

# FINAL TRANSCRIPT

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## **OSTK - Q2 2007 Overstock Com Inc Earnings Conference Call**

**Event Date/Time: Jul. 31. 2007 / 11:00AM ET**

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## CORPORATE PARTICIPANTS

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*Overstock.com, Inc. - SVP Finance*

**Dr. Patrick Byrne**

*Overstock.com, Inc. - Chairman, CEO*

**Jason Lindsey**

*Overstock.com, Inc. - President, COO*

## CONFERENCE CALL PARTICIPANTS

**Shawn Milne**

*Oppenheimer - Analyst*

**Rob Wilson**

*Tiburon - Analyst*

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*Stifel Nicolaus - Analyst*

## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to your Q2 2007 Overstock.com earnings conference call. My name is Rob and I will be your operator today. (OPERATOR INSTRUCTIONS). At this time I would like to turn the conference over to your host, Mr. David Chidester.

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

Good morning and welcome to Overstock.com's second quarter 2007 earnings conference call. Joining me on the call today 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, July 31, 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 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.

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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 and 8-K.

This conference call and webcast may contain certain non-GAAP financial measures. The Company's website located at investors.overstock.com includes a presentation of the most directly comparable financial measures calculated and presented in accordance with GAAP. It also includes a reconciliation of the differences between the non-GAAP financial measures with the most comparable financial measures presented in accordance with GAAP.

I will now review the financial results for the quarter ended June 30, 2007. Please note that all comparisons will be against our results from the second quarter of 2006 unless otherwise stated.

Total revenue for the quarter was down 6% to \$149 million. This was an improvement in growth from the first quarter when sales were down 11%. Gross profits on the other hand increased 18% to \$26 million. Gross margin expanded to an all-time high of 17.7%, up 370 basis points over last year. The gains in gross margin are due to significant improvement in our direct margins, which are up 610 basis points year-over-year to 16.7%, and an additional 150 basis point improvement in our fulfillment partner margins to 18.1%, both all-time highs. This is also a 170 basis point sequential improvement.

Our total operating loss is \$13.5 million, including \$6.2 million of restructuring charges. Excluding restructuring charges, our operating loss was \$7.3 million, down from the loss of \$15.6 million last year. Sales and marketing costs declined by 33% to \$8 million, or 5.3% of revenues, while G&A and technology costs combined were flat year-over-year.

Our \$6.2 million of restructuring charges primarily related to the cost of consolidating the footprint of our corporate headquarters, including the accelerated depreciation of facilities-related assets. And in addition, we reached an agreement in principle finalizing the closure of the last of our warehouse space in Indiana.

Our net loss was \$13.8 million for the quarter, or \$0.58 per share, compared to a net loss of \$15.8 million, or \$0.78 per share last year. We ended the quarter with just over \$93 million of cash and \$17.5 million of inventory and prepaid inventory. Cash flow from operations was positive \$15 million for the quarter and positive \$9 million over the trailing 12 months, a significant improvement over the cash outflows of \$6 million and \$40 million for the same respective periods last year.

And on that, I will now turn the call over to Patrick.

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

I never thought I would say I feel good about a quarter with a GAAP loss of \$13.8 million. But Jason, David and I feel great about this quarter. It is not just because of the \$13.8 million. Over \$15 million is depreciation, amortization and reserving for restructuring. That is really the last of the big stuff. It is because, as you're going to see in the slides, we feel we have really tightened things down much more quickly than at least other folks thought was possible. If you wonder who did it, I want to point out 130% of it -- of the credit goes to Jason and our other colleagues throughout the Company, and I'm responsible for the rest.

Before I turn to the slides and Q&A, I also want to thank you, our shareholders. If you are on the phone now as a shareholder, it means that you guys kept the faith through, Lord knows, a lot of pain on our side and mistakes of mine, and no doubt a tremendous amount of social discouragement. I hope as you see these slides you are glad that you did.

Let's turn to the slides, and you control your own slides. I will just call them as I go through them. Slide number 2. This is the Safe Harbor statement. Don't have to read again. Bottom line upfront gross margins are at record highs. Marketing is much more efficient. It is now about twice as efficient as it was before. G&A and technology expense structure is rationalized. And we are operating on one-fifth of the inventory that we used to operate on.

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Go to slide 4 please. I told you a year ago I think that we're going to quote -- I think that we're going to see starting within a couple of quarters a dramatic increase in inventory turns and gross margin.

Slide 5. Well, there's the gross margin improvement. And there's a little bit of running room there to come. Jason, do you -- and let's go to slide 6. There is the inventory graphed against the gross margin. The inventory scale is on the right. And we have dropped from at one point over \$100 million down to \$17.5 million in capital. We are running about four times as efficiently on inventory as we were at this point last year.

Jason, I will pause there. Do you want to pile on?

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

Yes. Just two points of caution, I guess. One is we're coming into the time of year where we start to get ready for Christmas, so I do think our inventory balances will begin to come up. And our margins, I do think there's still some underlying progress left to show itself in its margins. However, against that we have -- we are adding many more SKUs to our site. And we are adding SKUs to our site and we're trying to focus on areas where we don't have product or have limited selection of product. A lot of those areas are just naturally thinner margin categories. How those two play off of each other, I'm not quite sure.

I do think there's an underlying improvement in our margins yet to come, but I do think our mix will change over time. However, if our mix changes in over time and we have incremental sales that produce sales we otherwise wouldn't get, albeit at a lower margin, it should add incremental gross profit dollars. Clearly the goal here you pay the light bill will dollars, not percentage points. And we are trying to drive as many gross profit dollars as we can. And so future margins -- I don't know how those two are going to offset each other as we go forward.

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

Although you should mention I think that those products of which you speak, Jason, are going to tend to be partner products. And so what you said about not paying with gross percentage points but with dollars is especially -- it is important to know that we're not talking about building up our -- these new product lines aren't going to make us expand our inventory capital beyond the normal fourth quarter expansion.

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

Right. We will expand our inventory for the fourth quarter, but the thinner margin items, we're trying not to warehouse. They will come through the partner program.

