FINAL TRANSCRIPT

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the third quarter 2007 Overstock.com earnings conference call. At this time, all participants are in a listen-only mode. We will conduct a question-and-answer session towards the end of this conference. If at any time during the call you require assistance (OPERATOR INSTRUCTIONS).

I would now like to turn the presentation over to Mr. David Chiderster, Senior Vice President of Finance. Please proceed, sir.

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

Good morning and welcome to Overstock.com's third 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 responses to your questions reflect management's views as of today, October 19, 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. 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 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 ending September 30, 2007. Please note that all comparisons will be against our results from the third quarter of 2006 unless otherwise stated.

Total revenues for the quarter increased 3% to $162 million. Our fulfillment partner business grew 22% and accounted for approximately 75% of our sales, while our direct business declined by 30% and accounted for 25% of our sales. Gross profits increased 32% to $28 million. Gross margins were 17.5%, down 20 basis points from Q2 but a 390 basis point improvement over last year.

Marketing expenses decreased by nearly 50% to $8.8 million or 5.5% of revenue. As a result, contribution margin increased to 12% and contribution profit increased 376% to $19.4 million. Technology and G&A expenses decreased by 11% to $24 million on lower depreciation expense and corporate overhead. Our total operating loss was $4.9 million or 3% of revenue; a 1,200 basis point improvement over last year. Total operating expenses declined by 26%, meaning revenue growth significantly outpaced growth in operating expenses and there were no restructuring charges in the quarter.

Our net loss was $4.7 million or $0.20 per share compared to a net loss of $24.5 million or $1.19 per share last year. We generated $4.1 million of positive EBITDA for the quarter -- our first non-Q fourth quarter with positive EBITDA, and this is an $18 million increase from last year.

We ended the quarter with $91 million of cash and cash equivalents. Inventory, including prepaid inventory, increased to $27 million in preparation for the holiday selling season. And although this is an increase of $10 million over the previous quarter, this is down $46 million, or 63% from the $73 million of inventory and prepaid inventory that we had at this time last year.

And finally, cash flow from operations was negative $3 million for the quarter versus positive $760,000 last year. However, the trailing 12 months operating cash flow was a positive $6 million compared to negative $20 million over the same period last year.

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

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

Good morning. Jason?

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

Yes.

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

Okay. Let's go to the slides. And I'm going to start with slide three, achievements.

We feel great about this quarter. Well, we returned to positive growth having halved our marketing expense. We returned to positive EBITDA and those one-time charges in the past -- the restructuring charges -- really did turn out to be restructuring charges. And we have positive trailing 12 months cash flow and I think that only goes up substantially from here.

If we turn -- Jason, anything you want to say about slide three?

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

Just to generate EBITDA in a non-Q4 quarter; we've never done that in the history of our Company. So I think that's a big achievement for us. So, it's a good leading indicator of the emerging business model that's there. I think cash flows, especially in our business, are going to be out in front of profits because our depreciation expense is so high. I'm glad to generate positive EBITDA, especially in a non-Q4 quarter.

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

Yes. We're gaining altitude. And we're gaining altitude, which -- well, we'll get to that. Let's go to slide four.

Revenue and operating expense growth. Jason -- so the revenue is the 3%. The operating expenses have been declining dramatically. So they're 26% down versus last year and the gross profits are up. So, Jason?

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

I think what's significant here is if you look in the bottom right-hand portion of this graph, you see the dark blue line, which is our operating expense. And it's decreasing dramatically. And our revenue growth has increased. And I don't think those two lines have ever crossed, at least not for the last three or four years. So, to finally see our revenue accelerating and our operating expense coming down -- even when we were growing 100% or 80% or really high double digit percent growth rates, we were having to invest so much in the business at the time, our operating expenses were growing even faster. So the real story here is those bottom two lines finally crossing and you're seeing operating leverage in the business. That doesn't even include the what, almost 400 basis point improvement in gross margins as well. So you're really starting to see some operating leverage out of the business. And if we can get growth to continue, you're really going to see it.

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

Yes. Okay, next slide. Gross margin, slide five. And here the comparison between 13.6 last year, 17.5 this year. You notice it does tick down each Q3 because we're in the -- we're building up staff and training staff [anywhere else] in customer care, so there's a couple hundred -- or no, 20 basis points of downtick.

But we actually think that this is where it will stay or even, I think, drift up a point or two from here, setting aside any mixed change. We are coming on very strong in electronics. We've greatly expended our -- I know that in the past electronics have never been our strong suit, but we have in the last two months gotten live with a very large supplier. And I think our inventory, our selection of new electronic [shoes] is up about tenfold. And that tends to be a higher -- a lower margin business, higher average order size business.

Jason, what do you want to say on margins?

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

Well, the big comparison here is the same quarter a year ago; it's up 390 basis points. I'm pleased with our margins. I do think there's some possible expansion going forward here. But going against that is the head wind, like you say, as if our mix shift is more towards electronics. Although the gross margin percentage will cause it to decrease, there will be incremental sales, so the gross profit margins dollars or gross margins dollars will increase. So, I'm pleased with where margins are. Even if it comes down, it's a shift towards incremental sales, which as long as it's incremental positive gross margin dollars, I'm still okay with it.

