FINAL TRANSCRIPT

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PRESENTATION

Operator

Good day, ladies and gentlemen. Thank you for standing by, and welcome to the 2007 first-quarter Overstock.com earnings conference call. At this time, all participants are in a listen-only mode. We will facilitate a question-and-answer session towards the end of today's presentation. (OPERATOR INSTRUCTIONS).

I would now like to turn the presentation over to your host for today's call, Mr. David Chidester, Senior Vice President of Finance at Overstock. Please proceed, sir.

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

Thank you. Good morning and welcome to Overstock.com's first-quarter 2007 earnings 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, April 25, 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 and detailed commentary 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's 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 involves 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 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 S-1.

I will now review the financial results for the first quarter of 2007. Please note that all comparisons will be against our results from the first quarter of 2006 unless otherwise stated.

Total revenue for the quarter was $158 million, down 11%. However, gross profit dollars were up 7%, as gross margins in the quarter were 16%, up 270 basis points from 13.3% last year.

Our total operating loss was $17.7 million, including $6.1 million of restructuring charges. Excluding restructuring charges, our operating loss was $11.6 million, down from a loss of $14.2 million last year.

Of the $6.1 million of restructuring charges included in operating expenses, $4.7 million are for the cost of exiting our warehouse space in Indiana. We plan to completely phase out of operations there by August, and we will begin to see a reduction in fixed warehouse costs from this second quarter forward. The remaining $1.4 million of restructuring was for the accelerated depreciation of facilities-related assets at our corporate offices.

The loss from discontinued operations from our travel business was $3.6 million, the result of a $3.8 million impairment of its assets. As we announced this morning, we completed the sale of our travel business. For accounting purposes, the final valuation of the business and the related impairment were based on the present value of the discounted cash payments we received from the sale.

Our net loss was $21.4 million or $0.91 per share compared to a net loss of $15.9 million or $0.82 per share last year. We ended the quarter with $68 million of cash. However, we did receive an additional $11 million of cash today as part of the travel sale. Our operating cash flows were an outflow of $58 million for the quarter, but only an outflow of $12 million over the trailing 12 months.

And this concludes my financial review. I will now turn the call over to Patrick.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Good morning. That was, of course -- much of that was referring to slide 2. Please advance your own slides.

Slide 3 -- we have 15 slides we will go through. My general point is, Jason and I both feel, I think, that we are back on the rails. I think I mentioned last phone call I had never seen him so giddy, and you are going to see why in these slides.

On slide 3 of 15, I mentioned back in November that we should have one more stairstep in what we should be able to get out of our inventory. I think that shows on a GAAP basis; we're now running at 32 turns. Even on a reality basis, just considering that direct business alone, what we call the core, we're running at 12 turns. Now, this is all going to lead into why we think that margins and return on capital should be sustainable, and even likely to go up from here.

Okay, next slide, slide 4 -- I wanted to spend a moment on this to remind folks that there is the GAAP gross margin and then what we call juice. And the difference is basically the fixed warehouse costs and a little bit of coupons. Internally, we've always accounted for that differently. Coupons and shipping promotions we account as a marketing cost, but under GAAP it's a reduction of revenue.

So anyway -- but the main event is the difference between what we call core juice and core gross margins is the fixed warehouse costs. That -- we overbuilt our infrastructure, and these are our core versus -- in both cases, these are core what we call -- or what on a GAAP basis is called direct. So this is not including the partner business. So you see the improvement it's made in the last quarter. It can actually, I think, go up from there.

What is interesting is the spread, the size of the blue bar in between the two. That is a reflection of how much we overbuilt our infrastructure. We really overbuilt it for two reasons. One is that we plotted two years ago to have been $2 billion by now. We didn't expect, of course, to come to such a rapid slowdown in sales. So we had overbuilt anyway. And then on top of that, we've gotten about four times more efficient at running our inventory. So we just don't need all this infrastructure.

There's our core margins, about -- almost, oh, 7.5 points of margin are getting eaten up in that. It's possible to reduce that by about half. And it is twice overbuilt; it is overbuilt by a factor of two. So if you go to slide 5, you see it -- once you mix in partner revenue, which of course doesn't eat up any of that infrastructure, you see the difference between the gross margins and the juice. So the juice is how we think of our marginal gross profit on the next dollar of sales.

And you see that there is basically a 2% spread there. And again, I think that that is about twice what it needs to be. As we have gotten out of some of our warehouse space in this last quarter, we've booked charge for it, and even -- of our excess space, we have subleased about half of that, of what remains. So I think of that blue bar, there's about half of it we can pick up.

