UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2013

Or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number: 000-49799

OVERSTOCK.COM, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**87-0634302** (I.R.S. Employer Identification Number)

6350 South 3000 East

Salt Lake City, Utah 84121

(Address, including zip code, of Registrant s principal executive offices)

Registrant s telephone number, including area code: **(801) 947-3100**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the act). Yes o No x

There were 23,650,146 shares of the Registrant s common stock, par value $0.0001, outstanding on April 22, 2013.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

Overstock.com, Inc.

Consolidated Balance Sheets (Unaudited)

(in thousands)

	March 31, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$ 81,895	$ 93,547
Restricted cash	1,780	1,905
Accounts receivable, net	15,851	19,273
Inventories, net	21,535	26,464
Prepaid inventories, net	1,988	1,912
Prepaids and other assets	10,589	12,897
Total current assets	133,638	155,998
Fixed assets, net	25,937	21,037
Goodwill	2,784	2,784
Other long-term assets, net	2,867	2,166
Total assets	$ 165,226	$ 181,985
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 46,753	$ 62,416
Accrued liabilities	46,871	47,674
Deferred revenue	31,531	38,411
Total current liabilities	125,155	148,501
Other long-term liabilities	2,049	2,522
Total liabilities	127,204	151,023
Commitments and contingencies (Note 5)		
Stockholders equity:		
Preferred stock, $0.0001 par value:		
Authorized shares - 5,000		
Issued and outstanding shares - none		
Common stock, $0.0001 par value		
Authorized shares - 100,000		
Issued shares - 26,774 and 26,481		
Outstanding shares - 23,650 and 23,451	2	2
Additional paid-in capital	357,647	356,895
Accumulated deficit	(239,399)	(247,096)
Treasury stock:		
Shares at cost - 3,124 and 3,030	(80,228)	(78,839)
Total stockholders equity	38,022	30,962
Total liabilities and stockholders equity	$ 165,226	$ 181,985

See accompanying notes to consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Income and Comprehensive Income

(Unaudited)

(in thousands, except per share data)

	Three months ended March 31, 2013		Three months ended March 31, 2012	
Revenue, net				
Direct	$	41,942	$	40,897
Fulfillment partner		270,052		221,470
Total net revenue		311,994		262,367
Cost of goods sold				
Direct(1)		37,149		37,630
Fulfillment partner		215,909		177,229
Total cost of goods sold		253,058		214,859
Gross profit		58,936		47,508
Operating expenses:				
Sales and marketing(1)		18,705		14,475
Technology(1)		18,160		15,638
General and administrative(1)		15,088		14,822
Restructuring		(432)		98
Total operating expenses		51,521		45,033
Operating income		7,415		2,475
Interest income		34		29
Interest expense		(51)		(208)
Other income, net		345		432
Income before income taxes		7,743		2,728
Provision for income taxes		46		9
Net income	$	7,697	$	2,719
Net income per common share basic:				
Net income attributable to common shares basic	$	0.33	$	0.12
Weighted average common shares outstanding basic		23,594		23,392
Net income per common share diluted:				
Net income attributable to common shares diluted	$	0.32	$	0.12
Weighted average common shares outstanding diluted		24,016		23,414
Comprehensive income	$	7,697	$	2,719
(1) Includes stock-based compensation as follows (Note 7):				
Cost of goods sold direct	$	48	$	60
Sales and marketing		25		101
Technology		124		176
General and administrative		555		476
Total	$	752	$	813

See accompanying notes to consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Changes in Stockholders Equity

(Unaudited)

(in thousands)

	Common stock		Additional Paid-in	Accumulated	Treasury stock		
	Shares	Amount	Capital	Deficit	Shares	Amount	Total
Balances at December 31, 2012	26,481	$ 2	$ 356,895	$ (247,096)	3,030	$ (78,839)	$ 30,962
Net income				7,697			7,697
Stock-based compensation to employees and directors			752				752
Common stock issued upon vesting of restricted stock	293						
Purchase of treasury stock					94	(1,389)	(1,389)
Balance at March 31, 2013	26,774	$ 2	$ 357,647	$ (239,399)	3,124	$ (80,228)	$ 38,022

