

# FINAL TRANSCRIPT

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## **OSTK - Q4 2008 Overstock.com Inc Earnings Conference Call**

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## CORPORATE PARTICIPANTS

**Jonathan Johnson**

*Overstock.com Inc. - President*

**Steve Chesnut**

*Overstock.com Inc. - SVP, Finance*

**Patrick Byrne**

*Overstock.com Inc. - Chairman & CEO*

## CONFERENCE CALL PARTICIPANTS

**Nat Schneider**

*Banc of America-Merrill Lynch - Analyst*

**Colin Sebastian**

*Lazard Capital Markets - Analyst*

**Craig Bibb**

*Jasper Funds - Analyst*

## PRESENTATION

**Operator**

Good morning. My name is Marianne and I will be your conference operator today. At this time, I would like to welcome everyone to the Q4 2008 Overstock.com Inc. conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions). I would now like to turn the conference over to Jonathan Johnson, President. Sir, you may begin.

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**Jonathan Johnson - Overstock.com Inc. - President**

Thank you, Marianne. Good morning and welcome to our fourth-quarter and fiscal year 2008 conference call. Joining me on the call today are Dr. Patrick Byrne, Overstock's Chairman and CEO and Steve Chesnut, Overstock's newly appointed Senior Vice President of Finance.

Ladies and gentlemen, please keep in mind that the following discussion and the responses to your questions reflect management's views as of today, January 30, 2009 only and will include forward-looking statements. Actual results may differ materially. Additional information about factors that could potentially impact our financial results is included in today's press release and our filings with the SEC, including our 2007 annual report on Form 10-K/A and our 2008 Q3 quarterly report on Form 10-Q.

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

During this call, we will share certain non-GAAP financial measures. Our press release, the slides accompanying this webcast and our filings with the SEC, each of which is posted on our Investor Relations website, contain additional disclosures regarding these non-GAAP measures, including reconciliations of these measures to the most comparable GAAP measures.

With that, let me say that we are very pleased that Steve Chesnut has joined the Overstock team. He brings over 20 years of experience at two of America's preeminent retailers, Home Depot and Target. And we are confident that he will do a tremendous job at Overstock. I will now turn the call over to Steve to review our financial results.

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**Steve Chesnut** - *Overstock.com Inc. - SVP, Finance*

Thank you, Jonathan. I would also like to add that I'm pleased to be on board. From my perspective, Overstock is a great company with a bright future. It has got a great management team and I'm looking forward to working with Patrick and Jonathan and the rest of the Overstock team.

I would like to quickly review the financial results for the fourth quarter and fiscal year ending December 31, 2008. If I could ask you to please refer to our earnings release for the full financial statement and further details regarding our results and keep in mind that, unless otherwise stated, all comparisons in this call will be against our results for the comparable period of 2007.

Now let's take a look at the revenue line. Q4 revenue declined 13%. The sales mix was 81% fulfillment partner and 19% direct. For the year, revenue was up 9% with a sales mix of 79% fulfillment partner and 21% direct. Gross profit as a percent of total revenue was 17% in Q4, a 130 basis point improvement over Q4 2007. Gross profit dollars were \$43.6 million, a 6% decrease. This included a one-time gain of \$1.8 million relating to payments from partners who were underbilled earlier in the year. Gross profit as a percent of revenue for the year was 17.1% and let me note that was an all-time high for the Company on an annual basis. Gross profit dollars rose 15% to \$142.9 million.

Marketing and sales expense declined significantly in Q4, down 40% over last year to \$16.4 million, or 6.4% of revenue while total marketing expense rose 4% for the year to \$57.6 million as a percent of revenue. Let me note that that declined 6.9% or a reduction of 33 basis points. As a result of this, contribution expanded 43% in Q4 to \$27.2 million and by 23% for the year to \$85.3 million, another all-time best for the Company. Contribution margin was 10.6% and 10.2% for Q4 and fiscal year 2008.

Combined technology and G&A expenses decreased 17% to \$21.5 million in Q4 on lower depreciation and compensation credits the Company had accrued for profit sharing and executive bonuses throughout 2008. These were reversed in Q4 resulting in a one-time benefit of \$3.7 million when the Company decided not to make a profit sharing contribution and the senior executive team requested not to receive a bonus. For the year, tech and G&A expenses fell 5%.

