

OVERSTOCK.COM, INC  
Form 10-Q  
May 08, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2018

Or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-49799

OVERSTOCK.COM, INC.

(Exact name of registrant as specified in its charter)

Delaware

87-0634302

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

799 West Coliseum Way, Midvale, Utah

84047

(Address of principal executive offices)

(Zip Code)

(801) 947-3100

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

There were 28,897,666 shares of the Registrant's common stock, par value \$0.0001, outstanding on May 4, 2018.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

Overstock.com, Inc.

Consolidated Balance Sheets (Unaudited)

(in thousands)

	March 31, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$259,569	\$ 203,215
Restricted cash	447	455
Accounts receivable, net	21,798	30,080
Inventories, net	12,471	13,703
Prepaid inventories, net	858	1,625
Prepays and other current assets	22,091	16,119
Total current assets	317,234	265,197
Fixed assets, net	126,765	129,343
Intangible assets, net	24,653	7,337
Goodwill	22,058	14,698
Other long-term assets, net	35,564	17,240
Total assets	\$526,274	\$ 433,815
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$89,666	\$ 85,406
Accrued liabilities	92,105	82,611
Deferred revenue	41,712	46,468
Other current liabilities, net	182	178
Total current liabilities	223,665	214,663
Long-term debt, net - related party	39,977	39,909
Other long-term liabilities	6,539	7,120
Total liabilities	270,181	261,692
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock, \$0.0001 par value, authorized shares - 5,000		
Series A, issued and outstanding - 127 and 127	—	—
Series B, issued and outstanding - 555 and 555	—	—
Common stock, \$0.0001 par value		
Authorized shares - 100,000		
Issued shares - 32,048 and 30,632		
Outstanding shares - 28,866 and 27,497	3	3
Additional paid-in capital	547,184	494,732
Accumulated deficit	(300,561 )	(254,692 )
Accumulated other comprehensive loss	(595 )	(599 )
Treasury stock:		
Shares at cost - 3,182 and 3,135	(66,170 )	(63,816 )
Equity attributable to stockholders of Overstock.com, Inc.	179,861	175,628
Equity attributable to noncontrolling interests	76,232	(3,505 )

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Total equity	256,093	172,123
Total liabilities and stockholders' equity	\$526,274	\$ 433,815

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.  
Consolidated Statements of Operations (Unaudited)  
(in thousands, except per share data)

	Three months ended March 31,	
	2018	2017
Revenue, net		
Direct	\$ 16,270	\$ 22,828
Partner and other	429,061	409,607
Total net revenue	445,331	432,435
Cost of goods sold		
Direct(1)	14,772	20,963
Partner and other	336,690	324,565
Total cost of goods sold	351,462	345,528
Gross profit	93,869	86,907
Operating expenses:		
Sales and marketing(1)	77,214	37,618
Technology(1)	31,294	28,992
General and administrative(1)	39,755	22,610
Total operating expenses	148,263	89,220
Operating loss	(54,394 )	(2,313 )
Interest income	544	125
Interest expense	(874 )	(710 )
Other expense, net	(9 )	(3,724 )
Loss before income taxes	(54,733 )	(6,622 )
Benefit from income taxes	(277 )	(340 )
Consolidated net loss	\$(54,456)	\$(6,282)
Less: Net loss attributable to noncontrolling interests	(3,547 )	(379 )
Net loss attributable to stockholders of Overstock.com, Inc.	\$(50,909)	\$(5,903)
Net loss per common share—basic:		
Net loss attributable to common shares—basic	\$(1.74 )	\$(0.23 )
Weighted average common shares outstanding—basic	28,566	25,290
Net loss per common share—diluted:		
Net loss attributable to common shares—diluted	\$(1.74 )	\$(0.23 )
Weighted average common shares outstanding—diluted	28,566	25,290

(1) Includes stock-based compensation as follows (Note 8):

Cost of goods sold — direct	\$ 70	\$ 49
Sales and marketing	873	96
Technology	521	160
General and administrative	4,971	635
Total	\$ 6,435	\$ 940

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Comprehensive Loss (Unaudited)

(in thousands)

	Three months ended March 31,	
	2018	2017
Consolidated net loss	\$(54,456)	\$(6,282)
Other comprehensive loss:		
Unrealized gain on cash flow hedges, net of expense for taxes of \$0 and \$95	4	149
Other comprehensive income	4	149
Comprehensive loss	\$(54,452)	\$(6,133)
Less: Comprehensive loss attributable to noncontrolling interests	(3,547 )	(379 )
Comprehensive loss attributable to stockholders of Overstock.com, Inc.	\$(50,905)	\$(5,754)

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

(in thousands)

