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OSTK - Q4 2011 Overstock.com, Inc. Earnings Conference Call

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OVERVIEW:

OSTK reported 2011 revenue of \$1.05b and net loss of \$19.4m. Co. reported 4Q11 revenue of \$314m and net loss of \$3.4m.



CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

Steve Lemmer *Boldt Capital Management - Analyst*

PRESENTATION

Operator

Good morning. My name is Misty, and I will be your conference operator today. At this time, I would like to welcome everyone to the Overstock.com fiscal year and quarter four 2011 earnings 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). Thank you. Mr. Jonathan Johnson, President of Overstock.com, you may begin your conference.

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

Thank you, Misty. Good morning, and welcome to our fiscal year and fourth-quarter 2011 earnings conference call. On the call with me today are Dr. Patrick Byrne, Chairman and CEO of the Company, and Steve Chesnut, Senior Vice President of Finance and Risk Management. To begin, let me remind you that the following discussion and our responses to your questions reflect management's views as of today, March 2, 2012, and, may include forward-looking statements. Actual results may differ materially. We have additional information about factors that could potentially impact our financial results included in the press release and in the 8-K that we filed this morning.

During this call, we will discuss certain non-GAAP financial measures. The slides accompanying this webcast and our filings with the SEC, each of which are 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. Now those preliminary comments out of the way, let me turn the call over to Steve to highlight some of the financial results.

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

Thank you, Jonathan. Let me give you a brief review of our financial results for the full-year and fourth quarter of 2011. And as we review our financial results during the call today, please keep in mind that unless otherwise stated, all comparisons will be against our results for the full-year and fourth quarter of 2010. 2011 revenue was \$1.05 billion, that's a 3% decrease. Q4 revenue was \$314 million, a 10% decrease. 2011 gross margin decreased by 6%, and gross margin declined by 40 basis points to 17%. For 2011, contribution margin fell by 70 basis points to 11.1%.

Q4 gross profit decreased by 14%, and gross margin declined by 80 basis points to 16.2%. For Q4, contribution margin fell by 190 basis points to 10.2%. 2011 combined technology and G&A expenses increased by 18%, this is largely due to an increase in IT-related staffing and higher legal expenses. Q4 combined technology and G&A expenses increased by 24%. The 2011 net loss was \$19.4 million, and the Q4 net loss was \$3.4 million.

During the fourth quarter we retired the remaining \$34.5 million of outstanding senior convertible notes. This was partially funded through a \$17 million draw on our USBank line of credit. We also prepaid all of the outstanding technology leases for \$20.1 million, in cash, during Q4. We ended the year with \$97 million in cash and cash equivalents, and negative \$14 million in working capital. I would encourage you to review our Form 10-K that we filed today for more detailed information on our results. So with that, let me turn the call over to you, Patrick.



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

Thank you Mr. Chestnut, Patrick here. So, we are up to page 3, no reason to review those numbers again. I will start off by saying, obviously, it was an ugly end to an ugly year. There is lots of good questions to be sent in that we will be answering after we get through these slides. We do think, I think fundamentally, actually every department is running better than it's ever run with one exception, which is marketing, and that has definitely been stumbling. And my fault entirely, but we have made change -- the real ugly period, to be honest, came in the middle of the last quarter, say November to mid-December, I would say, the Christmas period. We definitely had some problems, some of expected contraction, very sharp, and our biggest problem over the last few years, it's two steps forward, one step back. When we have good, steady growth we can adjust our expense structure around it. It is when we have a great deceleration or even acceleration that sometimes has been hard to -- well, when the growth rate changes suddenly, some other things get -- some other ratios get cattywampus.

Two years ago we simply had a quarter, I think we were growing 55% and it tailed off, has been very lackluster growth, and then in the fourth quarter, there was a period with very sharp contraction. We stopped that, we have stopped the hemorrhaging, we have adjusted our significant adjustment to our corporate expense structure. And, we think we've come out of it quite handily, actually. Q1 is going to look surprisingly good, given where we've just been. But, we did have a tough year, no bones about it.

So, I'll hit slide 4, a picture depicting what Mr. Chesnut has said, we should not be contracting 3% in an industry which is growing 15%, so that's clearly a problem. Gross profit, everything else suffered, gross profit and contribution suffered with it. You get to technology and G&A, i.e. our corporate expenses, slide 7 versus our contribution margin, and that got upside down. Our contribution margin, we think 12%, 12.5%, is where it wants to be. And we got upside down on that.

