM Eastern time Tuesday, February 14. The replay can be accessed by dialing 888-203-1112 or 719-457-0820 and entering the access code of 4565193. At this time, I'd like to turn the call over to Mr. David Chidester, Overstock.com Senior Vice President of Finance. Please go ahead.

David Chidester, Overstock.com - SVP, Finance

Thank you. Good morning and welcome to Overstock.com's year-end 2005 conference call. Participating with me on the call today is Dr. Patrick Byrne, President of Overstock.com.

Before I turn to the financial results, please keep in mind that the following discussion and the responses to your questions reflect management's views as of today, February 7, 2006 only. As you listen to the call, I encourage you to have our press release in front of you since our financial results, detailed commentary and the President's letter to shareholders are included and will correspond to much of the discussion that follows.

As we share information today to help you better understand our business, it is important to keep in mind that we will make statements in the course of this conference call that state our intentions, hopes, beliefs, expectations or predictions of the future. These constitute forward-looking statements for the purpose of the Safe Harbor provisions under the Private Securities Litigation Reform within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements involve certain risks and uncertainties that could cause Overstock.com's actual results to differ materially from those projected in these forward-looking statements. Overstock.com disclaims any intention or obligation to revise any forward-looking statements. Additional information

concerning important factors that could cause the actual results to differ materially from those in the forward-looking statements is contained from time to time in documents the Company files with the SEC, including but not limited to, its most recent reports on Form 10-K, 10-Q, 8-K and S1.

I will first discuss a few of the financial highlights for the full 2005 year. Please note that all comparisons will be against our results from the full year 2004 unless otherwise stated.

I will start by reiterating what Patrick explained in his letter to shareholders, for 2005 forward, we will be capitalizing inbound freight and expensing it over the period that related inventory is sold. This adjustment has been made and is included in the full-year 2005 results but we're still finalizing how this will be reflected within the 2005 quarters. We anticipate updating the quarterly financial information within the next week or two. As a result, we'll not be discussing our quarterly results, however, we are still able to discuss 2005 highlights, which I will review now.

For 2005, total revenue was up 63% to 804 million; gross margins were 15%, 170 basis point improvement over 2004; and gross profit dollars increased 83% to 121 million. Operating expenses grew 103% to 144 million. Sales and marketing expense was up 97%; technology costs grew 233%; and G&A costs were up 68%.

Operating losses were 24 million or 3% of sales, up from 5 million or 1.1% loss last year. Our net loss was 25 million or \$1.29 per share compared to a 5 million or \$0.29 loss per share last year. We ended the year with 112 million in cash and marketable securities, 50 million of which consisted of our foreign currency bonds that fully mature on November 1 of 2006. We had 79 million of working capital and 92 million of inventory and we intend to reduce inventory by 15 or 20 million over the first six months of 2006.

Operating cash flows were an outflow of 6 million for the year and free cash flow was an outflow of 51 million, as we had cash out of 45 million related to capital expenditures. We did not achieve our goal of positive operating cash flow for the year as inventory was higher than we had anticipated. However, we estimate approximately 30 million of depreciation and amortization in 2006. Therefore, we believe that any cash losses in the first six months of '06 will be more than offset by cash received from reducing inventory and that cash used for capital expenditures will be offset by non-cash depreciation expense. And therefore, we believe we will generate positive operating cash flow in 2006.

Beginning in the first quarter of 2006, we will begin to expense stock-based compensation and we estimate the impact to be approximately \$1 million per quarter in 2006.

With that, I will turn the call over to Patrick.

Patrick Byrne, Overstock.com - President

Thank you, David. I'm going to follow up on one point David made, on the issue of capitalized inbound freight, just to give a bit more color on that. I mentioned at the end of the last call that we expensed inbound freight, which introduces a lot of noise into our margins because there's the third quarter where you are building inventory, you expense it all and so it hurts

your margins. And then in the fourth quarter, it makes your margins look artificially good because you are flushing through all this inventory and you have little to no inbound freight. And I mentioned then that we might start capitalizing at the end of the year, that in fact that noise I think was sort of artificial and it just made the first few quarters look artificially weak and the fourth quarter better than it should. Well oddly enough, our auditors have come back and agreed to the extent that they say so much so there's basically \$3 million of good, of benefit, to flow from this. And they are saying so the question is, where does that \$3 million get attributed? Is it 2 million in the fourth quarter? Does some of it go in the third quarter? Some of it may belong in '04. If it belongs in '04, then we actually have to go back and change '04 and say we didn't lose 5 million, we lost 4 million. So these are the kinds of issues that we still have not gotten a ruling from the auditor. Rather than delay the call until we worked it out, we decided to go ahead. But what that means is there is a \$2 million -- if we don't change anything, there would be a \$2 million benefit our way in the fourth quarter and the third-quarter numbers would stay the same and the fourth quarter would be, you can sort of back into, it would be a \$4 million loss. But that \$2 million benefit may end up getting sprinkled back earlier in the year, which means that we didn't lose as much as we thought we did but we lost a little bit more than the 4 million in the fourth quarter. So that's just the issue in front of us.

Okay, you have a Safe Harbor Statement -- obviously not going to read it again.

Slide 3, we're trying to adopt a new system where people are being -- analysts are being good about e-mailing Kevin Moon, our Director of IR, questions before hand. I would feel unfair if I'm not getting to everybody's questions but just over the last few days, questions have been coming in. We have organized them into this set of questions and we've produced the presentation that answers most if not quite all of these questions.