	Three months ended March 31, 2018
Equity attributable to stockholders of Overstock.com, Inc.	
Number of common shares issued	
Balance at beginning of period	30,632
Common stock issued upon vesting of restricted stock	166
Exercise of stock warrants	1,250
Balance at end of period	32,048
Number of treasury stock shares	
Balance at beginning of period	3,135
Tax withholding upon vesting of restricted stock	47
Balance at end of period	3,182
Total number of outstanding shares	28,866
Common stock	\$3
Number of Series A preferred shares issued and outstanding	127
Number of Series B preferred shares issued and outstanding	555
Preferred stock	\$—
Additional paid-in capital	
Balance at beginning of period	\$494,732
Stock-based compensation to employees and directors	2,395
Exercise of stock warrants	50,562
Other	(505 )
Balance at end of period	\$547,184
Accumulated deficit	
Balance at beginning of period	\$(254,692)
Cumulative effect of change in accounting principle	5,040
Net loss attributable to stockholders of Overstock.com, Inc.	(50,909 )
Balance at end of period	\$(300,561)
Accumulated other comprehensive loss	
Balance at beginning of period	\$(599 )
Net other comprehensive income	4
Balance at end of period	\$(595 )
Treasury stock	
Balance at beginning of period	\$(63,816 )



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Tax withholding upon vesting of restricted stock	(2,354 )
Balance at end of period	(66,170 )
Total equity attributable to stockholders of Overstock.com, Inc.	\$179,861
Equity attributable to noncontrolling interests	
Balance at beginning of period	\$(3,505 )
Proceeds from security token offering, net of offering costs (Note 2 - Noncontrolling Interest)	75,951
Stock-based compensation to employees and directors	4,040
Tax withholding upon vesting of restricted stock	(1,680 )
Net loss attributable to noncontrolling interests	(3,547 )
Paid-in capital attributable to noncontrolling interests	4,468
Other	505
Total equity attributable to noncontrolling interests	\$76,232
Total equity	\$256,093
See accompanying notes to unaudited consolidated financial statements.	

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Overstock.com, Inc.

Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Three months ended March 31,		Twelve months ended March 31,	
	2018	2017	2018	2017
Cash flows from operating activities:				
Consolidated net loss	\$(54,456 )	\$(6,282 )	\$(160,096 )	\$(8,128 )
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:				
Depreciation of fixed assets	6,581	7,698	27,731	28,792
Amortization of intangible assets	918	945	3,972	3,815
Stock-based compensation to employees and directors	6,435	940	9,572	4,863
Deferred income taxes, net	(267 )	(806 )	65,738	(771 )
Gain on investment in precious metals	—	—	(1,971 )	(201 )
Impairment of cryptocurrencies	8,793	—	8,793	—
Gain on sale of cryptocurrencies	(1,529 )	—	(3,524 )	—
Impairment of equity investment	—	4,500	987	7,350
Early extinguishment costs of long term debts	—	—	2,464	—
Other	185	38	1,023	381
Changes in operating assets and liabilities, net of acquisitions:				
Accounts receivable, net	8,282	6,527	(183 )	(2,528 )
Inventories, net	1,232	1,211	5,255	1,713
Prepaid inventories, net	767	(626 )	1,880	(1,536 )
Prepays and other current assets	1,471	(1,173 )	(642 )	(1,891 )
Other long-term assets, net	(2,261 )	(404 )	(4,164 )	(1,202 )
Accounts payable	4,325	(20,456 )	3,786	6,236
Accrued liabilities	9,274	(13,689 )	10,652	16,583
Deferred revenue	284	(1,593 )	6,565	(2,625 )
Other long-term liabilities	(216 )	73	(144 )	119
Net cash (used in) provided by operating activities	(10,182 )	(23,097 )	(22,306 )	50,970
Cash flows from investing activities:				
Purchases of intangible assets	(9,181 )	—	(9,604 )	—
Proceeds from sale of precious metals	—	—	11,917	1,610
Investment in precious metals	—	—	—	(1,633 )
Disbursement of note receivable	—	(250 )	(500 )	(1,068 )
Investment in equity securities	(16,970 )	(777 )	(21,381 )	(5,527 )
Acquisitions of businesses, net of cash acquired	(11,769 )	—	(11,769 )	43
Expenditures for fixed assets, including internal-use software and website development	(4,029 )	(11,344 )	(16,271 )	(64,033 )
Other	(1 )	(118 )	187	(92 )
Net cash used in investing activities	(41,950 )	(12,489 )	(47,421 )	(70,700 )
Cash flows from financing activities:				
Payments on capital lease obligations	(123 )	—	(206 )	—
Payments on finance obligations	—	(817 )	(14,499 )	(2,348 )
Payments on interest swap	—	—	(1,535 )	(422 )
Proceeds from finance obligations	—	—	—	7,978
Proceeds from long-term debt	—	—	40,000	25,150
Payments on long-term debt	—	(187 )	(45,579 )	(187 )