Total operating expenses were down 29% for the quarter and 9% for the year. Operating income for the quarter was a positive \$5.7 million compared to a loss of \$6.8 million in Q4 2007. For the year, the operating loss was \$10.9 million. This was a \$33.7 million positive swing over last year's \$44.6 million loss. Net income for the quarter was \$1 million, or \$0.04 a share. The primary difference between operating income and net income was a loss on the settlement of OTravel notes receivable of \$3.9 million. Our net loss for the year was at \$12.7 million or a negative \$0.55 per share. We generated a positive \$9.9 million in adjusted EBITDA in Q4 and \$15.1 million for the year.

Depreciation and stock-based compensation expense was \$4.3 million in Q4 and \$26 million for 2008. We ended the year with \$110 million in cash. This was down from \$147 million at the end of Q7. The big difference or the major difference between these is largely the result of \$20 million worth of stock buyback and debt retirement, plus \$19 million of CapEx expense. We generated \$2 million of positive operating cash flow in 2008.

Looking at our inventory levels, these were \$17.7 million and we showed \$39.7 million of working capital at the end of the year. This concludes my financial summary, so Patrick, let me turn the time over to you.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Thank you, Steve and let me echo Jonathan's comments. We certainly welcome having Steve Chesnut aboard. If you turn to your slides, I am going to start on page 3 of the slides, table of contents. I will be reviewing Q4 first and then fiscal year 2008.

Slide 4, just going to remind you of something I said, oh, a year and a half ago, that we could look for growth to come back -- it would first happen in the contribution level, then the gross profit dollars, and then the top line would be last to begin its

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growth. I am very pleased that we grew -- contribution dollars grew 43% in the fourth quarter and that is the line we are really focused on and managing our business around.

Turn to slide 5, please. The highlights, again, 17% gross margin, 40% decrease in marketing expenses, 10.6% contribution margin, adjusted EBITDA of \$10 million and \$15 million for the year and \$2 million positive operating cash flow. Seventh quarter in a row we are in that position.

Slide 6, quarterly revenue growth. Well, we had -- in the first half of last year, I think we maintained 27% through the year and it hit us -- you can almost pick the day that the bad headlines started showing up in the press in late August and -- the really bad headlines -- and then by September, it was amazing to me how much our metrics swing. I have said -- swung at that point -- and again, once around September 19.

From then on, I will give you just some color on the development of the quarter. The shrink was at its worst in November, bounced back some in December. Bounced back actually considerably in December and has continued to rebound modestly. But we ended up at minus 13% for the quarter.

Slide 7. The gross profits ended up down 6% year-over-year, but, slide 8, we have gotten significantly more efficient as mentioned in our marketing dollars and -- so first of all, we got more efficient, of course, on the margin line. We shrunk 13%, but only shrunk -- in revenue -- but only 6% in margin dollars, but our marketing is significantly more efficient and so our contribution dollars or our nectar, as we call it, is growing at -- grew at 43%.

Slide 9, the slide speaks for itself.

Slide 10, quarterly adjusted EBITDA. Now, just continues. It was a nice quarter, \$15 million. You see the development. Again, the picture speaks for itself.

Slide 11, quarterly cash flows from operations. Again, it is the seventh positive quarter of trailing 12-month cash flow.

Slide 12, GAAP annualized inventory turns. Now on a GAAP basis, they are at 30 and I think that this is about where they stabilized, where they will stabilize. On an actual -- of course, this is -- the GAAP doesn't mean as much to me -- actually it does -- it means more actually that the GAAP turns, but it is still interesting to me how we are managing our internal inventory. We are running it at 6.7. I think there might be room for a little bit of improvement there.

Slide 13, GMROI, annualized GMROI is 623%. We feel good about that. I would like to see on the direct basis that running at 100 or more.

Slide 14, net promoter score, all-time high of 73% and again, we get the data on the competitors out of the book by Fred Reichheld, The Ultimate Question. He is the inventor I believe of this score. Even our -- the red line -- the average American company, according to that book, runs at around 8%, 8% to 10% I think it says, and we are running at 73% now in the fourth quarter. The red line is the NPS of people who call our customer service, meaning they have had some kind of problem. They ran at 27%, which is an all-time high for the fourth quarter. That is -- so even the people who have some kind of an issue and call us give us a much higher score as a company than the average American company receives according to Professor Fred Reichheld.