Slide 4, Table of Contents. This presentation is going to go on, start with some bad and ugly things that happened in '05, hit some good things that happened and then looking forward and then for my Jihad. I know people seem to want to -- some people never want to hear about my Jihad. I don't even really want to talk about my Jihad any more but some people have expressed an interest.

Okay, slide 5. This is sort of a deep structure of what's really happened in '05. What you're looking at is a cumulative tech expense for Amazon divided by revenue, first of all for Amazon. And you can see where they sort of hit scale, where they had reached the point where they had put enough outlays down that it could support their large volume.

So, how do we look in comparison? There is slide 6. And this is a way of expressing, is how we have really run things on a shoestring until '05. We ran things on a shoestring. Probably, we ran the tires down till they were bald. Looking back, I would have been better off investing another percent or 2 in revenue as we went along. And I would have been better off investing a little bit more as we ran along instead of just coming up against the limits as we really have, over the last two years, we've had to get -- I go back to 2003 and we were just -- we were running on a shoestring to a greater extent than we even knew.

And what that meant was, Slide 7, in '05, we had to come out and when we started rebuilding, we may have started off thinking we were adding a bedroom but as we got into it, realized we had a lot of structural work to do and had to tear down the garage and lay a new foundation and all kinds of things. We do think that -- well we know the bulk of that is done. What I think, Dave, what did it all come to? 60 million?

David Chidester, Overstock.com - SVP, Finance

About 60 million, yes.

Patrick Byrne, Overstock.com - President

Our CapEx for this year will be half or slightly less than half of that, we expect.

The upshot though of the graph I just showed you was as follows. We actually we're starting -- this is our conversion rate. I have only taken out -- I took out a conversion rate, searched keywords like Google keywords, search words, because they introduce -- we started doing a lot more in '05 than '04 and they introduced a lot of noise into the situation.

So this is what our Slide 8 shows how we were running through August of '05, which is when we converted. As you can see, we were starting to do better and better. We really were up on the wave. Then in August, as we discussed in the third-quarter phone call, this is when we started cutting over to the new systems. They were not ready, I should not have cut over. They just weren't ready. And we immediately -- well we did have a sword hanging over our head, which was we were worried about making it through the Q4 without cutting over. That was really the great gamble, that should we have just delayed everything until January to do cut-over and tried to gut it out on what we had then, or were we running on bald tires that would not take us through Q4? That was the question.

You can see that on Slide 10, you can see that by October, we started getting things turned around. We actually, by about December 23, I think is when the last set of patches went in, of course that went in -- that's a little bit too late to help your Christmas season. We look back at that area that's shaded in red, and I think that contains about 100 to \$150 million, and that's just pure put that down to my error. We got killed by that.

We actually thought we would be able to pass the \$1 billion mark and even make a little bit of profit this year. And looking back, that technology cut-over on a lot of unripened systems that we should have -- we tested but it just was not there enough and we were too hasty and we probably should have figured out a way to gut it through the fourth quarter on what we had.

One positive is we did receive a nice rebound in the last two months despite a lot of competitive pressure, pricing pressure on the Internet. I will put it this way, the plumbing was clogged and we had a little backup in the system but things

have been cleaned up now. In fact, what's happening now is the new systems are so good that we're actually sort of exposing -- as we're able to drain the lake, we exposed rocks that we -- problems that we didn't know were there before under the old system.

So, now to some good things that have happened. On Slide 11, you see that we have reached 1.6% of e-commerce in the U.S. in the fourth quarter of this year. And on a trailing 12-month basis, we have now broken 1% of the e-commerce market. For comparison, Amazon is at about 5.5%. We're just taking market share.

We had to, I think to come up with Q4, I'll do some notes here. They had to estimate Q4 at 20% growth. And the holidays themselves were 24, but I think the quarter was more like 20. So we have gained market share and I think becoming a legitimate, well-known competitor on the net.

We always like to compare ourselves to Amazon. I look at how we benchmark, because they're really the last of the big pure plays out there. Amazon North America revenue and gross profit as a multiple of Overstock's. They were just a few years ago 18 to 24; they're down to about 6 times. In fact, if we don't make any accounting adjustment, if we just for the fourth quarter, they were down to about -- their gross profit, they're generating about 4.9 or 4.8 or 4.7 times as much gross profit as we are at this point. Now I'm disappointed in this.

My goal for the year was actually to get these under 4, to get to the point where we were a quarter of their size or more. And just the tailing off in the third quarter and then the total hitting the emergency brake in the fourth quarter prevented that. But still we're down to the point where if we just stick to the accounting principles we have had and show gross profit.

Now this is their gross profit, North America, and I should emphasize well we will get to that in just a second. Our gross margins have climbed, again, another 170 basis points last year. I'm not happy with this. I think we should have -- to be honest, I thought we would be able to get to just under 16 or so for the year. I really thought we could do 15.5 for the year. This again, this 15.0, there's certainly some costs associated with the problems we had in here.

I think there's still -- well, I know that there is 100 basis points more of inefficiencies we can pick up and there might be more than that. And so, I'm irritated at myself because although we got 170 basis points this year, I know there is more for us to pick up.

On slide 16, I'm going to go back to all these calculations of Amazon's margin and the gross profit that I'm comparing ourselves with. On Slide 16, you see the reported gross margins. What I want to mention for the nth time, that they don't count fulfillment costs in these margins. They move them below the line So to make them apples to apples with Overstock, you have to move their fulfillment costs back into their cost of goods sold. And if you do that, so you get an apples to apples comparison, you actually see that they're running 14, 15 and we have now essentially caught them in margin. Now this is apples to apples and all you have to do is read their footnote, 2 or something to see what this is. But this is an apples to apples comparison. In fact, in the fourth quarter, we have -- again, if we had not changed any -- depending on what the auditors say, if they don't change anything, you'll see that our margins actually pass them. But

if the auditors come back and say something else, that you've got to put all that 2 million back in the third quarter or something, well the year number will come out the same. So you see we've effectively caught them.