Going on to slide 6, sales and marketing expense as a percentage of revenue -- you see what really happened back in 2004, we actually had it down to 5%. As we reached this slowdown, which -- well, in 2005, in the middle is when the slowdown really started occurring. Actually, I'll just say the rate of increase went down. And all through 2006, we gunned the marketing spend really probably too much in an attempt to claw our way back onto that hyper-growth curve -- a mistake, and we don't intend to do that again. We've brought it down considerably; it may even come down a little bit from where it is here.

Going on to slide -- well, before we go on to slide 7, I will just mention that spike, that attempt to claw our way back onto the hyper-growth curve, we not only realized that that was -- well, not going to do it again, but the main event is we had to fix stuff, and 2006 was the year of fixing things. And as you -- you know, fixing the way we run inventory, fixing the way we do customer service -- all those things, well, they are largely fixed, as you will be seeing through these slides.

So that doesn't mean we are going to gas it again, but I think it means that -- I think that there are smarter ways to market. In fact, I look back over our history, and our early history was a history of figuring things out first. I think I mentioned this in the last call or the one before that. I really do look back at 2000, 2001, and we would figure something out and we would ride it for a year or a year and a half before other people figured it out. We'd figure something else out. And we've sort of figured three or four things out first.

I think we really stopped figuring out the new things about 2004, 2005. We have figured out something we missed, something really big -- well, I think it's really big. We are working on it diligently. A lot of it is actually coming together this quarter. But I am not going to make the mistake I made in past years, which was to tell the world what we have figured out. And so I am not going to mention what it is. But we see now that we missed something big that had happened on the Internet, and we have been working hard really for about six months to fix that.

Slide 7, contribution -- and here, you have my quote from the last July's conference call, where I've talked about, we have something here called nectar. The official term is GAAP, and that is just the gross profit minus the marketing spend. I said back then that it would get over 10 by the first quarter. Now, we have a -- and this is what it has done, and if we take the juice minus the marketing spend, you get nectar, and that did get to 10.5%. Jason points out that contribution is a GAAP term. Do you want to make -- anything to say to this, Jason?

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

Well, you are referring to our bet. This came from when Scott Devitt -- we were talking about this, and he was asking how this is going to change, and you said that our -- well, it says right here -- our gross profit minus our marketing expense. I'd like to see this over 10. And that's when we bet our steak dinner. And you asked Scott to please remind you of this in the first quarter, and what was it, and I asked Scott to please remind -- ask me how my steak was, because I was quite convinced we weren't going to do this, although I would have taken the under on even quite a bit smaller number. So I am surprised at the size it is as well -- pleasantly surprised.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

My view, our nectar got over 10. Jason wants to use GAAP nectar rather than nectar, but that's --

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

If Scott is listing, I haven't had my steak because he doesn't think he lost the bet.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Well, our nectar is over 10%. I didn't know nectar was a GAAP term. By the way, we are in separate cities, Jason and I. Anyway, we thought that this would be -- we knew by the middle of last year we had our game plan -- really, we had our game plan by end of Q1 last year, of what was going to have to happen. We knew things were going to get to really ugly and the Company was going to have to take medicine, but that we could come out of it a far better company.

That medicine was going to be in the form of some expenses. It was going to be in the form of dumping a bunch of inventory as we figured out, really, how to take our inventory management to the next level -- all kinds of things. We knew it was going to get ugly, maybe not as ugly as it got, but we thought we would come out in the first quarter smelling like a rose, operationally. And this is exactly what we, what I, at least, thought was going to happen in the first quarter.

Okay, slide -- and again, this spread between those, which is now 1.6, that includes a lot of excess warehouse space. Jason, as long as we're on it, do you want to talk about that on this slide, anything about the excess warehouse space?

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

Well, you can see that in our restructuring, we have approximately 800,000 square feet in Indiana that we really don't need now because our inventory has dropped from 100-plus million to 20 million range. And it's a high-class problem, but a problem nonetheless. We have a whole bunch more space than we need to hold the inventory that we need. So we have too much warehouse space, and we're doing everything we can as quickly as we can to get rid of it.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

What are we making public about what you have done already with that? I think it is in the financials. We have paid an exit fee to get out of half of it, and then we have abandoned the other half. And we've made some estimates about what we think it is going to take to get out of the rest of it, and we've accrued that in this quarter. So we are still in the half that we have paid the exit fee on, and we will be in that half until August.

So you will still see the cost of being in that warehouse until August 15, and then you won't see those costs at all anymore. So in other words, our warehouse costs are going to drop. For that particular warehouse, they will be cut in half, or not quite in half, starting April 1. So it has already happened. And then the rest of it will fall out starting August 15. Let me clarify, when Jason said abandoned, he did not mean in the legal sense. He means we have stopped shipping new inventory into it; instead, we're just directing it to Salt Lake. And we are actually subleasing that other space, and I think we have basically subleased about half of that remaining half by not long-term leases and so on and so forth.