Slide 15, I can't tell you how proud I am of this. We are now -- the National retail Federation and Amex do a survey of 8000 households. It's unprompted. They just say who gives you great customer service. We are now the second -- this came out a week or two ago -- we are the number two on their list, second to L.L. Bean, which is, having grown up in New England and I grew up on the legend of L.L. Bean customer service, this is a huge accomplishment. I congratulate Ms. Stormy Simon on this. And also that we passed Amazon. That is -- I don't know -- Jonathan or Steve, do you want to say anything about that or this in general?

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**Jonathan Johnson** - *Overstock.com Inc. - President*

We couldn't be more pleased with -- Stormy has done a great job putting the customer first, tenaciously representing the customer in all of our executive meetings and the whole team in our customer care department have just done a phenomenal job and this coming out right after the fourth quarter, which is our busiest time, is really a tribute to the great work they do.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

And I can say that over the last couple of years, the actual costs of customer service have more or less halved for us. So they achieved this taking us from not in the top 150 to number two while cutting the cost of customer service basically in half. So that was a great accomplishment for this team.

They also have a new -- they are now fully housed in our new warehouse that I've mentioned in past conference calls. They have a great facility, actually the nicest customer service facility I have ever seen, which they deserve, having been sort of tucked away in pretty cramped quarters before.

Slide 16, we are going to talk about 2008. 2008, we had 8.9% growth, gross margin was the highest ever, contribution margin was the highest ever. Operating expenses shrunk 9% and as Steve mentioned, it is the tech and G&A line combined is a good line to look at for us and we are finally reaching not just leverage and scale, but we have reached a point where that has been declining.

Slide 17, annual revenue, \$834 million. GAAP was an all-time high.

Slide 18, annual gross profit was an all-time high, 17.1%.

Contribution, slide 19, at \$85 million was another all-time high both at 10.2% and \$85 million.

Actually let me stay on slide 19 for a minute. I am hoping that we can -- I am going to start putting behind me the discussion of what happened in '05 and '06. But it is interesting to me that what is going on now in the -- we are running our business now about maximizing this contribution dollar number. Everything we do is about maximizing this contribution dollar number and we have realized that there is so much benefit and improvement we can make here for comparatively tiny cost on the tech and G&A side of the business, we believe we can still make this substantially better.

And oddly enough, many of the things that we are doing to make this better are things that we were forced into doing by having hit the speedbump three years ago. And so it turns out to have been a mixed blessing. We got a three-year headstart -- and those are the things that have to be done now given the current economic environment and other people are doing. And it turns out to have been maybe a -- not a mixed blessing -- a blessing in disguise that we got a three-year jump on doing these things.

Slide 20, annual operating expenses. In particular, I would like you to look at the orange line and the red line and you actually see that those are modestly coming down. Anything else would you -- Steve or Jonathan, would you like to mention about this?

**Steve Chesnut** - *Overstock.com Inc. - SVP, Finance*

To me, this is a great performance of effectively managing the business at the same time maximizing the contribution that every sales dollar is delivering.

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**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

And tech and G&A -- and I am sorry to the listeners, I am actually traveling, I'm in a hotel room -- tech and -- and where the Internet is not working now -- so tech and G&A for the year sum to 96, Steve?

**Steve Chesnut** - *Overstock.com Inc. - SVP, Finance*

Tech and G&A for the year sum to 96. That is correct, Patrick.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Okay. Let's talk a little -- I want to mention in the past I have said that you might see that even continue to come down for a couple of years as depreciation washed out of our system. I would like to -- and it has come down for a couple of years now -- but I would like to change that. I think it is going -- I don't think it is going to keep declining. We are making investments in expanding parts of our tech and G&A that offset or more than offset by a small amount our -- the decreases in depreciation we are seeing. Do you want to give an estimate, Steve, on what the combined tech and G&A might be in the coming year?

**Jonathan Johnson** - *Overstock.com Inc. - President*

I think it is going to be north of 100.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Slightly north of 100.

**Jonathan Johnson** - *Overstock.com Inc. - President*

Yes, slightly north of 100.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Okay. Steve, did you want to -- were you trying to say something too?