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

Okay. We said we were going to do it within a couple of quarters, and we made a reasonably abrupt improvement. Let's go to slide 7. Annualized inventory turns. I think we said last summer, okay, I think we're going to see starting within a couple -- the same quote --. This is our return on just our direct business, our inventory turn. It is running at 12.4. And if you go to slide 8, you actually see on a GAAP basis of -- we're running at 35.7 turns. And on a real physical basis in and out of our warehouse those goods, the 12.4, of course, the direct -- I mean, the partner program inflates this number and gives you a GAAP number that is arguably artificially high.

Slide 9. Our marketing costs are moving down from the 10 to 11 range to something in the 8 range. I said that back in -- six months ago. But I think they would be able to come down substantially from there. They are down to 5.3 now. And I don't think --.

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

Slide 10?

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

I'm sorry slide 10. Thanks. Down to 5.3 now. Jason, what do you want to say about marketing?

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

I'm really encouraged with this. It is a big driver in our contribution margin, which you will see next. I'm pleased with this. I think it would be great if they could stay this low. I'm not sure that it can. It might. Again you have a couple of factors going against each other. One, we're getting smarter and smarter at marketing. And you can see that effect here. Going against that is we're producing a bunch of new commercials and plan to be out there reinforcing our brand and investing in advertising dollars to try and drive growth going into the second half of the year. And so it wouldn't surprise me to see marketing come up some in the next couple of quarters.

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

Not dramatically though. I would be surprised to see it come up more than a point, if it comes up at all. We think for the moment we think this is the right neighborhood to be, that 5 to 6% range. I don't think you see it drop substantially or go up substantially. Jason, do you -- you may --.

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

Yes, I think it is probably going to come up a little in the next couple of quarters, but I hope not. We will see.

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

Next slide, slide 11. I pointed out my steak bet with Jason was I think contribution margin will be over 10% in the first quarter. It is over 10% in the first quarter. It can do better than that for the year. Go to slide 12.

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

No, that was in July of '06. That was a year ago.

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

Yes. So if you go to slide 12 you see what happened. We did have this great flushing out of things through the rest of last year. But it has -- it didn't quite make it to 10% in the first quarter. You would think Jason would have given me the --. Well, anyway never mind we are at 12.3 now.

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

I'm really encouraged with this. Obviously, the combination of much more efficient marketing and much higher margins than we have ever had, this is where the real driver in the business is. This is the big, big improvement, much higher than we have

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ever been. And when we were sitting there at 6.5% a year ago to think we would be over 10 this time of year was -- felt like a stretch at the time. I'm really pleased with how this has improved.

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

I think it was Mr. Devitt from Stifel, I'm not sure, who was just saying he thought he had misheard us. Somebody out there didn't even think this was in the realm of possibility, as I recall.

Slide 13. Contribution dollars. I'm going to jump up and down on this for a bit. You'll notice two things. First of all, huge growth versus the previous year. But look at the years '04 and '05 before things went bad, and basically the deal was we had flat contribution dollars quarters 1, 2 and 3, and then a spike in the fourth quarter. And we had that in '04. We had been in '05. Last year things came off the rails. But if you go to slide 14, you will see we -- not only are we growing 76% versus the same quarter last year, but 31% sequentially.

I think I said on the conference call at the beginning of the year, look for growth to come back. But growth was not going to come back starting at the top. Growth was going to start -- I think I even talked about maybe getting into the hyper growth range in contribution dollars. It would start there and then it drift up the income statement. I don't think we're going to end up back in hyper growth mode on the top line. At least I hope not. But I think that we would -- I knew that we would get back there first at the contribution dollars level, then at the gross profit dollar level, and then lastly the very top line would be the last to begin its growth again.

Jason, anything you want to say about contribution dollars?

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

No.

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

This is what -- we organized so much around this folks, and we look every morning. We know exactly -- we call it nectar internally. We know exactly what we have to pay, what we have to generate the day before to cover our nut. And it is the first thing we look at at 6.30 in the morning when the report comes out. We are really focused on this.

Slide 15. GIMROI, gross margin return on investment. For retailers out there this is a good measure. A lot of people in the retail trade look at this. Ours is 39% for the quarter. And if you -- and that is on a direct only basis. If you go to slide 16, you see it is 143%. It is basically gross margin times the turns. I think normally for a company to be in the 150, 200 range is pretty good for a year. We're at 39% just for a quarter on just the direct business. And when you give us the benefit of our drop shipping partners we're actually at 143%. We will probably due over 500% for the year.

I suppose I shouldn't make very specific predictions like that, but it sounds about right. Anything Jason? This is a tremendous -- a tremendous round of applause for Jason and his team for having accomplished this. Anything you want to add?

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

No, I love the improvement in this and contribution dollars. I think it shows the business is getting more healthy fast.

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

I can't wait to see people's new projections. Slide 17. Net promoter score. And I'm not sure if you can -- this is out of this book field, *The Ultimate Question*, by Fred Reichheld, which we have found to be very valuable. And a couple of years ago we started really organizing a lot of things around the net promoters score. I won't walk through the calculation again, but it is basically an all-in score of customer satisfaction.

The author of that book identifies what he calls NPS superstars on one part of his book. And there's names like Harley Davidson and FedEx and Apple and Costco that define the band of NPS superstars. We are now there at 70. We have a fanatic -- whenever we do customer satisfaction research we just have this fanatic following now. And people love us. Even the NPS score of people who had a problem and contacted customer service is at 15% now, whereas it was actually 28% yesterday. I happened to just notice. It is a -- and we get this information real-time practically, the next day. It is in an automated system. The average American corporation according to that book is 8% overall for everything. We are 70% for everything.

Anyway, if you talk to people about us, of course everybody knows by now the National Retail Federation and American Express last October did a study -- a survey of 8,000 households. And we were the fourth most -- and they asked who gives you great customer satisfaction? And we were the fourth most mentioned company in that poll, after I think Nordstrom's and Apple. And I forget who the third was.

So we really do have this fanatic following. They saw us through our problems two years ago. They have stuck with us, and they are just getting more and more loyal.

Next slide 18, restructuring. Jason, why don't you talk about this?