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

That's right.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Okay, moving on to slide 8, GMROI -- we know a lot of retail investors like to look at GMROI, gross margin return on investment. It actually reached 100 -- because we're able to operate with so much less capital now, even on a real basis, we reached 31% for Q1 on a real basis, meaning the physical basis of the goods we're buying, holding and then selling. When you do it on a GAAP basis, meaning all of our goods, it comes to 121% for the quarter.

Slide 9, customer satisfaction -- again if you go back a couple of years, you can see what happened. The dip is the -- Q3 is where we basically outgrew one set of clothes and hadn't really gotten into the other -- hadn't gotten the other set sewn. But it has come back. The NPS measure, which is out of that Fred Reichheld book, The Ultimate Question, he says that the average American company has a 5% to 10%, I think he says -- even people who contact customer service with us now have higher NPS scores than that. In fact, there is occasional days it's in the -- even the bottom line is in the 30s.

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

And one would assume that the people who contact customer service are the sample that actually had some type of a problem. So I am encouraged by that number.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Yes, I am very encouraged. And then at the high end is up in the 60s, puts us, according to him, according to that book, in the very top rank of the all-stars of corporate America. I mean, the all-stars for him is defined, I think, from 38 to 70 or something.

So our customer satisfaction has come back and is actually -- we see ways to make the next breakthrough. Stormy Simon is running that. There's another evolution that she is finishing up, and we actually see some of the benefits of that already.

Slide 10 -- this is what Jason and I are so excited about. This is our EBITDA, going back 2004. And 2004 was the last year that was sort of right on game plan. It was a year of great growth, small EBITDA losses during the first three quarters, and then making most of it back in the fourth quarter. And that was just the game plan, to grow like that and to be able to -- and let all that balance out -- three quarters of small losses and then a nice win in the fourth quarter.

Happened again in [Q5], but it was in Q5, of course, then starting in about Q3 that we started having problems. And even though we did come back in the fourth quarter, 2006 turned into a rout, increasing losses all through the year. Now what has happened, though, in 2007 is -- well, you can see, the EBITDA still is minus $8 million. But of that, $6 million is restructuring. It is $2 million of EBITDA loss.

I assume I don't have to tell folks -- and even that, I can tell you, has $1.5 million, $2 million of things that were more -- not mistakes, but things that -- we were tightening bolts down all through the fourth quarter and really didn't get everything tight until mid to late February. So I don't have to tell you -- in our view, our dream has always been to be able to be EBITDA breakeven in the first quarter, because if we can do that and then hold that for three quarters, you know what happens in the fourth. So we are substantially back to that point, basically the same -- setting aside the restructuring charge, which is a real charge.

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

I also like this so much in the first quarter and then '07 because we're not spending what we were spending on CapEx. I mean, even if you look back at '05, you would say, well, that was a pretty good year. If you think about how much cash we were running through, it wasn't such a great year because we were just spending so much money on our infrastructure. The reason EBITDA breakeven is so exciting now is our depreciation really is so much more than what we're spending on new CapEx projects. And so it is much closer to a cash number that it used to be.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Right. And in fact, I had a slide in there -- did the lawyers take that slide out on the CapEx and the depreciation?

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

No, is this in there.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

So this is why -- you may wonder why Jason and I say the business is back on the rails and sort of some superficial glance -- or I shouldn't be judgmental -- some people are going to say, this isn't any good. This is exactly what we dreamed of a year we could make happen. And we think we are back there. This is very encouraging to us. Again, if we can just hold some numbers like this through the first three quarters, then the fourth quarter should be a nice big surprise.

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

Another way of saying all that is this is an indicator that our cash burn number has decreased dramatically, and that is obviously very important to us.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Slide 11, we have been restructuring. You see our corporate headcount, so this is nonseasonal. Of course, during the fourth quarter we have more warehouse and more customer service. So this is the real corporate side of the business. And we probably -- well, you see that we reduced back to about where we were almost to Q2 of two years ago. These cuts are -- the risks are over, the real reduction -- the waves, reductions in forces are over.

This actually understates what happened, too, because if you went to 2005, as we made all these changes, we had armies of either consultants or technicians from 70 people or more, and generally very expensive people. As we've made the prop to jet conversion, as we moved from home-grown systems to the Oracle and Teradata systems, we had, besides the headcount that showed up here, we had a massive amount of expense for headcount that wasn't technically on our payroll.

And that has been cut, essentially, to nothing now. So if you really added the two together, we were probably up near 500 at some point, and now we're down to 349 as a real number. Jason, do you have any comment on that?

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

Yes. For example, in 2006 we spent, just in IT consultants alone, we spent almost $7 million in the year 2006. That number in 2007 will be almost zero. So instead of just corporate headcount, if you had corporate plus consultant headcount, this graph would look like a mountaintop. It has dropped dramatically.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Yes, in fact, like our IT payroll use to be X plus that $6 or $7 million, and now it is just -- including consultants, and now it is just X plus $1 million with no consultants. So it is a good trade. And plus, there are a lot -- I like working -- I like the employees better than the consultants, for the most part.

