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Q3 2019 Overstock.com Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Third Quarter 2019 Overstock.com Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions) I would now like to hand the conference over to your speaker today, Robert Hughes, Acting CFO. Please go ahead, sir.

Robert P. Hughes *Overstock.com, Inc. - Acting CFO*

Thank you. Good morning, and welcome to our third quarter 2019 earnings conference call. Joining me today are Jonathan Johnson, CEO of Overstock and President of Medici Ventures; Saum Noursalehi, CEO of tZERO; and Dave Nielsen, President of Overstock Retail.

Let me remind you that the following discussion and our responses to your questions reflect management's views as of today, November 12, 2019, and may include forward-looking statements. Actual results may differ materially. Additional information about factors that could potentially impact our financial results is included in the press release and Form 10-Q filed this morning. Please review the forward-looking statements disclosure on Slide 2 of today's presentation.

During this call, we'll discuss certain non-GAAP financial measures. The slides accompanying this webcast and our filings with the SEC, each 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.

Jonathan, with that, let me turn the call over to you.

Jonathan E. Johnson *Overstock.com, Inc. - CEO & Director and President, Medici Ventures*

Thank you, Rob. Good morning. I'm excited to be talking with our owners and other stakeholders.

With our company recently celebrating its 20th birthday and the change in leadership, it's an especially relevant moment to take an objective look at where the company offers real value and where it needs to be upgraded to maintain its competitive position. Overstock.com is the premier destination for customers shopping online for online deals and home goods. Medici Ventures is a one of a kind collection of the industry-transforming blockchain companies.

Those core propositions remain unchanged. We are focused on maximizing the value experience and profitability of the retail business, something Dave and I will discuss today. And we are focused on assisting the Medici Ventures family of companies get their products in production and improve those products' value to customers, something that Saum and I will discuss.

One of the things I've asked each of our executives to do is to narrow focus onto what matters most. All the retail initiatives are now focused on delivering home goods shoppers excellent deals with quick, enjoyable shopping and post-purchase experience. Medici Ventures is spending its time and resources on those companies getting products in production in what we think are the most transformative blockchain markets. We will discuss some of this narrowed focus today and then provide more details on this narrowed focus on our future earnings calls as we make progress in these areas. Let's go to Slide 4.

Let me briefly review the agenda for today's call. We'll begin with a discussion of the status of the OSTKO digital dividend. We'll then discuss tZERO, some of the other companies in the Medici Ventures family and Overstock retail. After highlighting some of our patent activities, we'll give a brief regulatory update. We'll then take questions via e-mail. Next slide.



Let me first discuss a topic many of our shareholders are excited about: the digital dividend paid in Series A-1 shares that trade under the OSTKO ticker on the tZERO platform. All our shareholders should be aware, Overstock's Board has announced a digital dividend of 1 share of the company's Series A-1 shares, OSTKO, for every 10 shares of the company's common, OSTK, Series A-1 or Series B stock held by our shareholders. Let me walk you through why I think this dividend is so important.

First, the Series A-1 shares have preferential access to dividends when declared.

Second, because these Series A-1 shares trade on the tZERO platform, it means there's a completely transparent record of transactions. OSTKO shareholders have a unique level of transparency of ownership in the securities markets. Each shareholder can know what he owns. That's a big deal. Also shares of the Series A-1 shares have same day, in other words, T plus 0 settlement, not the current T plus 2 settlement in the markets.

Third, the digital dividend will add tens of thousands of investors to the tZERO token trading environment. And it incentivizes broker-dealers to participate in and connect with the tZERO platform. This is a real value to Overstock shareholders. As the tZERO platform increases its liquidity, the value of tZERO should grow significantly. Next slide, please.

On October 28, Overstock announced a shareholder vote regarding the digital dividend. The purposes of this shareholder vote are twofold.

First, we want the Series A-1 OSTKO shares to be more easily transferable and to allow non broker-dealer institutions like banks to custody the digital shares. In other words, we want to make sure OSTKO shareholders can hold their digital shares in any location they choose and be able to transfer those digital shares in the event of divorce or death. Both these changes should increase the liquidity of this groundbreaking security.

Second, we want to allow the issuance of a full 1:10 ratio. To do this, we need shareholder approval to increase the number of Series [A-1] (corrected by company after the call) shares by reducing the number of Series B shares. I should note that there is no shareholder dilution with any of these proxy proposals.

These proposed changes to the certificates of designation will allow a broader group of shareholders to be able to hold the Series A-1 dividend the day of its distribution. Now because Overstock is in the process of registering the Series A-1 shares, shareholders with an account with a broker-dealer connected to the tZERO platform will also be able to trade the OSTKO dividend on the distribution date.