Outside legal expense, slide 8, \$16 million, I don't think we've ever revealed this before. Our outside legal expense was massive in the last year. The lawsuit against Goldman was not entirely the \$16 million, but it was over \$10 million of the \$16 million. Jonathan can fill in more detail on that if he wishes. Standby, legal expense, net income is, as we said, minus \$19 million. Cash flow still remained a point of optimism. We've got good, positive free cash flow and operating cash flow. We retired the last of our debt. At these kinds of prices, I am not adverse to taking on some debt, swapping some equity for debt, at this kind of price.

To Q4 results, we've just discussed recent events. We were again ranked number four in customer service. We had a major reduction in corporate staff in January. \$8.5 million and when you throw in other expenses and legal expenses, I think that you might see even in the plan or in the budget for this year, for 2012, there's quite a significant reduction overall. It's not just the corporate staff that legal expenses and some other expenses have contracted, or should be contracting with it. The prime broker lawsuit was dismissed in California on jurisdictional grounds. We are appealing that, but that's a far, far lighter bill and it should be for the next year or two.

I'm going to continue to 13, 14, 15, just keep repeating what we have been saying. Jonathan, you want to say anything about any of those slides?

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

No. I think they speak for themselves. You can see the absolute revenue dollars and the growth, or better sense of the shrinkage in each of those slides.

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

So, I would go to slide 17, the operating and free cash flow, which we care a lot about. We have remained positive and think we can really -- well I suppose I am not in the business of making predictions on these calls, but we actually feel pretty good about our cash flow now, and our cash position now. Inventory turns, slide 18, this becomes a problem of course when sales don't -- there was a period of last quarter where we were shrinking, we had really went into a very sharp contraction. Sharper I think, it's about as sharp as we have -- while not quite as sharp as we've ever experienced. There were periods where we have experienced 40% to 50% contractions in years past, when generally when certain geopolitical



events happened and for a week or something, we would suffer a very sharp contraction. We suffered very sharp contraction in the last quarter that lasted a very fair chunk, a significant chunk of the quarter.

Actually our return on capital is, our return on inventory capital certainly on a GAAP basis is fine. Customer net promoter score has -- slide 20, has still remained sort of astronomically high compared to retail and general. I just saw another scoring service came out, and it put us right at the very top. We scored an 83 on another scoring service. Customers, new customers --do you want to talk at all about our new customer CPA, Jonathan or Steve?

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

Steve, why don't you talk?

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

Yes, so from an aggregate standpoint, we keep on adding unique customers. During the quarter, we saw deceleration from acquiring new customers that we had seen the prior quarter in 2010. From a customer acquisition standpoint, we saw an uptick in that cost, part of that was continue to try and drive revenue in the fourth quarter and acquire new customers. So, it was a combination of a deceleration on new customers and our marketing costs to try to go grab customers.

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

Customer orders and I'm sorry, I can't quite make out the average order size.

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

So Patrick, let me take this one. So, during the quarter, we actually saw an increase in average order size. We went from just under \$113 per order to \$115. So pretty happy with the average order size.

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

Yes, continuing 24, 25 -- go ahead.

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

So on slide 25, this is a reflection in January or in Q4, we ended the quarter with 793 corporate employees, and January 3, we went through a reduction in force, and brought that number down to 730. We think that brings our expense structure much more in line with where a very modest conservative approach sort of outlook on where revenue and margins will go this year. That way, we have sized to manage the expense structure and now our quest is to drive top line growth.

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

Right. And I would say, we have also replaced a lot of -- our technology is starting to work for us, it is, rather than sort of consuming more man labor, getting it built tuned in. We have a lot of systems now that are doing things that either were previously done by employees or not being done at all. And, so that is part of the reason we've been able to rationalize this. I don't think we've missed a beat on slide 25 by this rationalization over the last year of labor force. Let's go to questions. Do you have anything else on the slides, Jonathan or Steve?



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

Yes, just let me point out one thing, Patrick, on slide 12, under recent events, during the quarter, we also deployed a marketplace initiative and we are starting to bring our assortment live on other marketplaces.

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

Okay, how much do you want to say about that?

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

That's all I want to say.

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

Okay.