I think that we're both -- we'll show this slide, I guess, next quarter and then probably stop showing it because the reduction in headcount is -- there is no more massive cuts to be done.

Slide 12 -- as a result of the restructuring and all these other changes, improvements in gross margins and a decrease in marketing expense, the contribution dollars per corporate employee in each quarter, you see that it actually reached $1100 in Q4. Obviously you can't pay the -- can't do that forever. Well, it is back. It is higher than it has ever been. And any comments on this, Jason?

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

No.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

That is new for you. Slide 13, restructuring -- why don't you talk about the charges?

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

Well, we had $6 million in the quarter. Again, $4.7 of that relates to our Indiana warehouse, which I think we have walked through. Dave, why don't you walk through this? Well, I think you have already really hit these points. These are the charges we took for getting out of the warehouse. There are some additional charges that we are taking as we are trying to scale back on our corporate headquarters as well. And so those two things combined get you to your number. I think the big restructuring charges related to the warehouse are done, and so all that is left is really any restructuring charges we have in conjunction with what we do with our corporate headquarters.

The other -- not restructuring charges, but discontinued operations charges, which add up to the total of, what was it, $11 million, Dave, of nonoperating losses -- those relate to the travel business, which we officially have now sold. And you won't see that in the future, either, because we sold it.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

It was a shame to sell that little jewel, but we wish the buyer best of luck. Jason -- okay, I know it is in the 8-K. People can read. Slide 14 -- this is depreciation and amortization of our currently owned assets. And I am emphasizing -- so this is not a projection in the sense of I really don't expect it to go to zero after 2009. And where we are in 2005, it was nice and tight. It was under $2 million a quarter. We went out and bought these huge honking systems, and it has swollen to $9 million a quarter now of noncash depreciation -- well, depreciation.

It has come down a little bit, a little over $8 million now. And it pays out. We depreciate as quickly as we can. In fact, our fights are usually about we want to depreciation and write off as quickly as we can. So most of this stuff is three years or less.

And to Jason's point, it isn't -- I hate EBITDA as a measure normally, because you do have CapEx. But we so overbuilt our systems, and in the case of our warehouse, we overbuilt so much that we're getting rid of some, but in terms of technology, we have just massive systems that we could grow and grow and grow and not use up.

So we don't really have that much capital expense. Now, for us at this point, doing a $350,000 CapEx is a big deal. I mean, it is something we all know about. We are back in that very tightfisted mode, having built the big infrastructure.

So while in reality our depreciation and amortization won't do this, it won't go all the way to zero, it is going to do this plus whatever we depreciate on new things we buy. There is very little of that. Have you put out an estimate, Jason, on what we are doing in CapEx?

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

We have not. But I think it is clear that this big drop you saw in our depreciation in the first quarter is real. And we're not spending anything near at all like we used to spend, and you will see this number continue to drop. There will be big decreases in '07 and then again in '08 if we spend what we think we are going to spend, which is a lot less.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

It is basically single-digit millions per year. Is that fair?

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

Sure.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

That could change, of course, but how we have budgeted things now, and we're not even sure how we use that much.

Slide 15 -- okay, so slide 15 is just the highlight reel. It is the gross margins bounce back as we -- actually, these are all all-time highs. Our gross margins bounce to 16%. Our contribution margin is over 10% on a nectar basis, on Jason's basis, 8.9%. Inventory turns are over 30 on a GAAP basis. GMROI on a GAAP basis is 121% for the quarter. And these are sustainable or even possibly something we can improve on.

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

I think these are all the indicators of why we were so excited about the operations. And we really thought the business could be better than it has ever been, and I think it is. I view -- as we said there, we had two really -- well, we had thousands of things to do, but I kind of divide them into two really big jobs. Job one was we had to clean up, and job two is we have to redecorate.

These all, I think, show that the job of cleaning up is largely done. And some of these numbers can get better, and if we sell -- if our mix changes, some might get slightly worse. But I think in general, these numbers are all going to get better, and they are as good as they have ever been. So I'm quite encouraged.

Now the job comes of redecorating, and redecorating means things like doing things to enhance the website so the customer experience and what they're going to see, I think, is going to get noticeably better over the years. Things like our SKU count -- our SKU count will to increase dramatically between now and the Christmas season, I think probably several times over. And they are all -- I think we can do all that without increasing our inventory levels and hurting our turns much, because it is all going to be through our partner business. So I'm quite encouraged with where we came from and what we have accomplished. We just have to do the next job now, which is to redecorate.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Also, before we go to questions, I'm going to throw something else in. I would like to shout out to the vendors who have supported us. I know in years past, or the four years I've talked about it, Oracle and Teradata -- there are some others I want to mention who have really, in some cases, more of that redecorating than the cleanup, but they are doing very good work for us.