See accompanying notes to consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Three months ended March 31,		Twelve months ended March 31,	
	2013	**2012**	**2013**	**2012**
Cash flows from operating activities:				
Net income (loss)	$ 7,697	$ 2,719	$ 19,647	$ (16,275)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Depreciation and amortization	3,863	4,034	15,838	16,385
Realized gain from sale of marketable securities	(12)	(7)	(14)	(7)
Loss (gain) on disposition of fixed assets		85	(13)	85
Stock-based compensation to employees and directors	752	813	3,466	2,988
Amortization of debt discount and deferred loan costs	5	35	43	128
Loss from early extinguishment of debt				1,226
Restructuring charges (reversals)	(432)	98	(454)	98
Changes in operating assets and liabilities:				
Restricted cash	125	(17)	273	330
Accounts receivable, net	3,422	1,560	(3,910)	(4,060)
Inventories, net	4,929	6,348	(4,890)	3,518
Prepaid inventories, net	(76)	(883)	(78)	(124)
Prepaids and other assets	1,462	3,156	(400)	1,581
Other long-term assets, net	53	694	(908)	244
Accounts payable	(15,729)	(27,587)	3,956	3,386
Accrued liabilities	(748)	(12,211)	11,004	(1,952)
Deferred revenue	(6,880)	(1,164)	4,717	4,695
Other long-term liabilities	(84)	93	449	411
Net cash provided by (used in) operating activities	(1,653)	(22,234)	48,726	12,657
Cash flows from investing activities:				
Purchases of marketable securities	(75)	(38)	(119)	(159)
Purchases of intangible assets			(6)	(4)
Sales of marketable securities	152	117	189	117
Investment in precious metals			(1,397)	
Expenditures for fixed assets, including internal-use software and website development	(6,062)	(2,127)	(16,424)	(9,192)
Proceeds from sale of fixed assets			56	
Net cash used in investing activities	(5,985)	(2,048)	(17,701)	(9,238)
Cash flows from financing activities:				
Payments on capital lease obligations	(2,563)	(77)	(2,598)	(735)
Drawdowns on line of credit				17,000
Payments on line of credit			(17,000)	
Capitalized financing costs				(140)
Proceeds from finance obligations				1,429
Payments on finance obligations				(23,939)
Paydown on direct financing arrangement	(62)	(57)	(241)	(221)
Payments to retire convertible senior notes				(24,505)
Purchase of treasury stock	(1,389)	(464)	(1,396)	(479)
Net cash used in financing activities	(4,014)	(598)	(21,235)	(31,590)
Net increase (decrease) in cash and cash equivalents	(11,652)	(24,880)	9,790	(28,171)
Cash and cash equivalents, beginning of period	93,547	96,985	72,105	100,276

Cash and cash equivalents, end of period	$	81,895	$	72,105	$	81,895	$	72,105
Supplemental disclosures of cash flow information:								
Cash paid during the period:								
Interest paid	$	20	$	149	$	453	$	2,142
Taxes paid		283		2		580		2
Non-cash investing and financing activities:								
Fixed assets, including internal-use software and website development, costs financed through accounts payable and accrued liabilities	$	116	$	121	$	497	$	12
Equipment acquired under capital lease obligations		2,563				2,563		
Equipment acquired under finance obligations								4,532
Lapse of rescission rights of redeemable stock								398

See accompanying notes to consolidated financial statements.

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Overstock.com, Inc.

Notes to Unaudited Consolidated Financial Statements

1. BASIS OF PRESENTATION

As used herein, Overstock, Overstock.com, O.co, we, our and similar terms include Overstock.com, Inc. and its subsidiaries, unless the cont indicates otherwise. The accompanying unaudited consolidated financial statements have been prepared by us pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our audited annual consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2012. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are, in our opinion, necessary for a fair presentation of results for the interim periods presented. Preparing financial statements requires us to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on our best knowledge of current events and actions that we may undertake in the future, actual results may be different from the estimates. The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

2. ACCOUNTING POLICIES

Principles of consolidation

The accompanying consolidated financial statements include our accounts and the accounts of our wholly-owned subsidiaries. All intercompany account balances and transactions have been eliminated in consolidation.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent liabilities in the consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, investment valuation, receivables valuation, revenue recognition, sales returns, incentive discount offers, inventory valuation, depreciable lives of fixed assets and internally-developed software, goodwill valuation, intangible valuation, income taxes, stock-based compensation, performance-based compensation, restructuring liabilities and contingencies. Actual results could differ materially from those estimates.