Stand by just a moment.

I am particularly proud of slight 18. This has been I feel like this is one of those -- maybe the largest unsung accomplishments at Overstock. Our brand over the last 2.5 years, we have gone from an unprompted name recognition for Overstock and that is, if you call 1000 households and you say name a place you go online for Internet shopping or for getting discounts on Internet shopping or something; I forget the precise question that they ask. It started off as 4% just 2.5 years ago. It is now 29%. That's, I believe, about the same brand as if you ask people -- as Target, if you ask people to name a department store in brick and mortar we can go and get good deals or something, you'll get that same people mentioning the Target, same percentage mentioning Target. That's what I've been told anyway. So we've made significant inroads on Amazon and even eBay in the sense of being named unprompted.

And as far as prompted name recognition, this graph goes back to only June of '04. It shows 47 to 70. The truth is when we started, this was when we started 2.5 years ago in terms of our advertising, this was either 9% or 11%, something like that. So we have taken our prompted name recognition from 11 to 70% over 2.5 years or it may have been 13% to begin with, to 70%. Again, I just feel like that is the kind of thing people spend more years and hundreds of millions of dollars getting to and we have been able to do that. I'm ticked that we lost money still but we've been able to do that within a couple of points of breakeven in such a short time has been quite an accomplishment for our branding staff or really for the whole company.

2006, Slide 20. 2006. We want to go -- I know I've used surfing analogies before and said we were up on the plane or up on the wave. I want to go to -- I'm not saying relaxed mode but or treading water mode. We're not treading water but we're stopping hyper growth for now. We're taking the next six to nine months to just burn in and harden our systems. I maybe should have done this two years ago. We have just got to harden our systems. To mix metaphors, we have been trying to overhaul an engine as we drove down the street, as we raced down the street, for too long. So we're pulling over, just going to harden the systems, reduce our sales and marketing spend. You'll see it come down by about 2% per quarter for a while, grow at the industry rate for the next two to three quarters. That's all we want to do, is grow at industry rates, reduce -- grow at the industry rate and I think losses will just about be depreciation and amortization. We will have some CapEx at a much lower rate but we're also shrinking inventory, so that all should be more or less a wash, and just focus on hardening our systems. We've reached the point where we are a legitimate online brand and it's time we stopped being so gumshoe about things.

Let's talk about cash. I know that Mr. -- well, I won't mention the fellow's name -- but one of the lackeys in New York wrote -- one of the compliant lackeys wrote an article about cash. The losses will approximate depreciation and amortization expense. I think we are going to -- our depreciation has gone in the last few years from I think it was 2.5 million just a couple of short years ago, to what was it last year, Dave? 15,

**David Chidester, Overstock.com - SVP,
Finance**

About 16 million.

Patrick Byrne, Overstock.com - President

And this year, 30?

**David Chidester, Overstock.com - SVP,
Finance**

We're estimating about 30.

Patrick Byrne, Overstock.com - President

So 30 million depreciation, that should be basically the losses. Reduction in inventory will offset capital expenditures. There is an inventory line of 40 to 50 million available to build inventory for Q4 if we want. Definitely do not -- we think that we can manage this year nicely and if we manage it tightly we should not have to raise any new capital.

We also actually have some additional borrowing available on a different line against our foreign bonds. And then our foreign -- we have these foreign instruments we've described before; they mature in September and November and they're \$25 million each.

Okay. I don't want to spend a lot of time talking about the Jihad as a -- and I'm not sure that's a very good definition for Jihad, I didn't put that in there. But I do want to tell you what I know and you believe anything you want to believe. I feel a fiduciary duty to give a quick update and I'm going to be very quick.

There's two aspects to this fight I'm in, thank God. One is the lawsuit. I know there's fellows out there scoffing at this and saying this is all nonsense. We have got guys threatening our witnesses. We have got guys calling our witnesses and threatening them. They are panicking. There are people calling in. By the way, there's now eight witnesses, at least seven of whom will willingly testify. One of them is a woman, very similar circumstances as the other three. Went to her boss, said what we are doing here is illegal or wrong. The guy just scoffed at her, walked away. She quit, she's now in med school. They have been calling her and saying, we can -- if you we recant, we'll lure you up and take care of everything and if you don't, we will make sure you never work and this kind of stuff.

So they can scoff at this all they want. They're making mistakes in my view. We think that this is a very large

lawsuit. We think that this is a -- we're looking for a 10-figure number to come out of this. There may be some other deep pockets associated with some of the folks we are sewing. And we're looking for, I guess I should say, it's a three-comma number out of this.

On the other side of the lawsuit is -- on the other side of Jihad is the naked shorting issue. Now, again, I'm just going to tell you what I know and you believe what you want to believe. We have -- the SEC just released last week what our naked short position was at the DTCC level on August 1, which is before all this started.

Now they released something that was ambiguous. They said an aggregate sale position on August 1 of 550,000 shares. It's not clear quite how to interpret that. You can interpret that as of the 600,000 shares that were supposed to settle that day, 550,000 didn't. Or the conservative way and to me probably, the more likely or at least the conservative way is that was the total accumulated sale. Well the DTCC has also indicated that the X clearing problem is about 5 times greater than the problem at the DTCC. That would bring the total aggregate sales to about 3 million on that day in August.