Now, like many of you, I'm frustrated with the delay this vote causes. But these adjustments are necessary to enable all shareholders to benefit from the digital dividend. The vote is an important step for the first dividend of its kind to give our shareholders access to the next-generation of capital markets, powered by tZERO. But it also gives our shareholders the opportunity to voice their view of the application of blockchain technology to the securities markets. Next slide.

The timeline for the shareholder vote is as follows. The record date for the proxy will be on December 18. We'll file the proxy the week of December 20. Based on NASDAQ rules, the meeting for the shareholder vote will be on February 13. I've said before, we intend to have the OSTKO dividend in our shareholders' hands within a month of shareholder approval. Thus, assuming shareholder approval on February 13, we expect to distribute a tradable Series A-1 OSTKO dividend on March 9.

While I would like for the company to distribute the dividend sooner, I'm confident in this schedule. The shareholder vote will significantly improve the value of the Series A-1 shares and be worth the wait for our shareholders. Next slide.

Now to the business updates. Medici is and will continue to be a significant focus for us. We are remaining true to our statement of not aggressively adding to the keiretsu and instead, helping our existing family of companies thrive by getting their products into production and into the hands of customers. We'll focus on the progress of just a few of those companies today. Next slide.



Saum will begin by walking us through tZERO's current focuses and some of the advancements that tZERO has made. Saum?

Saum Noursalehi tZERO, Inc. - CEO

Thank you, Jonathan. tZERO's business is transitioning from build to growth, and we are more focused as an organization than ever before and continue to make progress against our core objectives. tZERO is strongly positioned heading into 2020, the year we believe will be an inflection point for the company and the adoption of digital securities.

Before I jump into the business update, I want to reiterate tZERO's value proposition as well as the overall business opportunity.

Go to Slide 11. In the near future, the way in which we trade anything of value is going digital, and we stand to benefit from this opportunity.

Slide 12. What is tZERO's role in this? tZERO represents the next-generation capital markets platform, which allows assets to be digitized in the form of security tokens and provides a compliant way for these tokens to be traded. It is worth reminding everyone that this platform is live and trading securities today.

Slide 13. Some of the advantages of security tokens include democratized access and increased liquidity for traditionally exclusive assets, and this includes investment funds and commercial real estate; reducing settlement times from 2 to 3 business days to near instant; and automating regulatory compliance through the use of smart contract technology.

Slide 14. According to Finova, the World Economic Forum, Deloitte and McKinsey, the global market value of digital assets is expected to double in 2020 to \$1 trillion and rise to \$4 trillion by 2022. This is an 8x increase from where we are today. These are, of course, estimates. However, the key takeaway is the opportunity is quite large. On the right, you'll see some of the applications of this technology, which range from equities, debt, real estate funds to fine art, sports teams and even athletes and artists.

Slide 15. How do we monetize this opportunity? There are 3 key drivers for revenues. First, capital formation, which includes the tokenization business. And while this is primarily a referral fees today, it will evolve to be a percentage of capital raised once we have our own retail broker-dealer. Second, trading, which consists of commissions and listing fees. And third, licensing opportunities to broker-dealers, clearing firms, transfer agents and exchanges. Note that this revenue stream will become significant down the road as our business scales.

Slide 16. This is a diagram of our security token platform, both the supply side on the left or tokenization of assets, and the demand side on the right or investor-facing brokerage user interface. We spent the last year building this ecosystem and look forward to leveraging it to bring more investors and issuers together. I would also like to point out the bottom right that we have signed a contract with another third-party broker-dealer, ChoiceTrade, to trade security tokens.

Slide 17. This was the list of our company goals from last quarter, 2 items of which were to streamline investor onboarding and launch the tZERO Crypto app, both of which are now complete. The following slides will detail the progress we made on both of these fronts.

But before that, I'd like to touch on the DLR opportunity. While we completed the buildout of DLR 2.0's technology, we are focusing as an organization and believe the biggest opportunity is in security tokens. Given the robustness of our token and broker-dealer pipeline and the scale of the opportunity, it doesn't make sense at this moment to divert our resources and attention away from that. To that end, we made the decision to pause our efforts on DLRs. We see it as having potential in our ecosystem down the road and will explore integrating it into our in-house broker-dealer app and web experience when the time is right.

Slide 18. Upon launching our trading platform with Dinosaur Group, we were able to onboard about 5 investors per day. Through process and user experience improvements, we can now process roughly 400 accounts per day. And through further technology improvements, we expect that figure to be well over 1,000 accounts per day. This will allow us to handle the 40,000 to 50,000 Overstock investors looking to onboard to trade the digital dividend.



Slide 19. Through last month, we approved roughly 3,500 accounts on our Crypto app. As you can see, the number of monthly approved accounts has increased organically every month since launching in June. And we are doing this while still awaiting numerous licenses to give us access to some of the largest markets in the U.S. and in the world, including New York. This app is an important piece of our overall strategy of creating a platform that allows for the seamless trading of all-digital assets.