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

So you notice at the bottom I put this quote from the second quarter conference call last year [debt] that we're going to see within a couple of quarters a dramatic increase in inventory turns and gross margins. That's because as I think the listeners know, I tend to try to be very open and give everybody -- somebody taught me once that you want to communicate with your shareholders as if they're all your mother; what would you like your mother to know? So I give all this information. And some certain knuckleheads who I hope come on the call later, say, well, I'll take ten things and they'll pick the things that don't work and jump up and down and sort of ignore the ones that I call -- that we do manage to call.

So, we called that slide six. Again, the inventory turns on a -- first of all, the inventory itself fell from $73 million to $27 million. Of course, it ticked up from $18 million. And that is, last year was an aberration where the third quarter came down because we were just watching inventory. But basically we, at the end -- in September, we were receiving like crazy to build our inventory for the Christmas season. And actually, we'll probably get to $35 million or $40 million in another couple weeks before it comes down. And the turns -- of course, the turns are 9.4 versus 4.01 of last year; feel great about that. But again, it ticks down for the same reason for just temporarily.

Slide seven is the GAAP turns. And on a GAAP basis last year we turned 9.7. This year, 29.2. Again, the slight downtick from the previous quarter just as we build inventory at the end. But up from 9.7 last year to 29.2. Jason?

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

Well, just to clarify here, the bottom number is actual inventory that we have in our own warehouse, which I think is a nice improvement from a year ago. We're turning our inventory much faster. The top line is really an indication of the business model that we have. So we get tailwind from turns of inventory we don't touch. So, I think the bottom line is a big improvement year-over-year and that's our internal systems and our internal inventory turning better. And the top line is really an indicator of the strength in our business model.

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

Right. The top line and the spread between the two is really an indicator of the business model itself. Yes. Anything else?

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

No.

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

Okay. Slide eight. GMROI. For those who are retail-centric investors, a lot of people look at GMROI. 126% this quarter versus 28% last year.

And Jason, would you make the same comment that the spread between the lines -- basically the bottom -- actually the bottom line is at 39% to 28%. And again, that 28% is just a reflection of building the inventory at the very end of Q3. That's acceptable on for retailers just as retailers to have -- to make in a quarter. But you layer on top of it our partner business. And that's what makes the business potentially so sweet.

So, Jason?

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

Yes, I mean, these are per-quarter numbers. A lot of people are used to looking at GMROI but a lot of people report it annualized. These are -- they almost -- the top number looks like a lot of other big retailers' annual numbers, but this really is just a quarterly number.

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

Okay. Slide nine. Sales and marketing expense. And it's following -- I think we said in the beginning of this year that it was [10%, 11%] and going to drop to 8%, but we should actually be able to come down from there. Well, 5.5% -- we think 5% is the right annual number here. So it's half of at where it was in the third quarter of last year. Jason?

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

Nothing to add.

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

(inaudible) Okay. Half is maybe -- is the thing to say.

Contribution margin -- this is that bet Jason welched on. But the contribution margin, actually no. In fairness, I missed it by a whisker. Contribution margin, we -- when it was at 2%, we said it would be, well, going up over 10% and it's 12.0%. Not sure. Jason, what are your thoughts on that? Do you think it's going to go higher?

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

Pass.

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

Pass. Okay. We'll buy a vowel.

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

It obviously improves to a much improved business model. I mean, this is just looking farther and farther down the income statement. And we've just had a huge increase in the profitability of the business and a profitable [list] model is emerging. So I'm really encouraged by this number, just especially because it's so far down the income statement.

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

Yes. And there's lower fixed expenses [beneath that].

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

Yes.

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

Slide 11. I love this. We said that you would first see hyper-growth return -- you would first see growth return not at the top of the income statement but in the middle or two-thirds of the way down, the contribution dollars. And then growth in gross profit dollars and then growth in top line. Well, the growth in contribution dollars at $19.4 million, that's up 376%. Of course, that's a bit -- last year, it had fallen off a cliff. So that doesn't mean as much. But if you went back two years in our best -- when things were just going great and we were on the verge of coming off the rails, that was still $8.2 million. So we've more than doubled from there in two years. Feel great about that, actually. Jason?

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

Pass.

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

Pass. We go to the next one. Gross profit and contribution dollars. This is a new slide. The top of the bar is the gross profit dollars and then the blue bar is what we spend in marketing expenses. Our gross profit dollars at $28.2 million are up 32% from same quarter last year. And our marketing expenses again are half. So, just the contribution dollar is going to be the dark blue line. Again, the only thing to say is that's going on while the actual operating expenses are dropping. Jason?

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

Pass.

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

Okay. 13 -- EBITDA. Hallelujah. What do you say to this, Jason?

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

Well, I this is -- I echo your hallelujah, but I also think it's especially significant because the CapEx spend is so small. We're going to get to that here in a slide or two, but we've spent, what, $300,000 or something in the quarter. And so EBITDA to me is especially significant now because EBITDA is unfair, because you're not counting the depreciation when you look at EBITDA. And if you have a business where you're continually pumping in CapEx, you don't ever count the capital expenditures.