However, there are some people telling me that you know, whatever the failure to deliver problem is at the DTCC, there's really 15 to 20 times that amount in the X clearing system because of a technique called bed and breakfasting shares and people had walked me all through it, people from the British Virgin Islands and places like that have -- they tell me the real number is 15 to 20 times whatever the DTCC says.

Now on top of all this, we have of late more reason to believe that the number of sales at the DTCC may be quite a bit higher than that 550,000 that it was on the conservative interpretation back in August that it now could be on the order of several million. And if it's on the order of several million, that means by DTCC's own estimates, that's there's 5 to 6 times that in the system; that would bring it to 25, 30 million or more. And if you believe the 15 to 20 times, you start getting these ridiculous numbers.

But what that means is, there's somewhere between, depending on what you believe, 3 million, 10 million, 30 million or more undelivered Overstock shares in the system. As a sort of in support of the idea that's the case or higher, I went out and bought 50,000 shares at the end of November, never got -- they would not settle; the trade would not settle. I'm not talking about just getting paper. The trade wouldn't settle. It was 150 trades. My broker has gotten me the records on 144 of them; they are refusing 6. Of the 144 trades, on that day I bought in November, 144 turned out to be mismarked short sales that had been marked as long sales and took a month to deliver. So that was 97% of the volume apparently that day was naked short.

I have people calling me from -- I have got a guy calling me from Switzerland who says he bought 300,000 shares two months ago, cannot get a single one settled. I only got mine settled when I started putting some correspondence on message boards. The guy from Switzerland says he got 300,000, cannot settle. He's got a friend with 200,000, cannot settle., cannot get them settled. I have got a fund in the South called me, says they've tried mine but they can't get delivery and they're just not going to buy because they cannot get what they buy to settle, let alone getting anything turned to paper. So at some point, I believe that people listening on the phone,

and including me, we own somewhere between 80% and 20% of what we think we own, depending on how much of the counterfeit stock has been allowed to wash into the system. I think I have got a fiduciary duty to inform people of that.

Now, again, you guys believe anything you want to believe. I have told you the facts as I know them and you make up your own mind. But I do predict, I'm not telling anyone of course to buy stock, buy or sell, make your own decision. But if you buy stock and you just buy 1,000 shares and ask for proof of settlement and it's -- I have talked to just lots of folks on Wall Street who are getting quite an eye-opening experience when they try to do that. But no, it couldn't really be that 97% of the stock that is trading is FTD, I assume.

Okay, going to this slide. I'm just going to run through this. I think we have covered most of the questions here. I didn't do it one for one but I think we're ready to go to questions then, Jamie.

Questions and Answers

Operator

(OPERATOR INSTRUCTIONS). Aaron Kessler, Piper Jaffray.

Aaron Kessler, Piper Jaffray - Analyst

A couple questions. One in terms of reducing the advertising expenses, I believe you said sales and marketing are coming down 2 percentage points for the first few quarters. If you do pull that back though, what type of studies have you done to show what impact that would have on the revenue growth? And second, any expectation that at this point forward, G&A and technology expense will end the year at? Thanks.

Patrick Byrne, Overstock.com - President

Sure. On the revenue growth, I can tell you, you should model 10 to 15% growth, just industry growth for the first three quarters. Just model 10 to 15% and expect our expenditures on marketing as a percentage of revenue to come down sort of 2%, 1 to 2% each quarter. And with a little bit of luck, everything will be burned in and sometime in the third quarter, we will hit the gas again and see if we can't get back on the higher growth or even hyper growth curve.

David, do you want to handle the -- I know the numbers; I'm not sure what you want to release, David. What do you want to say about G&A and tech?

David Chidester, Overstock.com - SVP, Finance

Well, I think we talked earlier that it would be somewhere in

the 90 to \$100 million range. That's still the case. Probably on the high end of that range.

Patrick Byrne, Overstock.com - President

I might even go, that's right, high end of that range. I can say on marketing, by the way, because I know people some people saw the Super Bowl ad and they're saying well how does that tie into cutting marketing. We have a model that for the first couple of years, in terms of television and radio advertising, the model said -- our approach was kind of water torture. It was to tap, tap, tap constantly and constantly and I think that's how our brand built as successful as it did.

We are switching to a very different approach. Our total off-line expenditures this year probably will be about half of what they were last year. And we're doing that -- we're moving away from the water torture tap, tap tap, to a much lower level of background advertising on cable and so forth, much lower level, punctuated by very big, occasional, very big buys.

Oreo cookies, incidentally, I remember years ago reading that this was their philosophy, that everybody already knows Oreos, so they don't advertise on TV except for two weeks a year, where they blitz the world and remind people of Oreos. And that does more for their name recognition and brand than being continuous about it. I guess we're moving more towards that Oreo approach, although it won't be two weeks a year, it will just be the occasional very big, prominent ad, but the background level of ads has dropped I think about 70 or 80%.

Aaron Kessler, Piper Jaffray - Analyst

Any sense for what the total -- your off-line marketing as a percentage of the total marketing budget?

Patrick Byrne, Overstock.com - President

Yes, just a second. It's less than -- I think about 15%.

Operator

Scott Devitt, Stifel Nicolaus.

Scott Devitt, Stifel Nicolaus - Analyst

Hey, Patrick.

Patrick Byrne, Overstock.com - President

Congratulation on your own name change.