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Payments of preferred dividends	—	—	(109	) —
Proceeds from exercise of stock options	—	654	10	1,473
Proceeds from rights offering, net of offering costs	—	—	—	7,591
Proceeds from issuance of stock warrants	—	—	6,462	—
Proceeds from exercise of stock warrants	50,562	—	150,562	—
Proceeds from security token offering, net of offering costs	62,073	—	62,978	—
Purchase of treasury stock	—	(10,000	) —	(10,000 )
Payments of taxes withheld upon vesting of restricted stock	(4,034	) (822	) (4,441	) (1,354 )
Payment of debt issuance costs	—	—	(670	) —
Net cash provided by (used in) financing activities	108,478	(11,172	) 192,973	27,881
Net increase (decrease) in cash, cash equivalents and restricted cash	56,346	(46,758	) 123,246	8,151
Cash, cash equivalents and restricted cash, beginning of period	203,670	183,528	136,770	128,619
Cash, cash equivalents and restricted cash, end of period	\$260,016	\$136,770	\$260,016	\$136,770

Continued on the following page

Overstock.com, Inc.

Consolidated Statements of Cash Flows (Unaudited)

(Continued)

(in thousands)

	Three months ended		Twelve months ended	
	March 31,	March 31,	March 31,	March 31,
	2018	2017	2018	2017
Supplemental disclosures of cash flow information:				
Cash paid during the period:				
Interest paid, net of amounts capitalized	\$789	\$646	\$3,083	\$1,636
Income taxes paid, net of refunds	7	—	494	859
Non-cash investing and financing activities:				
Fixed assets, including internal-use software and website development, costs financed through accounts payable and accrued liabilities	\$965	\$1,317	\$965	\$1,317
Equipment acquired under capital lease obligations	—	—	1,421	—
Capitalized interest cost	—	—	—	66
Change in value of cash flow hedge	—	(240	) (1,498	) (2,493 )
Note receivable converted to equity investment	200	—	1,568	2,850
Cryptocurrency received in security token offering	13,878	—	13,878	—

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.

Notes to Unaudited Consolidated Financial Statements

1. BASIS OF PRESENTATION

As used herein, "Overstock," "Overstock.com," "O.co," "we," "our" and similar terms include Overstock.com, Inc. and its majority-owned subsidiaries, unless the context indicates otherwise.

We have prepared the accompanying unaudited consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our audited annual consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2017. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are, in our opinion, necessary for a fair presentation of results for the interim periods presented. Preparing financial statements requires us to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on our best knowledge of current events and actions that we may undertake in the future, actual results may be different from the estimates. The results of operations for the three months ended March 31, 2018 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

For purposes of comparability, the presentation of certain immaterial amounts in the prior periods have been conformed with the current period presentation. We retrospectively applied certain accounting standard updates as discussed in Note 2—Accounting Policies, Recently adopted accounting standards.

2. ACCOUNTING POLICIES

Principles of consolidation

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

Use of estimates

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

Cash equivalents

We classify all highly liquid instruments, including instruments with a remaining maturity of three months or less at the time of purchase, as cash equivalents. Cash equivalents were \$155.8 million and \$25.5 million at March 31, 2018

and December 31, 2017, respectively.

Restricted cash

We consider cash that is legally restricted and cash that is held as compensating balances for letter of credit arrangements and self-funded health insurance as restricted cash.

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## Fair value of financial instruments

We account for our assets and liabilities using a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. These two types of inputs have created the fair-value hierarchy below. This hierarchy requires us to minimize the use of unobservable inputs and to use observable market data, if available, when determining fair value.

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

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

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

Under GAAP, certain assets and liabilities are required to be recorded at fair value on a recurring basis. Our assets and liabilities that are adjusted to fair value on a recurring basis are cash equivalents, trading securities, and deferred compensation liabilities.

The fair values of our cash equivalents, trading securities, and deferred compensation liabilities are determined using quoted market prices from daily exchange traded markets on the closing price as of the balance sheet date and are classified as Level 1.

The following tables summarize our assets and liabilities measured at fair value on a recurring basis using the following levels of inputs as of March 31, 2018 and December 31, 2017 as indicated (in thousands):

p	Fair Value Measurements at March 31, 2018:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	\$ 155,763	\$ 155,763	\$ —	\$ —
Trading securities held in a "rabbi trust" (1)	78	78	—	—
Total assets	\$ 155,841	\$ 155,841	\$ —	\$ —
Liabilities:				
Deferred compensation accrual "rabbi trust" (2)	\$ 86	\$ 86	\$ —	\$ —
Total liabilities	\$ 86	\$ 86	\$ —	\$ —
Fair Value Measurements at December 31, 2017:				
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	\$ 25,455	\$ 25,455	\$ —	\$ —
Trading securities held in a "rabbi trust" (1)	74	74	—	—
Total assets	\$ 25,529	\$ 25,529	\$ —	\$ —
Liabilities:				
Deferred compensation accrual "rabbi trust" (2)	\$ 92	\$ 92	\$ —	\$ —
Total liabilities	\$ 92	\$ 92	\$ —	\$ —

(1) — Trading securities held in a rabbi trust are included in Prepaids and other current assets and Other long-term assets, net in the consolidated balance sheets.