Visual Science is a website analytics company we have been with for years. They have been here in D.C. It is a great, very, very high-end solution. They do a lot of selling to the government, I think. I think it's some ex-government scientists. So I've got nothing but great things to say about Visual Science.

But we did go in parallel and then bring -- well, we brought live Omniture and have cut over to them as our main analytics source. Omniture is a company that is about 20 miles from us. And their technology, they've upgraded in the last four or five months. They have issued a new release that is very powerful and it is very user-friendly. But in addition, it has a system called Genesis, which I will get back to in a second.

We have brought live Mercado. I won't mention who we used to be on, but our search engine is now Mercado. It is fantastic. They have been the best -- the implementation of Mercado, which we cut over to in mid-March, has been one of the smoothest -- well, maybe the smoothest corporate implementation we have ever done. Great company to work with and a very powerful merchandising system that they have that was attractive.

We also have companies doing -- Aggregate Knowledge does our product recommendations on our product pages and sometimes in our emails and such. ChoiceStream is powering our gift center and moving on into other areas of our site. That does personalization as opposed to recommendation. And then Kefta -- Kefta is a San Francisco-based company that does a lot of -- I don't know if you would call it content management. It is maybe a higher order -- some people confuse it with recommendations or something, but it's really a different product.

But one of the things that's working so well to tie all these together is Omniture. Omniture has this Genesis system that becomes the platform that everybody can integrate to. So it has been a very good partner for us to have. So given how much time they have spent, we have kind of become the test bed for these different companies working with each other. I wanted to call out to them.

Operator, may we go to questions?

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). Aaron Kessler, Piper Jaffray.

Aaron Kessler - *Piper Jaffray - Analyst*

Good quarter. Good to see the improvement in the margin side. And a couple questions for you. First, it looks like you're starting to really get expenses under control. When should we look for you to start to look to reaccelerate revenues? And as you look to reaccelerate revenues, how do you maintain that kind of 7% or below marketing level, because I believe you have tried to reaccelerate revenues last year and it didn't work out as you had planned. So how should we think about it this time out? Have you got the analytics in place? And I have one follow-up.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

I would not look for it this quarter. As I have said, I think that we missed something big in what is going on in the Internet, and we missed a way to market. And I am kicking myself because we used to sort of pioneer the new ways, and then other people catch up. We missed a way. Some other people we see have figured it out. They are ahead of us -- not a whole lot of people. And we are really focused on getting that done. And most of the things will be done this quarter and next quarter. So I wouldn't expect any big reacceleration. And then we're only going to reaccelerate dramatically if those work.

Aaron Kessler - *Piper Jaffray - Analyst*

And then a couple of other questions. Where would you expect gross margins can go on the direct side maybe over the next few quarters? And also, what was the Omniture platform able to do that Visual Sciences cannot do?

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Jason, what do you want to say about core margins?

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

I am pleased with where they are at. Hopefully, they can continue to sneak up. But I don't anticipate any huge stairsteps from here.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Yes, I wouldn't anticipate stairsteps. I think that they flowed up.

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

I hope they flowed up as well. I hope that they do. I think that they can.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Comparing Visual Science with Omniture is a little bit like comparing old girlfriends or something. It's just not -- and I can actually only say nice things about them both, which is probably a good rule.

Aaron Kessler - *Piper Jaffray - Analyst*

Was Genesis of one of the big differences, though, in terms of the platform that integrated all the

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Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Genesis is one of the big differences. I can tell you quickly, Visual Science, the take on them always was that that their technology has surged ahead of Omniture, and I would have to say that a couple of years ago, that is why we switched to Visual Science.

They really did have very advanced technology. Omniture introduced something in the fall that they would say catches up and surpasses Visual Science; at the very least, it dramatically closes the gap.

Maybe it does. But one of the other differences is Visual Science is so advanced that you kind of need -- you need almost a master's degree in Visual Science to operate it. It is very advanced stuff. And Omniture, whether it is as caught up or not -- I know some would dispute -- but you can get people in a few hours on Omniture, so you can have 30, 40 people in the Company using Omniture and figuring things out. It is harder to do that with Visual Science, whether or not their technology is a bit better.

And then I can't comment professionally on -- they would say that they still have the lead. Omniture says that they have closed the gap and even passed it. But the Genesis platform, plus the fact that Omniture is so close to us and they really smothered us with attention -- but the Genesis platform I think is the beginnings of something pretty powerful.

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

Just one more point on the core margins, and give some color on to why I'm cautious -- you have two things going on. One is we are getting out of fixed warehouse space, and you will see some of that effect in this quarter and then some in the third quarter. So everything else being equal, you would see them float up. However, another dynamic that is going on is as we liquidated all of our slow-moving inventory and things that didn't meet our metrics last year, we really sold everything and got our inventory extremely fresh.