But in this case, we have EBITDA still significant -- or depreciation still significant and dropping. And it's dropping so much because we're not plowing a lot of new money into capital expenditures. So, I'm very pleased to see positive EBITDA, but I think it's especially important just because we're not spending much at all on CapEx.

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

In fact -- good point. Let's go to slide 14, which says basically that. The capital expenditures are the earthquake and the depreciation is the tsunami. And the earthquake happened back in end of '04 and all through '05. And it's given rise to this tsunami, which is rolling through. We're basically on the back end of the tsunami now. And it really drops off pretty radically over the next four or five quarters. It drops over -- it drops by almost two-thirds, it looks like.

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

Yes, another way to look at that is that line that you see for capital expenditures and the sum of the light blue lines -- or light blue bars, all have to be the same. Basically what you're doing is you're taking the capital expenditures and then the blue bars are the depreciation that flows from it. So in other words, the blue bars are exactly the same as the line. And now that the line is so much smaller, the blue bars in the future therefore will be much smaller.

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

Right. We've actually spent -- although what's our accumulated depreciation this year to date? To high 20 millions? 25, 26 or something? 26, 27? We've only spent $2.2 million in CapEx year to date. And in this last quarter, a little over $300,000. And this isn't -- what do you want to say about CapEx going forward?

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

Don't see any big capital expenditures on the immediate horizon. A year or two out we might have some more data warehouse type things for -- nothing like we've done in the past.

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

Yes. Sort of $6 million -- $5 million or $6 million or $7 million. But that's not this year and it's not next year in our planning. It would be '09 or after. So, I can't think of any big CapEx that we could do before that. But I'm sure we'll be creative. We might think of something.

Slide 15, net promoter score -- my favorite. This, once again, the comparison numbers are taken out of Fred Reichheld's book. And this is an independent company which does this measurement for us constantly. And we're up there with eBay, a little bit above Apple, according to this. Yes, we're in the Superstar rank. So we just have a fanatic -- it's great talking to customers -- we have a fanatic following, achieving cult status among some households, I'm told.

Slide 16. So once again, we knew it was going to get ugly. Maybe not as ugly as it got, but we thought we would come out of it smelling like a rose. I'd say that EBITDA line is pretty much what I was hoping or expecting and of course it's going to rocket from here this quarter. And I think we're back. By being positive EBITDA and not having any capital expense, any survival questions are put to rest. We're accumulating cash. We're generating a nice cash flow and I think it only goes up from here, rather handily. Jason?

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

I think we can take questions.

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

Okay. Questions.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). Scott Devitt, Stifel Nicolaus.

Scott Devitt - *Stifel Nicolaus - Analyst*

Congratulations on stabilizing the business. Had a few questions. First on the gross profit margins, which it does look like when you look at it year-over-year improved dramatically. When you look at it sequentially, it actually dipped 20 basis points. So, I know long-term you suggested the business, to get to your math, needs to be about 20% gross profit margin. And [5-5-5] in terms of operating expenses to get to your optimal target of 5%. So, I'm wondering how that directionally your gross profit margins are going to get to that 20% level?

And then I would just add to that gross profit margin question is, historically you've said the direct business should be higher margin than the partner business, because if you take inventory risk, you want to generate a higher gross profit dollar per transaction. And even though inventory is down so low, which means you've cleaned out all the excess inventory, and as Jason has said, historically you want to generate -- you wanted to keep the inventory that generated 80% of the profitability and get rid of the other inventory, and yet gross profit margins in the direct business are still quite a bit below partner.

So, trying to reconcile all that so I can build a longer-term model from here. And then I had a couple of follow-ups. Thanks.

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

All right. Patrick, do you want to start or do you want me to start?

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

I'll hit the first one. The dip in gross profit margin -- in gross margin I don't think is significant. It is a -- partially it's a function of we bring in, in the third quarter a lot of people who shop in our margin line, in our gross margin lines, who are not really productive yet but we've got to get them there to get ready for the fourth quarter. So there's always going to be a pressure down in the third quarter, you know, a couple dozen basis points. In addition, the mix --

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

Can I just clarify there, Patrick? What you meant is training people at customer service and the warehouse and stuff like that.

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

Correct. Would show up in our gross margin. And they're not as productive in the first month or two. So that's why there's a little bit of downward pressure in the third quarter. And again, as electronics comes up, there's going to be some downward pressure. But on the other hand, I think there's more upward pressure than downward pressure, both certainly in the fourth quarter because we get to leverage our fixed infrastructure for the quarter with much higher sales. But also in general, I think that the analysis is still showing that we still have losers to cut and winners to expand in. So I think that there's more long-term, more upward pressure than not with a possible exception of if electronics really booms for us. Jason?

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

Yes. You asked a couple of questions buried in there. I think one was about our gross margins and the difference between the direct and the fulfillment business. If you look at our direct margins, they went from 9.8% a year ago to 15.9% this year. So what's that, Patrick?

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

6 -- 6.

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

So, that's the 600 basis point improvement in a year, which I do think is significant. The fulfillment business went from 15.8% to 18.0%, so the -- it also made a nice improvement. Now you're saying, rightfully so, hey, the 15.9% is not bigger than the 18.0%. And the answer is yes, you're right, not yet. But it's sure come up from the 9.8%. And we do think that there's room to go.