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

This quarter the biggest charge relates to the consolidation of our corporate warehouse -- or our corporate office space. We were in six floors here, and we have moved from six down to three. We also have reached a final agreement with OHL, who is our third-party warehouse that we used in Indiana, and we have closed that warehouse. And that has been bundled and netted into this number.

Just restructuring in general, I think when we first decided our income statement our cost structure didn't really fit for the business and the size of the business that we had, and we need to fix some things. There were really four or five big items that we needed to fix.

One was our corporate building, which you see here. And we have shrunk in half square footage-wise basically. The second one were data center issues. I guess second and third. There was a data center that we had signed a new lease -- just the building next door -- that we hadn't even moved into, but was going to be really expensive part of our cost structure for the next 10 years. We decided not to move into that and had to break the lease and that was quite costly. You saw that at the end of last year. We also moved out of the data center in this building into a data center that cost us much less.

What else? The other thing that didn't really go into restructuring but were big costs, or at least focused things that we eliminated was travel, which actually went into discontinued operations. But also some other smaller pieces, like our operation in Mexico and our build your own jewelry. When we look at the big costs out there, I think most of the ones that we identified going into it we feel like we have [slayed]. My hope is that restructuring will largely go away in the future.

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

Yes. I don't see any other major restructuring charges to come.

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

Yes. There might be one or two other things coming, but I don't think there's any really big thing.

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

Nothing in this order of magnitude that I can think of. Okay, slide 19. EBITDA. Now I'm going to preempt the knuckleheads who go out there and find quotes from the -- oh, Byrne has said in the past he doesn't like EBITDA. Well, yes, I have said that over and over. I have also said there's only two times EBITDA matters. And it is -- one is one when cash is real tight, which -- we were low on cash, but we have come back very nicely. And that doesn't seem to be an issue.

The other it is if a company is in the odd position of having made massive capital investments that it is now seeing the depreciation expenses run through its income statement, and it doesn't have to replace that capital equipment, then EBITDA is actually an interesting thing to know.

Well, that second point really does define us. We are -- have I think about \$40 million of noncash -- or \$38 million of noncash a year. \$35 million or so is depreciation. And so far this year we have spent, I think, about \$2 million on CapEx. I bet we get through the whole year with less than \$5 million. And that seems normal for now. For the foreseeable future we way overbuilt our infrastructure, so throwing back in that depreciation seems pretty good.

As you can see the line -- we used to be EBITDA positive in the fourth quarter. And our goal was basically to make enough back in the fourth quarter to basically breakeven for the first three quarters in the preceding years. Everything came off the rails two years ago. We have recovered, and we are actually back EBITDA positive in the third quarter. And I don't think we have done that.

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

In the second quarter.

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

In the second quarter. I don't think -- oh, I'm on slide 19. I don't think I -- we may not have been EBITDA positive for -- in a non-fourth quarter. I should have checked our history. We may have been back in the third quarter of '02 or something. But anyway now that is all EBITDA excluding these restructuring costs, which is the shaded area on the screen. Like Jason just said, that shaded area is -- that should be collapsing to a line against starting this quarter.

Jason, comments on this?

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

I think it is great. I think it is nice to be generating again, I guess excluding restructuring, to be generating cash again. A big improvement.

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

Okay. Slide 20. I will just hit these numbers. I will go to slide -- to line 8, EBITDA excluding restructuring. This is what fundamentally underneath it all the business has done. In the second quarter last year we lost \$7.5 million, and in the second quarter this year

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we gained \$2 million. So it was a \$9.5 million improvement for the quarter in the underlying economics of the business. I will call that the underlying economics of the business.

You'll notice over on the right, we're just about breakeven for the year to date in this score actually. Again looking at this quarter then there is the \$6.2 million of restructuring, and etc., etc. But as I look at the underlying economics of the business, I'm looking at line 8 and saying, well, we have gone from losing \$7.5 million to making \$2 million in the second quarter. And that fundamental sounds -- Jason?

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

Nothing.

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

Nothing, oh come on, don't pull a Charlie Munger on me.

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

The same thing I have said over and over, a great improvement. I think it is great.

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

Cool. Okay. And \$12.3 million year-to-date on that restructuring. Okay, next slide 21, depreciation. Why don't you hit this first, Jason.

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

I think you touched on it earlier. It is noteworthy every company in the world, if you took their historical depreciation and said what is their depreciation expense going to be in the future, it will always go down like this. Because if you assume that you're not going to add anything to the indoor and everything will naturally flow out the outdoor, this is what every company in the world's graph would look like.

Now, we of course are going to put things in the indoor. We do plan on having some capital expenditures. But like you said, what was added to the pot historically and what is now coming out in the year 2007, for example, is about \$35 million of depreciation expense in addition to fixed assets, which will create depreciation expense in the future, is about \$5. So we are seeing a big trend downward.

And you already starting to see that. Even if you look at the light blue to the dark blue and you can see how much it dropped just this quarter, or what it is projected to drop from the second to the third quarter, that is a big drop. It is going to continue to drop going forward. As long as we spend something like we're spending now, which is \$2 million year-to-date, and what is coming through the expense is \$35 million in this year, this number is going to go down dramatically.

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

The spread between EBITDA and GAAP net income is going to narrow dramatically. When we talk -- sit around now and talk about things to buy, I mean if something is \$100,000 -- or there is one thing we're thinking of that is \$200,000 to \$300,000, these

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are big for us now. We do have the big planned capital outlays. We really built our technology infrastructure to be pretty [bomber].

Let's go to slide 22. Some nice graphs. Gross margin at an all-time high. Contribution margin, inventory turns, GIMROI. Slide 23, questions. I'm going to -- Jason, I have a set of questions that have been e-mailed in from a few people. Do you mine -- shall we just -- do you have those questions in front of you too?

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

Go ahead.

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

Well, Glen from Alson Capital. I hope I don't -- I hope you weren't hoping to be anonymous. But I will identify the questioners. Options -- his first question -- options for large cash balance, maybe a share repurchase. Core operations have smaller reinvestment needs given the strength of the partner business, any thoughts on that?