**Steve Chesnut** - *Overstock.com Inc. - SVP, Finance*

This is I think represents what you were talking about, Patrick, which is we are in this investment cycle of building this business and so these development dollars or investment dollars really propelled this business and build it onto a platform of substantial upside going into the future as this economy spins back.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Yes. And what is nice is that the cash for those investments seem to be generated by the business comfortably now.

Slide 21, annual adjusted EBITDA, all-time high once again and I can't wait till another couple years tick by and we are not looking at that valley in our rearview mirror.

Slide 22, annualized cash flows and slide 23, again, just some highlights.

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Before we go to questions, there are a couple of questions that have been sent in, one or two from Sam Antar, the Crook. I will give my quick summary on them. One is why do we adjust -- why is adjusted EBITDA reconciled not to operating income but to net income and my answer is net income is net income, it is the bottom line. The other complaint Sam had, Sam the Felon had was -- what was his other issue, Jonathan?

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**Jonathan Johnson** - *Overstock.com Inc. - President*

He has asked the question if we have had any change in accounting for internal software use and development. I think we ought to let Steve answer that question.

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**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Great.

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**Steve Chesnut** - *Overstock.com Inc. - SVP, Finance*

The answer is there has been no change in accounting policy. What we have done is we have shifted who is doing the work. There has been a historical preference to take it and use third-party contractors. We are now moving to more of an in-house development process and so the accounting policy hasn't changed; we are just now starting to capitalize the development of internal development work.

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**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

And we used to -- when we bought it from third parties, we capitalized it back then too.

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**Jonathan Johnson** - *Overstock.com Inc. - President*

That's correct.

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**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

So that is the difference. And Steve or Jonathan, do you want to comment on the first question on the reconciliation of EBITDA or adjusted EBITDA?

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**Jonathan Johnson** - *Overstock.com Inc. - President*

One other comment. We did that thoughtfully. We consulted with our auditors and outside counsel and it was fully disclosed how we have done in our recent filings with the SEC and we think it has been completely transparent.

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**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Right. And the complaint that we reconcile it to net income? Is that as nonsensical as it sounds is I guess what I am trying to ask?

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**Jonathan Johnson** - *Overstock.com Inc. - President*

I would say yes. And net income is the bottom-line performance. It seems like a very good number to reconcile to.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Okay. And so I echo Steve's comments on the capitalization of software. We went from buying outside software and capitalizing it to building it in-house and capitalizing it. We are -- we have a mild preference within. I am always desirous of expensing and not having -- but we -- our policy hasn't changed and we have the same policy we did before.

The next question I have is from -- is that enough time we spent on Sam Antar, the Crook's questions, Jonathan?

**Jonathan Johnson** - *Overstock.com Inc. - President*

Absolutely. I know we have got some folks queued up with questions to ask.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Real questions. And I have one more, one from Craig Bibb. He asked if we are going to declare Chapter 11 this year and well, Mr. Bid, sorry to disappoint you, but you're going to have to make your own determination on that. Best of luck with that though. Okay, questions on the line?

**Jonathan Johnson** - *Overstock.com Inc. - President*

Operator?

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions). Nat Schneider, Banc of America-Merrill Lynch.

**Nat Schneider** - *Banc of America-Merrill Lynch - Analyst*

Hi, guys. I wanted to give you -- a couple things you mentioned in the call hear. You talked about November being quite down and then December upticking nicely. How much of that downturn and then following uptick is due to the shift of cyber week from November to December this year? And just to help us figure out where to go from it, is December then -- is more of a blended average between the two really sustainable growth level or is it more going into -- or should we look at this uptick in December as more of the situation improving?

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Well, good question. First of all, I should be clear that the uptick still was negative and I am talking about sort of minus 20% for November versus minus 10% for December or minus 12% or minus 10%, something like that. So that is the rough magnitude. I could be a few percentage points off. Something you have to factor into that was, yes, absolutely, the Cyber Monday falling at December.



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Also, the previous November, we had an unusually strong November and so it gave us a tougher comp and so there were some elephants moving under the table that way. I don't see any reason, Jonathan, that I can't say how bookings are running in January, are we, just to help them frame things?

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**Jonathan Johnson** - *Overstock.com Inc. - President*

Sure, go ahead.