That kind of leads into the next question you asked about the business model and how do you get to 20% and [5-5-5]. It's a good question but it's a tough question to answer in Q3. We, like all retailers, are very seasonal towards Christmas. And it's hard to look at a lot of numbers until you have the fourth quarter revenue and then you can look at the annual number. A long way of saying, once we have -- we only have fixed warehouse costs for our direct business, and yet we haven't had the fourth quarter yet. So, when you look at our margins of 15.9 and 18.0, which add together to the 17.5% when you weight them, the direct business is the one that has the most upside in the fourth quarter because you get to amortize those same fixed warehouse costs over so much more volume, when the fulfillment partner business goes up with sales and doesn't really scale on the fourth quarter that much.

So I think when you look at it on an annualized basis, we'll get much closer and that gap will close quite a bit. And then next year hopefully we think it will improve more.

If you look at the business model and say 20%, [5-5-5] and then 5% for operating profit, you know I say this every time I talk about this, I said that, I don't know, a year ago or however long it was, when I said it I said plus or minus a point or two on any line, but we do think there's 5% operating profit to be had out of this business.

Just to note, when I said it, our gross margins for 2006 were 12.7%. And our total operating expenses were 24.8%. So that made an operating income of minus 12.1%. We were a long, long ways away from even showing that we had a business model emerging. Now, the last couple of -- so we did 17.5% margins this quarter. We do think there's some upside there. Then if you look at the three 5's before you get to the operating income, the first is marketing. It's gone from -- was it 11 last year to 5.5 this year. It's not 5 but it's getting closer. And again, all these numbers you have to look at once Q4 has happened. The other number is G&A. I think we're at 5.5%. What was G&A this quarter, Dave? Six? (multiple speakers) This quarter was 7%. Sorry, 6%.

But then when you look at it on an annualized basis, of course, G&A will go up with the fourth quarter but not as much as sales will. And it will drop dramatically. And on an annual basis even for this year I think it's going to get below 6%. So next year as G&A's come down, I think we're pretty close on marketing and G&A.

Then you look at tech. And tech, 9% I think it was this quarter. But again, it doesn't go up like sales will in the fourth quarter. So when you look at it at the end of the year, well, tech this quarter was what, 14.5? And I'm not giving you guidance here. I'm just trying to do math for you. If tech was, say, 15% in the fourth quarter, and revenue -- I don't know, last year we did revenue of $300 million. Just use that same number. 15% on $300 million; that's 5%. And so when you annualize that number you're going to get for the year somewhere around 7. And with depreciation dropping as dramatically as it is, you take each one of those numbers and they're pretty close. And it's not very hard at this point, especially the way the lines are -- expenses are dropping and revenue is coming up some, it's not that hard to see that there definitely is operating profit to be made here.

Now, at what level will you actually have 5%? I don't know. I hope it's less than $1 billion, but it's going to be somewhere -- $900 million, $1 billion, somewhere around there, I would guess. It depends on how long it takes and how much depreciation is bled out of our business by then. But I think it's getting quite close.

Scott Devitt - *Stifel Nicolaus - Analyst*

Okay. I appreciate that. I understand the seasonality dynamics. [More] I was trying to get at the point of why really be in the direct business given the capital returns [with] not investing in inventory are so much higher and you make more money. But I guess we can take that piece of it offline and maybe your longer-term goal is to not be in the direct business.

But I'll just kind of lead into the next question. Which is, this is kind of a competitive industry, I guess I would say, in terms of there being many alternatives. So optically, those folks that have been around your business for some time and understand the optics of year-over-year dynamics. And when you look at it over a multi-year period, these things look quite different. So I'm wondering if some of the positive dynamics in terms of gross profit margins are peaking to a certain extent and the operating expenses are troughing. Because whether you're talking to eBay, Amazon or smaller companies like Sierra Trading Post or Zappos, I mean nobody is slowing investments. So, over time you have to spend a pretty significant amount of revenue of the Company in terms of tech and content and CapEx to keep up competitively and improve a value proposition.

So I'm really, again, just trying to understand that long-term you can't not invest in the business in the most competitive side of retail, which is the Internet. And that I think is at the core of whether your business is under or overvalued. So that would be my question about how you think about the expense structure long-term and the need to invest in it.

And then finally, just around the legal costs, could you talk about what the quarterly run rate is in terms of your legal costs and how long you think that's going to be around and kind of what's going on in that area? Thanks.

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

Thank you, Scott. Jason, do you want to hit that question first before I hit it or what?

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

Sure. Well, when we say not investing in CapEx, we're talking about big hardware type systems to make all our website and everything else run. We do have a large staff of developers. Our focus recently has been on improving the business and making things much better for the customer experience. So, we are investing a ton that you see in our quarterly expense line in tech to improving and making a lot of new developments in the business. We're not buying new big irons and new hardware.

So, we did have this business growing so fast that we built way out in front of it. And when we talk about not having to spend more on CapEx, we're talking about not having to spend more and able to handle more traffic. Because we built this business -- we built the infrastructure to handle a much, much bigger business. But we're not suggesting at all that we're not investing in new developments for the website.