I'm with you, Glen. Although I'm not sure I would get much support from my colleagues. But we have got \$93 million in cash and --.

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

I'm not with Glen. I think it is a good idea, but it feels good to have a little bit of a backstop. And I'm not ready to start buying our own stock right now but --.

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

Well, okay. I may be alone with Glen on that one. But I see your point. If we're generating nice cash at this level, I think we ought to just --. Anyway, excellent progress on the turnaround. Thank you very much.

[Adrian Rife], a committed shareholder. I have noticed a decrease, if not absence, of the infamous Overstock commercials via radio and TV. Has Overstock lost brand recognition and awareness during this period?

Actually not. We have been -- well, we're still at 61% the last time I saw it, 61% aided awareness. I forget where unaided is. And that is down a little bit from 65 or something like that. But, no, we're in the press so much that it seems to have maintained our visibility.

Do you plan on ramping up marketing efforts as you see stronger financial results? Jason?

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

I think so, some. Yes, we talked about that. We are producing some new commercials that will have a new look and feel. And we will be spending more money than we have recently. And you will start seeing them again more. We also are trying to market smarter. And we're finding ways to get traffic without having to spend money. Again, how those two things offset each other, I'm not quite sure. But I do think you'll see us spend more -- a little more money than we have in the past on TV and radio.

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

But production, we're doing -- we're making a new set of infamous Overstock commercials, or soon to be infamous Overstock commercials. In fact, Storm is leaving next week to shoot them. They are quite a bit different, and I think that they are going to be even more infamous. We're actually -- she is going to a town where they are going down to shut down the freeway to film one of the commercials, believe it or not. But anyway, I think that they're going to be even more interesting and spoken of than the commercials you have seen in the past. We're going in a new direction.

Okay, Andrew Spinola, Equity Research, Needham & Company. Please provide an update on auction, auto, travel and their financial and strategic contribution to the business. We like how they -- to understand how they fit in the model.

I will leave that -- that is more your bailiwick, Jason. Why don't you take that?

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

Auctions and auto and travel?

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

Yes.

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

I think I'm going to let you answer that one.

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

Okay. First of all, travel does not fit anymore. We have sold it. Jason sold it. I mean handled the sale. Auctions and auto, they're both at the point where they are very close to breakeven, much closer than they have ever been. Well, auctions, which was always a money loser is basically running at breakeven. Auto is -- we are seeing a -- we probably should put the graph up next time of how much business we're getting through it, how many leads.

And I think it fits the model because it is an over stock supply chain. We just have to get the search engine on the front of the supply chain configured correctly. But there is really quite an explosion in leads going on -- in leads we're generating for auto dealers. And it is generating revenue. It is still losing in the single digit thousands of dollars per week now. But I guess it is generating \$30,000 a week in revenue -- or \$30,000 a month in revenue, and costing us a little bit less than \$60,000 to operate. The business is five or six months old. Give us some time to work with that.

I think that -- we have done some research recently to see I think what we have to do in auctions. It too, it is something that lost us millions of dollars in the past. But it has been -- it has got profitable weeks. It has got some weeks that are a couple of thousand dollars unprofitable. But one thing it does, is it gets us -- it has gotten us hundreds of thousands of new customers. I think at this point maybe it has got to be close -- it is probably over 1 million people have come to us first through auctions, and then come in and become Overstock shoppers. I like these two.

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

I think also of note, what has changed over the past couple of years in these businesses is the amount of time and the amount of interaction with the rest of the business. In other words, in the past that you could take a lot of executive time and competed

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a lot for development time and a lot of resources, which were scarce -- they took up a lot of resources, which were scarce away from the normal business. That is all kind of ended. And there is some investment going on here, because we think there is some upside, but the interaction between the normal business and the trade-offs that we have to make, we don't have to make anymore. They kind of have their own team, their own development. It is more of a skunk works operation than it ever really has been. And I don't think it is the distraction that used to be on the business.

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

Andrew has another question. Please provide an estimate of legal costs incurred during the quarter in order to estimate normal OpEx. Well, if what you are referring to -- I don't know -- our legal bills are a couple hundred thousand dollars a quarter in general, maybe a few hundred thousand. Jason, do I have that number right?

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

I think it is a little more than that but --.

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

A couple of hundred thousand a month.

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

Okay. If what you're asking about -- I would usually -- I don't know if I have ever talked about the mitzvah on this call. The mitzvah being my efforts against some quirks on Wall Street. But if what -- and normally I don't really bother answering any questions. If you are involved in this story at all, you know how much of a media circus it is. And how much -- I assume you know, how much mud just gets thrown. If I sit there answering all the asinine incorrect spurious allegations then it is just a vicious circle. And I don't want to get into that too much.

But one of the things that people throw out that is legitimate is how much does this stuff cost. Well it costs very little. It is all on contingency. The two suits we have filed are on contingency. Yes, there is costs when I file out fly out to San Francisco or Jonathan flies out to San Francisco, things like that. But there is not cost associated with the lawyers themselves. So it is really diminimus.

As far as all the other things, I just always assume that people know better when I don't even comment on the stupid things that get said in the press. But I guess since somebody has asked about the lawsuit, I'm going to hit a couple of these. It is Kafkaesque. For example, if you look back last May I put out a press release saying we celebrate we received an Overstock subpoena -- an SEC subpoena an Overstock. I got trashed though. How could you say that, etc., etc.? And then the party line a month ago became -- or two months ago -- oh, Byrne hated the SEC investigation. Well, I guess they think that just by lying and lying and repeating the lie loudly and often enough, they can make -- and they just hope nobody checks that not only did we disclose that, I put out a press release about it. It is allegation after allegation like that.

There is -- because this fellow from Whole Foods was commenting anonymously on message boards. The New York Times interviewed me. I pointed out all the -- well, I commented on Overstock and Fool and Investor Village. And I have dozens of times identified myself and made clear who I was. But they managed to sort of carve their language very carefully to omit that in their stories.

