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## Conference Call Transcript

OSTK - Q4 2006 Overstock Com Inc Earnings Conference Call

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## CORPORATE PARTICIPANTS

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## CONFERENCE CALL PARTICIPANTS

**Aaron Kessler***Piper Jaffray - Analyst***Justin Post***Merrill Lynch - Analyst***Bill Lennan***First Albany - Analyst***Scott Devitt***Stifel Nicolaus - Analyst*

## PRESENTATION

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**Operator**

Good day, ladies and gentlemen, and welcome to the Overstock.com, Inc. fourth quarter 2006 earnings conference call. My name is Tonya and I will be your coordinator for today. (OPERATOR INSTRUCTIONS). As a reminder, this conference is being recorded for replay purposes. I would now like to turn the call over to your host for today's call, Mr. David Chidester, Senior Vice President of Finance. Please proceed.

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

Good morning and welcome to Overstock.com's fourth quarter 2006 conference call. Joining me on the call today is Dr. Patrick Byrne, Chairman and CEO; and Jason Lindsey, President and Chief Operating Officer.

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 5, 2007 only. As you listen to today's call I encourage you to have our press release in front of you, since our financial results, detailed commentary and the CEO's letter to shareholders are included and will correspond to much of the discussion.

As we share 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 statement.

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

I will now review the financial results for the quarter and year-end ending December 31, 2006. Please note that all comparisons will be against our results from the fourth quarter and full year 2005, unless otherwise stated.

Total revenue for the quarter was \$297 million, down 6%. For the year we had total revenue of \$796 million, down 1%. Gross margins in the fourth quarter were 10.3%, down from 14.6% last year. For the full year gross margins were 12.8%, down from 15% in 2005.

Total operating expenses were \$71 million during the quarter, and \$197 million for the year, an increase of 36%. And as a percent of sales this equates to just under 25%, up from 18% last year.

Sales and marketing expenses were down 9% for the year to \$73 million. However, G&A costs increased 49% to \$54 million, and technology costs grew 150% to \$70 million. I will note that included in our fourth quarter technology and G&A costs is approximately \$6 million related to the early termination of a co-location data center lease and the accelerated depreciation of other facilities-related assets. And this is one of the first big steps we have taken to reduce our tech and G&A expenses going forward.

Our net loss was \$41 million for the quarter or \$1.92 per share, compared to a net loss of \$6 million last year, or \$0.33 per share. For the year our net loss was \$97 million, which equates to 12% of revenue and a \$4.77 loss per share.

We ended the year with \$128 million in cash and cash equivalents. This includes \$40 million that we raised in December through a private common stock offering. We had a positive operating cash flow of \$54 million in the fourth quarter, bringing us to a negative \$25 million operating cash flow for the year. With that I will turn the call over to Patrick.

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**Patrick Byrne - *Overstock.com* - Chairman, CEO**

Q4 was the end of a washout year of 2006. I'm going to give more color than I have given before. And we have talked about -- or I have talked about systems famously -- the systems problem. And there's lots of things that have gone on here, but there is really a set of issues that are deeper than the systems issues that -- well, like I say, I feel I owe you more color as owners.

Now whenever I try to give folks more color as to what is going on, even though I will say, look, this is all my fault, take responsibility, I'm not making excuses, and I try to explain what I've done wrong, that always somehow -- the bad guys always transform that into oh, Byrne is making excuses. I'm not making excuses. Once again, I'm taking total responsibility for this. But as owners I think you are due more color perhaps of what is really going on.

In 2004 we did \$500 million. In that time, or in that -- up until that point, I would say that our infrastructure and our expense structure chased our revenue the whole way up. We thought we were okay all those years, but in many ways we as -- I will put this way, when outside people came in they would look at us and say, you guys are operating on a ridiculous shoestring and without -- inappropriately. And certainly Sarbanes-Oxley started making us think harder about how much of a shoestring -- how thin a shoestring we wanted to be operating on.

And another thing is, if you had asked us at the end of 2004, well, we just have done \$500 million, what does the next couple of years look like? For all we knew, we were going to be doing \$1 billion, \$2 billion. Now it may seem odd that we wouldn't know -- really have any idea what our next couple of years of revenue were going to be. Except remember in the previous four years we had grown from \$200 million to \$500 million. So there was no real way for us to know what was going to be -- what our revenue was going to be.

In consequence we decided to build out our infrastructure and our expense structure. And to get -- I think that there was a period in early 2005 when we were starting to realize that while we had skimmed through previous Christmases and holiday seasons. Sometimes run them and gun them. Sometimes neat tricks on a shoestring. If we really did have -- continue to have those kinds of growth rates ahead of \$1 billion, \$1.5 billion, \$2 billion that we were really playing with fire.

So we built out our infrastructure, as has been much discussed. We have discussed less the fact that we built out our expense structure to support a Company that continued along those lines. We built out our expense structure in the sense that we moved to a much bigger building from 36,000 feet to 130,000 feet. We overbuilt a new IT co-location facility. We built a huge facility, probably much more than we really needed.

We really expanded our staff. The staff expansion also came as a result of the computer problems. There was a period where we actually just about doubled the size of our merchandising staff, just because there had to be all kinds of people processing POs and doing things by hand instead of -- or manually in some sense versus what we had had before.

I would also say that in some sense I lost the discipline that I had had for first several years of the Company. Lost the discipline of -- that had really been part of us operating on a shoestring. And we did consciously say it is time to get ahead, and it is time to pad things.

We were just -- well, then the melt down comes. And 2006 was really a year of getting things back under control. First of all, the infrastructure. The infrastructure is under control, and is tuned and is beautiful. But we're not done. The expense structure is still -- we built the expense structure for a \$2 billion company, and we got stuck here, and we have had to fix our expense structure. And we're not finished with those fixes.

We have fixed some things and we have fixed them better than they ever were before, as you're going to see. Our capital management is superb. And we developed a system for bringing discipline and capital allocation to the buyers. Jason has taken that over with a really superb team of several people he has built underneath. And the discipline and capital allocation is superb.