Now, one thing that we didn't sell was all of our spring garden and patio-type stuff. And the reason we didn't is we spent a lot of time looking at it and trying to determine if it was best to just get rid of all that stuff at Christmas, or would it be cheaper to lock or stock it and hold onto it until the spring and then sell it then. And after having done several tests, there's just not much you can sell as far as garden and lawn patio in this country in December. So what we ended up doing was holding it.

So we do still do have several million dollars' worth of stuff that we call our excess inventory from last year that we didn't liquidate that we are going to be liquidating now and even into the beginning of the third quarter. And although we reserved against that and do feel like we have an adequate reserve and that we will be forced to -- we will release that reserve some as we sell that stuff, I'm just not sure exactly the clearing price of all that. So you put those two factors together, and I think it should float up, but I wouldn't be surprised if it doesn't come up much for another quarter or two.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Did you mention what it was, Jason? If you did, I missed it.

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

Just garden and patio -- outdoor, spring-type inventory.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Yes, furniture. And we are giving great deals on that garden and patio -- we call it wicker, but it is really the wrought-iron -- is it wrought-iron, Jason?

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

Yes, wrought-iron with pads and stuff that are over the top of the wrought-iron -- lounge chairs shares and things like that.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

If you want to both help us out and get yourselves a great deal, come in. We've got millions of dollars of that stuff, and Jason --

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

We are selling it for less than we bought it for in China. So it really is a good deal.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Jason -- he dumped everything at Christmas. It's kind of funny -- years ago, when I ran merchandising, I would say, by the time you liquidate something, you are better off just cutting the price and dumping it through the website. And we always -- anyway, now that Jason is running merchandising, I think he came to the same conclusion. And at Christmas, that is what happened to our margins. We just realized instead of trucking the stuff off to a liquidator, we just cut the prices and moved it out and got the new customers. But the one set of things he didn't do was the millions of dollars of that furniture, wrought-iron furniture you can't sell at Christmas.

But we do have -- a big chunk of our inventory is still that. And when that disappears over the next two months, three months, that is a significant chunk of our inventory. And Jason has taken a very healthy reserve against all of that inventory. But anybody who wants a great deal on some patio furniture, we are the place to go. You're helping us and yourselves.

Operator

Doug Anmuth, Lehman Brothers.

Unidentified Participant

This is actually Brian on the line for Doug. Two quick questions -- first, what sorts of things are you doing to grow the partner business that makes you believe the SKU count can dramatically increase?

And secondly, are you seeing any meaningful acceleration in any categories on the site, I guess, beyond [BMBG] -- has there been any notable change in the mix?

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

I am going to open up the first one to you, Jason, on partner. We do have somebody that we have done nice business with, Vcommerce. They also -- they're a partner integrator in Phoenix. And they also handle targets. But Jason, do you want to -- I know it's public because we're also doing it. Would you expand?

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

Yes, we have an agreement with Channel Advisors who represent another large universe of partners who sell via the web. And we are in the process of integrating with them. We think that by -- actually a month from now, this time next month, we should be live. And we have many partners who are integrated with them, but not Vcommerce. So it will open up a new universe of partners.

And where we've started is we have spent a lot of time over the last couple of months identifying places on our shelves where we are just kind of empty and identifying places where people come, search, but we don't have a very good selection, if no selection at all.

The first big wave of partners that we will be signing on through Channel Advisors and where we're spending all of our focus is just that -- to fill out categories where we don't have any selection or have very poor selection. So we're really trying to stock the shelves, and you will see a dramatic improvement in our product selection, and accordingly, our SKU count.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

And I am sorry, Brian, what was the second part of your question?

Unidentified Participant

Are there any categories on the site beyond the media categories where you are seeing a pickup? Was it furniture? Was there electronics? Any color on that would be helpful.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

We are seeing things change. There's probably been more volatility among the departments than we have ever seen before as a reflection of these new ways we are measuring and realizing that some products weren't really very good to be doing in terms of return on capital. And then some areas, we are great. We could put more capital into them. But we are not -- I don't think we want to say which departments are doing better than others. Jason, would you--?

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

That is fair.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

There is more change going on than we have ever seen before.

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

But I do think you can say basically all of our departments are going to have a much bigger selection over the coming months.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Channel Advisors, for those who don't know, is a company that started off hooking up power sellers on eBay. They did $1.6 billion in gross merchandise value last year. I think they have about 1000 partners or maybe 1500 partners. So that means they are doing an average of $1 million to $1.6 million a year on eBay and also, they do Amazon -- they integrated with Amazon as well. Well, that set of people will be exposed to us. We actually had planned on -- I gave a talk at their conference a few weeks ago, and we hoped to be live in April. And it looks like we're just pushing off a few weeks into May.