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**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

We are running at about minus 3% for January. Now that is based on what people -- when people order, of course. When you go to GAAP, you go from ordering to when it -- not only now when we ship it, but when they actually receive it, so there may be some things move back and forth there. But we are running -- if you just count sales as when people are putting in their credit card and buying something and all the other things balance out over time, we are running at minus 3%, 4% January. So does that -- Nat, does that give you sort of a --

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**Nat Schneider** - *Banc of America-Merrill Lynch - Analyst*

No, that helps a lot. And it kind of folds into another question. As you look at -- you look at relatively difficult comparisons in the next three quarters versus a relatively easy comparison against 4Q '07. Why -- looking at it running at negative 3%, it seems to be -- versus your negative 12% you did for the quarter and against a much harder comparison than 1Q '08 -- it sounds like something fundamentally improved on the consumer side. Is that something you did? Is that something you are seeing in the market or is this too little to extrapolate from?

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**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

No, it is not too little. You are down the right track. I am wondering if there is a choice all of the above. There is a lot of factors going on. One, we've got the great customer service. We have good prices, we have good products and we have figured out aspects of the marketing game. Sort of every month, we are just getting better and better at that.

Another thing you should know is January happens to be -- this month was a very tough comp for us. Last year, we had a very good January. So we are kind of surprised at this.

I guess another -- I mean there is another set of factors that neither of us had mentioned yet, Nat, that probably are as big collectively as the ones we just talked about and that is what is going on in the retail world. And starting in November, we basically are up against an industry going out of business sale. When guys like -- just picking a name out of a hat -- when Neiman Marcus is running 70% off sales, it is tough to be a discounter because that is -- on the other hand, that is not a sustainable business model for them.

However, there was -- not only was there margin pressure for us this -- I think that our margins would have been much better was there not this exceptional margin pressure from the brick-and-mortar competition this year. Everybody sort of knew in the fourth quarter what I -- the scuttlebutt I got around the country was people understood that if you wanted -- for the first time in years, they were saying if you want the good deals, you don't go online, you go to the brick-and-mortar stores. And there are still -- we are still up against that. Now their selection is getting smaller and smaller.

You probably have a better idea than I do. I get a lot from the suppliers who -- my sense is there is a lot of folks who are just cleaning out their supply chain right now in anticipation of closing doors or closing 30% of their doors. So that is also -- on the one hand, it gives us a downdraft because we have just got much tougher pricing competition from brick-and-mortar. On the

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other hand, it gives us an updraft because we get suppliers and retailers calling us with goods and dumping goods to us at a great price.

On the other hand, it gives us a downdraft because the consumers are sitting on their wallets. So there are a lot of elephants bumping around under the table. Some of them are going away I think February 1 or over the next few weeks because that is just not sustainable for other people. So you now -- I am not sure that is much of an answer, Nat, but that -- you now know everything I know. I think that the picture will become clearer for us both over the next few months.

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**Nat Schneider** - *Banc of America-Merrill Lynch - Analyst*

Well, then that goes into the next question. How long does it take a retail supply chain to rationalize its inventory levels? I mean we had a step function down, a lot of people were calling it September 15, but some time around then. Has the industry -- with huge promotional discounts, I am not seeing -- as you mentioned, you are not seeing that much selection anymore in the stores in these ridiculous clearance sales. How long does it take for that to happen and have the liquidators kind of -- have they just done the liquidation through the normal stores and through the normal channels and then the supply chains rationalized or is it -- is there going to be a lot of inventory that has to come your way at good prices?

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**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

A lot of good questions there. First of all, the normal supply chain for a retail store is about 80 to 90 days at a large retailer. They are running at four or five turns. Secondly, the general rule of thumb is if the goods are in the retail store already, it is more costly to box them up and reverse logistics than out to a DC and send them to us than it is just for them to liquidate them within the store.

So on the other hand, if goods are still in the distribution center or back in the warehouse on the West Coast or they are on the high seas or they are back in China, it is easier to make a deal with us. And it is easier and they get more money out of it.

So I think, and I don't want to be -- I want to give you a straight answer without sounding like I am dissing anybody in the industry, which I am not, but I think that a lot of these folks have a January 31 end of year, which is smart incidentally and if I made a mistake -- amongst my mistakes here has been when we set up the company we should have made a January 31 calendar year. My sense is that there is a bunch of people who are flushing out their supply chains for January 31 and then with the anticipation of shrinking their number of stores or even doing something more drastic.