Customer service- it is not all the way there yet but, as you saw I think in November or so, we got selected by American Express and National Retail Federation as the number four ranked customer service in the country. We weren't in the top 100 or 150 the previous year. That was Stormy. She took it over, and she is not happy with it yet. She wants to be number one. But so it has made a lot of progress. And it has a ways -- she still sees grounds for areas of improvement. I would say we got that pretty well fixed, to be number four. Again, her goal is to get us to number one this year.

Logistics- Steve Tryon, is over. And our logistics had just gotten drum tight, both in terms of shipping the right thing, shipping everything promptly. Our handling costs are now just drum tight, lower than they have ever been.

Our margins, you're going to -- yes, they were lousy now in the fourth quarter and for the year. Part of that comes with a reduction -- remember, we were operating at about the same size a year ago, and we had almost \$100 million of inventory. We now have -- we started the year with \$20 million of inventory. And that is not affecting us -- we aren't losing a step. In other words, that \$20 million is as good and can support as much sales as the \$90 odd million, \$93 million I think at the end of the previous year.

There are some things that aren't fixed yet. The marketing partially is. We have developed a team. We have hired a superb fellow. He was the Chief Marketing Officer of a large credit card company, and he is -- I have been for about five months running a group -- actually building a group that we call internal marketing. The function we have always had, but not really focused on. We have built it into a real department. Solid people with experience there.

And you see a lot of changes going on in our Web design, website. We have also have some outsource relationships where we have picked up virtual marketing experts and a few other companies who are supporting us. You see recommendations, pretty good recommendations now on our site. And a lot of site design evolutions. If you watch our site you should be -- you will be seeing -- you are seeing changes week by week.

But our expense structure is still inappropriate for a Company of this size. And what we have to do now, having gone from one end, operating on a shoestring to suddenly padding it up in preparation for what, if we did hit \$1 billion, \$2 billion, is -- we have to shed some of the expense structure. We have already shed the staff that was overbuilt, where we had to shed staff. We also -- but there is more. There is other expenses in rent and systems and such that we are -- that we're rightsizing to our current size business.

With that as an introduction, I am going to hit the slides. Side 2 is a repeat of what Dave Chidester said. Slide 3. Here is conversion. And there is more of a pattern here than might be at first apparent. If you take a look, it sort of bottomed out -- originally bottomed out in August. What this slide shows is how are we doing conversion this year versus the previous year, I'm sorry, 2006 versus 2005.

What really happened is it started really degrading halfway -- dramatically halfway through the year. We thought we had it turned around. We thought we had it -- well, we did have it turned around in August. And from August up through the end of November you see we -- with a few spikes against us. This is week by week. The conversion rate of '05 minus the conversion rate -- actually the conversion rate of '06 minus the conversion rate of '05.

You see from August up through November we thought -- well, we did have it fixed, and it was improving. What happened in December is interesting. What that is we had a big influx of traffic. That is the traffic that we had gotten that we had been the worst at converting. And I will

leave it to your imagination what kind of traffic that is in December. So we had this big swing against us as this big segment shift came. But of course we really isolated where we need to improve. And it is that segment of traffic which suddenly swelled and moved against us.

If you go to slide 4, you actually see -- not quite so clear a pattern, but the same basic idea. We had up through by the end of November I think we had it fixed. We have that big slug of traffic coming in December that is our worst -- that we have been the worst at handling. It has bounced back right after the holiday season is over. You can just see it bounce back a bit.

So again we know -- we had fixed between slides 3 and 4 I think we had fixed the conversion problem in most of our traffic. But there is a big slug we had not, and that is the big slug that hit just in the holiday season.

Moving to slide 5. Jason, are you on?

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**Jason Lindsey - Overstock.com - President, COO**

Yes, I'm here.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Why don't we share these slides. Go to slide 6, folks. Jason, why don't you talk about this.

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**Jason Lindsey - Overstock.com - President, COO**

Slide 6?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Slide 6, inventory turns.

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**Jason Lindsey - Overstock.com - President, COO**

Did you skip slide 4 and 5?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

No, I did them.

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**Jason Lindsey - Overstock.com - President, COO**

Okay, I wanted to say a couple of more things on side 5.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Go ahead. Back on slide 5. Go ahead.

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**Jason Lindsey - Overstock.com - President, COO**

The operations: we have given you many updates in the past about operations, and we have talked about our aggravation points. I don't want to get too much into that. I just want to tell you that that group still meets. We have divided our order process flow into 17 different steps, and we have scored each one of the steps on how aggravated you would be as a customer. We continue to meet, and that number -- the aggregation scores

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continue to drop. And it is better than it has ever been, and it has improved again almost every month as we go by. We're still seeing improvements there. And I don't think there is much to gain at this point, because we're systematically approaching zero, or as good as you can get.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

In fact, Jason is being modest. If we actually had just stuck with our original way of measuring, we went from 5 million to probably under 1,000 or under 500 aggregation points. However, in the course of fixing all these little leaks, and all these little issues, we would turn up new ones and we keep adding those to the score. But it still is a score that is in the four digits. But on the original issue -- on the original yardstick, Jason --

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**Jason Lindsey - Overstock.com - President, COO**

It would be negative I think, because we have turned so many things of point that didn't even exist as points before. So it is gotten much better.

The second point on this slide is inventory control and gross margins. I don't know if you can see from the press release, but our inventory balance has gone from about \$100 million this time last year to about -- or excuse me at year-end -- to about \$20 million at year-end. So our inventory on roughly the same amount of sales, that means we have gotten five times better at turning our inventory.

And all the things we talked about before as far as classifying all of our SKUs as either red and green, and 80% of our -- excuse me, 20% of our inventory was doing 80% of our gross profits, or more than that. We took all that to heart in the fourth quarter. And although the fourth quarter results are very bad, and I admit they're very bad, they are bad on purpose.

In other words, we used the fourth quarter to get rid of all the slow-moving inventory. And I'm quite pleased with the inventory balances we have now. And all the study that went into the red and green and, was this really going to work, it sure seemed like theoretically it was going to work. But I'm pleased that the fourth quarter is now over. We have sold it. Our inventory turns are much higher. Our margins are much higher. And it really does feel like we have made a lot of progress there.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

And we sucked a lot of cash back out of the system.