Slide 20. We have accomplished a lot since our last call. I will highlight 3 of these wins. First, as stated earlier, we signed an agreement with our third broker-dealer ChoiceTrade, which will increase liquidity on our ATS. Second, we signed an agreement with Alliance Investments to tokenize \$25 million in equity in a Manchester-based condominium project named River Plaza. Note that this could be the first of potentially \$600 million in commercial real estate that Alliance could tokenize and trade on our platform. Third, our joint venture with Box Digital, BSTX, recently filed an application and proposed a rule book with the SEC regarding the launch of the world's first fully regulated digital securities exchange. This filing is now open to public comment, which is a big step towards being live and trading.

Slide 21. We have narrowed our focus as a company from 5 goals to 3 goals, which I really like. These are, to tokenize and trade quality assets, improve liquidity on our ATS, and as stated earlier, launch the BSTX or Boston Security Token Exchange.

Slide 22. We have been building out our issuance business development team over the past few months, and the benefits are really starting to show. Currently, we are in discussions with over 160 potential issuers spanning real estate, entertainment, asset managers and many more. A few of these assets are in the final stages of due diligence, and we hope to have them trading in the next few months. We are confident we can drive a number of these over the finish line in the near to midterm.

Slide 23. Finally, we are taking a multifaceted approach to improve liquidity on the ATS. First, we are in discussions with approximately 120 broker-dealers to trade security tokens. Dinosaur Financial Group is up and running, and we have agreements in place with ETC and ChoiceTrade, which we expect to be up and running in the months ahead. In addition, OSTKO digital dividend will be another catalyst for adding additional broker-dealers to our ecosystem. Second, we are launching our proprietary broker-dealer, which is awaiting regulatory approval, currently targeting late Q1, possibly early Q2. And lastly, we are in discussions with several additional clearing firms to further expand the reach of our digital asset trading.

As you can see, we are very busy and moving forward. Jonathan?

Jonathan E. Johnson *Overstock.com, Inc. - CEO & Director and President, Medici Ventures*

Thanks, Saum. It's great to see the steady progress tZERO is making under your leadership and that of the upgraded tZERO executive team. I love the focus, and I've never been more confident in tZERO. And I'm excited to see how the OSTKO dividend enhances the liquidity on the tZERO trading platform. I hope our shareholders understand the importance of the OSTKO dividend. Next slide.

Next, I'll highlight 4 Keiretsu companies that have made significant strides recently.

Slide 25. Evernym is the only new addition to the Keiretsu since we last spoke, and it is one we have been actively pursuing. We believe identity is a key thread in what Medici Ventures is building. Evernym is world-class, having launched the Sovrin Foundation and assisted the Worldwide Web Consortium in creating the gold standard in self-sovereign identity.

The promise of self-sovereign identity is that the subject of identity data, namely you, should be the sole owner of that identity data. Given breaches, leaks and unauthorized selling of identity data since the birth of the Internet, we believe self-sovereign identity is the next killer app of blockchain.

While it's hard to place an exact value on the identity management as an industry, its value is clearly marked in the success of companies like Okta and arguably the identity management space's largest player, Facebook, which allows you to log on to many sites using your Facebook credentials. It's great to welcome Evernym to the Keiretsu, and I look forward to its contribution to our blockchain technology stack.

Slide 26. Let's talk GrainChain. Luis Macias and his team continue to bring Internet-of-Things triggered smart contracts to the world, this time in Honduras with the coffee supply chain. I expect the growth of GrainChain to continue in Central and South America as there are thicker margins and greater efficiencies to be gained in those regions. The GrainChain platform allows banks to connect with more farmers and reduces cost and friction for exporters and buyers by eliminating middlemen and reducing overhead. The smart contracts in the system protect all players by ensuring contracts are paid as written rather than being renegotiated based on human biases.

It's hard to overstate what GrainChain has achieved. While it is starting with a small portion of the coffee supply chain in Honduras and the grain supply chain in Mexico, having all players in the supply chain recognize the benefits of this technology is no small feat. We expect the success to grow as farmers, bankers, buyers and exporters realize the benefits of the transparency and traceability in the process.

Slide 27. Yet again, I'm talking about Voatz. This makes a full year of quarterly calls featuring Voatz. Voatz has two projects I'd like to highlight.

First, the Utah County voting pilot I mentioned on our last call went off without a hitch, and you can even watch an independent audit of those votes performed on a Facebook live stream. The county then expanded the pilot to the general election to voters with disabilities. That voting ran through November 5, and while we don't want to scoop any news from the county, things went well, including Utah's oldest voter, 106-year-old Maccene Grimmett, who was born before women had the right to vote, voting from her home on a mobile device using Voatz's blockchain-based, safe, secure and auditable mobile application.