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**Jonathan Johnson** - *Overstock.com Inc. - President*

Patrick, can we have maybe Steve give a little color on that since he's the retail guy.

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**Steve Chesnut** - *Overstock.com Inc. - SVP, Finance*

Everything you were spot on with, Patrick. The other dimension I would add in is that some of these retailers also have reaches back into China and foreign markets and so some of that inventory they ordered four or five months ago is still going to flow in. So whether it is soft lines where they are over in China sourcing, some of that we are still going to feel a little bit of an impact coming in Q1 as they try and liquidate through what they have placed on orders four or five months ago.

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**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Yes. I think that that pressure though is already lifting. In other words -- so the dynamics of being up against guys who are effectively running a going out of business sale was a very powerful dynamic in Q4 and I think it is a powerful dynamic and is

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a dynamic still. I expect it to decrease modestly after February 1, but I could be wrong. But I expected that kind of pressure starts lifting. In fact, it already has started lifting, but I expect it to lift more after February 1. But it still will be a factor in Q1.

**Nat Schneider** - Banc of America-Merrill Lynch - Analyst

Understand. Okay. Two quick questions just before I get back into the queue. In the past, you have said that marketing spend is at least partially related to the following quarter, so it is not all direct marketing. You have some brand marketing that affects the next quarter's revenue. How has the -- or maybe the next two quarters. You have had pretty controlled marketing spend in 3Q and 4Q. Do you see the effect on 1Q and 2Q because of that or have you switched to a more direct marketing model?

**Patrick Byrne** - Overstock.com Inc. - Chairman & CEO

Well, we have always -- we have generally been 70% or 80% direct. In the early days, we were 100% direct. We are still -- we are still staying within that range, but we think we have learned just how to dial-in and measure better than we ever did before. Now this improvement is not driven from having just cut like branding spend and that got us -- this is more to me an equilibrium where we are now where we are reporting than -- we could have of course -- you can make I suppose any quarter look good by just cutting your branding spend and sort of surfing the wave for a few months, but then is going to drop out beneath you. That is not what has happened here. We have reached, in my view, sort of an equilibrium marketing spend. I still think there is another 15% or 20% we can improve it, but this was not -- we were past the point of making sort of the dramatic adjustments one way or the other.

**Nat Schneider** - Banc of America-Merrill Lynch - Analyst

Okay. And just a final one, trying to get to that \$100 million plus in G&A and tech for next year, tech is at least somewhat [monoable] and it has its -- the lines I can see where they are probably going with depreciation turns the other way on you as you have increased some CapEx spend. But G&A, I'm getting -- it is a little harder for me because it seems like you took out a lot of bonuses from this year is I think what you said at the beginning of the call or in 4Q. Is that a sustained -- is it going to pop back up or is it going to --

**Patrick Byrne** - Overstock.com Inc. - Chairman & CEO

Not pop, but if it was 96 this year, I would expect 100 to 105 next year. And why -- maybe 106, 107. And the reason is we now see a lot of -- well, a lot of things that the advanced -- who I think of as the really advanced retailers, the things they have done, we are now doing. A lot of it takes development. We have gone -- we have -- development used to be the bane of my existence. We would line up 28 projects to do for the year and look at our resources and figure out the three we could get done. We now have a strong development staff that is not spread too thin and they are not only -- they are very strong technically. We have really, we have really gotten a much stronger team than we had two, three years ago or before.

I'm reminded -- Bill Gates said something about one great engineer is worth a thousand good engineers. We have gotten some really top-quality software engineers from very well-known firms. And we just -- we just have a very strong development team now. There is twice -- there is 10 times as many as there were two or three years ago. So there is that cost and then there is also the kinds of things we are doing with our Teradata system, are pretty advanced. There is only a few people who we believe have done these things before. And so we think it is very well worth spending \$10 million on this stuff to really get ourselves to the leading edge of sort of retail sophistication. But I will stop there and toss it to Steve Chesnut who might want to put some color on that.

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**Jonathan Johnson** - *Overstock.com Inc. - President*

Patrick, this is Jonathan. If I may, I do want to comment that G&A in Q4 versus G&A in Q1 '09. Q1 '09 is going to be up. We did have some -- because Q4 retail was tough, our bonuses across the Company were smaller and we weren't accruing for a bonus in Q4. So there may be some comp issues that make G&A -- I don't want to say pop -- but increase in Q1.