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**Jason Lindsey - Overstock.com - President, COO**

The other thing that I'm excited about is we talked about for years that our margins -- our margins for our direct business, meaning the business where we touch and warehouse the inventory, theoretically should definitely be higher than our partner business, because we have a whole bunch of extra expenses because of that, and we are taking capital risk, etc. But for some reason, we never really seem to get there.

And I'm quite encouraged that in '07, I do believe that our direct margins will be higher than our partner margins, which is where we should have been all along. In other words, if we touch it there should be a few hundred extra basis points as a reward for having gotten our hands dirty. And I think you'll see that in '07.

And then as far as cost-cutting, I do think you did a pretty good job of, Patrick, explaining what is going on there. There's some --

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Why don't you give your own color to it.

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**Jason Lindsey - Overstock.com - President, COO**

Well, I think there's a lot of things that need to get reduced. That process has begun. You'll see it much more in '07. A couple of the real big ones are, like you mentioned, rent. We're in a very nice part of town. Our entire building here, our headquarters, just recently all went on the market.

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We plan on moving as soon as we can lease this building out into our warehouse. And since we have excess warehouse space now that our inventory has shrunk so dramatically, there will be no incremental rent for moving into our warehouse. And the cost to build that space out will be very minor, meaning several months' rent here at our corporate facility. I think the breakeven -- the economic decision is very easy. It makes sense for us to move over there.

Another place where you see just way too many expenses is in IT. And I think if you look at our '04 IT cost versus our '06 IT cost, you can see that they are 4X as a percentage of sales what they used to be. Part of that is '04 we were on a shoestring, and we were probably spending too little. But in '06 we're clearly spending too much for the size of business that we have. So I think you'll see our IT costs drop dramatically during the year. And we will remove as many of those costs as we possibly can without putting in jeopardy the business.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Although some of those, before you get off IT, some of those -- a lot of that IT cost is depreciation.

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**Jason Lindsey - Overstock.com - President, COO**

Yes, I was just about to say in '08 you'll see -- in '08 just over \$10 million of expenses will drop off that are depreciation. And the depreciation, there's nothing we can do about that other than -- we have written a few assets off that you have seen in '07.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Although a fair bit of -- I don't know if you want to quantify it -- but a fair bit of what went on in '04 was also taking charges related to these kinds of events, cost-cutting events, not so much writing down -- writing off of equipment, but restructuring our rents and things like that.

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**Jason Lindsey - Overstock.com - President, COO**

Yes. Well, I think the way to look at depreciation is my guess is that in '08 you'll see depreciation go down something close to \$10 million, plus or minus a couple of million dollars. I don't anticipate a lot of new capital expense this year, although there will be some. I think net net I would expect in '08 about \$8 million to \$10 million of depreciation expense to come out of our expense structure.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

How about rent? Do you want to say what you -- on the rent?

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**Jason Lindsey - Overstock.com - President, COO**

I know that you'll see at least \$3 million, because you have seen in December we reached an agreement with our landlord for that new co-location facility. So \$3 million will come out. If you look at additional rent, I think there's another -- depending on the success of renting out our new buildings and what we can get for them -- I hope that there is more than \$10 million more to come out.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Yes, it sounds right.

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**Jason Lindsey - Overstock.com - President, COO**

Which is a big number for our business. I'm sorry you were on slide 6, Patrick?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

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Sure. Go ahead. I thought that you wanted to talk about slide 6.

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**Jason Lindsey - Overstock.com - President, COO**

I don't know that we have a lot left to talk about on slide 5. You can see that we've gotten much more efficient. Our inventory turns have gone up dramatically and --.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Now is that turn number calculated on the average inventory for the quarter or the ending in inventory?

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**Jason Lindsey - Overstock.com - President, COO**

David?

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

Average inventory.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

So you are actually going to see that move up again quite a notch from there. I think that you would see that over 20 right away.

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**Jason Lindsey - Overstock.com - President, COO**

Yes, I think we have made a lot of progress there. And I think that it will be evident over the coming quarters.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Okay.

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**Jason Lindsey - Overstock.com - President, COO**

Slide 7, Patrick.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

This is a big one. This is the net promoter scorer we have been reporting for about a year, since we started tracking it. This comes out of that Fred Reichheld book I've mentioned several times, "The Ultimate Question". For comparison I will remind you that in that book he -- our score is now at an all time high, 70%. By comparison I think the average company in America, and he says in that book, scores like an 8. And the superstars score 35 to 70. And he allows about 20 superstars listed in that book. Well, we are at the -- our score is at the highest end of that.

We really have fanatic customers. What we've realized though -- and just this is in part due to this -- we really have got a very senior guy out of -- as I said he had been a Chief Marketing Officer at a large credit card company, a wonderful fellow. And he has joined us full-time. He is gradually -- I'm sort of -- we are pilot, copilot on internal marketing now. And I'm peeling off over the next month or two. But he has already built a nice analytics groups, is finding some very interesting things.

And one is, there's one aspect of customer behavior that turns out to drive an awful lot for us, and to drive our growth. I am not going to say exactly what it is, but it is one particular event in customer -- say, migration. Migrating from people who are just giving you a try to people who have become hardcore, diehard Overstock fans.

That event, if you graft how people were behaving along that dimension, it basically looks like this chart on page 7, only shifted to the right a good six to nine months. It is kind of as though the NPS score drove -- the collapse in our NPS score, this net promoter score, how happy we were making customers. And here it just shows it getting down to 37. But the truth is I think that we were eating up a lot of goodwill. 37 still is much better than the average company, but we were just -- I think it only dropped to 37 back in '05 because we had so much goodwill built up.

You -- if you graft this other aspect of behavior it is -- this graft just shifted to the right six months. So it looks -- actually it is a little bit more than six months. So it looks like this customer -- this NPS score drives this other trigger in customer behavior, and then the other -- that trigger in customer behavior drives growth. And that is the chain which makes us optimistic that as the months roll by we will see a return to -- certainly not the levels of hypergrowth before. I can't imagine, but --. Anything else you want to say on this, Jason?

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**Jason Lindsey - Overstock.com - President, COO**

No.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

I will say this is a combination not just of customer service. Although the service team has been organized and gotten trained and is disciplined in a fantastic way, but this is also a reflection of all kinds of other things we are doing from the products we're buying to the timeliness with which we and our partners are shipping them.