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

Our other financial instruments, including cash, restricted cash, accounts receivable, accounts payable, accrued liabilities, and debt are carried at cost, which approximates their fair value.

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### Accounts receivable

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

### Allowance for doubtful accounts

From time to time, we grant credit to some of our business customers on normal credit terms (typically 30 days). We maintain an allowance for doubtful accounts receivable based upon our business customers' financial condition and payment history, and our historical collection experience and expected collectability of accounts receivable. The allowance for doubtful accounts receivable was \$1.4 million and \$1.3 million at March 31, 2018 and December 31, 2017, respectively.

### Concentration of credit risk

Three banks held the majority of our cash and cash equivalents at March 31, 2018. Our cash equivalents primarily consist of money market securities which are uninsured. We do not believe that, as a result of this concentration, we are subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships.

### Inventories, net

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

### Prepaid inventories, net

Prepaid inventories, net represent inventories paid for in advance of receipt.

### Prepays and other current assets

Prepays and other current assets represent expenses paid prior to receipt of the related goods or services, including advertising, license fees, maintenance, packaging, insurance, and other miscellaneous costs, and cryptocurrency-denominated assets ("cryptocurrencies"). See Cryptocurrencies below.

### Cryptocurrencies

We hold cryptocurrencies, such as bitcoin, which are included in Prepays and other current assets in our consolidated balance sheets. Our cryptocurrencies were \$9.0 million and \$1.5 million at March 31, 2018 and December 31, 2017, respectively, and are recorded at cost less impairment.

We recognize impairment on these assets caused by decreases in market value. Such impairment in the value of our cryptocurrencies is recorded in General and administrative expense in our consolidated statements of operations.



Impairments on cryptocurrencies were \$8.8 million for the three months ended March 31, 2018. There was no impairment on cryptocurrencies during the three months ended March 31, 2017.

Gains and losses realized upon sale of cryptocurrencies are also recorded in General and administrative expense in our consolidated statements of operations. We occasionally use our cryptocurrencies to purchase other cryptocurrencies. Gains and losses realized with these non-cash transactions are also recorded in General and administrative expense in our consolidated statements of operations and are also presented as an adjustment to reconcile Consolidated net loss to Net cash provided by (used in) operating activities in our consolidated statement of cash flows. Realized gains on sale of cryptocurrencies were \$1.5 million for the three months ended March 31, 2018. There were no realized gains or losses on sale of cryptocurrencies during the three months ended March 31, 2017.

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## Fixed assets, net

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

	Life (years)
Building	40
Land improvements	20
Building machinery and equipment	15-20
Furniture and equipment	5-7
Computer hardware	3-4
Computer software	2-4

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

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

During the three months ended March 31, 2018 and 2017, we capitalized \$2.4 million and \$3.5 million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally. Amortization of costs associated with internal-use software and website development was \$3.4 million and \$4.3 million, respectively.

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

	Three months ended March 31,	
	2018	2017
Cost of goods sold - direct	\$83	\$83
Technology	5,478	6,685
General and administrative	1,020	930
Total depreciation, including internal-use software and website development	\$6,581	\$7,698

Total accumulated depreciation of fixed assets was \$192.3 million and \$186.4 million at March 31, 2018 and December 31, 2017, respectively.

Upon sale or retirement of assets, cost and related accumulated depreciation and amortization are removed from the balance sheet and the resulting gain or loss is reflected in the consolidated statements of operations.

Fixed assets included assets under capital leases were \$1.8 million at March 31, 2018 and December 31, 2017. Accumulated depreciation related to assets under capital leases was \$602,000 and \$458,000 at March 31, 2018 and December 31, 2017, respectively.

Depreciation expense of assets recorded under capital leases was \$144,000 and \$1.3 million for the three months ended March 31, 2018 and 2017, respectively.