Cash equivalents

We classify all highly liquid instruments, including money market funds with a remaining maturity of three months or less at the time of purchase, as cash equivalents. Cash equivalents were $56.1 million and $76.2 million at March 31, 2013 and December 31, 2012, respectively.

Restricted cash

We consider cash that is legally restricted and cash that is held as a compensating balance for letter of credit arrangements as restricted cash. Restricted cash was $1.8 million and $1.9 million at March 31, 2013 and December 31, 2012, respectively, and was held primarily in cash or money market accounts.

Fair value of financial instruments

Our financial instruments, including cash, cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities are carried at cost, which approximates their fair value because of the short-term maturity of these instruments.

We account for our assets and liabilities using a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. These two types of inputs have created the following fair-value hierarchy:

- Level 1 Quoted prices for identical instruments in active markets;

- Level 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

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- Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires us to minimize the use of unobservable inputs and to use observable market data, if available, when determining fair value.

The fair value of these financial instruments was determined using the following levels of inputs as of March 31, 2013 (in thousands):

	Fair Value Measurements at March 31, 2013:			
	Total	**Level 1**	**Level 2**	**Level 3**
Assets:				
Cash equivalents - Money market mutual funds	$ 56,070	$ 56,070	$	$
Trading securities held in a rabbi trust (1)	200	200		
Total assets	$ 56,270	$ 56,270	$	$
Liabilities:				
Deferred compensation accrual rabbi trust (2)	$ 255	$ 255	$	$
Restructuring (3)	620			620
Total liabilities	$ 875	$ 255	$	$ 620

The fair value of these financial instruments was determined using the following levels of inputs as of December 31, 2012 (in thousands):

	Fair Value Measurements at December 31, 2012:			
	Total	**Level 1**	**Level 2**	**Level 3**
Assets:				
Cash equivalents - Money market mutual funds	$ 76,248	$ 76,248	$	$
Trading securities held in a rabbi trust (1)	264	264		
Total assets	$ 76,512	$ 76,512	$	$
Liabilities:				
Deferred compensation accrual rabbi trust (2)	$ 266	$ 266	$	$
Restructuring (3)	65			65
Total liabilities	$ 331	$ 266	$	$ 65

(1) Trading securities held in a rabbi trust are included in Other current and long-term assets in the consolidated balance sheets

(2) Non qualified deferred compensation in a rabbi trust is included in Accrued liabilities and Other long-term liabilities in the consolidated balance sheets.

(3) The fair value was determined based on the income approach, in which we used internal cash flow projections over the life of the underlying lease agreements discounted based on a credit adjusted risk-free rate of return. See the roll forward related to the restructuring accrual at Note 3 Restructuring Expense.

Restricted investments

In December 2009, we implemented a Non Qualified Deferred Compensation Plan (the NQDC Plan) for senior management. Deferred compensation amounts are invested in mutual funds held in a rabbi trust and are restricted for payment to the participants of the NQDC Plan. We account for our investments held in the trust in accordance with Accounting Standards Codification (ASC) No. 320 *Investments Debt and Equity Securities* . The investments held in the trust are classified as trading securities. The fair value of the investments held in the trust totaled $200,000 at March 31, 2013 and are included in Other current and long-term assets in the consolidated balance sheets. Our gains and losses on these investments were immaterial for the three months ended March 31, 2013 and 2012.

Accounts receivable

Accounts receivable consist primarily of trade amounts due from customers and from uncleared credit card transactions at period end. Accounts receivable are recorded at invoiced amounts and do not bear interest.

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Allowance for doubtful accounts

From time to time, we grant credit to some of our business customers on normal credit terms (typically 30 days). We perform credit evaluations of our business customers financial condition and payment history and maintain an allowance for doubtful accounts receivable based upon our historical collection experience and expected collectability of accounts receivable. The allowance for doubtful accounts receivable was $875,000 and $797,000 at March 31, 2013 and December 31, 2012, respectively.

Concentration of credit risk

Cash equivalents include short-term, highly liquid instruments with maturities at date of purchase of three months or less. At March 31, 2013 and December 31, 2012, two banks held the majority of our cash and cash equivalents. We do not believe that, as a result of this concentration, we are subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships.

Financial instruments that potentially subject us to significant concentrations of credit risk consist primarily of cash equivalents and receivables. We invest our cash primarily in money market securities which are uninsured.

Our accounts receivable are derived primarily from revenue earned from customers located in the United States. We maintain an allowance for doubtful accounts based upon the expected collectability of accounts receivable.