Operator

Justin Post, Merrill Lynch.

Justin Post - *Merrill Lynch - Analyst*

Patrick, could you talk a little bit about traffic to the site? You did see total sales down a bit year over year. What are the core traffic metrics you are watching? And then secondly, obviously the partner revenues are driving -- or fulfillment partner revenues are up. Can you talk about the revenue per partner or any metrics on number of partners that you have added over the last six months or so?

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Traffic -- I know that everybody is looking at traffic. And the thing to probably look at is Hitwise. Hitwise, we have always found, when we study it, is the most accurate on traffic. Actually, and Nielsen is good, too. But we're not really -- we have gotten out of the game of being really uptight about how big our traffic numbers are. We look at things on a revenue per visitor basis. And what we have realized is and the reason we were able to cut marketing expenses -- what did we cut it as a percentage?

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

From 11% to 7% or something like that.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

So almost 40%, and sales came down 11%. It is because we're cutting the inefficient marketing. What happened is -- the vast majority of our marketing has always been online. And that game has really gotten bid up. And we just decided to stop chasing it. And as we went through and got very granular about what was succeeding and what wasn't, we just started hacking. And we kept -- we did shrink 11%, but with spending 40% or so less on -- no, it wasn't 40%. But it was -- anyway, we still overspent some in January, I will say, but it really took until the middle of February to really get the bolts tightened down there.

That is why we tell you if this is a game of getting -- the car ran off the road and it's bringing it back on the road and driving it again, certainly the two wheels -- the two tires of the supply chain side are back on the road. They are fine. The third tire of marketing expense and cutting bad marketing expense, that is back on the road. The fourth one of finding a cheap way of getting momentum back, it's not quite there yet.

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

And regarding your question of partner revenues, I actually think the amount of partner products on site over the last six months has probably gone down, although I haven't looked at the -- I think it has gone down. And the reason it has gone down is because all the metrics that we put in place for our core products this last summer about velocity, meaning if it's on the site, it's got to move and it's got to sell, and we really institutionalized a bunch of procedures about our pricing and making sure products are always moving. We basically did that for ourselves this summer, and then this fall we implemented a version of that for our partners, in other words, things that our partners put on our site have to move over a certain amount of time and they have to move at a certain rate or we take them down.

So we've actually gone through a pretty serious process of culling products and partners. So the SKUs they put on the site and the amount of people we deal with has come down as we have culled products and partners that aren't selling and aren't providing adequate customer service to our customers.

So again, the two-step process was one, you've got to clean house. I think we've done that. Now we have to redecorate. And that's why we're focusing so much on areas where we don't have a good product selection. And so it's really just now, over probably the middle of March, where we really started an effort to, okay, let's put a whole bunch of new stuff on the site in areas where we don't have selection. So to date, the increases have been getting the clutter out of the way and getting products that people want, and that has kind of spurred the increase. I think going forward, the increase will be a whole bunch of selection that we just didn't have before.

Justin Post - *Merrill Lynch - Analyst*

And a quick follow-up. So if revenues were down 11% and revenues per visitor were up, is it fair to say that visitors were maybe down more than 11%?

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Yes.

Operator

Scott Devitt, Stifel Nicolaus.

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

Scott, who won the bet?

Scott Devitt - *Stifel Nicolaus - Analyst*

I am going with Jason and I'm recommending Gorat's, on Patrick's bill. But that is my opinion. First question is on Google Checkout, which you haven't integrated yet, is that coming? I understood it was possible that it would be a 1Q integration.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

The answer is yes, it is coming, and it is coming this year, but it won't be 1Q. It will be probably 3Q.

Scott Devitt - *Stifel Nicolaus - Analyst*

And then secondly, you talked a lot about the first quarter, and the metrics did dramatically improve as you cleaned out the direct inventory in the fourth quarter. And you've also shied away from just longer-term guidance or projections about the business. But now that it's becoming fairly predictable, excluding possibly the capacity to grow revenue, can you just talk to the operating expense line items below gross margin, sales and marketing, tech and development, and G&A as a percentage of revenue to run the business? You have significantly reduced the CapEx spend, and do you think that is sustainable long term as well?

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

I will let Jason answer this question other than to say, on the technology, it is absolutely sustainable. We went from spending 1.5% of revenue on technology to spending about 8%. It is coming back down. And neither of those were the right number. The right number was about halfway between the two. So yes, CapEx is quite sustainable at a low level.

Jason, why don't you address --

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

Regarding guidance, this is kind of a slippery slope. And our officials stance has always been we don't offer guidance. So my comment, I guess, first is I don't want to go into the line items in the model and tell you what I think and don't think about the different line items. I can say, just like I said last quarter, Dave told me 10 minutes before the call that the consensus estimate was somewhere around $60 million. And I've said on the call I was quite comfortable with that.