QUESTIONS AND ANSWERS

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

Okay, Patrick we've had a number of questions that have been sent in. Let me pose them one at a time, we will go through some of them and then we will take maybe some questions on the call and finish up by wrapping up with some of the other questions that have been sent in. One of our shareholders notes that we've done a lot of things in fits and starts over the last 12 to 18 months, and talks about Eziba and the O.co rebranding and the hiring of tech people only to downsize later on, and asks us to talk about the filter that we use for new business ideas.

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

Okay, well first I think, all the final responsibility for these decisions are mine. Totally mine, my fault, bad decisions are my fault, the good ones are invariably my colleagues. Part of the decision-making, I'll run through a number of these questions that were sent in on this point. A big part of the decision is what the commitment is to pursue a business idea, what's the commitment in terms of manpower and money. We in general have gotten away from very large multi-million dollar ideas, and we're trying lots of things, and often the things that cost a few hundred thousand dollars to develop and launch.

Eziba, I would put in that category. We are doing others like that, and some of them work. A lot of things are working beneath the hood that we have been wanting to do for years and are making our site better and better. And in fact, in general, that's the direction we are steering rather than sort of independent things like Eziba, we've realized that the human capital and the financial capital are best deployed in starting programs that are very close to something we know and understand already. And it's just an extension of -- and so I think our site has gotten significantly more intelligent, not just attractive, but the technology underlying the site and the various optimization routines that are going on are driven by different groups of people, and we've really decided that generally, I think I can only think of one exception at the moment, that's where our resources are best spent.

O.co was my bad call and I should be clear, actually. Stormy left marketing largely about 1.5, 2 years ago. She has been working on another project of that is I think one of the most important ones we've ever done, having to do with our partners, and it's working beautifully. She's developing this -- she's been developing that for a year and a half. But, there was some bad decisions, for which I take responsibility in marketing. O.co was odd in that it worked out one level, it did get out there into people's heads, but what we discovered, and we turned it up slowly, and we actually



had nice adoption from the beginning of last year, gradually people shifting to O.co and then we got into the Christmas season and it worked terribly. For people who were not familiar with us, there was a tremendous amount of traffic diverting to O.com, and we figured it was about 8 out of 13 people who were trying to visit us through O.co, 8 were typing O.com.

So anyway that was a part of the slide. There was another big decision I made it last year on an aspect of marketing that also was a bad decision, for competitive reasons I don't want to disclose it, but we tried something -- we were doing something that wasn't working very well, we tried killing it, and it turns out that it was better not to have killed it, and just to have let it keep going and not have a good ROI than to kill it altogether. So, some bad decisions in marketing that were totally my fault.

And, I think that, however, we have reached a place where we're doing things much more incrementally and we're able to test. And this is to me, sort of the big development in the last year, our ability to test not just at the cosmetic level within the site, but deep down in the site in terms of algorithms has finally really snapped into place. We can test things we've been dreaming of testing for years. And, that we never really could test adequately, and now we are testing. And we could not have tested for technological reasons, could not have tested correctly before, but for the last several months, we've been able to test, we're learning. And so I would say that in general the filters are in place now. We really aren't trying -- we don't want to pursue big expensive ideas. And we've backed away from the big expensive ideas for couple of years, for example, Eziba was not a big expense idea to test and it did not catch on.

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

Patrick may I comment on Eziba, if I can interrupt? My view on Eziba was definitely something worth trying, and I think that what we have learned as a management team is to try things particularly that are relatively low-cost, but if they don't work, turn them off quickly. In the past, we've rolled new things out, sometimes we've left them running for a long time, auctions would be an example. That we saw Eziba's performance and what it was bringing and what it was not bringing to the Company. We made a quick decision to go back. So I would actually view the Eziba test roll-out and turn-off as a positive rather than a negative.

Another aspect of this question was the ramp-up in dev hires and letting some of those developers go in January. We have for many quarters been talking about ramping up our dev hires and as we've been managing our expenses, we've been very careful not to let those dev hires go because of the projects that we needed to get done. But over time -- anytime that an organization hires a lot of people, some of those people are going to be better than others, so when it came time to do a little bit deeper cut in the work force, if frankly made sense to stop giving development a pass and cut some of those people away. So again, I think that hiring ramp-up was something that we needed, and perhaps we should have been culling people earlier than we did, but I am pleased with the cuts we made in January.