So I think the fix is in. The quick run on it, just to set the story straight is this. I think there is a massive crack in our financial system. I think that we're facing a 1929 kind of event. For two years I have been trying to do something about that. That is how

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I got involved in this. Yes, I am mad also on behalf of Overstock shareholders. We filed these suits. Of course, the skill reporters want to say, oh, this is just a CEO who is mad his stock went down. Even though I did it when the stock was going up.

And, yes, we filed suits. And I think that somebody owes Overstock shareholders billions of dollars. I am mad about that. But that is in the context of a much bigger picture that I think our country has got a real problem bubbling to the surface. And to me a great deal of the stuff that shows up in the press is just misdirection. They want to clog that message from getting through, so they just try to portray it, oh, this guy is mad about his own stock price.

So when you read these things just remember, to me, yes, I think Overstock shareholders -- somebody has been out there trading tens of millions of shares that they had no expectation of delivering on day three. They were essentially counterfeiting our stock. They owe us money. But beyond that we got -- I think we have a massive social problem in our Capital Markets that the regulators should be addressing.

I will get off my soap box now. That is the last of the pre -- of the emailed questions that had been sent in. Let's go to questions, operator.

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## QUESTIONS AND ANSWERS

### Operator

(OPERATOR INSTRUCTIONS).

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

I see a couple of people with questions.

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### Operator

Aaron Kessler, Piper Jaffray.

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### Unidentified Participant

This is Judy in for Aaron Kessler. A couple of questions. Where are you now in terms of your product mix? And how much more expense cuts can you still make, and what are the timing of these? What were the factors that drove gross margins up on the sequential basis? And what are your target for gross margins for the fulfillment and direct? Thank you.

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

Jason, what you take your first crack at that.

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

There was a lot of buried questions in there. You asked a question about product mix, and I'm not sure if you mean mix between partner and core, or whether you mean mix between electronics or sheets or books? I will try and answer --.

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

Since you won't answer it, if it is the second question, since we don't give that, let's just assume it was the first question.

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

Great. Well, our partner business has continued to grow while our direct business has decreased. We are trying to make both of them grow. So part of that shift is a shift -- part of the increase in our gross margins is a shift between our core -- excuse me, our direct and our partner fulfillment business. However, those businesses, the margins discrepancy between them has narrowed dramatically. In other words, if you look at our direct business in this same period a year ago, it was 10.6% GAAP gross margins. In this quarter it was 16.7. And our partner business was 16.6 a year ago and 18.1.

So if you take the 16.7 and the 18.1, they have both come up, and they both have come up nicely. But the one that has come up the most is our direct business. I think that explains most of the increase in our margins from a year ago and sequentially. They have both come up dramatically.

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

I have nothing to add to that. Thank you, Judy. As long as you're on, any other questions?

**Operator**

Shawn Milne, Oppenheimer.

**Shawn Milne** - *Oppenheimer - Analyst*

Good progress here. Patrick, just one philosophical question on your partner versus your direct business. The partner business has continued to grow, and from a variable gross margin percentage basis has certainly always been in a more narrow band. Why wouldn't you really focus on that and try to take some of the variability out of the business? That is a philosophical question.

Then secondly, Jason, just on the technology line, obviously where you talked about depreciation, some of that bleeding off, and I think some of that comes through that line. What do you think a runrate in that line could look like as you end '07 and head into '08? Thank you.

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

The first question about why don't you focus more on your partner business and less on your direct business, I think the answer is we have. If you look at the growth rate quarter over quarter from the three months ended June 30, 2006 and 2007, the growth rate for the direct business is -37% for direct, and for the fulfillment business it is up 17%.

**Shawn Milne** - *Oppenheimer - Analyst*

I see that. I am just wondering, and kind of hearing you talk about getting more inventory on the direct side. Maybe I'm hearing you wrong. So to me it seems like certainly taking it in terms of variability in the business -- gross margin variability we have seen over the years, you're buying group has made mistakes sort of once every year or once every other year. It seems -- maybe I just misheard you.

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

Well, I guess what I was trying to say is we don't want to abandon altogether our direct business. And since the margins are so much higher than they have ever been, regardless of mistakes are not, our inventory is so much cleaner. To support this level of sales and have \$17 million of inventory when at the same time a year ago I think we had close to \$80 million, the amount of mistakes that can be buried in that are much smaller. And the procedures that are in place now to make sure things are moving all the time and nothing sits, we are so much more comfortable in investing in that direct business than we used to be. We don't feel like we are taking the risk we used to be.

But your point is correct. There has been a natural shift to the partner business. We have much less risk in our business model inherently because of that shift. And I don't think any of us are saying we have to hurry and dive back into the core, although it does break my heart a little bit to see growth almost 40% negative in the direct when the partner is up 17%. I don't think our direct business needs to shrink that much. I don't think we're talking about shifting away from the partner business. I just think we are talking about not having direct shrink so much.

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

But I think that we are -- if you know mind me -- first, Sean, great to hear from you. You have always been an astute follower of our Company for good and bad. But you may have misheard. When we were talking about expanding products and adding new products that were low margin, we weren't talking about -- specifically the low margin products, by which we mean electronics, we are definitely not adding those core. That is all partner business that is coming on.

We try to be agnostic and just have certain -- we say from investing our own capital we want to make 4 to 5 percentage points more. It is true now. But we are not out there are saying -- there's nobody here saying, hey, let's purposely built core backup just to build core backup.

On the other hand, if this year was the year of the partner in the sense of we were able to use our information and dial in our partners. And we are doing a lot of good stuff at our partner management. I would say there's a chance that 2008 is going to be the year that core comes rushing back, because we have such information now that we might be able to go to partners and suppliers and we know what to buy.

Now all that stuff, all that capital equipment we bought -- there is enterprise, information systems and Teradata and stuff, the implementation of which gave us a bit of a bellyache. It is unbelievable now that the data and the analytics groups that are using our Teradata and our Oracle systems and Business Objects and all that to produce the kind of planning and demand analysis that Jason has people doing.

It is a different realm for our buyers. They tell me this all the time. Instead of going out to shows and just sort of going by gut, they have unbelievably detailed instructions basically. We know exactly -- we're doing much more refined measurement and analysis of what people are searching for, what they're navigating to, and where the demand is. We are analyzing the demand. And we're going out to fill the demand as opposed to buying stuff that we think is at a good price and hoping to feed it out to our customers. We're looking -- it has turned into a -- from a product push business to a demand pull business.