Second, Jackson and Umatilla counties in the State of Oregon used the Voatz mobile app to enable a secure means for active duty military and their dependents and other overseas voters to participate in the recently completed November 5 election. Continuing the theme, that went off seamlessly too.

The Voatz mobile app has now been used in live elections in 4 states: West Virginia, Colorado, Utah and Oregon. Voatz's record of success should lead to more pilots in new markets and expanded opportunities in existing markets.

Slide 28. Let me briefly mention PeerNova. In a fairly hostile environment for capital in the blockchain space, PeerNova raised \$31 million in a Series B round. We were pleased to be part of that round as a follow-on to our previous involvement with PeerNova. Peernova will carve out the back office portion of a fintech market expected to surpass \$300 billion by 2023. We believe PeerNova is on the cusp of greatness, only held back by the long sales cycles of the large enterprise customers it seeks to service. Those that get on the PeerNova train will be able to recognize significant increases in efficiency through PeerNova's use of cryptography and a proprietary blockchain to simplify auditing.

Next slide. While I've highlighted more companies than usual, it's only because our companies in the Keiretsu are maturing and continue to push product to production and into the hands of customers. The blockchain space is maturing as a whole, and customers are beginning to recognize the benefits of blockchain. This trend will only continue.

Next slide. Let me now turn to the Overstock retail business. I want to say it's great to be back working shoulder-to-shoulder with this retail team. Many of our shareholders will remember I was the president of Overstock from 2008 through 2013, and that Overstock had its first profitable year in 2009.

Next slide. Before I turn to Dave, I want to take a minute to talk about the Overstock retail team. In the period between 2009 and 2016, Overstock had a run of 7 of 8 profitable years. Now, 9 of the 11 retail executives shown on this slide were here then and were part of the team that produced those results. This is a team that knows how to grow and to make money in e-commerce. I'm confident we will do so again.

So Dave, I'll let you walk our shareholders through our Q3 results and our current focuses in Overstock retail.



David J. Nielsen *Overstock.com, Inc. - President of Overstock Retail*

Thank you, Jonathan.

Next slide. As we told you in our updated retail guidance, the third quarter was trending towards flat adjusted EBITDA, and the results came in right where we expected it. While we had planned for a higher contribution, the team did an admirable job of managing expenses in line with contribution. Let me point out, this is also a significant year-over-year Q3 improvement.

Next slide. As we shared in our updated retail guidance, we missed our target contribution number as a result of some headwinds in the market at large and because of some disruptions in the freight side of our supply chain. We have some additional data around these headwinds further on in the presentation, and we'll elaborate on the challenges we faced in the third quarter. Before we do, I'd like to size up our market for you.

Next slide. As we mentioned last quarter, Overstock retail is in an exciting market that, while it is facing some headwinds at the moment, had a great deal of promise for long-term growth and profitability. The home furnishings market is a \$300 billion highly fragmented market with a relatively small online penetration when compared to other product categories. At a 19% penetration level, we can be fairly confident that the online segment of this market is going to experience elevated levels of growth for the foreseeable future. We also know that with less than 35% of the market consolidated in the top 5 players, differences in consumer preference will keep the market relatively fragmented with lots of room for profit enhancing differentiation.

Next slide. The primary reason for the home goods market being so fragmented is that customers have highly differentiated preferences in how they shop. The home experiences that delight some will actively turn away others. We've made significant progress in understanding how these consumers break down; not on a demographic or socioeconomic level, but in terms of their fundamental preferences in shopping for home goods.

Next slide. We found a cohort of customers that is fundamentally deal oriented, but who does not enjoy making significant time commitment to shopping for home goods. This market segment represents almost 40% of the total home furnishing spend. These are customers that naturally over-index in shopping at Overstock and who most favor our unique experience. Our strategy is to expand our moat around these customer segments and customize our shopping experience to meet their needs.

Next slide. We do that through 3 principal areas of investment. First, we want to be the easiest platform for them to find the products they want to buy. These are not customers who view home shopping as a form of recreation. They want a beautiful home, but they don't want to work to get products that fit their style. Second, these are customers who take great satisfaction in getting a deal. They enjoy beating the market on the price they pay for the quality they desire. And finally, we need an excellent post-purchase experience with painless delivery, returns, and customer service to pull brick-and-mortar customers out of the showrooms and into the online experience. We have a set of metrics that we use to judge our progress against these objectives that we share with our shareholders so that you can hold us accountable in our progress against the strategy.