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

Yes. Well I am never pleased to cut, but we did ramp that department up extremely quickly over the last four or five years. And, we may have been a little belated ramping it up, and then we grew it so quickly, and we were extremely selective on the way and we had never really made any deep cuts. But, it meant that when you ramp up a department like that, no matter how selective you are on the way in, it means that when you go from 7 to 160 people, which is what I think what we did, when the time comes to say, can you cut 30 or 40 people, you can find them.

And then in addition to question is on the bonus and this is a fair, very fair question. And it is why do we pay bonuses. Well we come up with the bonus formula, usually it changes each year. We have it at the beginning of each year, we publish it, people understand it, and it's designed to incentivize what the behaviors we are trying to really focus on that year. And, what seems fair.

There have been years when the formula generated, even if results were bad, it generated a large bonus, and there have been definitely years where we had relatively good results that the bonus, the formula, really generated a small bonus pool. And, that just has to do with reality sometimes working out differently than as was anticipated by the formula. We really have lived by that bonus formula and again, there were times when it generated a fairly -- where people made a very large improvement overall in the year but the formula didn't -- would spit out a small bonus, and when that happened, we lived by it and we told people we have to live by it.

There have been at least two years that the executives came and said they felt the bonus pool was too chintzy given the progress that their colleagues had made, that they voluntarily said we would surrender our bonus, and executive bonus is just a sliver of the overall bonus pool, and they would say we've surrendered our bonus so as to augment that the general employees got. So we just lived by this bonus pool. So sometimes it does end up -- it has generated results that are a little bit odd-looking to the eye, both on the positive and the negative side.

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

May I comment on the 2012 bonus plan? Just to kind of give the investor community some insight into the thinking? As we look at it this year, we said we are going to establish a net income floor that, unless, let me use a different term than net income, we call it management income internally, which is kind of income from the business before corporate expenses, i.e. interest, some litigation, and we established that floor at \$19 million, so there is no bonus pool being created unless management income exceeds \$19 million. That way, I think it's well designed to protect the investment community in the process.

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

Right. And I would say as far as the senior talent, I have never had such confidence in this team. Well I've never had such confidence in our team, as we finally have, I think, all the right executives in place and none of the wrong executives in place. With the exception, as I have said in the past, marketing. There was something of a hole there, I think after Stormy left and there was some management confusion, I would say, among the leadership. And within the leadership, within the department. That has been resolved, we have -- the leadership within the department is the best I have ever worked with. And we hired, we can't say who, but Jonathan, can I explain what has happened of late or not?

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

Sure, I think you should.

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

We hired a very senior person from another company, who will be starting in a couple weeks. The announcement has not been made who it is, and from the company the person is coming from and such, so somebody with large brand as well as the kind of experience, very quantitative and such. However, unlike I would say, in the past, we really have, at the next level down, we really have some very strong leadership in their respective chimneys within marketing, and this is just sort of the last person I think we've been missing. That announcement will be made within a couple of weeks, who it is.

But in the meantime, we've actually quite -- we're shrinking 10% in the fourth quarter and there were periods in there where we were shrinking 30%-ish, 40%-ish. We have bounced back nicely. We have bounced back handily. It still isn't where I wanted to be. So, walking into a good situation with good people in place, but the senior leader will be announced within a couple weeks.

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

Yes, and Patrick let me just provide a little more color. The senior leader is going to be a Senior Vice President of Marketing, basically filling a Chief of Marketing position. He comes from -- he has a retail background, and we think he is going to be a very good addition to the executive team, and provide good marketing leadership within the Company.



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

Let me explain, Stormy, 1.5 years ago, well Stormy was the best, but 1.5 years ago I moved her off to do something that I don't think anyone else has done, well, at least as we are doing it. Basically taking everything we have done in customer care and creating a duplicate version of it all and pointing it up the supply-chain. So, we now have, as we have customer care, which is one of the best in the world, if not the best in the world according to some people, we now have partner care and supplier care. And it's the same kind of an operation pointing up the supply-chain. I think it's making an enormous difference. To hear our suppliers tell it, they love it.

There is a large group that has been built, a partner-care team. So building all of that has taken Stormy 1.5 years. I don't regret pulling her off Marketing in order to do that. But it has meant that we have had a bit -- well we've had more turmoil in the department than we should have. I think the tumultuous period is over. It's actually running reasonably slickly now, every day, every week, we're learning lots of things we've never learned before, but what we have is a senior person from another retail company coming in.