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

We did miscommunicate there because the partner business has been gaining steam. And we're still really doing a lot for the partner business to grow. If you remember last call we talked a lot about Project Snowball, which was to identify places where we had limited or no selection and fill it with product. That was all to be filled via the partner program. Our SKUs are up dramatically. And we have a lot of internal weekly goals of how do we get our partner's SKUs up even more.

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So our partner business, we are stepping on the gas. And we can't be pushing harder on the partner business. But I guess the message we also wanted to get across was we don't want to abandon our direct business, because it really has improved dramatically. We are more comfortable than we have ever been about being in that business and making sure products are always moving and not getting burned.

And our margins are up dramatically. I think that now that we have closed our warehouse in Indiana and now that -- you'll see the rest of that drop off on August 15. And then when the volume comes through in the fourth quarter and you see the amortization of so much more volume over the set of fixed costs, I think there's a real chance you can see our direct margins come up significantly, even from where there at. Well, they always do in the fourth quarter because of that fixed cost game. That is where -- I think those are our thoughts between the direct and partner business.

As far as the technology question you asked, it is a tough one. We're sure trying to spend less on technology. We do have a lot of depreciation falling out of that line. What it ends up being on a percentage of sales of course depends on what our sales are going to be. But directionally we sure don't think that number is going to go up. And we hope it goes down going forward.

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

I see Rob Wilson from Tiburon, a long -- party not heard from in a while.

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**Rob Wilson** - *Tiburon - Analyst*

Can you help us with the Direct division, the gross profit margin. Is that gross profit margin higher solely because of expense savings, or is there some underlying merchandise margin improvement?

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

Jason, anything you want to say?

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

There's both. There's expense savings. Our fulfillment expense is down. Our customer service costs that are also in that number are also down. But then what we pay for the goods and what we sell for them, we have a higher margin than we have had. We have a lot of new processes in place where we are making sure goods are moving all the time. Which has allowed our inventory levels to drop dramatically, because things aren't sitting around. And through that process we think we have found what products historically have been profitable and had high gross margins and which products haven't, and we have eliminated and not reordered the ones that were losers for us. The answer is both.

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

I'm going to add on to that. First of all, we take your call. I want you to know we take everybody's call. We have an hour and we try to limit ourselves to that. But people should know that we will take anybody's call. So there's a few people who have been out there threatening to call in. I was hoping to see them on the line. They haven't done it so far.

Echoing what Jason said on the product selection, we have -- in some cases we have learned hey, we just can't buy as well and handle it as well as our partners. If our partner -- we got some fantastic partners, and they are such specialists, and they know their areas so well, and they have optimized their supply chain so perfectly for just the productline that they are that we can't compete. And we have realized that rather than try to compete we have really build a nice echo system with our partners. We

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got -- we have -- I have had occasions in the last four months to spend a fair bit time with partners, and we are building a really nice echo system with them.

And then lastly I would point out again, going back to this information system, the granularity we have now with our costs is so good we get at the end of -- we get an approximate income statement each morning from the previous day, but we get a very good one each week. And it turns out -- it is coming out of the data warehouse. And when the financial guys at the end of the month close the books, it is trued up pretty tightly. And part of that is because we now have such granular costing of our expenses and getting them attributed to the right products. Well, that means we have been able to find out that there is products -- when you're doing a bunch of allocations, you've got to weigh -- we are thinking that some products are more profitable than they really are, and some products are less.

It has gotten so granular for us we can see -- and then the Pareto rule applies -- actually the 80/20 thing. But it probably was even worse than 80/20. So just by -- Jason has been aggressive about cutting losers in all kinds of ways throughout the cost structure in the products. And by cutting losers and reinforcing the winners, there is an underlying benefit that is driving the gross margin.

Setting aside the fact that, yes, Steve Tryon, who has been running our logistics system and Stormy Simon, who has been running our customer service, they have picked up -- they have added a couple of points of margin themselves just because they have really tightened the -- and I mean our warehouse runs just swimmingly now, as does customer service. But a lot of the improvement, and certainly the improvement in the capital management is being driven -- especially is being driven by this underlying information that is so much clearer than it used to be.

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**Rob Wilson** - Tiburon - Analyst

You guys in the past have talked about your direct margins potentially being higher than your partner margins. Do you expect that to happen this year?

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

They are already -- Jason?

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

The problem that you look at at the internal financials, Patrick, which is juice, which excludes the fixed warehouse costs. So if you exclude fixed warehouse costs they are higher. On a GAAP basis I think they are 16.7% for the direct and then 18.1. So they're still behind again in the fourth quarter. I'm not sure you ever even thought about that question on a GAAP basis, Patrick.

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

No, you are right. I am always looking at it internally where --. And okay, I am sorry.

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

But on a GAAP basis you will have the fourth quarter, the partner business doesn't really get that much of a lift because of volume because everything is variable. The direct business does get a big lift from volume because it has a fixed set of expenses that get amortized over much more sales. They're getting close now. I do think that the direct business could gain on it. And I haven't played much around with the math to see if it will surpass it or not, but it definitely should increase because of that phenomenon.

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**Rob Wilson** - Tiburon - Analyst

One final question, Patrick. I think you referenced earlier you don't talk about category changes or sales mix changes between categories. Why would you not give us some idea directionally what is happening with category mix?

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

Well, one is just for competitive reasons. Two is we don't really know ahead of time. I can tell you that we're going to be pulling on in just a few weeks a very large number of electronic SKUs. And the electronic SKUs may be single digit margins. And on the other hand they tend to be \$300, \$400 average order sizes, and it is all partners. So it is all -- just should be incremental margin dollars. But other than that, we haven't -- Jason, what do you like to say about categories?

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

The reason we don't give it out is for competitive reasons. The truth is, is internally we have been kind of agnostic. We try and figure out what customers want and then we sell it to them. And then we do look at our improvements in margins and try and filter out internally the noise because of shift in mix. But we don't really spend a lot of time trying to drive one versus the other.