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### Equity investments under ASC 321

At March 31, 2018, we held minority interests (less than 20%) in nine privately held entities. Our interests in these entities are accounted for under ASC Topic 321, Investments - Equity Securities ("ASC 321") and included in Other long-term assets, net in our consolidated balance sheets. These investments lack readily determinable fair values and are therefore measured at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer. Dividends received from such investments are reported in current earnings. We review our investments individually for impairment by evaluating if events or circumstances have occurred that may indicate the fair value of the investment is less than its carrying value. If such events or circumstances have occurred, we estimate the fair value of the investment and recognize an impairment loss equal to the difference between the fair value of the investment and its carrying value. In such cases, the estimated fair value of the investment is determined using unobservable inputs including assumptions by the investee's management including quantitative information such as lower valuations in recently completed or proposed financings. These inputs are classified as Level 3. See Fair value of financial instruments above. Because several of our investees are in the early startup or development stages, these entities are subject to potential changes in cash flows, valuation, and inability to attract new investors which may be necessary for the liquidity needed to support their operations.

The carrying amount of our investments under ASC 321 was approximately \$13.7 million and \$6.5 million at March 31, 2018 and December 31, 2017, respectively. There was no impairment loss or other adjustment to our investments during the three months ended March 31, 2018. We recognized \$4.5 million impairment loss during the three months ended March 31, 2017. The impairment loss was recorded in Other expense, net on the consolidated statements of operations.

### Equity method investments

At March 31, 2018, we held minority interests in, five privately held entities. We can exercise significant influence, but not control, over the investees through either holding more than a 20% voting interest in the entity or through our representation on the entity's board of directors. Based on the nature of our ownership interests, we have variable interests in these entities. However, because we do not have power to direct the investee's activities and we are not the investee's primary beneficiary, we therefore do not consolidate the investee in our financial statements. Our interests in these entities are recognized as equity method investments included in Other long-term assets, net in our consolidated balance sheets.

The carrying value of our equity method investments exceeded the amount of underlying equity in net assets of the investees and the difference was primarily related to goodwill and the fair value of intangible assets. The difference related to intangible assets is amortized over their estimated useful lives. We record our proportionate share of the net income or loss of the investee and the amortization of the basis difference related to intangible assets in Other expense, net in the consolidated statements of operations with corresponding adjustments to the carrying value of the investment.

The carrying amount of our equity method investments was approximately \$16.0 million and \$6.5 million at March 31, 2018 and December 31, 2017, respectively, and the difference between the carrying value and the amount of underlying equity in net assets of each investee was not significant. Our proportionate share of the net income or loss of our equity method investees for the three months ended March 31, 2018 and the three months ended March 31, 2017 was not significant.

### Noncontrolling interests

Our wholly-owned subsidiary, Medici Ventures, Inc. ("Medici Ventures"), conducts its primary business through its majority-owned subsidiary, tØ.com, Inc. ("tZERO"), which includes a financial technology company, two related registered broker dealers, a registered investment advisor, and an accredited investor verification company. tZERO and its consolidated subsidiaries are included in our consolidated financial statements. Intercompany transactions have been eliminated and the amounts of contributions and gains or losses that are attributable to the noncontrolling interests are disclosed in our consolidated financial statements.

On December 18, 2017, tZERO launched an offering (the "security token offering") of the right to acquire, if issued by us in the future, tZERO Preferred Equity Tokens (the "tZERO Security Token") through a Simple Agreement for Future Equity ("SAFE"). The security token offering is expected to run through May 14, 2018 but may be extended or shortened. At March 31, 2018, the SAFEs qualified as equity classified financial instruments issued by tZERO. At March 31, 2018, cumulative proceeds from the security token offering totaling \$92.9 million, inclusive of \$13.9 million of proceeds received in

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cryptocurrencies, have been classified as a component of noncontrolling interest within our consolidated financial statements. As of March 31, 2018, tZERO has incurred \$16.0 million of offering costs associated with the security token offering that are classified as a reduction in proceeds within noncontrolling interest of our consolidated financial statements.

At March 31, 2018, tZERO held majority interests in tZERO Advisors and Verify Investor, LLC. During 2018, tZERO purchased 65.8% of the membership units of ES Capital Advisors, LLC ("ES Capital"), a registered investment advisor under the Investment Advisers Act of 1940, which was accounted as an asset acquisition. tZERO operates the ES Capital business under the name tZERO Advisors and offers automated investment advisory services under the FinanceHub tab on our Website. tZERO also purchased 81.0% of Verify Investor, LLC, an accredited investor verification company. This transaction is described further in Note 3—Acquisitions, Goodwill, and Acquired Intangible Assets. These entities are included in our consolidated financial statements. Intercompany transactions have been eliminated and the amounts of contributions and gains or losses that are attributable to the noncontrolling interests are disclosed in our consolidated financial statements.