We have just now gotten so we can measure -- over 2006 we got so we could measure so many little details of our business. And we look at all these aspects of our business and how they relate to net promoters score at the individual customer level. When we see a type of product or a type of -- or a group of customer service agents who are generating -- who, when consumers interact with them are giving us lower NPS scores than they should, that is what we're using to isolate our problems. It has really been a powerful metric for us.

Slide 8. This is auctions. And I will mention this because this is the sell through rate. And in fact -- Jason, was that a comment?

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**Jason Lindsey - Overstock.com - President, COO**

I have got a head cold.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Well, as you can see, our sell through rate was in the low single digits. For comparison I believe eBay is 27% or 28% on the way we measure on the -- using the yardstick that we use to measure sell through rate. There is different ways, but apples-to-apples I believe they are 27%, 28%.

We made a lot of changes in the fourth quarter. I have mentioned that two years ago it lost over \$5 million. Last year it lost a little bit over \$1 million. This year it is already profitable. It has been profitable since December. It suddenly is catching fire, at least in the sense of sell through rate. We've cut the expenses out of it dramatically. And in fact we had a day at 31% a few days ago. 31%. The first day we have been higher than our understanding of what the eBay sell through rate is.

The people who are selling -- we can go into why -- this isn't material in the sense that it is really going to be able to affect our income this year. But this -- you can see this systematic change is something that we finally got the right combination of oxygen and nitrogen into the hearth here, and it is flowing.

Let's go to page 9, Questions. I have a couple of questions that have come in. Let me start. Jonathan, can you take the phone? Are you anywhere around?

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**Jason Lindsey - Overstock.com - President, COO**

Yes, he is right here next to me. Can I just make a comment about the estimates before we go to Q&A?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Sure.

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**Jason Lindsey - Overstock.com - President, COO**

I had Dave print this out for me this morning. And I have an advantage over you, Patrick, I have seen what the consensus estimate -- or the analyst consensus for us for 2007 is. And I know many of the analyst have models, and it is a difficult spot that they are in because they're trying to update their models without guidance.

And I just want to make a couple of comments, because maybe it will help the Q&A. You have us for the year at a 5% growth rate, and 8.5% of sales on marketing. When I look at that -- and you have operating income of \$60 million -- more than a \$60 million loss. Although in total I think your numbers seem reasonable, and I am okay with all of them, I do think that we get there a slightly different way. We're really trying this year to spend less marketing as a percentage of sales. And so I think you'll see as we go through the year we will not spend 8% of our sales -- excuse me, 9% you have on marketing. I think it will be less than that. And I think our strategy --.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

We're already below that actually, aren't we?

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**Jason Lindsey - Overstock.com - President, COO**

Yes. I have looked at your numbers and they all seem reasonable. I am okay with the totals, but I think we get there a slightly different way. I think we spend less on marketing, and you have to just your sales growth down accordingly.

So did you want me to get Jonathan on the phone here? I'm going to have to go to the speaker phone, so hopefully the noise --.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Sure. Just ask him to put his mouth close to the mike.

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**Jason Lindsey - Overstock.com - President, COO**

You still there?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Yes. Actually, before we go to Jonathan, I want to make one more comment on what you said. We, five or six years ago, considered co-locating our warehouse. And it is one of our biggest mistakes I think that we didn't -- my bad. But like five years ago when we outgrew our first facility, and we went into a second shoestrng facility, we thought then moving to the warehouse, which is about 15 miles away.

And at a time we had so few people, and it would have inconvenienced a lot of people. And we actually had one whole department that was, you will basically lose most of us, if you do it. But we should have just gone to the warehouse. I have been in companies, catalog companies, which run out of their warehouse. Have their office space in their warehouse. And we are -- at least Jason and I, are so excited about building a nice office over in the warehouse.

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I think a fair bit of the internal friction in the Company comes from all the coordination from the buyers, and the copy editors, and guys taking the photos, and logistics and managing of samples back and forth. So I'm excited to be over there. Jason, do you have any comment on that?

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**Jason Lindsey - *Overstock.com - President, COO***

No, I think -- I agree it was a mistake in the past. We should have told that entire department, all three of them, that you've got to just live with it. I think it is going to be great for business. It will be fantastic for our expense structure, and it is going to feel like old days.

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**Patrick Byrne - *Overstock.com - Chairman, CEO***

When you gave those -- we know where \$3 million -- we're cutting out of rent, and it could be another \$10 million. That is versus our normalized expense structure, not the expense structure we showed in 2006, which includes a fair bit of restructuring charge.

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**Jason Lindsey - *Overstock.com - President, COO***

I think it will be very powerful. You look at -- it is going to take '07 to get all these leases and rental problems all fixed. It is going to take '07 to get our cost structure more right sided for our business. But you look to '08, along with depreciation decreasing and all those expenses decreasing, I'm quite encouraged that our expense structure can get there.

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**Patrick Byrne - *Overstock.com - Chairman, CEO***

It is almost like -- well, it is almost like -- it is true. We overshot the mark. We just overshot the mark, and built an expense structure for a business that we thought might be \$1.5 billion, \$2 billion or so by now.

But we had -- we have operated at a much thinner expense structure before. It is actually one I think we're maybe more comfortable than how chubby we got. I think we are all really looking forward to getting back. We don't want to get as lean as we were before, but it feels good. It was not feeling like our nature to get to be living in as nice a space as we are living, and to have just gone with the high-end solutions to everything. It feels very satisfying for us to be getting back to that tighter expense structure. Although we obviously can't cut as deep as -- we can't make it as small as it was before. We have \$10 million or \$11 million out of depreciation next year, and then a similar size coming out the following year. Anyway, Jonathan.

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**Jonathan Johnson - *Overstock.com - General Counsel***

Yes, sir.

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**Patrick Byrne - *Overstock.com - Chairman, CEO***

I have some questions that have come in from email that Kevin has given me that includes stuff on -- now that we're suing the entire financial world -- shall I just punt that to you? Anything you want to say about the lawsuit, why don't you say it in one go, and then we won't talk about it. And be as brief as you would like.

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**Jonathan Johnson - *Overstock.com - General Counsel***

We filed a lawsuit on Friday against several of the prime brokers that we believe have been manipulating our stock by selling shares and not delivering those shares. We feel we have a good case. We feel we have a good damage model. And we look forward to hearing their responses and their answers and starting discovery. We feel we're well represented by the attorneys that are handling it, and so we are eager to go forward.