Valuation of inventories

Inventories, consisting of merchandise purchased for resale, are accounted for using a standard costing system which approximates the first-in-first-out (FIFO) method of accounting, and are valued at the lower of cost or market. We write down our inventory for estimated obsolescence and to lower of cost or market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Once established, the original cost of the inventory less the related inventory allowance represents the new cost basis of such products. Reversal of the allowance is recognized only when the related inventory has been sold or scrapped.

Prepaid inventories, net

Prepaid inventories represent inventories paid for in advance of receipt. Prepaid inventories were $2.0 million and $1.9 million at March 31, 2013 and December 31, 2012, respectively.

Prepaids and other assets

Prepaids and other assets represent expenses paid prior to receipt of the related goods or services, including advertising, license fees, maintenance, packaging, insurance, and other miscellaneous costs, as well as investments in precious metals. Total prepaids and other assets were $10.6 million and $12.9 million at March 31, 2013 and December 31, 2012, respectively.

Fixed assets

Fixed assets, which include assets such as technology infrastructure, internal-use software, website development, furniture and fixtures and leasehold improvements, are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the related assets or the term of the related capital lease, whichever is shorter, as follows:

	Life (years)
Computer software	2-4
Computer hardware	3-4
Furniture and equipment	3-5

Leasehold improvements are amortized over the shorter of the term of the related leases or estimated useful lives.

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Depreciation and amortization expense is classified within the corresponding operating expense categories on the consolidated statements of income as follows (in thousands):

	Three months ended March 31,	
	2013	2012
Cost of goods sold - direct	$ 104	$ 108
Technology	3,416	3,598
General and administrative	343	328
Total depreciation and amortization, including internal-use software and website development	$ 3,863	$ 4,034

Internal-use software and website development

Included in fixed assets is the capitalized cost of internal-use software and website development, including software used to upgrade and enhance our Website and processes supporting our business. We capitalize costs incurred during the application development stage of internal-use software and amortize these costs over the estimated useful life of two to three years. Costs incurred related to design or maintenance of internal-use software are expensed as incurred.

During the three months ended March 31, 2013 and 2012, we capitalized $3.0 million and $1.5 million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally. Amortization of costs associated with internal-use software and website development was $1.7 million and $2.2 million for those respective periods.

Leases

We account for lease agreements as either operating or capital leases depending on certain defined criteria. In certain of our lease agreements, we receive rent holidays and other incentives. We recognize lease costs on a straight-line basis without regard to deferred payment terms, such as rent holidays that defer the commencement date of required payments. Additionally, tenant improvement allowances are amortized as a reduction in rent expense over the term of the lease. Leasehold improvements are capitalized at cost and amortized over the lesser of their expected useful life or the life of the lease, without assuming renewal feature, if any, are exercised.

Treasury stock

We account for treasury stock under the cost method and include treasury stock as a component of stockholders equity.

Other long-term assets

Other long-term assets consist primarily of long-term prepaid expenses.

Impairment of long-lived assets

We review property and equipment and other long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability is measured by comparison of the assets carrying amount to future undiscounted net cash flows the asset group is expected to generate. Cash flow forecasts are based on trends of historical performance and management s estimate of future performance, giving consideration to existing and anticipated competitive and economic conditions. If such asset group is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair values. There were no impairments to long-lived assets recorded during the three months ended March 31, 2013 and the year ended December 31, 2012.

Goodwill

Goodwill represents the excess of the purchase price paid over the fair value of the tangible net assets acquired in business combinations.

Goodwill is not amortized but is tested for impairment at least annually. When evaluating whether goodwill is impaired, we make a qualitative assessment to determine if it is more likely than not that its fair value is less than its carrying amount. If the qualitative assessment determines that it is more likely than not that its fair value is less than its carrying amount, we compare the fair value of the reporting unit to which the goodwill is assigned to its carrying amount. If the carrying amount exceeds its fair value, then the amount of the impairment loss must be measured. The impairment loss, if any, is calculated by comparing the implied fair value of the goodwill to

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its carrying amount. In calculating the implied fair value of goodwill, the fair value of the reporting unit is allocated to the other assets and liabilities within the reporting unit based on estimated fair value. The excess of the fair value of a reporting unit over the amount allocated to its other assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized when the carrying amount of goodwill exceeds its implied fair value.