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

Yes, it is more at the SKU or at least the subcategory level. So I'm sorry, Rob, it is partially for competitive reasons, but also there is not a master plan that we can we reveal to you. It is so opportunistic.

**Rob Wilson** - Tiburon - Analyst

Thanks for taking my call.

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

I see a couple of more people with questions. Nathan Schindler. Oh, I am sorry, Natalie. I see a Nat Schindler.

**Nat Schindler** - Piper Jaffray & Co. - Analyst

No, it is Nat Schindler.

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

Sorry. Somebody just whispered --.

**Nat Schindler** - Piper Jaffray & Co. - Analyst

I get that a lot. My voice usually clears it up though. Thanks for taking my call. My question is on the partner relationships, with Amazon going heavily into this space over the last few quarters, and obviously eBay having probably more and more trouble holding on to sellers, where are you gaining, and what type of sellers, and how do you differentiate your partner's and the partners that you're going after versus people who probably started their cycle at eBay, and are they not transitioning to Amazon, or are you winning them directly from Amazon? I just wanted to figure out the competitive dynamic there.

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And also what is the mix between your partner sellers who are more traditional off-line sellers, or clearance liquidators, versus Amazon who might be more heavily weighted towards true e-commerce sales?

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

Well, I will start that. I think that we have a much better -- a much different relationship with our partners than does eBay with its sellers or Amazon with its marketplace sellers. It is a much more -- I think it is much more beneficial for them. We provide a different and more comprehensive set of services. We really not trying to be -- we filter out a lot of partners and a lot of -- we just have a much more tightly integrated relationship with our partners.

I try not to go into that too much for competitive reasons, but I do know that every once in a while when we have -- and we're actually fine with this. If a partner wants to try Amazon, and put products up on Amazon, we say go ahead. The economics of the results are so much better on our site that we don't really have a loyalty thing that we have noticed. In fact, if anything, we don't have a loyalty problem with our partners vis-a-vis Amazon or eBay. When they get into our club they're treated differently. And the economics have a relationship -- of our relationship are so much more favorable for them that I don't -- I have never felt any loyalty was a factor there. Jason, you are more face-to-face with them, do you want to add on to that?

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

No, I think that is exactly right. I think we have much fewer partners and we treat them different. And because of that we have a much more intimate relationship with our partners. And we have a lot of mechanisms where we try and understand what we can do for them, and treat them as good as we can. So far it has worked well for us.

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

And we're doing more. There's a lot more in development to bind them closer to us. So that is the short answer.

**Nat Schindler** - *Piper Jaffray & Co. - Analyst*

Thank you very much.

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

[Quint Slattery] is the last person I have on the Q&A list.

**Quint Slattery** - *Analyst*

A quick question. In terms of topline growth when should we see a resumption of year-over-year topline growth? And also, when do you guys expect to be earnings positive on an EPS basis?

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

On a GAAP basis?

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**Quint Slattery** -- Analyst

No, on a pro forma basis.

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

Well, I will take the first question, and I will said this quarter. I think that you will see topline showing year-over-year growth this quarter. Jason, why don't you take the -- on a pro forma basis, I think we can show profit now. But, Jason, what do you want to say about that?

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

We have stayed out the giving guidance realm. We have tried to tell you what we know about our business and facts, pro and con, and let you make up your own mind. If you believe in EBITDA is profitable, and you believe that the restructuring charges really are one time, or they're not recurring, and that is your definition of pro forma, then we were \$2 million profitable this quarter.

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

But you're talking GAAP.

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

If you're talking GAAP, then again I don't want to tell you my opinion. I will tell you all the facts that I know of and you make your own opinion.

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

So sorry. That was a typically oracular answer from Jason. Anyway, we will -- anything else you want to ask, sir?

**Quint Slattery** -- Analyst

No, that's all. Thank you.

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

I wasn't trying to be rude. Our reality is that we have never really given guidance, and we have never told people when we're going to be profitable. There's lots of questions, and rightfully so, about our execution and we deserve those. We probably deserve everything we get about whether people question whether we can execute. We think that you see several quarters here in a row of executing to just what we said we were going to do. And we're happy with the progress that we have made. And we have talked kind of about each line starting at revenue, and then margins, and then G&A and technology. You can fill in your own boxes of what you believe on all those lines are going to do and make your projections for the next few quarters.

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

Actually I would argue that we -- where several years we did just what we said we were going to do. We used to give ranges like 60 to 100% growth and with plus or minus 1% on earnings. I think we actually did that for a couple of few years until things

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come off the rails. People would have you forget that. But we came off the rails, but we said we would fix it. And looking at these slides, I think it is clear we're making and a lot of progress towards fixing things.

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

Yes, you answered specifically, Patrick, that you think we'll have year-over-year growth this third quarter. I hope you're right. We will see.

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

It is feeling -- we are one-third of the way into the quarter, and it is feeling that way to me.

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

Okay.

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

Nothing massive. If we get into single digit growth percentages I will be -- for this quarter -- that will be -- but I really -- it's.

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

I will be ecstatic if that happens.

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

In the past we were all about hyper growth. This year we said we're going to be -- I am about hyper growth, but in the contribution dollars. Let's just stabilized the patient on the top line and fix everything beneath it was the goal. And I think we have come a long way.

Okay, next I see Scott Devitt is on the phone. We will take that as the last question.

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**Scott Devitt** - *Stifel Nicolaus - Analyst*

The question just kind of goes back to the comparison domestically with eBay and Amazon. What has been most interesting with those businesses over time is that as they have gotten bigger they become a shopping comparison site themselves, and so become less reliant on some of the third-party traffic. Whereas you today there is typically one product that you can search for and the price, the fixed-price, that it is on your site is what you pay. So there's not on-site competition, which makes you more reliant on third-parties for distribution.

I was just wondering if you could talk through maybe your interest in changing that over time to where more merchants could compete on the same product? Or if not, just how your pricing works in terms of how you set prices on the site? Thanks.