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

Patrick, let me ask two other questions that have been submitted, and then we'll open it up to take some questions from those that have dialed in. One question asks about the lawsuit, and why has this been a good thing for the Company and what can we expect going forward?

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

On the -- well I would like to turn it over to you, I'm going to hit the first part. I felt and feel a sense of duty that this has to be done. This has to be done. When the world understands what it is that happened and the stuff from Goldman gets revealed, I have felt a very strong ethical duty that this had to be done. There is no way I can back out of this. I will then leave it Jonathan to talk about the cost benefits. I basically feel there's a serial killer on the loose. There's a serial killer named Goldman Sachs on the loose, and somebody has to expose them and stop them. Jonathan?

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

Let me talk about some of the benefits we're receiving from this effort and where it is going forward. First, a lot of the activity that was very obviously happening, for example, our being on the regulation SHO threshold list, because of massive amounts of failed-to-deliver on our stock, has ended. The SEC has closed many, not all but many of those loopholes. So I think the efforts that we have taken have been a benefit to our shareholders and to the market in general on that front. This is something that gets talked about in Washington, President Obama issued an executive order to look into how naked short selling can be used as a tool of economic warfare, so I think there's been a real benefit to this.

As far as the lawsuit goes, we of course were disappointed that the judge in California, while acknowledging the manipulation was going on, determined that the California court wasn't the right place to try that. We have entered into --we considered filing a suit either in New York or in New Jersey where it's clear that this manipulation was going on. We've entered into a tolling agreement with both Merrill Lynch and Goldman Sachs so the statute of limitations has been tolled and is not running, and we will appeal this suit in California, hopefully get to take it to trial in California, but if we lose on appeal, our rights are preserved in New York and New Jersey. So, going forward, the appeal is not a management-intensive process. It is also not a very expensive process, from an outside counsel perspective. There is no discovery, there's not the massive documents to look through, it's really just making legal arguments, most of which are well-formulated from the briefings that we have done during the discovery and pre-trial part of the case.

So, you've seen that our legal expenses last year were up in the \$16 million range. That included our fight, roughly half of that included our fight against Wall Street. Another big chunk of that was the successful defense against a patent fall down in Eastern Texas where not only were we found not to have infringed Alcatel Lucent's patents, but we were able to invalidate one of their patents. I think all of those expenses have been well spent. Unfortunately, lawsuits cost a lot of money, but I think we've been justified in our expenditures.



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

And, we have developed a reputation. We've seen this pay off on a couple of occasions of late, where people, when patent trolls, and there's a whole -- for those listeners who don't know, there's a whole industry of people who think that they've patented the Internet, or they bought patents somewhere along the way, and then they come in and say, look, we've patented having a shopping cart, we patented having the most basic things, they claim patents on.

And most people pay them -- most people pay them to go away. And in one case recently, other folks in the industry paid them big money, more than our legal budget for last year, to go away. And we fought the patent, spent \$2 million fighting the patent, and got it invalidated and so that's Jonathan and Mark Griffin, our General Counsel. So we hope that has -- didn't we have some evidence recently, Jonathan, that people have come to understand that they are risking their own, that there is a risk to coming after us with patents?

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

Yes, we recently had a patent troll that had filed suit against us, asked us if they could withdraw the suit, and it was dismissed with prejudice, and so we are done with that. And we did not have to pay a single penny.

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

So, it was an expensive reputation to build, but we think that it will have benefit in the future. Then, I would say in addition, I see that I'm asked here about my time spent on TV. Why don't I spend more time talking about uplifting parts of the business, Worldstock and things like that. The truth is, I don't get to control it when I go on TV. And, not only -- although of course I love talking about Overstock and I do feel that the TV appearances have certainly helped -- well I'd like to think that they have helped enhance our brand. Not only don't I get to choose, I often don't know until the moment I am on satellite, what I'm even going to talk about, or maybe I thought I was going to get to talk about Overstock and I end up talking about being asked about Obamacare or the Federal Reserve or something.