In accordance with this guidance, we test for impairment of goodwill in the fourth quarter or when we deem that a triggering event has occurred. Goodwill totaled $2.8 million at March 31, 2013 and December 31, 2012. There were no impairments to goodwill recorded during the three months ended March 31, 2013 and the year ended December 31, 2012.

Revenue recognition

We derive our revenue primarily from direct revenue and fulfillment partner revenue from merchandise sales. We also earn revenue from advertising on our shopping and other pages. We have organized our operations into two principal segments based on the primary source of revenue: direct revenue and fulfillment partner revenue (see Note 8 Business Segments).

Revenue is recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or the service has been provided; (3) the selling price or fee revenue earned is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. Revenue related to merchandise sales is recognized upon delivery to our customers. As we ship high volumes of packages through multiple carriers, it is not practical for us to track the actual delivery date of each shipment. Therefore, we use estimates to determine which shipments are delivered and, therefore, recognized as revenue at the end of the period. Our delivery date estimates are based on average shipping transit times, which are calculated using the following factors: (i) the type of shipping carrier (as carriers have different in-transit times); (ii) the fulfillment source (either our warehouses or those of our fulfillment partners); (iii) the delivery destination; and (iv) actual transit time experience, which shows that delivery date is typically one to eight business days from the date of shipment. We review and update our estimates on a quarterly basis based on our actual transit time experience. However, actual shipping times may differ from our estimates.

We evaluate the criteria outlined in ASC Topic 605-45, *Principal Agent Considerations*, in determining whether it is appropriate to record the gross amount of product sales and related costs or the net amount earned as commissions. When we are the primary obligor in a transaction, are subject to inventory risk, have latitude in establishing prices and selecting suppliers, or have several but not all of these indicators, revenue is recorded gross. If we are not the primary obligor in the transaction and amounts earned are determined using a fixed percentage, revenue is recorded on a net basis. Currently, the majority of both direct revenue and fulfillment partner revenue is recorded on a gross basis, as we are the primary obligor. We present revenue net of sales taxes.

We periodically provide incentive offers to our customers to encourage purchases. Such offers include current discount offers, such as percentage discounts off current purchases and other similar offers, which, when used by customers, are treated as a reduction of revenue.

Based upon our historical experience, revenue typically increases during the fourth quarter because of the holiday retail season.

Direct revenue

Direct revenue is derived from merchandise sales to individual consumers and businesses that are fulfilled from our warehouses. Direct revenue comes from merchandise sales that occur primarily through our Website, but may also occur through offline and other channels.

Fulfillment partner revenue

Fulfillment partner revenue is derived from merchandise sales through our Website which fulfillment partners ship directly to consumers and businesses from warehouses maintained by our fulfillment partners.

Consignment

We offer a consignment service to suppliers where the suppliers merchandise is stored in and shipped from our warehouses. We pay the consignment supplier upon shipment of the consigned merchandise to the consumer. Revenue from consignment service business was less than 1% of total net revenues as of March 31, 2013 and March 31, 2012, and is included in fulfillment partner segment on a gross basis.

International business

At March 31, 2013, we were offering products to customers in over 100 countries and non-U.S. territories. We do not have sales operations outside the United States, and are using a U.S. based third party to provide logistics and fulfillment for all international orders. Revenue generated from our international business is included in either direct or fulfillment partner revenue, depending on whether the product is shipped from our warehouses or from a fulfillment partner. Less than 1% of our revenues as of March 31, 2013 and March 31, 2012 were from international customers.

Total revenues from International sales were $2.9 million and $2.3 million at March 31, 2013 and March 31, 2012 respectively.

Ecommerce marketplace channels

During 2012, we began offering some of our products for sale in online marketplaces of other Internet retailers websites, which allows us to reach a broader potential customer base. Under the terms of our agreements with these ecommerce marketplace retailers, the retailers typically earn a fee that is a percentage of the selling price of the orders they send us. Revenue generated from these ecommerce marketplace channels is included in either direct or fulfillment partner revenue, on a gross basis, depending on whether the product is shipped from our warehouses or from a fulfillment partner. Ecommerce marketplace channels were less than 3% and less than 1% of our total net revenues for the three months ended March 31, 2013 and March 31, 2012, respectively.