Next slide. The first benchmark for product-finding is essentially a measure of how quickly and easily a customer is able to find a product that interests them. As you can see from the chart on the left, we made significant progress both year-over-year and quarter-over-quarter. We intend to continue to invest in this part of our experience, and we'll update you on that progress in coming quarters. The middle chart illustrates the improvements we are making in the time a customer has to wait between page loads. There is a significant amount of industry research from Google and others that shows latency between pages significantly reduces a customers' willingness to shop a website. Again, while we have made gains in recent quarters, we believe that we need to accelerate this progress to meet our objectives, and this will be a major emphasis for us in the coming quarters, especially for mobile. Finally, from the chart on the right, we saw a significant continued improvement in our SEO rankings this quarter. While we were pleased with the elevated rankings, we also note that we and others that benefited from the changes Google made in June have given back some portion of those gains in October in conjunction with the most recent Google algorithm update. As of now, those rankings appear stable, and we continue to believe that our strategy around customer experience will continue to produce long-term improvements in this metric. We also believe that as we solve for some of the market headwinds experienced in Q3, we can better monetize this traffic than we did during the quarter.



Next slide. In our ongoing effort to provide our customers with the deal-rich experience they love, we continue to provide solid results in our private label program and returns costs. This, combined with our other cost reducing and value-enhancing initiatives, has allowed us to improve our perceived price advantage versus other retailers even while expanding our gross margins year-over-year. That said, our rate of improvement has slowed a bit. Some of the reasons for which can be seen on the next slide.

As you can see from the chart on the left, the sales we generate on products that received tariff increases dropped 12.2% post-tariff cost increases. It is important to note that not all Chinese-manufactured products received cost increases due to tariff increases. We have diversified our sourcing over the last several years, bringing down the total assortment from China from nearly 85% after the 2008 recession to about 50% now. Our suppliers continue accelerating this transition to Vietnam and other markets, but tariffs will continue to cause some near-term pain. Another major reason for our updated retail guidance is illustrated in the chart on the right. We've shared with you for several quarters that we were in the midst of a freight rebalance. The new carrier involved in this rebalance, XPO, initially performed well during a proof-of-concept test earlier in the year with very competitive rates. Based on that test performance, we had projected in our outlook and on our last call, several million of quarterly savings in freight spend for the rest of the year. We found, however, that as we scaled the program, XPO's service levels deteriorated, turning that anticipated \$1.5 million savings for the third quarter into more than a \$2 million loss or a \$3.7 million negative net swing. The good news is as we finish the quarter, we moved that freight back to our existing carriers, and our service levels snapped right back, bringing us in line with our historical rates.

Next slide. On the chart on the left, you see our 2-day delivery messaging also dipped in the quarter as we scaled our freight with XPO based on the degraded service levels previously mentioned. We are pleased that since placing that business back with our existing carriers, we realized immediate improvement, and we are once again seeing growth in the amount of product with 2-day delivery messaging to our customers. Finally, we believe the chart on the right is a solid affirmation of our strategy given that even in this very difficult market, we saw nice improvement in the repeat purchase rate of our customers.

Next slide. In our effort to provide greater transparency and accountability to shareholders, last quarter we began listing the initiatives we intended to execute on to roll out our strategy. As you can see, we completed a number of these initiatives in the quarter. The notable exception being the failed freight rebalance that we rolled back at the end of the quarter to our existing carriers; hence, the red X and the green check. Some of these initiatives like return costs, reductions, mobile app improvements and our private label expansion, are expected to be ongoing for several periods into the future.

Next slide. For that reason, you'll see we intend to continue reporting on some ongoing initiatives in Q4 as well as new initiatives like machine learning-based style personalization, prepositioning of our Black Friday door buster deals for lower cost and 2-day delivery and free returns for Club O members.

Next slide. On our Q3 financial summary, let me call attention to a key point. While macroeconomic and other factors were drivers in lower-than-expected revenue in the quarter, gross margin and in turn contribution margin came in better than anticipated. We believe there is opportunity to reinvest more aggressively in driving the top line without compromising contribution dollars, and we intend to do so in the fourth quarter.

Next slide. While contribution in the quarter did not come in where we had hoped for reasons previously mentioned, the team did an admirable job in their expense discipline to preserve contribution dollars.

Next slide. And finally, while we had hoped for even greater contribution growth, we still did see a 16% improvement in quarterly retail contribution year-over-year. We believe, in spite of the macro environment, our value positioning in the market represents an opportunity. A great example of this is our performance in 2009 when we posted our first year of profitability and ended the year with much stronger than market growth. The retail business will continue to pursue its strategy of strengthening that value proposition to take advantage of the current market conditions.

With that, let me turn the time over to Jonathan to discuss some updates on corporate business at large.

Jonathan E. Johnson *Overstock.com, Inc. - CEO & Director and President, Medici Ventures*

Thanks, Dave. I too am confident about the opportunities for Overstock retail. The team and the innovative tech it is building to improve experience for deal-conscious customers is going to position us very well.