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

Yes. I'm going to go back a step. First of all, I think the quickest way to summarize what you said on the operating profit -- operating margin, Jason, is when we were at minus 12, we said we could get to -- we had a rough target of plus 5. And we've gotten from minus 12 to minus 2. So we've gotten two-thirds of the way there and it's not even fourth quarter business yet. So, that's just how I would summarize that, all that arithmetic you gave.

As far as not investing in the business, I think that's totally false, although I can see why it looks that way from the outside. But first of all, as Jason says, we made these huge capital expenditures two years ago. What's going on is we can now -- and we basically have a $10 million cushion I think in the business. So if we had to, there's another $10 million we could cut. But we're not. Because that $10 million is going into investing and figuring new things out and so on and so forth.

What's different is a great deal of things that we used to do in the -- that we would have done with hardware or that we were doing with hardware, we can now do as code within the systems that we already have, like within Teradata. Teradata has proven enormously powerful for us. The stuff we used to do like Propeller -- that was all about collaborative filtering, we've turned -- and it would -- took big boxes and all this stuff. Well, that's become just code running within Teradata. So, and that really actually stands for a lot. There's more and more we're doing in the software as opposed to the hardware side of things, thanks to the big hardware systems we bought. So you won't see it in big CapEx. We actually have a new version of Propeller that we're testing now. It's all being done out in the code rather than in big clusters.

Anything else on that? Oh, legal. Jonathan Johnson, SVP of Corporate Legal Affairs, happens to be with me here in New York. Go ahead, Jonathan. Take it away.

Jonathan Johnson - *Overstock.com - SVP, Corporate Affairs and Legal*

Hi, Scott. You asked about our legal expenses and run rate. Our legal expenses I think are probably at a quarterly low, at least for the past several years. Part of the reason for that is the two big cases we're involved in, the Rocker and Gradient litigation and the Prime Broker litigation are contingency matters that we pay nothing to our lawyers at this point and incur very little expenses month to month on.

So legal expenses are low right now. I would comment that it's been a great quarter for our legal team. In the Rocker and Gradient case, both Rocker and Gradient have petitioned the California Supreme Court to review the case, to try and get it dismissed. And the California Supreme Court summarily rejected their petition. So --

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Scott Devitt - *Stifel Nicolaus - Analyst*

Brusquely? Would you say brusquely?

Jonathan Johnson - *Overstock.com - SVP, Corporate Affairs and Legal*

I would say brusquely. And so we're back at trial court and discovery is starting. We anticipate sending our discovery requests quickly, soon.

Scott Devitt - *Stifel Nicolaus - Analyst*

It has been remitted, correct?

Jonathan Johnson - *Overstock.com - SVP, Corporate Affairs and Legal*

It's getting remitted to the trial court, so it's back in the trial court's jurisdiction.

On the Prime Broker case, we had a great quarter there too. The Prime Brokers have filed a -- what's in California is the equivalent of a motion to dismiss. And the court -- I think they drove the hoop and got blocked there too. The court rejected that -- most of those claims. And so we are in discovery. Initial discovery has been served on the Prime Brokers and they've served some on us and things are going forward. So it's been a long time waiting to get out our flashlights and start looking in these people's books. But that's where we are now.

Scott Devitt - *Stifel Nicolaus - Analyst*

Our the wheels of justice going to grind fine on this one?

Jonathan Johnson - *Overstock.com - SVP, Corporate Affairs and Legal*

Well, I tell our staff at the office that the wheels of justice grind slow and fine. They've proven to grind slow and I'm confident that they will grind fine.

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

Okay. Well, that was a nice sober analysis. Just what you would want from your counselor. I think it was a fantastic quarter that way. What I'm finding fascinating is the whole social side of this, is here these fellows have their pet journalists who are trying to waive any possible victory of the most minute is a big victory for these guys.

Their argument that this is about free speech, which is shameful -- this is illegal activity, just read the affidavit, it has nothing to do with free speech -- but their argument, which has been dutifully repeated by [Joan O'Sayre] of the New York Times and [Rodney Boyd] and so on and so forth, these I call it they're capture journalists. They -- well, that argument has now been denied by the Marin County Court; the Appellate Court 3 to nothing. The California Attorney General filed an Amicus on our side. And now the Supreme Court also denied it.

So, I'm just kind of curious to see how it is these fellows extract themselves from spinning out a party line that is becoming increasingly divorced from reality. And the best I can tell is having just a code of silence has to descend over the whole thing. Because -- so, okay. That's the end of the Scott Devitt question.

Operator

Aaron Kessler, Piper Jaffray.

Aaron Kessler - *Piper Jaffray & Co. - Analyst*

Congrats on the positive EBITDA in the non-Q4. A couple of questions here. First, maybe you can give us a sense of your marketing programs, maybe which ones are showing the best ROI, either external or internal, and maybe you can give us an update maybe on your search engine marketing or your search engine optimizations. And then I have one follow-up.

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

Okay. Well, the marketing -- I think of this more as it's been a combination of killing losers and expanding winners. But so far what we've seen is mostly killing or dialing down the least productive, the lowest ROI parts of our marketing program. But we're definitely getting a better site experience for people. We have Mercado on our site, which gives not only great search results but has led us more to guided nav, which we really like. It's extracting a higher revenue per visitor, although it's not always easy to disaggregate how much of that is from site design and how much of that is we're buying better visitors or really we stopped buying bad visitors.