Scott Devitt, Stifel Nicolaus - Analyst

Thank you very much. I had several questions if you had a little bit of time. First, I want to touch on -- I think you switched over from DHL to UPS at some point in the past couple of months and I wondered if you could talk about that in detail, how it may have changed the customer experience and if it is just on the direct business or partner as well? And then I will follow up with other questions.

Patrick Byrne, Overstock.com - President

We did on the 1st of November switch from DHL to UPS. We had a very good experience with DHL and I don't want to slag them in any way. We had a great experience for a couple of years with them. I think that the UPS presentation to the consumer is probably a little bit better than DHL. Do you have a different feeling on that?

Scott Devitt, Stifel Nicolaus - Analyst

(multiple speakers) actually, I think the shipment tracking is much better with UPS, which is the biggest benefit from my end.

Patrick Byrne, Overstock.com - President

Yes. But even when the truck pulls up to someone's house, the UPS is just a little bit better known and I think people are a bit more comfortable with it. But UPS came to us with a fantastic deal and it wasn't as cheap as DHL. But on the other hand, DHL -- everybody was starting to hit us with oil surcharges that were changing the landscape anyway. But what UPS came to us with a fantastic package in terms of the what they were willing to provide us and it wasn't just -- it was a good competitive price, but they wrapped it up with a lot of very attractive offers that -- and part of it was the tracking.

When we went with DHL -- we zone skip, which means to save money, we load up an 18-wheeler at our Salt Lake City warehouse and we drive it to someplace in Western Ohio or Pennsylvania or something depending on who we do business with and drop it off there. And it just saves us a lot.

Well when we were with DHL, to be honest, the customers couldn't get tracking information for that whole period. But now UPS is scanning it at our warehouse so before it leaves onto zone skipping. So the customer gets the information, doesn't have to wait three days for a tracking number, starts getting information within three or four hours of placing the order, generally. So that's attractive.

As far as getting the partners to roll over onto UPS, that takes

-- we actually tried that a couple of years ago; I forget which carrier it was with. Because remember, as I'm sure you know, only 45% of our total charges come out of our warehouse, the rest are elsewhere. The problem was if we gave our partners our shipping number, they could ship on it and it was a heck of a lot of work for Dave and his crew to reconcile at the end of the month to make sure people hadn't been just using our number. Part of what we want to do with UPS is to resolve that. And Dave, you're the guy who had to do the work. Where does that stand?

David Chidester, Overstock.com - SVP, Finance

I think it is a fairly big project because we have so many partners. But you know we have done it sort of experimentally with certain big partners and had it work just fine. So it's something that we will look at doing especially if our rates are significantly better than theirs.

Patrick Byrne, Overstock.com - President

Remember we are likely to have -- to generate a total of about or close to \$100 million of shipping charges this year between the partners and the core business. So for that size, for that volume, people are willing to do extra things for us. And if we can create -- I am very excited about that idea, Scott. I've wanted to do it for years. And I would love to sort of convert all of our partners to our shipping account, get the benefit of our favored nation rates and back up that much, that volume of business to whatever carrier we're doing business with. But working out things so it's not a nightmare for Dave to reconcile each month has been the problem so far.

Scott Devitt, Stifel Nicolaus - Analyst

And to follow up with a more financial-related question. In 2006, you gave a lot of financial metrics. I was wondering if you can just put them altogether and give us an understanding of your capital needs in front of the inventory build in the fourth quarter and the maturity of the foreign currencies and specifically focused on EBITDA and free cash flow, as well as the first three quarter cash needs. And if you can bridge all those numbers together, I think that would be very helpful.

Patrick Byrne, Overstock.com - President

Okay. So, shall I give a start to this, Dave, and then you go back and correct me with --? First of all, I'll talk about our instrument. I guess it's about time or close enough we -- this is maybe partly repetitive, but I'm not sure we have ever given this much detail. We have a foreign currency instrument with Lehman Brothers; it's really two instruments, each for 25 million. And it was really a hedge against the basket of eight Asian currencies. The way it's structured was that if the dollar

went down against the Asian currencies over the roughly two years of the bond, we got 85% of the benefit as if we had just converted into Asian currencies. If in the unlikely, so we thought, scenario that the dollar appreciated against Asian currencies, our hedge did not lose us money. Well, it loses us money quarter by quarter, but if we hold the bond to maturity, it matures and we get all of that back. So, something that I'm sure surprised many of us is the dollar did appreciate and so this instrument has lost money and I think at this point, what's our accumulated loss in it, David?

David Chidester, Overstock.com - SVP, Finance

2.6 million.

Patrick Byrne, Overstock.com - President

2.6 million has flowed through our income statement but if we just hold it to September, we actually get that 2.6 million back. And we get it and this comes in mid-September is 25 million and mid-November is 25 million. So anything else, Scott, on the Asian currency instrument or should I go to the rest of your question?

Scott Devitt, Stifel Nicolaus - Analyst

You can move on and if you can roll in CapEx as well.

Patrick Byrne, Overstock.com - President

Okay. CapEx should be a little bit less than half of last year, it's at 25 to 30 million. Set that aside, our depreciation in the first three quarters will be what, David, about 22 million?

David Chidester, Overstock.com - SVP, Finance

Yes, 22, 23 million.

Patrick Byrne, Overstock.com - President

And you guys know, I hate talking about EBITDA. But if one were to talk about EBITDA, one would say that should all come out breakeven. I hate talking about EBITDA for a bunch of reasons because people don't like to count the cash when it goes out the door when they buy the product, when they buy the machine and if they don't want to count it as it depreciates, at some point, they spent the money. And if they

just live on EBITDA, however they never -- it's like saying I should never count, but I had to write that check.