Something I'd like to highlight briefly this quarter that may not be well-known by our shareholders is the patent activity throughout the organization. Let me start by saying each business in the organization manages its own patent protection activities and philosophy. When you look at the combined patent activity, it should give our shareholders a glimpse into the impressive innovation taking place across the organization,

Slide 48. This first slide shows the patent activity of our Overstock retail business. Under the patents pending grouping, you can see the total number of U.S. patent applications filed by Overstock Retail. The issued or allowed grouping speaks for itself. Overstock Retail has had real success receiving patents around e-commerce and online advertising among other innovative ideas. And the international grouping shows the number of filings outside the United States regardless of status.

Slide 49, please. This slide shows the patent activity for Medici Ventures and tZERO. The activity in this area is exciting because many of these patent applications pertain to novel applications of blockchain technology for capital markets and include an issued patent covering a bridge between legacy Wall Street systems and new technology. The reason there are so many more pending patents than issued patents is that blockchain is still such a new area of innovation. You can also see the heavier emphasis on international filings. Remember, these companies are targeting both domestic and international markets.

Next slide. This third slide shows the activity of the Keiretsu companies, including the patent activity in the previous 2 slides plus all but 2 of the other Keiretsu companies. There's a lot of meaningful innovation taking place across the organization. I should note that many of the Keiretsu companies are pursuing an open-source strategy in the pure spirit of blockchain, and we support that philosophy too.

I share these slides with you because we believe the intellectual property being generated in Overstock Retail and in the blockchain businesses has material value and is worth protecting.

Slide 51. Overstock and tZERO are on the leading edge of trying to create a blockchain-based capital market. We are getting the attention of the marketplace and at times regulators. We have a goal of changing the way capital markets work and doing so in a way that is secure, trustworthy and simple for investors. That includes compliance with all regulatory laws in a highly regulated complex marketplace. And it means engaging in regular dialogue with and answering requests of regulators. We have regular meetings and conversation with the SEC's Division of Trading and Markets and the Division of Corporation Finance, and with FINRA to give each group insights into the new things we are doing with our tZERO group broker-dealers, PROsecurities ATS, and the OSTKO dividend.

We believe in engagement and dialogue with regulators. We do not hesitate to change direction to get on the same page as regulators, particularly as it advances our mission of creating a more secure, trustworthy and simple capital market. While partnership may be too strong a word, we respect the important role the SEC and other regulators play to protect investors, maintain fair and efficient markets, and facilitate capital formation. It's not just by accident that those ideals parallel ours.

We're also engaged with the SEC's Enforcement Division as Overstock has received 2 voluntary document requests, with the last one in December 2018. Overstock produced those records the SEC requested about 6 months ago. In addition to those requests, on October 7, 2019, we received a subpoena from the SEC requesting information and documents related to the dividend we announced to shareholders in June 2019 and copies of stock trading plans of executives. We are cooperating fully, and we continue to have conversations with the staff to address any questions it may have. Of course, we hope the SEC will be satisfied with what we've provided and move on from its inquiry. Obviously, I cannot assure you the commission will do so, nor can we know the timing as to any decision the SEC may make on these matters. As we always have, we will continue to engage with the staff so that it will have both what it needs to conduct its review and see our perspective.

Next slide. It's been nearly three months since I took the helm. I acknowledge that it's been a trying quarter for our owners. It's good to



have it behind us. I remain excited about the company's prospects. I'm exhilarated each morning as I pop out of bed, and, I must admit, I'm exhausted each night when my head hits the pillow. As a company, we are focused, we are stable, and we are moving forward.

QUESTIONS AND ANSWERS

Editor

Let's take some questions. We have some questions e-mailed in ahead of time. We've had some that have come in during the call.

Saum will start with one that is directed at tZERO: Please update investors on the tZERO pipeline of potential token issuers for both the tZERO platform and the Box JV.

Saum Noursalehi tZERO, Inc. - CEO

Sure. As I stated, our business development team is in conversations with over 160 issuers from a variety of sectors. 10-plus of these are in due diligence, 3 to 5 of which are in the final stages. And we hope to have them trading either by the end of the year, which was my original target, or in the first quarter.

Jonathan E. Johnson Overstock.com, Inc. - CEO & Director and President, Medici Ventures

Okay. Dave, there's one that's come in about Retail and Wayfair. On the Wayfair earnings call, Wayfair indicated it was being negatively impacted by tariffs. The tariffs are causing the price of merchandise on its platform to fluctuate, which lengthens the buying cycle. Is Overstock experiencing the same kind of thing?

David J. Nielsen Overstock.com, Inc. - President of Overstock Retail

Yes. As mentioned during the call today, our products that received tariff increases decreased in revenue by 12.2% post-tariff cost increases. It's important to note that not all of our Chinese manufactured products received cost increases. And we've diversified our sourcing over the last several years bringing down the total assortment product in China from nearly 85% after the 2008 recession to about 50% now. And our suppliers continue accelerating this transition to Vietnam and other markets, but tariffs will continue to cause near-term pain.