I was comfortable with that. I am comfortable with it. I'm still comfortable with it. In fact, I'm more comfortable with it now that I was before. But I still think it's a good number. We just have focused so much on cleaning house as opposed to redecorating. Now that we start to shift to redecorating, I do think that we will start to see improvements in sales at some point in the future, but we just don't know what sales are going to do. Because of that, I just don't think that I would change the estimates at all.

Additionally, you have restructuring charges. We had some significant ones, and other than corporate we do think they are largely behind us. But we just don't know what is going to happen at corporate. So you kind of put all that in a bag, and given the changes that have happened, I'm still comfortable with $60 million. I think it's as good a guess as any, and I think that that's probably a pretty good guess. I think $60 million is probably about right for the year.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

I think you actually said last time, Jason, didn't you say, minus $20 million, minus $20 million, minus $20 million, zero?

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

Well, I think Scott asked a question about what does this business look like in the long term? What is it that you're shooting for? And what we are all shooting for around here are margins of somewhere around 20%. And you spend 5% on marketing, 5% on G&A, 5% on tech, and that leaves 5% for operating profit. We talk a lot about that. Every executive meeting, as we look at our financials and how they are going and what marching orders we are shooting for, that is exactly what we are shooting for. And I still believe that someday that is, plus or minus a percent or two on any of those lines, that is pretty close to -- that is what we're trying to achieve.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

But I think you also said in terms of earnings, four quarters, I remember you saying what you just said. And I thought, correct me if I am wrong, that you sort of said you thought $60 million would break out minus $20 million, minus $20 million, minus $20 million, zero. And the first quarter was minus 21. Do I not recall that accurately, that you said that, or--?

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

I am not sure I said that. But I think if you, with a really broad brush, because again, there is a lot of people that make up the average, I think something like that is kind of how they get to the $60 million.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

The big restructuring charges -- I think essentially all the restructuring charges are behind us, except for if we move corporate. And that will be another big restructuring charge.

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

If we do, it would be, yes.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

But we're -- I don't know -- 50/50 or something now, whether it is actually going to happen. We would like to. So that's also what makes it hard for us to get too specific this year on guidance. But Jason's long-term model of 20/5/5/5 and operating profit of 5 sounds -- is what we shoot for.

Unidentified Participant

And then just one final question. You are focusing a lot more on the commission or partner revenue in inventories, $16 million now. Do you think the inventory levels will grow from here throughout the year? What are your thoughts on that maybe in terms of a percentage of direct costs over time, the inventory line?

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

I think they will probably go up some. But again, you do have two things going on there. One, we have some inventory that is kind of left over that was spring inventory that we're trying to liquidate now, and you are going to replace that with better inventory. So those two dynamics are going against each other, although the $16 million number is a net number against the reserve against that inventory.

So I do think it will come up. We are a retailer, so we are going to build inventories in the third quarter and then sell it in the fourth. I think in general, to sustain this level -- if our sales for our core stuff didn't go up, this is a very good level of inventory, and I think it would stay quite stable.

Our hope, obviously, is that in the future, our sales go up, both core and partner, at some point. And when they do, I think the inventory levels to support it will go up. I don't think there's much more operational efficiency as far as days on hand or inventory turns from where we're at. In fact, the inventory turns slide in the graph is not overstated -- it's a fact, it's just math, but it has the tailwind of a huge liquidation. So naturally, that number should come down.

But 10 to 12 inventory turns in a year on a real basis, on a GAAP basis, because of our partner business, it is going to show 25 or 30 -- I think is good, and I don't think it needs to get a lot better than that. I think our inventory levels, around where we are at with these type of sales levels, is probably about right. But I do think sales will go up and we'll build inventory for the fourth quarter, so they will go up for that reason as well.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

I guess we have time for one more question, if one there be. Is there one?

Operator

Sir, due to time constraints, that will conclude the question-and-answer session. I would like to turn the call over to Jason and Patrick for closing comments.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

Jason, go ahead.

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

I am pleased with the quarter. I think we made a big improvement. I am pleased with the margins, the inventory efficiency, our contribution margins. I think it was a very big step in the right direction. And I hope that we can maintain it and keep making more steps in this direction. I am pleased with what we did this quarter.

Dr. Patrick Byrne - *Overstock.com, Inc. - Chairman and CEO*

I will echo that. We saw about a year ago that we had to run a gauntlet, but on the far side, we saw daylight. And looking through the graphs on slide 15, these are all operational improvements, and I am thrilled with them. I think that if we had -- this is what we aimed for a year ago, but I'm not sure that either Jason or I believed we could actually get to this point. But we're excited about these operating improvements. Look forward to talking to you next quarter.

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

Thank you.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the presentation, and you may now disconnect. Have a wonderful day.