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**Patrick Byrne - *Overstock.com - Chairman, CEO***

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Okay. I guess if anybody -- stick around, in case somebody else wants to talk about that. A good summary. Let's see, what else. What are the new topline growth expectations internally? Jason, do you want to say anything to that?

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**Jason Lindsey - Overstock.com - President, COO**

No, I would say that we're spending a lot of time trying to be more profitable. And we are willing to make some trade offs between lower growth and higher profitability, which are trade-offs we weren't willing to make in the past, because we were growing 100%. And we thought as long as we could ride that train, we should.

So we are spending a lot of time now culling back from the 10 or 11% of sales we spent on marketing. We are judiciously slicing that back, cutting the worst performing of that, and seeing how it affects our gross profit dollars. And we're going to continue to cut that until we pass the point on the curve of diminishing returns.

We don't know -- one of the reasons we don't know, and can't give real good guidance on what our sales are going to be, is because we are -- we're cutting back and watching it as we go. And when we hit that point, we will let you know. But I think we're at -- the first big step is to go from the 10 or 11% we spend on marketing as a percentage of sales last year -- we're going to -- we know we're going to cut that back to 9 and then 8 and then 7. And at some point around there we will probably stop.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Just in terms of what the comps look like for us, January last year was actually a very strong month. I know the first quarter is when things started to just really decelerate. But January was a very strong month. In fact, it was only after Valentine's Day that the effects of all that NPS stuff started really washing through and customer behavior changed and it deteriorated for quite some time, and then started coming back late in the year. But anyway the point is in terms of what our growth numbers will look like, just in the immediate future, January was a tough comp. February got a little bit easier, and then from there on the comps get easier and easier.

But we are trying to -- we want to right size the business for an \$800 million business. We want to right size the expense structure, and not be counting on growth, and be able to get to a profitable business at this size. And then if the growth kicks in, we will be --.

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**Jason Lindsey - Overstock.com - President, COO**

I think also -- just generally I think you're going to see growth continue to decrease as we determine the right efficiency of our marketing spend. And then eventually, hopefully later sometime in the year, you'll see it start to pick up. I would think if you're building a model that would it be worst in the first half of the year and better in the second half of the year. I don't know what else to say other than that.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

I have got a couple of questions here. Rob Wilson from Tiburon, now that you have had a major fire sale in Q4 '06, when are you going to increase conversion? Is it fair to expect a major sales decline in Q4 '07, if you decide to limit markdowns?

I don't really think so. I think that there is a lot of other effects going on than just what our pricing was on these products in Q4. There is a whole lot of things reflecting customer behavior and how we were treating them and such. There is just too many other dynamics that were -- to limit it to just that.

There's another question. I don't know if you have this in front of you, but Dave, you should probably answer this. Rob Wilson, Tiburon Research asks, depreciation and amortization spiked at \$12.4 million for cash we are spending. Why a spike given a \$7.5 million runrate in Q1 through Q3? What quarterly rate should we expect going forward?

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

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That is the effect of what we have talked about. Some of the assets that we accelerated the depreciation on, as we're moving out of some of this facility space. You'll see it come back down to \$8 million, \$8.5 million the first half of year. Then it will drop to \$7 million, \$7.5 million the second half of the year. That is per quarter. And then you'll see it continue to drop as we go into '08. That is kind of a trend.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Last of the written questions that have come in. Kevin or Tonya, why don't we go to any more questions on the line.

## QUESTION AND ANSWER

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**Operator**

(OPERATOR INSTRUCTIONS). Aaron Kessler, Piper Jaffray.

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**Aaron Kessler - Piper Jaffray - Analyst**

A couple of questions. First, in terms of the contribution margin, can you give us an update on when the target is to get positive on that? I think you and Jason had a bet on that last time.

And then also in terms of what you're sourcing, how will that influence what your marketing costs, such that if you're sourcing a lot less, are you going to be bidding on a lot fewer terms and much more strategic marketing than in the past?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

As far as the contribution margin, well, I think our bet was for Q1. And I said that we would see it at 10%. Jason took the under. Jason, do you want to -- I will let you buy out now for --.

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**Jason Lindsey - Overstock.com - President, COO**

Well, if your guys in marketing would hit their number, I might lose that bet, but since I'm not -- I don't know. I am -- I will say that we have made much more progress much quicker than I would have expected, so I still take the under.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

He will take the under. It is going to be close. It is going to be close. It is going to be far better than it has been for quarters. I'm sorry, what was the second point?

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**Aaron Kessler - Piper Jaffray - Analyst**

The second one is in terms of what you're sourcing, how does that impact what your marketing costs will be?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Jason, do you want to handle part of that?

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**Jason Lindsey - Overstock.com - President, COO**

I don't think so. I'm not sure I understand the question.

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**Aaron Kessler - Piper Jaffray - Analyst**

If you are all saying that you are going to be sourcing a lot less inventory, and obviously you seem to be bidding on a lot fewer key words, a lot more strategic marketing and such. You are actually going to have a higher turnover rate, so much more efficient marketing.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

You have hit the nail on the head. We think that there is stuff we have probably overbid for. Our SKU selection isn't going down so much as you would think, even though we are carrying much less inventory. We are replacing it with a lot of partner product.

But people are -- I see looking at Alexa and talking about, well, our traffic is way down. That is purposeful. What we have done is -- put it is way, if the traffic is down 45%, it doesn't mean the revenue is down 45%. What we have realized is we were buying a lot of traffic -- our revenue per visitor you should see going up significantly from this quarter forward, just like our margin. We have just stopped paying for a lot of traffic we realized wasn't economic for us.

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**Jason Lindsey - Overstock.com - President, COO**

Yes, and I think your question -- I do understand it now -- assumes that there is -- because our inventory goes down there is a direct correlation in our SKU count going down, and we are really not seeing that. Our SKU count has gone down some, but nothing -- our inventory has gone down. It is one-fifth of what it was before. Our SKU count has gone down some, but nothing even close to that. And so you don't see that change.