Jonathan E. Johnson Overstock.com, Inc. - CEO & Director and President, Medici Ventures

Okay. Thank you. Another question: For the Medici holdings, what is our percent ownership and how much capital have we invested in each one?

We get this question often. Many of the keiretsu companies ask that we not disclose our percent ownership interest in them. Even with this request, as a public company we must disclose that information for some. You can find the information on tZERO and MLG in our consolidated financial statements and information on most of the other companies in the 10-Q on Page 15. For those not covered in those two locations, we generally own less than 6% of the companies.

Another question about Medici: As you've suggested recently, your primary focus is on existing holdings. Do you still feel that way? Or do you see additional opportunities to add more companies to the portfolio?

As I mentioned as we went through the slides, the current holdings will be our primary focus for the time being, but we've always got our eyes peeled and our ears to the ground for something world changing. Future funding is more likely to be follow-on funding to companies already in the keiretsu, like we did with PeerNova in October.

A couple of questions on the dividend. In fact, we've received a lot of questions about the status of the digital dividend and when it will happen. I think we've gone into great detail on Slides 5 through 7. But I will add, again, that our team has been talking with regulators who have been helpful in guiding us. Assuming we're successful in getting shareholder approval to amend the Series A certificate of designation, it feels like we've now crossed all "T"s and dotted all "I"s.

Another question about the dividend: Someone asks, with all the counterfeit shares in existence, how will you ensure that the votes for



this dividend will be from those who actually, in quotes, own the shares?

This is a great question and one near and dear to me given all that I've worked on in this area. Let me start off by saying we recognize the risk of fraud and have policies and procedures in place with Computershare and Broadridge to make sure only record holders of common Series A and Series B shares of Overstock can vote. That said, this question highlights the problem of today's financial record-keeping system. This is why tZERO, with its use of blockchain technology, is so needed in the capital markets. There is slop. There is delay. There are many opportunities for manipulation in Wall Street's archaic recordkeeping system. Everyone knows it's far from a perfect system. What is the answer to the mess? In my mind it's simple. It's the innovation of blockchain with its instant clearing, immutable ledgers, transparency, and its exponential efficiency that not only cleans up the existing mess, and there's no company out there trying harder and better poised to introduce blockchain to capital markets than our own tZERO.

Another question on tZERO, speaking of tZERO. Saum, in a previous conference call, Patrick Byrne said he would spin-off tZERO before the end of 2019 should the company be unable to sell the retail business. What is current management's thoughts on this?

Saum Noursalehi tZERO, Inc. - CEO

Sure. This is something we are interested in but not right now. We get a lot of synergies by being owned by Overstock. This includes leveraging talent, we get talent from Overstock. When we no longer need it, we can shift that talent back to Overstock. We're also working closely with Overstock on the digital dividend, which Jonathan described, and we really see that as a model for many other companies that are interested in going digital. We can also draw capital from Overstock if necessary. So at this time, it just doesn't make sense to spin out. But we are going to look for the right moment to do so.

Jonathan E. Johnson Overstock.com, Inc. - CEO & Director and President, Medici Ventures

Yes, the synergies are real, all the way down to Saum and I sharing an office when Saum is in Salt Lake.

Speaking of the retail business and its potential sale, we've been asked: can you provide an update on where things stand on the potential sale of the retail business?

There is nothing new to report. When there is, we'll let the market know.

Another question on retail: eBay and Etsy are suggesting changes to online sales tax legislation following last year's Supreme Court rulings are negatively impacting their performance. How, if at all, is it affecting Overstock sales?

I've been intimately involved in the sales tax matters for years. And we haven't seen any real negative impact, likely for two reasons. First, our model is different than that of eBay and Etsy because we are not an open marketplace for small and individual sellers. And second, we were proactive in preparing for the potential Supreme Court ruling and were thus able to implement, quickly, sales tax collection and remittance without much work that eBay and Etsy are likely having to do now. The states aggressively go after small sellers to collect sales tax.

Got a question come in about our CFO. It says, why did your last CFO leave? And where are you in your efforts to find a long-term replacement?

Mr. Iverson gave his notice at 6:10 p.m. on the day he left, effective immediately. He didn't provide a reason. He did assure our outside auditors that he had no concerns with the company's financial statements or accounting practices. The search for a replacement is progressing nicely. We've engaged the executive search firm Spencer Stuart, and it's compiled a nice slate of interested candidates that I anticipate we will begin interviewing soon. In the meantime, it's great to be working closely with Rob Hughes again. He stepped into the acting CFO role without missing a beat. Now, Rob is eager to get back to MLG full time, but he's graciously agreed to stay in the acting CFO role until we find the right person to be our full-time CFO.

Question about some of the class-action lawsuits: Can we get an assessment from the company regarding the merit of the class-action suits being filed by the various firms claiming insider trading and mismanagement?