On the other hand, there seemed to be two times when EBITDA matters. One is when you have made huge capital investments that you really can now live off for some time. And the other time EBITDA matters is if people are raising questions about liquidity.

So in this case, I think that the losses you are going to see over the next two or three quarters should approximate depreciation. So what that means is -- or you know the implication of that -- basically EBITDA breakeven.

And then you say well we do have CapEx on top of that so that's going to be a cash drain. Yes, it is but we ended up with -- our hump was filled because we had this deceleration in the end of the year, we ended up with far more inventory than we need. So, we are actually bringing that down fairly aggressively, 15, 20 million over the first two quarters and that should more or less pay for the CapEx. David Chidester, do you want to -- (multiple speakers)

David Chidester, Overstock.com - SVP, Finance

I would just add that because we do have some cash needs, as you say, during the first nine months, Scott, we have an instrument at Wells Fargo where we can borrow against the bonds and make them liquid. So they will come back to us 25 million September 20th, 25 million November 1. And then we won't need to borrow it; we'll have the liquidity. But just the short-term liquidity needs we can borrow against those bonds and we have an additional inventory line we can borrow against inventory if we need to. So that provides liquidity even though those bonds technically aren't liquid right now.

Patrick Byrne, Overstock.com - President

Right, the Wells line -- and I have to do a plug here for Wells. Wells has been a fantastic partner. We have a line against that 50 million and it's not -- the 50 million of Lehman instruments and it's not for the full 50 but we have several tens of millions of borrowing capacity on that. We also have another Wells line against our inventory for 50 million on very attractive terms. So, that's why -- I don't think we even have to dig very far into them, given everything else I have told you, but that's why I think we're just fine on cash and we should not have to raise cash this year.

Operator

Frank Gristina, Avondale Partners.

Frank Gristina, Avondale Partners - Analyst

Thank you for taking my questions. I would like to try to get an update on some of the businesses that you've launched in the last two years and just get an idea of what your thoughts are for growth. And then if possible, I'd like to visit some customer metrics that you have given historically but they're not available on the slides or in the press release. Could you give us an update on Ski West in particular? This is supposed to be their -- fourth quarter was supposed to be their strong seasonal quarter. Can you give us an idea of how much revenue is comprised from Ski West?

Patrick Byrne, Overstock.com - President

Very little on a GAAP basis, anything that you're going to see. We actually had gross merchandise sales -- if we include auctions and travel -- I think we must have been about -- David, you report our gross merchandise sales, it's about 870 for the year, right?

David Chidester, Overstock.com - SVP, Finance

Correct.

Patrick Byrne, Overstock.com - President

And there's really about 60 more in ski and auction, so 930. Ski West did okay. The business we bought made money through the second half of the year. We, on top of that, we already had started development of a travel business that we sort of integrated -- we spent six months integrating into Ski West and writing off, we wrote off all the development costs of code and different things we have done, we wrote to zero. So travel as a whole showed a loss for the second half of the year but the business we bought made money, made a nice little chunk of money. And then on top of that, we have gotten everything we think fixed and together in travel, so even in January, the whole business made money not just the business we bought but now everything worked together is making money. It made a nice little sum in January.

But as far as how its effect on our GAAP numbers, you won't see anything because we don't book anything gross, it's all net there.

Frank Gristina, Avondale Partners - Analyst

So roughly 60 million in gross merchandise sales; is that for the full year?

Patrick Byrne, Overstock.com - President

No, the 60 million was for -- I'm sorry, we did 30 million of auction GMV for the full year and we did about 30 million of Ski West GMV for the half-year.

Frank Gristina, Avondale Partners - Analyst

Great. Okay, thank you, that's helpful. You had mentioned that you guys have about 100 million in shipping charges each year. How much of that do you think you're going to be able to get the consumer to pay in '06? In other words, really another way to look at this is how much of your gross margin pressure that you've seen is a function of the loss of fee shipping and moving toward free shipping?

Patrick Byrne, Overstock.com - President

Well, some, it's definitely put some pressure on things. The 100 million I'm interested by, in other words, if we do 1.1 billion or something this year, 1 billion, 1.1 billion, you know, that's going to be between our partners and ourselves we will cut checks for 100 million to UPS and FedEx, DHL. Definitely, price -- people are competing in shipping fees.

Now in our case, we don't -- we have never really -- we've built our shipping, our true cost of shipping into the products and then we charge this 2.95 on top of that, which is to pay for well one thing is to keep people from making too many small purchases and so forth. So I don't think the competitiveness on shipping rates affects us as much. We never have to give up more than that \$2.95.

Frank Gristina, Avondale Partners - Analyst

Fair enough. But if you're building into the price of the product, my next question was about some of the competition I have seen, specifically on linens. It seems like some of your peers are really pushing, in particular Amazon, they're pushing apparel and linens. Are you seeing any price pressure on your products to maintain your discounts to what at one point were premium vendors?

Patrick Byrne, Overstock.com - President

I'm not aware that. David Chidester?

David Chidester, Overstock.com - SVP, Finance

No, I'm not aware of that. We have not seen anything directly that has affected our business.

acquisition costs, any comment on that?

Frank Gristina, Avondale Partners - Analyst

Okay great. And then in terms of kind of housekeeping, can you give us an idea of your new B2C customers and the unique B2C customers and maybe an average order price? Or if you put this in a press release, just direct me to it?

David Chidester, Overstock.com - SVP, Finance

We can get that detail to you. We didn't provide that in this call but you can talk to Kevin Moon and get that detail. I think the average order size is actually up to \$103 in the fourth quarter and I think that's the first time it has touched over \$100.