And I would say, at least 50% of the time, I don't even know what I'm going to be -- I am told to be in the satellite studio and I'm either not told what we are going to be talking about or I'm told one thing, but there's some other breaking news and that's what they want me to talk about. I still think it's worth doing. It helps, I think it still helps build our brand, and build awareness for us. I would love nothing more than to get on TV and talk for 10 minutes every time just about Overstock and Worldstock and things like that. But, it's really, I'm afraid part of the -- it's not part of the equation that I get to determine that.

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

Okay. Misty, why don't we -- we'll do some of these other questions in a minute, but Misty, why don't we open it up to those that have called in?

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

Wait a second, Jonathan I see there's another set of questions from Sanjeev.

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

Some of those we have answered, I would like to take a few from the call, and then hand the rest to Sanjeev.

Operator

(Operator Instructions). We will pause for just a moment to compile the Q&A roster.



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

While we are waiting for the roster, let me ask you this, Patrick. Sanjeev's asked, talked about Zappos and how it has grown at roughly the same rate as Overstock, but that it's been valued at a much greater level. Do we as management have any comment on why the market values Overstock and Zappos so differently?

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

I don't. That's how the market, Sanjeev could answer that much better than I could answer that, and I don't really -- I can't say I pay attention to that. It's -- how Amazon valued Zappos versus how the market values us is not something that I'll comment on.

Operator

You have a question from the line of Steve Lemmer.

Steve Lemmer - *Boldt Capital Management - Analyst*

Hi, a question about a comment, Patrick, you made a little bit ago that I was hoping you could give more clarification on. You said that you're not adverse to swapping equity for debt. I presume that means taking on debt and buying back shares? What's the plan for this? What are the thoughts now? Things going wrong direction kind of leveraging up, if you could just give more color on that comment, then I have one other question for Jonathan after.

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

Sure, Steve. You did read me correctly that, yes, if we could issue debt at an attractive enough price, that wouldn't be interested in issuing any debt with any warrants, but a piece of straight debt and at 8%-ish or something where we understand the market is for BBB these days, if we could issue debt at that level and buy in equity I think that's something we would strongly consider.

Steve Lemmer - *Boldt Capital Management - Analyst*

Any thoughts on how much debt you would take on? How much stock you would buy back? I know that depends a little bit on the share price and also the timing of when you might do this?

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

Well, I should be clear, this is -- I am sharing my thoughts, not that there is -- there is no plan to do this. There's no plan, it's something we have of late discussed but, somewhere north of 50 and less than 100 would be the appetite. And, Jonathan, is there anything inappropriate of me? So these are just my ruminations, rather than any corporate plan at this point.

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

Yes, we don't have a corporate plan on this front. We do have an S-3 filed and effective and it allows us to issue debt, and if the market conditions are right and we get the right prices, we always consider -- we're always looking to manage our capital structure and our balance sheet the best we can.



Steve Lemmer - *Boldt Capital Management - Analyst*

Okay one other question, this is a follow-up to the lawsuit question you answered a second ago. Basically, Jonathan, you said one of the benefits to the shareholders is that these loopholes in Reg SHO and whatnot have been closed, but having said that, in doing this, cash flow essentially would have been 50% higher had you not done it, and the stock price is probably 60% lower so I'm not exactly sure how closing Reg SHO helps us if it really doesn't have any effect on the stock price, which I thought was the ultimate goal in battling this problem. So, your thoughts on that, considering it has cost so much, and free cash flow would have been 50% higher?

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

Had these loopholes not been closed, and had manipulators been allowed to continue unchecked, failing to deliver millions of shares a day, who knows what the stock price would have been, and who knows what would have happened there. So, it's little bit of a guess, Steve, to know if it has benefited the stock price or not, I don't know. But I think it has been good for Overstock and good for the market in general.

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

I have already uttered so many words on this subject, I am going to keep mine now to just a footnote and that is, when the story comes out, and we now have five years discovery, we know soup-to-nuts what happened. We have the whole story in a way we did not even a year or two ago and so it's not supposition, we have the whole story. When it finally comes out, which I just have to trust that it will, what happened and what certain parties were doing, I think it will become more clear at least, why it just had to be done. The people made a decision to destroy us in 2004, 2005. There is some large entities that made a decision to destroy us.

And I think then if we had not fought back, and lord knows, it turned into a hell of a fight, but if we had not fought back as we did, I don't know. Jonathan, do you think we would even be around today? But people will understand when the whole story comes out, why it certainly is not black-and-white -- this is a very difficult question. Jonathan? Do you have any comment? This has been your --?