Additionally, I think, as marketing is trying to be more efficient in cutting off their low hanging fruit as well, I do think that they are bidding on less key words, but what it means is they are spending on less as a percentage of sales. And I think it all kind of came down together, and I don't think it is a dramatic effect.

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**Aaron Kessler - Piper Jaffray - Analyst**

The marketing that you are cutting back, should we see that is more on the brand side, as opposed to like performance-based search marketing?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

It has been on the brand side. A lot of it is just -- on a percentage basis the brand side has taken the bigger cuts. Although we are seeing -- that has only been 20% of our spend anyway, so there's not as much we can take out of that.

But we are taking a lot out of the online spend. We are looking at the profitability of customers from different channels, and realizing we can't afford to lose money on one channel because that channel is a channel that never -- that gives us just real bargain basement shoppers who don't come back or something, whereas other channels are more valuable channels. On a dollar basis the majority of the cuts are coming out of online, but on a percentage it would be higher on the off-line.

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**Jason Lindsey - Overstock.com - President, COO**

The good thing is we're looking at all of our marketing spend and looking at the return for that spend. And as we decrease marketing spend, we are starting at the worst return and just moving up the ladder. So I think that is the right way to do it.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

I would say that what we used to think of as broadly being in two groups, I think we're up to now we have split it into 14 groups, and we're looking at the payback literally every morning for the previous day. Now the -- and making allocation decisions weekly. We just have gotten more fine grained about the whole thing.

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**Operator**

Justin Post, Merrill Lynch.

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**Justin Post - Merrill Lynch - Analyst**

Can you talk a little bit about your long-term business model? You said that the average transaction value was around \$100 in the quarter. That was a nice disclosure. I appreciate that. If you have gross margins in the \$16 to \$17 range longer-term -- I don't know if that is your target -- you can comment on that.

But how do you expect the cost per order on the marketing side to trend from here obviously down? Where do you see your business model getting to longer-term that is going to allow Overstock to be profitable?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Well, when you say our cost per order, what are you referring to exactly? The marketing cost per order, the IT cost per order? How are you --?

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**Justin Post - Merrill Lynch - Analyst**

The marketing cost, you either could break it down per order or average for incremental customers to the site to make an order.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

My expectations on margin are a tad higher than what you just said. Our marketing cost per order, as Jason said, we are moving down from 10 to 11% of that \$100 to something already in the 8ish range. But we think that should actually be able to come down more and even -- and certainly if we just want to maintain an \$800 million business come down substantially from there. To make that happen and keep the \$800 million business, we have to be better at the whole CRM analytics side of things, and the site conversion side of things.

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**Jason Lindsey - Overstock.com - President, COO**

I look at our business model and say -- for one minute you kind of have to exclude books, because books we don't make a lot of money on. We make some, but it generates a lot of traffic and customers. So if you exclude books out of the equation, and just think about our income statement and how does it work long-term, I think margins are somewhere around 20%. You subtract 5% for marketing, 5% for IT, 5% for G&A, and you have 5% of profit left. I think you can push those numbers around a point or two however you want, because it is all theoretical and we're not there yet. But it is pretty easy to see all these expenses lining up to 20% gross margin, minus 5% from marketing, minus 5% for IT, and minus 5% for G&A, with 5% left for profit. Is that fair, Patrick?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Yes, that is exactly right.

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**Justin Post - Merrill Lynch - Analyst**

One follow-up. How are your efforts to bring repeat customers back to Overstock playing out right now with the new technology?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

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Well, that is when I talked about the fellow who is located -- the kink in our migration. Think of it not just as somebody goes to being a onetime shopper to a diehard believer, but there's a whole migration in their behavior of many steps -- of several steps. What we found is there was one step, one step specifically that it just dropped off. And so we have discovered the step and we just have to fix that step. But we have isolated the problem.

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**Operator**

Bill Lennan, First Albany.

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**Bill Lennan - First Albany - Analyst**

I have three for starters. Jason made reference to gross margin (technical difficulty).

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**Patrick Byrne - Overstock.com - Chairman, CEO**

You are cutting out a bit. Could you speak closer to the phone?

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**Bill Lennan - First Albany - Analyst**

Jason made some reference to gross margin on the direct business perhaps getting better than partner long-term. I wonder if you would tell us how. You have got a couple of levers you can throw there. And what I am most interested in is I think your first cost, what you actually pay for underlying goods has room for improvement, and/or just be better -- smarter at buying. That is question number one.

Question number two is just a clarification. Where is the \$5.5 million co-location agreement termination cost in the P&L order? I (technical difficulty) sense for where it is.

Then question number three, technology comprises really two lines, depreciation and everything else. You talked a bit about depreciation. Where does everything else go? I'm trying to get a handle on whether that is a headcount driven thing, and how we should model the non-depreciation portion of technology?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

I am just going to hit the last one first. IT, you can roughly think of our IT cost as being half depreciation, half headcount. I think you can see the headcount as staying stable, and the depreciation dropping. Jason, is that fair?

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**Jason Lindsey - Overstock.com - President, COO**

Yes, what the -- not quite fair. It is half depreciation, half everything else. And everything else is IT, co-loc facilities -- or excuse me, IT, the payments to Oracle for software. So it is half IT, half everything else. Everything else I agree with what you said.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

The depreciation starts dropping away really a little bit in the second half of this year. But really starts dropping away in '08 and most -- is mostly gone by then. We really don't have significant capital expenditures. We see certainly to maintain that \$800 million business. So, Jason, why don't you go back to margins. I'm surprised you said 20%. I'm all over 20%, but I didn't know you're going to --.

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**Jason Lindsey - Overstock.com - President, COO**

It is 20% if you exclude -- just taking books out of our business model hikes it up a couple of points right there. Even if you say 17 or 18 plus percent minus books gets you pretty close to 20.

Our direct versus does our partner business, we have always said we should make more margin for our direct business because we are taking inventory risk. We haven't gotten there. I think just by eliminating the 80% of our products that lost us money last year, we get a lot of the way there.

One of the reasons you won't see that right away is because our infrastructure was built to hold this \$120 million worth of capital. And so the amount of money that we're spending for warehouse space that we're not using, you will see in the first and second quarters really puts a drag on our direct margins. But as we solve that problem, I'm confident that by the end of the year, assuming we solve our rent problem, you will see our direct margins be higher than our partner margins.