David Chidester, Overstock.com - SVP, Finance

That's what B2C included.

David Chidester, Overstock.com - SVP, Finance

That's all included.

Patrick Byrne, Overstock.com - President

I mean that's with the BMVG included?

David Chidester, Overstock.com - SVP, Finance

With BMVG, yes.

Patrick Byrne, Overstock.com - President

The non BMVG orders are over \$120.

Frank Gristina, Avondale Partners - Analyst

Okay, I guess I was really interested in the customer

David Chidester, Overstock.com - SVP, Finance

Yes, the CPA is included; it was \$21.05. So it actually came down some from the last two quarters.

Frank Gristina, Avondale Partners - Analyst

And that is just for the B2C or is that all-inclusive, auction (multiple speakers)?

David Chidester, Overstock.com - SVP, Finance

Actually, I apologize. \$21 is for the whole year, so you sort of have to back into what Q4 was because we're not giving quarterly information. But we will have that available soon.

Frank Gristina, Avondale Partners - Analyst

Okay, well, thank you for taking my questions.

Patrick Byrne, Overstock.com - President

Who are we up with? Rebecca Kujawa.

Operator

Rebecca Kujawa, Stanford Group.

Rebecca Kujawa, Stanford Financial Group - Analyst

Thank you very much. I am a little bit confused about the guidance for the revenue growth. Going through the slide presentation, the information that you provided about the conversion rate I think was really helpful. It seems like you actually started to get a little bit of your momentum back at the end of the fourth quarter, but it appears like you're pulling back fairly extensively in your sales and marketing and expect a significant deceleration in growth. Why is that? Why is your strategy changing so much? I mean I know you said to harden the systems but I'm not sure I understand why?

Patrick Byrne, Overstock.com - President

Well, it's to harden systems. We feel like we have been racing down the street trying to overhaul this thing for years. And we want to -- we have -- when we create the list, every year, we create the list of projects we want to get done and usually we take two years worth of work and try to cram it into one year and halfway through the year we are triaging what we really need and what we don't. This time we just want to take six months and just focus on getting done the projects that in some cases should have been done several years ago. So we just want to come off the accelerator and take a little bit of a pause.

I'm all for by the end of the second quarter or the beginning of the third, I probably want to be -- I'm saying hey we can stop the gas and get back up there but of course everyone else here says, no, no, we need all three quarters. But the fourth quarter, I think you'll see us go back to much higher -- well I'd like to think -- I expect us to go back to higher than industry growth rates by the fourth quarter.

David Chidester, Overstock.com - SVP, Finance

And Rebecca, some of the point of fixing the things, we want to fix things that we have already implemented and put in place and make them better and we're hoping that that actually helps increase conversion is that -- and rather than do new projects, fix all the things and make sure they're working correctly, all of our systems, including the Web site, including personalization and some other things that we started but haven't really got finished. That will help increase conversion in and of itself. So that's really what we are thinking.

Rebecca Kujawa, Stanford Financial Group - Analyst

A clarification question, Patrick, you said a couple of times that you would decrease sales and marketing as a percent of sales 2%. Do you mean like 2 full percentage points, so if it were 10% in the full year 2005, you're talking about 8% potentially for Q1, Q2-ish?

Patrick Byrne, Overstock.com - President

Yes. Well I actually mean sort of 8% for Q1, 6, 7% for Q2 and sort of backing off the throttle that way.

Rebecca Kujawa, Stanford Financial Group - Analyst

Okay. And then the last question and I know there's a lot of other people waiting, but you indicated you expect industry growth rate for the next couple of quarters, but I would have expected you were referring to industry growth rate to 20 to 25%. But I think I heard you say 10 to 15% for the next couple of quarters. Are you looking at a subset of the industry or did I misunderstand?

Patrick Byrne, Overstock.com - President

No, I think of the industry -- I think the industry grows in the fourth quarter at sort of a 20 to 25% but during the year, I think of it as growing more like 13, 15, 17%; do I have that wrong?

Rebecca Kujawa, Stanford Financial Group - Analyst

I think the comScore data and Commerce Department data is actually suggesting still the 20 to 25% for most of the year. I think comScore, it said for the full year it was 24%. I could be slightly off on that but I'm pretty sure I'm not off by 10 percentage points.

Patrick Byrne, Overstock.com - President

Are you talking about '05 or what they expect for a '06?

Rebecca Kujawa, Stanford Financial Group - Analyst

For '05, all retroactive.

Patrick Byrne, Overstock.com - President

No, no, no. I don't think the industry was growing over 20 in the first two quarters of last year but we may be looking at different data. Anyway I think of sort of 15% is about what the industry grows during the year and then it surges forward 24% or something and then it averages out to about 20.

Operator

Paul Keung, CIBC World Markets.

Paul Keung, CIBC World Markets - Analyst

A question actually the same one as Rebecca. The one thing that is still confusing me is in the past you've talked about the strength of the brand, the organic growth and trying to get a little more loyalty by improving the consumer experience on the site. So if you're still spending I guess a sizable amount on sales and marketing and I know you're going to take this foot off the lever, what would your organic growth be, industry aside, if you kind of put the metrics? And where is January for that matter, just to give us a comparison on where we are at right now?

Patrick Byrne, Overstock.com - President

Well okay, I doubt we're going to release January in February, but Dave?

David Chidester, Overstock.com - SVP, Finance

We're not going to talk about January today.