## Leases

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

## Treasury stock

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

## Goodwill

Goodwill represents the excess of the purchase price paid over the fair value of the net assets acquired in business combinations. Goodwill is not amortized but is tested for impairment at least annually. When evaluating whether goodwill is impaired, we make a qualitative assessment to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the qualitative assessment determines that it is more likely than not that its fair value is less than its carrying amount, we compare the fair value of the reporting unit to which the goodwill is assigned to its carrying amount. If the carrying amount exceeds its fair value, then the amount of the impairment loss must be measured. The impairment loss, if any, is calculated by comparing the implied fair value of the goodwill to its carrying amount. In calculating the implied fair value of goodwill, the fair value of the reporting unit is allocated to the other assets and liabilities within the reporting unit based on estimated fair value. The excess of the fair value of a reporting unit over the amount allocated to its other assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized when the carrying amount of goodwill exceeds its implied fair value.

We test for impairment of goodwill annually or when we deem that a triggering event has occurred. There were no impairments to goodwill recorded during the three months ended March 31, 2018 and 2017.

For three months ended March 31, 2018, we recognized \$7.4 million in goodwill related to a business acquisition as described in Note 3—Acquisitions, Goodwill, and Acquired Intangible Assets. The change in goodwill relates to a non-reportable segment, included in Other as described in Note 9—Business Segments.

Intangible assets other than goodwill

We capitalize and amortize intangible assets other than goodwill over their estimated useful lives unless such lives are indefinite. Intangible assets other than goodwill acquired separately from third-parties are capitalized at cost while such assets acquired as part of a business combination are capitalized at their acquisition-date fair value. Indefinite lived intangible assets include intellectual property and investment advisor licenses purchased in connection with our tZERO Advisors and DeSoto businesses. Certain licenses are subject to annual renewal terms with immaterial fees which are expensed as incurred. Indefinite-lived intangible assets are tested for impairment annually or more frequently when events or circumstances indicate that the carrying value more likely than not exceeds its fair value. In addition, we routinely evaluate the remaining useful life of

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intangible assets not being amortized to determine whether events or circumstances continue to support an indefinite useful life, including any legal, regulatory, contractual, competitive, economic, or other factors that may limit their useful lives. Definite lived intangible assets are amortized using the straight-line method of amortization over their useful lives, with the exception of certain intangibles (such as acquired technology, customer relationships, and trade names) which are amortized using an accelerated method of amortization based on cash flows. Definite lived intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable as described below under Impairment of long-lived assets.

Intangible assets, net consist of the following (in thousands):

	March 31, 2018	December 31, 2017
Intangible assets subject to amortization, gross (1)	\$25,181	\$ 17,779
Less: accumulated amortization of intangible assets subject to amortization	(11,361 )	(10,442 )
Intangible assets subject to amortization, net	13,820	7,337
Intangible assets not subject to amortization	10,833	—
Total intangible assets, net	\$24,653	\$ 7,337

(1) — At March 31, 2018, the weighted average remaining useful life for intangible assets subject to amortization, excluding fully amortized intangible assets, was 6.64 years.

Amortization of intangible assets other than goodwill is classified within the corresponding operating expense categories in the consolidated statements of operations as follows (in thousands):

	Three months ended March 31, 2018 2017	
Technology	\$755	\$905
Sales and marketing	119	20
General and administrative	44	20
Total amortization	\$918	\$945

Estimated amortization expense for the next five years is: \$3.0 million for the remainder of 2018, \$2.7 million in 2019, \$2.0 million in 2020, \$1.7 million in 2021, \$800,000 in 2022, and \$3.6 million thereafter.

#### Impairment of long-lived assets

We review property and equipment and other long-lived assets, including amortizable intangible assets other than goodwill, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability is measured by comparison of the assets' carrying amount to future undiscounted net cash flows the asset group is expected to generate. Cash flow forecasts are based on trends of historical performance and management's estimate of future performance, giving consideration to existing and anticipated competitive and economic conditions. If such asset group is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair values. There were no impairments to long-lived assets recorded during the three months ended March 31, 2018 and 2017.

Other long-term assets, net



Other long-term assets, net consist primarily of our investments in equity securities, and long-term prepaid expenses. See Equity investments under ASC 321 and Equity method investments above.

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### Revenue recognition

We derive our revenue primarily from retail merchandise sales on our Website. We also earn revenue from advertising on our Website and from other sources. We have organized our operations into two principal reporting segments based on the primary source of revenue: (i) direct revenue and (ii) partner and other revenue. Net revenue from contracts with customers is further disaggregated by Retail and Other net revenue as disclosed in Note 9—Business Segments.

On January 1, 2018, we adopted ASU 2014-09, Revenue from Contracts with Customers (Topic 606). See Recently adopted accounting standards, below. Under Topic 606, revenue is recognized when control of the product passes to the customer or the service is provided and is recognized in an amount that reflects the expected consideration to be received in exchange for such goods or services. Shipping and handling is considered a fulfillment activity and fees charged to customers are included in net revenue upon completion of our performance obligation. We present revenue net of sales taxes, discounts, and expected refunds. We record an allowance for returns based on current period revenues and historical returns experience. We analyze actual historical returns, current economic trends and changes in order volume and acceptance of our products when evaluating the adequacy of the sales returns allowance in any accounting period.