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**Patrick Byrne - *Overstock.com* - Chairman, CEO**

Jason, you just put your finger on a problem we ought to mention. Right now, and going forward, I think our direct margins -- certainly our juice is far higher -- is significantly higher on the direct side than the indirect. The problem is the direct side, the difference between juice and GAAP margin is the fixed infrastructure. And which we have on the direct side and which we don't have on partner. That infrastructure was built -- is far more than we need now. And so on a GAAP basis, how quickly are people going to see direct margins exceed indirect margins on a GAAP basis?

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**Jason Lindsey - *Overstock.com* - President, COO**

Somewhere between the third and fourth quarter. Again, it just depends on -- you're asking me how quickly can we lease out empty warehouse spaces, and that is a tough one to answer.

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**Patrick Byrne - *Overstock.com* - Chairman, CEO**

But what we have is we are ready -- if our direct juice, which is just the margin, but not counting the fixed warehouse cost which we look at, that has taken a big surge forward, as Jason has washed out all the stuff to which we should not be committing capital anymore. And so we have never had a spread between them like this so positive where the direct has so much higher juice margin.

However, now you add in the direct cost -- and we are stuck with this legacy. We built the infrastructure both to be -- to support a higher level of sales. And we didn't imagine that we were going to be getting on a GAAP basis like 20 or 25 turns, which I think you're going to be seeing right away. We do have that infrastructure to get out of, and so you might not see it on the GAAP basis immediately, but Jason says the third quarter, so I'm sure he is being conservative.

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**Jason Lindsey - *Overstock.com* - President, COO**

All I am saying is I think somewhere between the third and the fourth quarter, hopefully, we will have our warehouses shrunk down to the right size for our business. That is when I think you'll see it.

Bill asked three questions. The middle question I don't think we answered, which is where do you see the \$5.5 million co-location termination payment. And Dave correct me if I'm wrong, that is in our G&A expenses, is that correct?

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

It is actually in our technology expenses which relates to the co-location facility.

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**Jason Lindsey - *Overstock.com* - President, COO**

I think that answers all three of your questions.

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**Bill Lennan - *First Albany* - Analyst**

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May I throw in one more just quickly? The books, movies and video (technical difficulty) was significantly higher as a mix of revenue than we expected. And we used to think of it as a stealth marketing event. Leave money on the table [with this] segment because it drives (technical difficulty) of goods. What is the strategic role of BMVG in '07? Should we expect to see it remain a larger part of the mix to try and drive traffic in a less expensive way than television?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

A couple of comments. One its surge caught us by surprise too. It really --.

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**Bill Lennan - First Albany - Analyst**

Was it a surge or an escalation?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Escalation actually. No, I think it really -- it was more of a surge, or was that a joke.

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**Bill Lennan - First Albany - Analyst**

That was a bad joke. Ignore it.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Well, I wondered if you meant was it going to stay. It did in the holiday season, we just suddenly had a lot of new shoppers. But in general in 2006, it provides a very substantial portion, less than half, but a substantial fraction of our new customers. And the new customers have gone on to have customer value that is getting pretty close to average for everybody. So it is a -- and it is a very cheap way of acquiring that substantial fraction of our customers.

It also has a strategic role in that as we get more people, even if they are normally down bedding buyers or furniture buyers, as they shop in books and DVDs and music, we learn about them in ways that let us recommend -- make more powerful recommendations for them, even back in furniture and bedding and such. We just learn more about them from the types of books and things -- or our systems learn more. Nobody, no human is consciously looking at any of it. It has that strategic role. It just gives us a richer psychographic picture.

If you shop around our site now, you see that our recommendations at the product page level, and sometimes even at the home page level, are getting pretty good. I mean they seem solid to me, the ones that I got. And we just definitely have the numbers to bear that out. And our gift finder is working well. Now we've got to move this -- the application of these recommendations and personalization elsewhere in the site, but part of information that drives that is getting people to buy, or even just click around in books and movies. So it has a strategic role there too.

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**Operator**

(OPERATOR INSTRUCTIONS).

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**Unidentified Company Representative**

I think our hour is up, Patrick.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Our hour is up. Do we have -- let's take one more question, and then we will stop.

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**Operator**

Scott Devitt, Stifel Nicolaus.

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**Scott Devitt - Stifel Nicolaus - Analyst**

I wanted to be sure I understand the co-location agreement that you're exiting. The \$5.5 million of expense, that impacted the fourth quarter?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Correct.

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**Scott Devitt - Stifel Nicolaus - Analyst**

So how much -- what is the annual expense that was flowing through?

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

That agreement wasn't signed until halfway through the fourth quarter. We have never actually even moved in there. Again, it was built out -- we told our landlords to build it out a year and a half ago, and then became available for us halfway through the year. If you -- the way to look at it is how much rent are we extinguishing from our income statement going forward. And I think that number is around \$3 million a year.

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**Scott Devitt - Stifel Nicolaus - Analyst**

Then Jason, the \$60 million that you quoted from consensus expectations of operating loss in '07, is that inclusive of the \$5 million or so with stock comp, is that including that?

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**Jason Lindsey - Overstock.com - President, COO**

Yes.

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**Scott Devitt - Stifel Nicolaus - Analyst**

So it is \$55 million on a cash basis. Is that right?

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**Jason Lindsey - Overstock.com - President, COO**

Yes, I think the number -- the sheet I have that Dave printed out for me showed \$66 million loss.

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**Scott Devitt - Stifel Nicolaus - Analyst**

\$66 million, okay.

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**Jason Lindsey - Overstock.com - President, COO**

Yes, it shows \$66 million of operating loss, which should include stock comp in there.

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**Scott Devitt - Stifel Nicolaus - Analyst**

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As you think about the business over maybe a three-year time horizon, so you can normalize CapEx, how much capital does it take to run the business? Amazon spends about 2.5% of revenue in CapEx. I'm trying to understand your business on a cash basis, normalizing for all these depreciation events. Is \$20 million the right number on an annualized basis?

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**Patrick Byrne - Overstock.com - Chairman, CEO**

I think that is -- myself, I think that is way high. But, Dave or Jason, do you have point of view?