Patrick Byrne, Overstock.com - President

So I don't know how to predict what you're saying. I just am trying to avoid abrupt control movements. I don't want to cut our marketing from 10 to 4 overnight. I want to back it off, back if off and see. I don't really know where the equilibrium is, Paul, in terms of if we just on a steady-state, if we just said from here on out, what would we have to spend to grow the industry rate? I would imagine it would be in the 3 to 5% range. But that is sort of over a year period, not quarter by quarter.

Paul Keung, CIBC World Markets - Analyst

It's interesting to see that you are spending still a sizable marketing budget and you are one-third of the way into the quarter and yet you're putting up a number that is 10 to 15 or even 15, it seems to suggest maybe no sales growth in the back half of this quarter; and that's what's confusing about the numbers.

Patrick Byrne, Overstock.com - President

Well, it is more, part of the issue is, the quarters that were -- last year, the first quarter was an extraordinary quarter. So it's a fairly tough comp. And yet in the third quarter it is going to be an easy comp and so you sort of have to factor that into it too.

Operator

Ladies and gentlemen, due to time constraints, we will take our final question from Justin Post with Merrill Lynch.

Justin Post, Merrill Lynch - Analyst

Thank you. A question about your partners. Obviously, you kind of missed your forecast six months ago and there has been a lot of technology integration. How is the partner outlook right now? Can you (technical difficulty)

Operator

I do apologize, sir, could you please press star one for me once again?

Patrick Byrne, Overstock.com - President

If not, if Justin doesn't come back, I will just take the question as is.

First of all, our partners are saints. They put up with -- Justin, if you come back on, just interrupt me.

Justin Post, Merrill Lynch - Analyst

Can you hear me?

Patrick Byrne, Overstock.com - President

Yes, go ahead. (multiple speakers)

Justin Post, Merrill Lynch - Analyst

Yes, I just asked about the partners. I think you do disclose it in your 10-Q or 10-K, I'm sorry, how many partners you have at the end of the year. What the count and what is the mood right now and how have they made it through the integration? And then just a quick question, can you remind us of the take rate on the GMV on the travel side?

Patrick Byrne, Overstock.com - President

Okay. The take rate is about, I think about 1% industry standard. But as far as the mood of the partners, I would say that the August, September, October, November mood was not so good. Although their mood was great, we were hurting them. Although the way we got over that was when we could not get our accounting precise, which was the case through several payment cycles. We overpaid them and we did it purposely. We paid them more than we knew we would ultimately -- we actually just couldn't account for taking their returns deduction. And so when products come back from us we -- if a partner product gets sent out and then gets returned to us in Salt Lake City, we normally take some amount off their payment. We actually just handled it by saying our systems problems are our fault; we will just keep overpaying you for a while and then true it up later when we get back to having granular information. As far as I can tell, that happened in December --

David Chidester, Overstock.com - SVP, Finance

Patrick, we had the information; we could account for it; we just didn't have the detail for them to look at to see what they were getting paid or what we were deducting, so we didn't want to deduct it before we could provide the detail. But we did have the right accounting on the transactions.

Patrick Byrne, Overstock.com - President

Yes, we didn't have -- we couldn't have -- giving them the information so they could reconcile was a problem. And so, we did what we -- first of all, I think that they were saints, they were patient. Remember our relationships with our partners are not like -- we don't want 50,000 partners. We have got a lot of them are mom and pops who we know depend on us for 50, 70, 80% of their business. And we work together; we really do see each other I think as business partners.

So they were pretty understanding. Yes, I heard grumblings and -- but it's funny even when people expressed their grumblings to me, it was all with -- we're not just some distant company to them. We're very -- on good, close terms with all of them. And so they typically said, we understand you're going through systems problems, no problem.

Some of them started saying you know, this is really turning into a pain in the butt. I can't get reconciled, even though you're paying me what you owe me or even a little more, I can't get reconciled. So, that was really the issue. But we certainly did not -- I'm not aware of losing a single partner over it. I apologize, I will apologize again to the partners that we discomfited. David, what are we up to in terms of total partners?

David Chidester, Overstock.com - SVP, Finance

You know, I don't know the total number. I think it's approximately 400 partners, is about what we are up to now.

Patrick Byrne, Overstock.com - President

Rich Paongo is here with me; he says 460.

David Chidester, Overstock.com - SVP, Finance

Yes, okay.

Justin Post, Merrill Lynch - Analyst

Great. And then I guess for the take rate, you said 30 million in GMV. I'm trying to get to the revenue take rate, which I think is going to be higher than 1, maybe I didn't state the question correct.

David Chidester, Overstock.com - SVP, Finance

I think our travel -- just to clarify, the travel business we have, which includes Ski West, which is much higher than most global travel businesses, it runs much higher than 1%. It runs in the double digits.

Patrick Byrne, Overstock.com - President

It runs in the double digits and that's what shows up as GAAP revenue too. So it doesn't have an appreciable effect on GAAP amount. I'm sorry, take rate they use here to mean -- what I've seen is the guys in the travel industry use it like conversion.

Justin Post, Merrill Lynch - Analyst

Yes, net revenue rate, which is generally about 10%.

Patrick Byrne, Overstock.com - President

Thank you. It's the point now having arrived, it's 10:03. I thank everybody on the call for listening and look forward to

talking in a few months again. Let's go to this system -- I think it's pretty efficient to have people e-mail a couple, few days before the earnings call to e-mail questions and then we can produce a slide show that hits most of the questions. Thank you all.

Operator

Once again, ladies and gentlemen, that concludes today's call. Thank you for your participation. You may disconnect at this time.

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