So all the decline in traffic that you see isn't as meaningful to us because a lot of that was traffic we realized was just -- was not very valuable. On the other hand -- by the way, as far as our traffic numbers go, somebody, Nielsen showed us up 10% for September. I don't want to get too much into the details, but the only traffic numbers that I ever look at that match what we experience internally come from a company called Hitwise. So if you're trying to follow us for some reason, Hitwise are the ones who are able to figure out our traffic better than others.

As far as expanding -- so we are getting higher revenue per visitor and getting better retention and so on and so forth. But I would say -- I said in my letter that we were about one-third of the way through the list. That was the third and mostly had to do with dialing things down; identifying some things and dialing them down. We have some good programs that are achieving really good results this year. They're still at the phase where they're small enough, they're not moving the needle too much, but they're entering the size -- they've now reached the size where they can move the needle for next year. But beyond that, I don't want to discuss in any detail which ones are working better than others.

Aaron Kessler - *Piper Jaffray & Co. - Analyst*

Great. And maybe you can give us a sense maybe of where your conversion rates are today and what the long-term goal for those. And then at what point should we expect you to switch back to more of a growth focus?

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

Well, we're about 3% conversion. And I think that we're going to get through the fourth quarter, pile up some cash. I think we're going to -- frankly, I think we're going to smoke what everybody thinks this quarter in terms of earnings. And then from there we'll be positioned to start moving the throttle back in a bit. But I really -- I think that this 5% number on marketing is a good number. I don't think it's 5% each quarter; it probably goes to 6% or a little bit more than 6% for quarters one, two and three and then drops below 5% in quarter four. And so then you get a blend of five something for the year. So I think that you'll see a shift back in the first quarter towards a growth emphasis.

But I don't really -- now, we're a little bit gunshy there. I don't really -- I'm not intent on getting back to 50% growth. We just want to do everything right, move the throttle in, and as long as all the other needles stay properly aligned, we'll take it. And if that's an industry 20%, 15%, 20%, 25%, that's fine. Although I think we're doing things right enough now and we are finding these seams that have let our marketing become twice as effective. It's now twice as effective per dollar as it was last year. And it only got that way because we did find some seams that we had overlooked of -- that I don't think I'd -- I think that there's a -- I wouldn't shut out the possibility of getting back to some higher industry growth rate.

Jason, do you want to add?

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

No.

Aaron Kessler - *Piper Jaffray & Co. - Analyst*

Great. Thank you, Patrick.

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

Thank you, Aaron.

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

I guess you did say one thing that caused me some pause, about what you said about the estimates. Dave, are you still on the line?

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

Yes.

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

What does the world have us for -- what are the estimates for net income for Q4 and for next year?

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

About $4 million for Q4; $4 million of net income. And losing about $12 million in 2008.

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

So $4 million positive for Q4 and a loss of $12 million for 2008?

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

Correct.

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

Yes. I think 2008 is too low. I would really be disappointed if we don't make money next year. For Q4, that seems reasonable to me. But definitely as you go out to next year, I would really be disappointed if we don't make money next year.

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

Well, Jason and I, we have healthy disagreements on this. I think that even the fourth quarter number is too conservative. But time will tell.

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

We'll see.

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

We'll see. Okay. I show that we have on the line Shawn Milne, [Brian Fensky] and Rob Wilson. And by the way, I meant what I say -- Sam Antar, if you want to join us as an [interloper], I've got to stick around -- I've got to leave in 15 minutes, but I'm hoping you'll join, Sam.

But first, operator, let's go to Shawn Milne from Oppenheimer.

Operator

Shawn Milne, Oppenheimer.

Shawn Milne - *Friedman, Billings, Ramsey Group, Inc. - Analyst*

Good morning, Patrick, and good quarter here. Just kind of surprised people are still thinking through gross margins. That's been now three quarters in a row of improvement. Clearly the new news today is the 5% marketing number. Aaron talked about it a little bit. Can you dive in a little more, Patrick? Is it the elimination of more off-line campaigns that just didn't get it done? What is really driving the improvement there?

And then when you talked about potentially putting the throttle down a little bit next year, would that be primarily with ad campaigns, more online campaigns that you can measure more real-time so we don't get into a situation of delevering that line next year?

And then I think there was some commentary about -- last comment there was some commentary about people looking for a big loss next year. We were looking for about $22 million in EBITDA in '08, about a 3% EBITDA margin. David, would you care to characterize that? Thanks. Bye.

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

Thank you, Shawn. I'll hit these quickly. Everything is being driven by CRM analysis. And we've got great -- we finally have good systems that can do that sort of heavy-duty work and really solid people. We're getting more -- really good statisticians and Ph.D.'s in math and statistics and people who have done CRM before.

And what we're looking at is customer value by different channels. And what we're discovering is some channels are not on -- at one level of analysis, down to the gross profit dollars it generates or the gross profit minus the marketing costs, looked good to us. But then when you really get into the lifetime value, they're not very good.