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**Jason Lindsey - Overstock.com - President, COO**

I think it is high unless we are growing. If you -- there's a trade off there, right? If you want to say we are growing 40%, then that might be (multiple speakers).

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**Scott Devitt - Stifel Nicolaus - Analyst**

Say you are growing 5 or 10. What is the run rate CapEx requirement for the business?

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

It is tiny.

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**Jason Lindsey - Overstock.com - President, COO**

Yes, if you are growing 5 or 10, it is much less than 2.5%.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

The truth is that even with 40%, our systems are now built to hold so much more traffic and so much more volume that --.

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**Jason Lindsey - Overstock.com - President, COO**

Right. The first two years the 40% cost us almost nothing because we have already paid for that. Then after that I'm sure there is -- of course there will be some incremental cost. But there's a trade-off. If you soon assume we're not going to grow, you can't assume we're going to spend 2.5% on CapEx.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

In fact, 40% over two years is basically double. I can't imagine that we would have to spend anything to beef our systems up with just one double from here.

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**Jason Lindsey - Overstock.com - President, COO**

Right. There will be some incremental expenses. I don't know what our software licenses and bandwidth and things like that, but as far as the hardware and what we can -- the throughput of our systems, I don't think we really need to invest much at all for the first double.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Maybe even more than that.

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

The big reason is because in '05 we spent almost 10% of sales on IT. And so we just don't need to spend it now.

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**Jason Lindsey - Overstock.com - President, COO**

Like I said, we have already paid for it.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

I think if I believe the IT guys, they would say we could probably double twice. Well, I know what they tell me that this system can do and that system can do, and the Web servers and the ERP system. And it is -- they paint numbers like we could be much more than 2 to 4 times the current size, without really any new serious infrastructure. At 6 to 10 times our current size we have just would have to go and think about some major investments, but we --.

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**Jason Lindsey - Overstock.com - President, COO**

We tried to give you some insight into your question. We understand your question, and hopefully you understand our answer, which is there is trade offs between growth and how much we have to spend on CapEx. But understand that, since we spent so much in '05 on CapEx in '04 -- well, '05 -- that our next double or two kind of has already been paid for.

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**Scott Devitt - Stifel Nicolaus - Analyst**

I just have one final question. Let's just -- for my sake let's say it is \$10 millionish, 1% of revenue. So you can add back about \$25 million of non-cash expenses, because your depreciation today is higher than a run rate, which would get you to a \$35 million cash loss on a normalized basis at \$750 million to \$800 million in revenue.

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**Jason Lindsey - Overstock.com - President, COO**

You are assuming '06 is normal.

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**Scott Devitt - Stifel Nicolaus - Analyst**

I'm assuming '07, because you were talking to the \$60 million. What I'm doing is I'm trying to understand the depreciation as it exist today, how much capital it actually requires to run the business. And then what you are talking to in terms of the loss in '07, which is a more normal loss because it begins to show the erosion of depreciation. If I take CapEx, this is \$10 million number, and I give you the benefit, so I give you the \$25 million of cash -- of non-cash cost back, and I add them back to operating loss, it gets you to about \$35 million in cash operating loss.

Whether that is the right number or if it is somewhere around that number, the final question is just, can you bridge us -- do you think your business is cash breakeven around these levels? And as if so, can you walk us through the math that gets us from \$35 million to 0 in terms of the trail off depreciation, how you can cut heads and things of that major? nature?

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**Jason Lindsey - Overstock.com - President, COO**

I think you are mixing two things. One, you are saying, okay, '07, and you are taking that \$60 million number and now you're saying, okay, let's look at a normalized world. Part of that normalized world is what does your income statement look like? Well, this \$60 million income statement doesn't show where we think margins will eventually get. The consensus estimate for margins is 15%. Yes. It also has 9% marketing, and then 5% growth in sales.

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I would say for '07 that seems like a reasonable guess. But then you start off and say well a normalized world is you're going to lose \$60 million. Let's take the wash of CapEx in and out and that gets you a 25% pick up. How do you have a profitable business here? We have a profitable business here because I don't believe in the 15% gross margins on a steady-state. I don't believe in the 9% marketing on a steady-state. I think the assumption of '07 is normal. That is what I say I don't buy that.

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**Scott Devitt - Stifel Nicolaus - Analyst**

Okay. So if you think you can get to 20, that is \$40 million, which gets you there, so maybe that answers my question.

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**Jason Lindsey - Overstock.com - President, COO**

Yes. And I don't think marketing at 9 is correct.

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**Scott Devitt - Stifel Nicolaus - Analyst**

Okay. All right. I'm just trying -- it is quite a dynamic model, so I am trying to understand.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

You guys, we don't envy you. You have a tough job. Not as tough as ours, but a tough job. What else have you got, anything else?

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**Scott Devitt - Stifel Nicolaus - Analyst**

No, that it. Thanks a lot.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Jason, do you want to take any more calls? It is 10.08. Do you want to wrap it up?

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**Jason Lindsey - Overstock.com - President, COO**

Yes, I think we could.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

Great, thank you, Jason. Any last comments from you?

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**Jason Lindsey - Overstock.com - President, COO**

No, I think it was a tough year. I apologize to our owners. We lost a lot of money. And it was a very bad year. I think '07 is going to be a much better year, but it is going to include a lot of expenses of the turnaround situation that we're in. And I'm optimistic for the future.

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**Patrick Byrne - Overstock.com - Chairman, CEO**

I have never heard Jason so optimistic for the future actually. Okay, that is all we have to say. Thank you, owners, for sticking with us, those that have. We have been through tough times. '06 was a wipe out year. And there was a lot of pain, but a lot of it -- all the pain of tightening the belt and resizing our expense structure, we got our infrastructure fixed, but our expense structure still isn't there. But we have already taken steps at the end of the year and the first part of this year. We have made most of the decisions and made some of the changes. And there is -- we just have to carry them out in the next few months.

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But I actually have never heard Jason -- I'm just not going to comment on my own emotions, but those of you who know Jason, know you probably never heard him so optimistic. But we do have our work cut out for us still. But we do think we've gotten through the toughest part. Thank you all for your time. Bye-bye.

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**Operator**

Thank you for your participation in today's conference. This concludes the presentation. You may disconnect. Have a great day.

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