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

I would say first of all there is more price competition going on on our site than might be immediately obvious. But it is going on behind the scenes, first of all. It is going on in the way as we deal with our partners and in other things we do within the site. There's actually mechanisms that force some kind of -- some competition. But our point is we would rather have a narrow deep relationship with a tiny fraction, 1,000th of the suppliers that eBay does, and work with them. And the quid per quo for that is they can make more margin and such with us. And just -- on the one hand --.

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

Sell more units.

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

Yes, sell more units. Make more dollars but have better --. Our motto is buy it on Overstock, sell it on eBay. If you compare the prices of the stuff on Overstock it is cheaper than on eBay for commodity goods and such. In fact, they are people -- there are lots of people who make their living buying on Overstock and selling on eBay. I don't think we could get permission from the legal department to actually make that our motto. But there is more going into the pricing to make sure that our prices are sharp then maybe aware -- there is going to be obvious to someone just coming to our site. Jason, that is more your bailiwick, so why don't you --.

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

I think it is a good question. I think there is a lot of competition going on behind the scenes. But when we do have something up on the site, we hope that by that point it is already the best price. And then you're going to get the best customer service, because we have done our homework and make sure you're dealing with partners who do give the best customer service. We try and filter most of that out for the customer.

But then you still look at it and say, okay, does the business model work? Can you as you get bigger have enough marketing efficiency so that the model works? I think that you are seeing just that happen. I think we are -- well, just look at the last few quarters and look at how much -- I think we spent what, 30 to 35% less on marketing this quarter than we did last quarter. And our sales are -- we're definitely getting much more efficient. Now you go to the very bottom line and say, can the marketing be efficient enough that the business model works? And I think so.

We talked about -- I think it was in February after the fourth quarter, and we said how does this business model really work? We had 9% gross margins. We were spending 10% on sales and marketing, and 4.5 on G&A and 7 on technology. And you say, how does it ever work? And that is when we talked about the 20%. You've got to get gross margins to 20%, and then sales and marketing somewhere around 5, G&A around 5, and technology around 5. And again, give or take 1 or 2 points on any of those lines, if you do that 20 minus 5, 5, 5 is -- that is 15 in cost. So you had 5% in operating profit.

If you look at the progress that we have made from that point, this quarter we did 17.7% margins. That is not the 20% goal, but it is a long ways away, it is a big improvement from where we were. Sales and marketing was at 9.9; now it is 5.3. That is pretty close to the 5. And then G&A and technology, you know you have to look at those because they are fairly smooth throughout the year, but the sales ramp dramatically. You kind of have to look at those on an annualized basis. And last year they were close.

I think the business model over the last couple of quarters has proven that it has made gigantic steps in the direction of how you can see what we talked about, which is this business model can work. And can you continue to drive traffic and get enough out of your repeat traffic that this business will sustain itself forever? And everyone can make their own decision. But I'm pleased

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with the progress. And I really think that we are keyed up for the second half of the year, and that the business model really is starting to take shape.

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

Absolutely. Just going back to that point, I think you can -- if you check the kinds of product -- if you check my claim that you can buy it on Overstock, sell it on eBay, that tells you that if there is -- if you do some research and you see that spread there, then you've got to --. And always remember to include shipping and such when you do that because that is one of the games people play. It tells you that, if you do in fact confirm my claim, that you're going to see that the prices are generally lower on our site. Then that tells you that there must be some of that price competition mechanism going on. It is just not going on in as visible way to the consumer as it is on Amazon or eBay.

Although I actually do like the Amazon model of how they have a product and then a whole bunch of people selling it at different prices. And it is a Dutch auction basically. That is a nice model. And not out of the question we would do something like that some day. Probably if we did that, it would be with the books, music, movies and games, BMMG, rather than with the other commodities.

But there's already -- our partners have loyalty to us and we have loyalty to them. Part of that works out in the sense that we have -- if there is somebody selling a product out on the Internet for last than our partner is able to sell it to us, we want to know why and how. And it shouldn't be possible for that happen.

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

I wasn't trying to avoid your question, Scott. You basically said, hey, since you're not playing the game as a comparative shopping engine, you are relying on third-parties to drive traffic, how is that ever going to work? Well, I think the root of the question is, if we can have good enough deals so that when people come to our site, whether we get them through third-parties or whether we are getting them for free, or through our customers returning whatever, can we bring them to the site and make enough margin that it works on a consistent basis going forward, and can we do it in high enough volume. I think the answer is yes.

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**Scott Devitt** - *Stifel Nicolaus - Analyst*

And would there be a scenario in which you would dramatically increase the selection on the site, or is that not in the plan short-term?

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

Yes, in fact, I think we tried to talk about that a lot in the last couple of quarters. We haven't given out numbers, but it is significant. The amount of partner products on the site --.

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

It is way up.

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

It is way up and it is up dramatically. Even since April or May it is up dramatically. Yes, you are exactly right. That is how we do it. We've got to get much more product selection on the site. But what we don't want to do is we don't going to have our valued

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partners, who had been there for a long time, selling something that is a great price for the customer and they like it, and just pepper it with a whole bunch of other things almost just like it and dilute everybody's sales.

Instead what we're trying to do is take areas where there is little competition or no selection at all and fill the shelves there. Yes, absolutely, you're going to see our product selection go up, and it is going up dramatically.

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

And as we work with partners, it is really less about bringing on new partners, although there is some of that. We're bringing on new partners into an area where we don't have product. But a lot of -- we have been going out to our partners and getting them to expand their SKU count on our site.

Anyway, is a two-way street, the loyalty with the partners. And we're trying to do a lot for them that makes them more profitable, and so they can expand their SKU selection on our site.

Okay, thank you Scott. Anything -- is there any more? That is the last Q&A. Gee, I was hoping for some other guys. Anyway it is 10.15 here. Thank you for your time. Jason, any last words from you?

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

No. I'm pleased with the progress we have made. I'm liking how the business model is taking shape. And I think we're well-positioned for the second half of the year.

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

Absolutely. Okay, well, we look forward to talking to you in a few months.

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

Bye-bye.

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

Bye.

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**Operator**

Thank you again, ladies and gentlemen. This brings your conference call to a close. Please feel free to disconnect your lines now at any time.

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