Other businesses

We operate an online site for listing cars for sale as a part of our Website. The cars listing service allows dealers to list vehicles for sale and allows buyers to review vehicle descriptions and post offers to purchase, and provides the means for prospective purchasers to contact sellers for further information and negotiations on the purchase of an advertised vehicle. Revenue from the cars listing business is included in the fulfillment partner segment on a net basis. Revenue from our other businesses is less than 1% of total net revenues.

Club O loyalty program

We have a customer loyalty program called Club O for which we sell annual memberships. We record membership fees as deferred revenue and we recognize revenue ratably over the membership period. The Club O loyalty program allows members to earn reward dollars for qualifying purchases made on our Website. We also have a co-branded credit card program (see Co-branded credit card revenue below for more information). Co-branded cardholders are also Club O members and earn additional reward dollars for purchases made on our Website, and from other merchants. Reward dollars earned may be redeemed on future purchases made through our Website. Club O reward dollars expire 90 days after the customer s Club O membership expires. We account for these transactions as multiple element arrangements and allocate revenue to the elements using their relative fair values. We include the value of reward dollars earned in deferred revenue and we record it as a reduction of revenue at the time the reward dollars are earned.

We recognize revenue for Club O reward dollars when customers redeem their reward dollars as part of a purchase at our Website. We recognize other income when Club O reward dollars expire or the likelihood of reward dollars being redeemed by a customer is remote (reward dollar breakage). Due to the program s short history, currently no reward dollar breakage is recognized until the reward dollars expire.

In instances where customers receive free Club O reward dollars not associated with any purchases, we account for these transactions as sales incentives such as coupons and record a reduction of revenue at the time the reward dollars are redeemed.

Co-branded credit card program

We have a co-branded credit card agreement with a commercial bank for the issuance of credit cards bearing the Overstock.com brand, under which the bank pays us fees for new accounts and for customer usage of the cards. The agreement also provides for a customer loyalty program offering reward points that customers will accrue from card usage and can use to make purchases on our Website (See Club O loyalty program above for more information). New account fees are recognized as revenue on a straight-line basis over the estimated life of the credit card relationship. Credit card usage fees are recognized as revenues as actual credit card usage occurs.

Deferred revenue

Customer orders are recorded as deferred revenue prior to delivery of products or services ordered. We record amounts received for Club O membership fees as deferred revenue and we recognize it ratably over the membership period. We record Club O reward

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dollars earned from purchases as deferred revenue at the time they are earned and we recognize it as revenue upon redemption. If reward dollars are not redeemed, we recognize other income upon expiration. In addition, we sell gift cards and record related deferred revenue at the time of the sale. We sell gift cards without expiration dates and we recognize revenue from a gift card upon redemption of the gift card. If a gift card is not redeemed, we recognize other income when the likelihood of its redemption becomes remote based on our historical redemption experience. We consider the likelihood of redemption to be remote after 36 months.

Sales returns allowance

We inspect returned items when they arrive at our processing facility. We refund the full cost of the merchandise returned and all original shipping charges if the returned item is defective or we or our fulfillment partners have made an error, such as shipping the wrong product.

If the return is not a result of a product defect or a fulfillment error and the customer initiates a return of an unopened item within 30 days of delivery, for most products we refund the full cost of the merchandise minus the original shipping charge and actual return shipping fees. However, we reduce refunds for returns initiated more than 30 days after delivery or that are received at our returns processing facility more than 45 days after initial delivery.

If our customer returns an item that has been opened or shows signs of wear, we issue a partial refund minus the original shipping charge and actual return shipping fees.

Revenue is recorded net of estimated returns. We record an allowance for returns based on current period revenues and historical returns experience. We analyze actual historical returns, current economic trends and changes in order volume and acceptance of our products when evaluating the adequacy of the sales returns allowance in any accounting period.

The allowance for returns was $6.7 million and $10.6 million at March 31, 2013 and December 31, 2012 respectively. The decrease in allowance for returns at March 31, 2013 compared to December 31, 2012 is primarily due to decreased revenues mostly due to seasonality.

Credit card chargeback allowance

Revenue is recorded net of credit card chargebacks. We maintain an allowance for credit card chargebacks based on current period revenues and historical chargeback experience. The allowance for chargebacks was $130,000 and $182,000 at March 31, 2013 and December 31, 2012, respectively.