And then other things, now that we can take it to that level of granularity, other areas which we didn't think were that special, maybe, we now see are very special. We have -- in fact, our television expense is down significantly from a year or two ago. We are finding -- another thing that's happening is some seams are opening up in the Internet that we thought were ored out, I mean, were mined out five years ago, five or six years ago. And people -- it's one of these things where the water sloshes to one side of the bathtub and then the other. There's seams appearing where that people thought five or six years ago, wow, they're overpriced and they stopped buying them. And they have really dropped to the point that inventory is now available that does make sense in those seams. And of course, I don't want to say where the arbitrage is, but --

But Jason, why don't I stop there and --

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

Well, I think Sean pinpointed the differences between our optimism and our outlook. I think 5% marketing is a best case scenario. If I were projecting the next couple of quarters, I definitely would not put in 5%. And I think that does pinpoint why you think the immediate future is going to be -- you would guess it would be better than I would. So, as you're building your model, it's up to you. But I do think that's kind of a best case scenario.

And the reason I think that is because going from 11% to 5.5%, that was step one, which was identifying the losers and discarding them. And that caused a huge drop in our marketing expense as a percentage of sales. Now step two is identifying the winners and adding to them. And as we do that and as we find places where we can spend money, we won't be bashful about trying to get growth back. And so, if we find some of those, which we're starting to see some, I do think you'll see us pour money into it. And it could easily add up to 6% or 7% as a percentage of sales in the short run.

But if you look for the year next year, 3% EBITDA, Dave -- I've never done the math as a percentage of sales. What does that number look like to you?

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

Well, that's -- yes. I think we'll probably have in the $27 million to $30 million range in non-cash charges. So, you know, Sean's talking about $22 million of EBITDA; that basically comes out to losing a few million dollars next year. I think he shows losing like $3 million next year. So I don't think that's real far off. And I don't think we're talking about making a lot of money.

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

I thought that we were all comfortable saying that we thought we would be GAAP positive next year.

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

Yes, I think we are. And he's saying loss of $3 million GAAP and we're saying, well, we think it's going to be better than that.

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

Okay. Of course, my expectations are higher than what Jason and David say, but that's what makes a horse race.

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

So, yes, obviously the other factor is where is revenue, do you know? Is 3% the right number? I think the way to look at it is we think it's going to be positive. And we're going to have $27 million to $30 million of non-cash charges. And where you come out from there -- those are the two data points we can gave you.

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

Remember, by the way, that there's in comparison with this year, there is $16 million, $17 million of what we've called restructuring this year. And it really is restructuring in the sense of it's not going to happen again next year. There's only one possible thing that could -- well, [obviously] you never know what's possible -- but the only thing that we would consider is if we can find a tenant for our building and we can move over into our warehouse, we could save $4 million or $5 million a year. But if we did that, it would probably be some CapEx and restructuring.

So other than that -- so even what you see in our income statement for this year has $16 million or $17 million that just won't be there next year [setting it]. And then there's another $8 or $9 million of depreciation that is reduced. So we get to start with a big tailwind for next year.

Okay. Let's go to [Brian Fensky].

Operator

[Brian Fensky], Lehman Brothers.

Brian Fensky - *Lehman Brothers - Analyst*

Good morning. Brian Fensky on for Doug Anmuth. Just had a quick question. How significant is the new product selection on the site? I know you said you signed up a big partner and consumer electronic selection is much better now on the site. Just want to get a feel for how significant that will be, particularly in the fourth quarter, and potential impact on conversion rates and I guess average order size. Are you seeing an impact already? Thank you.

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

Thank you. I think it's very significant. And our selection -- and when we talk about selection, we set aside books, movies, music, games, because those numbers are so much bigger. But our selection is dramatically increasing and we think going to go higher; not just in electronics but really in category after category. Jason?

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

Agreed.

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

Do you want to give any numbers about the size of the selection?

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

No, but it's very dramatic. It's gone up significantly.

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

And I think it can go up quite a bit from here as well. And that's, again -- like electronics, you can add -- we can have 100,000 SKUs be going up there over the next six months. That sort of swamps all the other numbers. But even within -- in fact, we just finished the rollover the other night to the new Mercado 4.2 engine. And that was one of the main reasons for doing it, was that plus switching to the 64 bit architecture will let us go over 1 million SKUs. And that's our goal now. 800,000, 900,000 of them are books, movies, music, games. But we're all about expanding our selection at this point.

Let's see. Rob Wilson, Tiburon.

Operator

Rob Wilson, Tiburon Research.

Rob Wilson - *Tiburon Research Group - Analyst*

Yes, thank you. And good job.

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

Did that hurt so much, Rob? Did that hurt so much to say? I'm kidding. Rob, even though you've always been a very fair guy, even when you've said negative stuff about us. You've always been quite fair.

Rob Wilson - *Tiburon Research Group - Analyst*

I call it as I see it. First question, on your gross profit margins, do you feel like you've reached parity with Amazon, once you consider the fulfillment costs in their income statement? Maybe we'll start there.

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

That's a good -- I haven't looked at their sheet for a couple of quarters, but yes, I always thought that -- as I recall, they're reporting around 24 but there's about eight -- seven or eight in fulfillment that they move out.

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

Yes, Patrick, they're running -- overall, they're running in the 15% to 16% range. Their domestic business is about 18%. And so we're about equal with their North America business, but their international business is quite -- 600 or 700 basis point worse. So, overall, we are -- our gross margins are higher than Amazon's now.