**Steve Chesnut** - *Overstock.com Inc. - SVP, Finance*

That's correct. That's absolutely correct. And I think it just goes back to what you said, Patrick, which is we are in a strong development build the business cycle, make smart investments and part of that is on the expense line to do that.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Yes. But unlike in the past when the airplane was in a shallow or a shallow dissent or even a, at one point, a tailspin and we had to -- it was a risk to make these developments -- to make these investments, we did it hoping we could get it out of the tailspin or out of the glide. We now have the nose above the horizon, we are gaining altitude, we are generating cash and we are just putting -- investing a portion of that cash back into these investments.

**Nat Schneider** - *Banc of America-Merrill Lynch - Analyst*

Okay. Well, thank you very much, Patrick and thank you for taking all my questions. Sorry for going on for a while there.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

No, you are welcome. Any time. Okay, and thanks, Steve. Mary, next question please.

**Operator**

(Operator Instructions). Colin Sebastian, Lazard Capital Markets.

**Colin Sebastian** - *Lazard Capital Markets - Analyst*

A quick question here and I apologize I jumped on late if you already addressed this. But related to the conversation on bringing back the consignment model, I am curious for a little more detail on the profile of your potential partners here and if you are seeing some interest from some of the retail survivors as well, which could become longer-term relationships. And then also related to that, the incremental investments or human resources, the (inaudible) might require upfront, particularly if this is more of a Q1 opportunity and certainly stores have been ordering much more conservatively over the past several weeks and months to reduce inventory levels going forward.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Well, it is a -- there is not an increase in manpower associated with this. Somebody -- we had sort of figured out it was time to go into this and we have gotten the development done. Somebody showed up on our doorstep with a very attractive deal and that -- part of it included a -- part of it -- they sounded us out about could we do this on consignment and we were able to say, gee, it just so happens, yes. We have taken down this big warehouse space in Salt Lake. We are sort of folding ourselves into it one piece at a time. We have a couple warehouses that were (inaudible). We had a few warehouses and we were sort of -- we have been migrating inventory to there, we're selling out of one warehouse and resupplying into the other and gradually folding

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operations into it. And somebody came along with an attractive deal and they brought up consignment and we had actually just finished a development that would let us do it.

So we think that the world is right for this. We can do it pretty efficiently. It doesn't require any new manpower where we are set up to do it and I think it is very attractive for our partners, as well as people in the distribution business, as well as people who want to do business with us on -- I guess the easiest way to say it is people who want to do business with us, it gives us one more -- one more card to play on how we can work with them. And it seems to be very attractive to them that we can offer this, so they can sort of focus on what they do best. So I think it is going to -- I don't know how to estimate how well it is going to do. It doesn't represent any new cost to us and we do have the development, the software engineering done that let's us handle this now.

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**Colin Sebastian** - *Lazard Capital Markets - Analyst*

And you'll be selling into your marketing (inaudible) existing customer base as opposed to looking for a new set of customers I presume?

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**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Yes. Although we have the flexibility to take -- to take 4000 lamps, put them in and sell 3600 of them to our customer base, pick, pack and ship one at a time and the last 400 bulk ship out to a store somewhere. We have the flexibility to do B2B or B2C out of this.

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**Jonathan Johnson** - *Overstock.com Inc. - President*

Patrick, if I can comment, I think as we have improved our warehouse operations, we have become a very attractive consignment supplier providing the consignment operations to partners and other vendors. We pick, pack and ship extremely efficiently and I think others should look at this and will find it very attractive.

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**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Our costs now of pick, packing and shipping are on an equilibrium basis below, significantly below, 15% below the very best we used to think we could do at the height of the Christmas season. So when we used to do our planning and stuff that was around at the height of the Christmas season, we could, with all the efficiencies of huge volumes, we could run at X, a cost of X. We are now running at 85% X just on a normalized basis.

So we have really -- a fellow, [Carol Morale], running the warehouse, and Steve Tryon have really leaned that out, although they believe there is even more to take out of it.

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**Colin Sebastian** - *Lazard Capital Markets - Analyst*

That's good to hear. And then I guess lastly, and I'm not sure if you mentioned this already, but if you have any comments on top-line trends for the month compared to the fourth-quarter growth particularly would be helpful.