Cost of goods sold

Cost of goods sold includes product costs, warehousing costs, outbound shipping costs, handling and fulfillment costs, customer service costs and credit card fees, and is recorded in the same period in which related revenues have been recorded. Cost of goods sold, including product cost and other costs and fulfillment and related costs are as follows (in thousands):

	Three months ended March 31,					
		2013			2012	
Total revenue, net	$	311,994	100%	$	262,367	100%
Cost of goods sold						
Product costs and other cost of goods sold		239,197	77%		201,793	77%
Fulfillment and related costs		13,861	4%		13,066	5%
Total cost of goods sold		253,058	81%		214,859	82%
Gross profit	$	58,936	19%	$	47,508	18%

Advertising expense

We expense the costs of producing advertisements the first time the advertising takes place and expense the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized as incurred based on the terms of the individual agreements, which are generally: 1) a commission for traffic driven to the Website that generates a sale or 2) a referral fee based on the number of clicks on keywords or links to our Website generated during a given period. Advertising expense is included in sales and marketing expenses and totaled $16.5 million and $12.5 million during the three months ended March 31, 2013 and 2012, respectively. Prepaid advertising (included in Prepaids and other assets in the accompanying consolidated balance sheets) was $569,000 and $1.2 million at March 31,

2013 and December 31, 2012, respectively.

Stock-based compensation

We measure compensation expense for all outstanding unvested share-based awards at fair value on date of grant and recognize compensation expense over the service period for awards expected to vest on a straight line basis. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from estimates, such amounts will be recorded as an adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, and historical experience. Actual results may differ substantially from these estimates (see Note 7 Stock-Based Awards).

Loss contingencies

In the normal course of business, we are involved in legal proceedings and other potential loss contingencies. We accrue a liability for such matters when it is probable that a loss has been incurred and the amount can be reasonably estimated. When only a range of probable loss can be estimated, the most probable amount in the range is accrued. If no amount within this range is a better estimate than any other amount within the range, the minimum amount in the range is accrued. We expense legal fees as incurred.

Restructuring

Restructuring expenses are primarily comprised of lease termination costs. ASC Topic 420, *Accounting for Costs Associated with Exit or Disposal Activities,* requires that when an entity ceases using a property that is leased under an operating lease before the end of the contractual term, the termination costs should be recognized and measured at fair value when the entity ceases using the facility. Key assumptions in determining the restructuring expenses include the terms that may be negotiated to exit certain contractual obligations (see Note 3 Restructuring Expense).

Income taxes

Income taxes are accounted for under the asset and liability method. Deferred income taxes arise from temporary differences between the tax and financial statement recognition of revenue and expenses. In evaluating our ability to recover our deferred tax assets within the jurisdiction from which they arise, we consider all available positive and negative evidence, including projected future taxable income, scheduled reversals of our deferred tax liabilities, tax planning strategies and results of recent operations.

At March 31, 2013 and December 31, 2012, we have a full valuation allowance against our deferred tax assets, net of expected reversals of existing deferred tax liabilities, as we believe it is more likely than not that these benefits will not be realized. Significant judgment is required in

making this assessment, and it is very difficult to predict when our assessment may conclude that the remaining portion of the deferred tax assets is realizable.

We have tax deductions from stock-based compensation that exceed the stock-based compensation recorded for such instruments. To the extent such excess tax benefits are ultimately realized, they will increase shareholders equity. We utilize the with-and-without approach in determining if and when such excess tax benefits are realized, and under this approach excess tax benefits related to stock based compensation are the last to be realized.

Earnings per share

Basic earnings per share is computed by dividing net income attributable to common shares by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income attributable to common shares for the period by the weighted average number of common and potential common shares outstanding during the period. Potential common shares, comprising incremental common shares issuable upon the exercise of stock options, restricted stock awards and convertible senior notes are included in the calculation of diluted earnings per common share to the extent such shares are dilutive.

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The following table sets forth the computation of basic and diluted net income per common share for the periods indicated (in thousands, except per share data):

	Three months ended March 31,			
		2013		2012
Net income attributable to common shares	$	7,697	$	2,719
Net income per common share basic:				
Net income attributable to common shares basic	$	0.33	$	0.12
Weighted average common shares outstanding basic		23,594		23,392
Effect of dilutive securities:				
Stock options and restricted stock awards		422		22
Weighted average common shares outstanding diluted		24,016		23,414
Net income attributable to common shares diluted	$	0.32	$	0.12

The following shares were excluded from the calculation of diluted shares outstanding as their effect would have been anti-dilutive (in thousands):

	Three months ended March 31,