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

On a apples-to-apples basis.

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

Apples-to-apples there about, we're about the same.

Rob Wilson - *Tiburon Research Group - Analyst*

Okay. And looking at Q4, how fluid is your marketing budget internally? Are you prepared for any increase in competitive pressures or downturn? What sort of a range are we talking about as far as total marketing dollars spent in Q4?

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

I missed the last ten words -- say that again, Rob?

Rob Wilson - *Tiburon Research Group - Analyst*

What sort of a range are we looking at for total marketing spend in Q4? Are you prepared in case the competitive pressures worsen or the macroenvironment worsens? Are you planning to spend more or less? Is there a range internally that you're working with?

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

Yes. There's a -- I think on the order of $15 million is the right number. There are different dials and some of them are sticky. They can only be adjusted really once a quarter. Some of them are -- and that's probably 20% of the spend. 80% of the spend is with dials that can be adjusted weekly or daily, or in some cases, literally hourly we adjust them. So, overall it's very fluid. And we look at it every morning. We meet five mornings a week and review. We have a very complicated sheet that 20 of us in marketing sit and review column by column and make decisions really each morning.

And then there are some people who literally are doing -- making some changes hour by hour in their fields. For example, key word buys on Google. You can actually make -- you can make real-time changes. So it's very fluid. 80% of the spend is very fluid.

Rob Wilson - *Tiburon Research Group - Analyst*

So as we sit here today, you're kind of expecting to spend $15 million in Q4?

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

Jason, do you want to comment on that?

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

Well, I think the answer is 80% of our spend is fluid, so it depends.

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

Yes. That would be a good -- I think that would be a good estimate. That's -- don't you?

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

Yes, I mean, if you had to just pick a number and guess. But again, really so much of it is pay for performance. It really just depends on the sales that are coming in and the efficiency of the marketing spend. But yes, if you asked me to just pick a number today, that would probably be a good guess.

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

Yes, if it went over that, I think that it would be because we also were surprising to the upside on revenue.

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

I don't know about that.

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

Okay. If you said $1 million -- at $15 million, plus or minus $2 million, I think you've -- 80% or 90% likely we hit that range.

Rob Wilson - *Tiburon Research Group - Analyst*

Fair enough. And one final question. Where do you expect your cash balance to be at the end of the year?

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

Well, at the end of the year it's going to be ridiculously high, but that's because we're holding for another 15 days a bunch of vendor's money. Jason, do you have the model there in front of you? I'm in New York, by the way, so I don't --

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

I don't. David, what do you --?

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

Yes, I think it's going to be $150 million, $160 million most likely or even higher. But once again, a lot of that is, like Patrick says, it's just us holding money. But we finished last year about $130 million. I think this year we're going to be closer to $160 million.

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

If you think of January 16 ending -- I would think that $100 million, $110 million sounds -- David?

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

Yes, I think we'll settle $110 million plus, somewhere in that area. That's probably the way to think about it.

Rob Wilson - *Tiburon Research Group - Analyst*

Okay, well, I appreciate you taking my call. And again, Patrick, good job.

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

Thank you, Rob. Nice to hear from you. And I got a message that somebody from Gagnon, whom we have not heard from in ages -- [John Revough] from Gagnon is on the phone with a question.

Operator

[John Revough], Gagnon Securities.

John Revough - *Gagnon Securities - Analyst*

Hello, gentlemen. I was just curious, what percentage of the traffic comes in through comparison shopping sites, such as [Shop Sell] and stuff like that?

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

I'll take that, John. It's relatively small. But we are working very hard to get a major -- to get our feeds built so we can expand and particularly shop.com. When I say that there are these seams where which we have sort of died out on and we're getting back on top of, that's actually one of them, the comparative shopping engines.

We have to be able to adjust bids to the SKU level, which means we have to be able to make analysis, go to the SKU level, which is a capacity we've only recently gotten. So although I'm not going to give you the precise number, I will tell you that it's small and it's smaller than it should be. And it's a place that we're going to be hitting very hard. In fact, we're working -- there's a whole team working night and day and we're sliding pizzas under the door so they can get a new bridge built to shop.com by Black Friday.

John Revough - *Gagnon Securities - Analyst*

Wonderful. Thank you.

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

Thank you, sir. Okay, I have 10:02. Sam Antar, are you on the line? Come on, Sam. Okay. I've got to get over to a talk. I thank everybody who is on the phone. Jason, do you want to add anything?

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

No, I'm encouraged with how things ended. I feel like for five years we've had to ask the question every single quarter, when are you going to be profitable? It feels good to finally say, well, we're going to be profitable this quarter, in Q4, and we're going to be profitable next year. I think that's a red letter day for Overstock. And I think that cash flows are a real leading indicator that things have improved. And I'm encouraged. So watch the cash flows and EBITDA improve over the coming quarters.

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

Yes, it's chop wood and carry water. But every once in awhile you get to stop for a nice coldie -- that being a cold lemonade in Utah. Thank you very much, those who have been believers and stayed with us. And we're glad things are working out. Bye bye.

Operator

Thank you for your participation in today's conference. This concludes your presentation. You may now disconnect. Good day.