The way security class-action attorneys work is that once one files a suit, others file copycat suits. Eventually, the judge will consolidate all of them into one suit and appoint a lead attorney. So the number of suits filed is not disconcerting at all. Neither is the substance of the claims. We think they're meritless, and the company will defend them vigorously. By the way, the last time a gaggle of security class action attorneys sued company, when the judge consolidated the suits into one and appointed a lead attorney, that lead attorney thought the case was so meritless he dismissed the suit on his own.

Dave, here's a retail question: there are fewer shopping days this year between Thanksgiving and the holidays. What if any impact do you think that will have on Overstock sales?

David J. Nielsen *Overstock.com, Inc. - President of Overstock Retail*

We expect little impact from the shortened holiday period in 2019. There really isn't any hard evidence that fewer shopping days hurts holiday sales. Some folks will point to 2013, which was the last time we had this type of calendar set-up as evidence that fewer shopping days will be a drag on sales. However, there are a number of factors as to why 2013's poor performance was what it was: payroll tax hikes that year, the SNAP reduction hurting lower income consumers. The previous short holiday season before that was 2008, which is when the world started to collapse from the financial crisis that hit in September of 2008. So anyone pointing to the calendar as a driver for weak sales in 2013 or 2018 is really ignoring a number of other large factors.

Jonathan E. Johnson *Overstock.com, Inc. - CEO & Director and President, Medici Ventures*

Good points. Saum, how will tZERO be able to execute its plans particularly with such high regulatory oversight?

Saum Noursalehi *tZERO, Inc. - CEO*

If it were easy, everyone would be doing it, so it is challenging. But with that said, we're working very closely with regulators to implement the next evolution of capital markets. This will require providing essentially all the traditional investor protections that exist today while also offering the disruptive benefits of distributed ledger and smart contract technology.

Jonathan E. Johnson *Overstock.com, Inc. - CEO & Director and President, Medici Ventures*

Thanks. A question on free cash flow: are you still on track to once again be able to use free cash flow generated from your e-commerce business to fund your blockchain-related efforts?

Well, that remains the goal, and we still believe it is an achievable goal. But the Q3 headwinds we discussed earlier have set that back a bit. As you will recall, we were well on the path to profitability in 2008, got set back by the recession, but still got to profitability in 2009. We think we can do it again.

Question from a shareholder, Michael: How much effort is going into ending this SEC investigation?

As I mentioned in our regulatory update, we are fully cooperative with the SEC. We answer any inquiry it makes as quickly as we can. I would say outside the legal group, this takes very little time from anyone else at the company.

Another question: We had multiple investments in voting-related efforts. What are they? And what do you see as the long-term opportunities for them?

We have three companies in the voting space: Voatz, Votem and, to some extent, SettleMint. I've discussed during the slides the real progress that Voatz is making. I think there will be a day soon, sooner than people think, when everyone will be able to use their mobile devices to vote in a safe, secure and auditable way. No more waiting in lines. No more hanging chads. No more not knowing if your vote was really counted. Voting as we do today, will feel as outmoded as sending a fax. Some still will but not many. That's the future in voting that I see.

Any thoughts on the revenue model for MLG?



Yes. MLG is still young in developing its business model. That said, MLG is in discussions with two government agencies for paid projects that each have different revenue models. Under one proposed agreement, MLG would be paid a per title fee for each title issued. Under the other proposed agreement, MLG would receive a percentage of all real property-related taxes and fees for use of its technology and services. So there are various ways that MLG can generate revenue by its activities, and we're really excited about what MLG is doing.

Another question about Medici Ventures and keiretsu: Which of the holdings have you most encouraged about their ability to drive long-term shareholder value and why?

Well, it's always a tough question. It's like asking which of my kids do I most love or am I most excited about. But at the risk of picking one over another, I'll answer the question with multiple of the companies. tZERO, for all the reasons that Saum has discussed. MLG, for the answer I just gave, and because the idea of unleashing dead capital in most of the world is really needed. Voatz, again for the reasons I've discussed. Peernova, because of the size of the banking back office compliance market. Bitt, because when Bitt successfully helps the central banks of the world issue digital currencies the unbanked of the world will be the beneficiaries. And GrainChain, because providing a way for farmers to get paid more quickly is a great go-to-market story.

Final question: Jonathan, now that you've had time to settle into the CEO role, how is your long-term strategy different from that of your predecessor? And how is it the same?

That's a great question, and it's a fair question. The core value propositions of this company remain unchanged. We're focused on maximizing the value, experience and profitability of the retail business. We're focused on assisting the Medici Ventures family of companies to get their products in production, improve their products' value to customers. But we are narrowing our focus to what matters most. I hope you've got a sense of that during this call, and I know you will on our calls in the future. This will continue, that I can promise.

We thank our owners. We thank our shareholders and other stakeholders and we'll talk with you at the end of the fourth quarter. Thanks so much.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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