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**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Yes, and you probably want to review the transcript, because I did speak about this somewhat extensively at the beginning. But yes, this month is showing up at minus 3% so far month-to-date. And basically, November was the nadir. November was

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about a shrink of 20%. We had a very tough comp from November of the previous year. December came back to about minus 10%, and January is running at minus 3%. And January, we had a very good January last year, too. So you now know all I know.

**Colin Sebastian** - *Lazard Capital Markets - Analyst*

Thanks, Patrick.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Sure, Colin. Anything else, Colin?

**Colin Sebastian** - *Lazard Capital Markets - Analyst*

That's it.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Okay. Thank you.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Jonathan -- Or Mary, do we have another caller?

**Operator**

Yes, sir. Craig Bibb, Jasper Funds.

**Craig Bibb** - *Jasper Funds - Analyst*

So let's get back to my question. You guys generated negative free cash flow in '08. You have negative equity. You have \$110 million of cash at 12/31, but you haven't paid your suppliers yet. So to me, it looks like it is starting to become tight and revenues are declining as we enter '09.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Well, what matters in my view is contribution dollars, not revenues, and the contribution dollars are growing nicely. But you're entitled to your opinion. I hope you act on it. You know, the market is just a big prediction machine, so place your bet and take your chances.

**Craig Bibb** - *Jasper Funds - Analyst*

Are you guys looking at raising capital?

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**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Not at all. Well, Jonathan, do you want to give a legal answer to that? Let me guess, it is that we are at all times examining the market for -- evaluating the capital market.

**Jonathan Johnson** - *Overstock.com Inc. - President*

We have a shelf out there that we filed -- it went effective in December. When we issued the press release around it, we said we have no current intentions to raise money. And we think it is prudent capital management to have a shelf registered, but my answer is, just like yours, Patrick, right now, no, not at all.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Steve Chesnut -- (multiple speakers).

**Craig Bibb** - *Jasper Funds - Analyst*

It looks like, in the fourth quarter, you were able to create cash flow by slamming down marketing. Is that likely to continue in '09? How should we model that?

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Well, as I just mentioned to, was, it Colin before, no, it wasn't -- the -- although we did -- marketing has gotten much more efficient, it is not a fact that we sort of slammed it down into some non-equilibrium position just to make the quarter look better. We now have -- we have just gotten it significantly more efficient. So I think you can model it at about where it is now. I actually think we can improve modestly from here. But Steve Chesnut, I want to hear your thoughts as the new CFO. Would you like to answer Mr. Bibb?

**Steve Chesnut** - *Overstock.com Inc. - SVP, Finance*

I think, one, this is a very viable model and I think it has got great long-term perspectives on it and I think we are continuing, as we go through and look at the model, to find efficiencies in it. Marketing is merely one leg. I think Steve Tryon's work out there in the warehouse is another and this -- I mean to me, this is a very viable long-term model. I don't see short-term liquidity issues.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

We are interested, Craig. Are you -- did I understand that you asked about the bond as well? Did you send an e-mail about the bond?

**Craig Bibb** - *Jasper Funds - Analyst*

The convertibles?

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Yes.

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**Craig Bibb** - *Jasper Funds - Analyst*

No, I don't think I had a specific question around that.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Okay. We are interested in possibly buying some of that in.

**Craig Bibb** - *Jasper Funds - Analyst*

Great. All right. Thanks a lot.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Mary?

**Operator**

At this time, gentlemen, there are no further questions. Do you have any closing remarks?

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

I do not. Chop wood, carry water. Jonathan?

**Jonathan Johnson** - *Overstock.com Inc. - President*

Chop wood, carry water. I think we are off to a -- we're working on it in '09 and we expect to keep working hard for all of it.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Stephen, welcome aboard. Do you have any last comments?

**Steve Chesnut** - *Overstock.com Inc. - SVP, Finance*

This is going to be a great 2009.

**Patrick Byrne** - *Overstock.com Inc. - Chairman & CEO*

Thank you, shareholders who stayed with us through the dark ages and I hope to reward you for your patients and confidence. Goodbye.

**Operator**

Thank you. This concludes today's Q4 2008 Overstock.com Inc. conference call. You may now disconnect.



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