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

Well, I agree with that. I frankly don't think we would've been around had we not chose to fight this fight but, that's just my opinion.

Steve Lemmer - *Boldt Capital Management - Analyst*

Okay, thank you.

Operator

(Operator Instructions).

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

Patrick, another question that has come in, is does management think it has a good handle on operating expenses at the current time given that with \$1.1 billion in revenues and making losses last year, do we think we've got things under control?

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

I really do. It's really not -- we have tightened up our expenses, we -- our cash expenses, do you want to say the number that's in the management income number you quoted, Steve, in terms of what our expense structure is? Probably not. But we have tightened up our expense structure, we don't think it's a problem, although we have the ability and the will to -- if our contribution margin kept sliding, we have the ability and the will to keep knocking millions of dollars out of our expense structure but we think we have tightened it up appropriately. And, it's just a matter of getting the contribution margin growing again.

And, also, we've arrested, without going into too many details -- certainly as I've mentioned, there was some very ugly period in the middle of the last quarter where we were shrinking much faster than the 10% that the overall quarter turned out to be. And we have arrested that slide and started bringing it back. I think, given that, I think we made some healthy cuts this year in January in our expense structure, and I don't think any more are warranted now until we see how the current round plays out. But, we do feel like we arrested the slide, and are climbing back.

Operator

(Operator Instructions).

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

Any other questions, Misty?

Operator

There are no questions at this time.

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

Okay let me then address some final questions we've received about internal controls, and about our amendment of the 8-K we filed the day after our annual shareholder meeting. That amended 8-K initially reported that our shareholders had approved our executive compensation and the Board's recommendation about the frequency of future advisory votes on executive compensation. The SEC's rules required an amendment of that 8-K within a few months after the annual meeting to report the Company's decision regarding the frequency of future advisory votes on executive compensation. At our annual meeting, we, management, had recommended the votes be held every three years. The shareholders approved that recommendation. So, it wasn't much news that we intended to follow the shareholder vote, which followed our original recommendation.

But, the fact is, we filed an amendment and it was late. In January, we realized that we needed to file the amendment and we filed it within a day. It was in inadvertent mistake and a minor one at that. Since it was obviously late, there was no need to say so in the amendment, but missing the amendment deadline could have adversely affected our S-3 eligibility. When we requested from the SEC a waiver for the late filing, the SEC granted it, so our shelf registration in the form of Form S-3 is still valid.

We also received a question whether we should have filed an 8-K to report the late 8-K amendment as a triggering event under our finance agreement with USBank. The answer is no. The 8-K requirement applies only if the consequences of an event are material to the registrant. As is our practice, we analyzed the question of materiality and all the facts available to us, and we determined it was not material. USBank agreed and quickly provided a waiver when we requested it. Since that analysis, nothing leads us to question our determination.



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

Do you want to expand on why it was immaterial or minor?

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

Well, having the S3 in place or not frankly, was not something we think is material to the Company and the late filing was minor because it said we intended to follow what we recommended to the shareholders, and the shareholders approved.

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

Okay. Any last words?

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

No, but I think we have answered questions that have come in. We are nose to the grindstone, working hard, focused on some important initiatives within the Company and, as Patrick said, I think we've arrested the decline we saw in the fourth quarter and we're looking forward to 2012.

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

To tell you the truth, we are -- I can't recall, it's been some years since we've been this optimistic as we are internally, which doesn't mean that we're complacent, we don't think we have all the problems worked out, but almost everything is humming and even the part that hasn't been humming for some time, marketing, which has been dribbling along, or worse, it definitely seems to be -- have made a good, aggressive, sharp turn in the right direction. And, I've never been so confident as the people we have running the different chimneys within marketing. Most of them have been there a number of years. And we have a lot of things kicking in. We have a lot -- we have more things kicking in now than I can ever remember at any stretch, and we don't want to overstate it, but we are very optimistic about this year. Steve Chesnut, since you are the CFO, I am sure you can give a healthy dose of -- well, I don't know.

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

Let's leave it at that, Patrick, and we need to continue to execute.

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

Okay.

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

Misty, thank you very much, and shareholders and owners, those that are interested, thanks for following us. We will talk to you next quarter.

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

Thank you very much.



Operator

This concludes today's Overstock.com fiscal year-end and quarter-four 2011 earnings conference call. You may now disconnect.

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