Generally, we require authorization from credit card or other payment vendors whose services we offer to our customers (such as PayPal) or verification of receipt of payment, before we ship products to consumers or business purchasers. From time to time we grant credit to our business purchasers with normal credit terms (typically 30 days). For sales in our partner business, we generally receive payments from our customers before our payments to our suppliers are due.

We evaluate the criteria outlined in ASC 606-10-55, Principal versus Agent Considerations, in determining whether it is appropriate to record the gross amount of merchandise sales and related costs or the net amount earned as commissions. When we are the principal in a transaction and control the specific good or service before it is transferred to the customer, revenue is recorded gross; otherwise, revenue is recorded on a net basis. Currently, the majority of both direct revenue and partner revenue is recorded on a gross basis.

Revenue related to merchandise sales is recognized upon transfer of control to our customers which generally occurs upon delivery of the product to our customers. As such, customer orders are recorded as deferred revenue prior to delivery of products or services ordered. As we ship high volumes of packages through multiple carriers, it is not practical for us to track the actual delivery date of each shipment. Therefore, we use estimates to determine which shipments are delivered and, therefore, recognized as revenue at the end of the period. Our delivery date estimates are based on average shipping transit times, which are calculated using the following factors: (i) the type of shipping carrier (as carriers have different in-transit times); (ii) the fulfillment source (either our warehouses, those warehouses we control, or those of our partners); (iii) the delivery destination; and (iv) actual transit time experience, which shows that delivery date is typically one to eight business days from the date of shipment. We review and update our estimates on a quarterly basis based on our actual transit time experience. However, actual shipping times may differ from our estimates.

During the three months ended March 31, 2018, we recognized \$34.9 million of net revenue included in Deferred revenue at December 31, 2017.

The allowance of returns was \$15.4 million and \$17.4 million at March 31, 2018 and December 31, 2017, respectively.

We evaluate the revenue recognition criteria above for our broker dealer subsidiaries and we recognize revenue based on the amount of consideration that we expect to receive on securities transactions (commission revenue) on a trade date and gross basis.

#### Direct revenue

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

#### Partner and other revenue

Partner and other revenue is derived primarily from merchandise sales of inventory sourced through our partners which are generally shipped directly to our consumers and businesses. Through contractual terms with our partners, we have the

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ability to control the promised goods or services and as a result record the majority of our partner revenue on a gross basis. Partner and other revenue comes from merchandise sales that occur primarily through our Website, but may also occur through offline and other channels, including through our broker dealer subsidiaries in our Other segment.

## Club O loyalty program

We have a customer loyalty program called Club O Gold for which we sell annual memberships. For Club O Gold memberships, we record membership fees as deferred revenue and we recognize revenue ratably over the membership period. The Club O Gold loyalty program allows members to earn Club O Reward dollars for qualifying purchases made on our Website. We also have a co-branded credit card program which provides Club O Gold members additional reward dollars for purchases made on our Website, and from other merchants.

Earned Club O Reward dollars may be redeemed on future purchases made through our Website. We recognize revenue for Club O Reward dollars when customers redeem such rewards as part of a purchase on our Website. We account for these transactions as multiple element arrangements and allocate the transaction price to separated performance obligations using their relative fair values. We include the fair value of reward dollars earned in deferred revenue at the time the reward dollars are earned. Club O Reward dollars expire 90 days after the customer's Club O Gold membership expires. We recognize estimated reward dollar breakage, to which we expected to be entitled, over the expected redemption period in proportion to actual redemptions by customers. Upon adoption of Topic 606, Revenue Contracts with Customers, on January 1, 2018, we began classifying the breakage income related to Club O Reward dollars and gift cards as a component of Partner and other revenue in our consolidated statements of operations rather than as a component of Other expense, net. Breakage included in Partner and other revenue was \$1.7 million for the three months ended March 31, 2018. We also recognized a cumulative adjustment that reduced Accumulated deficit by approximately \$5.0 million upon adoption related to the unredeemed portion of our gift cards and loyalty program rewards.

Our total deferred revenue related to the outstanding Club O Reward dollars was \$5.9 million and \$6.5 million at March 31, 2018 and December 31, 2017, respectively. The timing of revenue recognition of these reward dollars is driven by actual customer activities, such as redemptions and expirations.

## Advertising Revenue

Advertising revenues is derived primarily from sponsored links and display advertisements that are placed on our Website, distributed via email, or sent out as direct mailers. Advertising revenue is recognized in net revenue when the advertising services are rendered. Advertising revenues were less than 2% of total net revenues for all periods presented.

## Cost of goods sold

Cost of goods sold includes product costs, warehousing costs, outbound shipping costs, handling and fulfillment costs, customer service costs and credit card fees, and is recorded in the same period in which related revenues have been recorded.

Cost of goods sold, including product cost and other costs and fulfillment and related costs are as follows (in thousands):

	Three months ended	
	March 31,	
	2018	2017
Total revenue, net	\$445,331 100%	\$432,435 100%

Cost of goods sold

Product costs and other cost of goods sold	333,521	75 %	326,803	76 %
Fulfillment and related costs	17,941	4 %	18,725	4 %
Total cost of goods sold	351,462	79 %	345,528	80 %
Gross profit	\$93,869	21 %	\$86,907	20 %

Advertising expense

We expense the costs of producing advertisements the first time the advertising takes place and expense the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are

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recognized as incurred based on the terms of the individual agreements, which are generally: 1) a commission for traffic driven to our Website that generates a sale or 2) a referral fee based on the number of clicks on keywords or links to our Website generated during a given period. Advertising expense is included in Sales and marketing expenses and totaled \$68.9 million and \$33.8 million during the three months ended March 31, 2018 and 2017, respectively. Prepaid advertising (included in Prepaids and other current assets in the accompanying consolidated balance sheets) was \$834,000 and \$987,000 at March 31, 2018 and December 31, 2017, respectively.

### Stock-based compensation

We measure compensation expense for all outstanding unvested share-based awards at fair value on the date of grant and recognize compensation expense over the service period for awards at the greater of a straight-line basis or on an accelerated schedule when vesting of the share-based awards exceeds a straight-line basis. When an award is forfeited prior to the vesting date, we recognize an adjustment for the previously recognized expense in the period of the forfeiture. See Note 8—Stock-Based Awards.

### Self-funded health insurance

We have a partially self-funded health insurance plan for our employees. We maintain a stop-loss insurance policy through an insurance company that limits our losses both on a per employee basis and an aggregate basis. Although we intend to maintain this plan indefinitely, we may terminate, modify, suspend, or discontinue this plan at any time and for any reason.

We are responsible for estimating our liability for unpaid costs of insured events that have occurred, which includes known cases on a case-by-case basis, and also for events that have occurred, but have not yet been reported. The accrued liability related to the self-funded health insurance plan was \$1.6 million and \$1.0 million at March 31, 2018 and December 31, 2017, respectively, and is included in Accrued liabilities in the accompanying consolidated balance sheets. Actual claims may differ from the amount accrued and any difference could be significant.

### Loss contingencies

In the normal course of business, we are involved in legal proceedings and other potential loss contingencies. We accrue a liability for such matters when it is probable that a loss has been incurred and the amount can be reasonably estimated. When only a range of probable loss can be estimated, the most probable amount in the range is accrued. If no amount within this range is a better estimate than any other amount within the range, the minimum amount in the range is accrued. We expense legal fees as incurred (see Note 6—Commitments and Contingencies).

### Income taxes

Our income tax provision for interim periods is determined using an estimate of our annual effective tax rate adjusted for discrete items, if any, for relevant interim periods. We update our estimate of the annual effective tax rate each quarter and make cumulative adjustments if our estimated annual effective tax rate changes.

Our quarterly tax provision and our quarterly estimate of our annual effective tax rate are subject to significant variations due to several factors including variability in predicting our pre-tax and taxable income and the mix of jurisdictions to which those items relate, relative changes in expenses or losses for which tax benefits are not recognized, how we do business, fluctuations in our stock price, and changes in law, regulations, and administrative practices. Our effective tax rate can be volatile based on the amount of pre-tax income. For example, the impact of discrete items on our effective tax rate is greater when pre-tax income is lower.

Each quarter we assess the recoverability of our deferred tax assets under ASC 740. We assess the available positive and negative evidence to estimate whether we will generate sufficient future taxable income to use our existing deferred tax assets. We have limited carryback ability and do not have significant taxable temporary differences to recover our existing deferred tax assets, therefore we must rely on future taxable income, including tax planning strategies, to support their realizability. We have established a valuation allowance for our deferred tax assets not supported by carryback ability or taxable temporary differences, primarily due to uncertainty regarding our future taxable income. We have considered, among other things, the cumulative loss incurred over the three-year period ended March 31, 2018 as a significant piece of objective negative evidence. We intend to continue maintaining a valuation allowance on our net deferred tax assets until there is sufficient evidence to support the reversal of all or some portion of these allowances. The amount of the deferred tax asset

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considered realizable could be adjusted if objective negative evidence in the form of cumulative losses is no longer present and additional weight may be given to subjective evidence such as long-term projections for growth. We will continue to monitor the need for a valuation allowance against our remaining deferred tax assets on a quarterly basis.

Tax laws and regulations themselves are subject to change as a result of changes in fiscal policy, changes in legislation, the evolution of regulations, and court rulings. On December 22, 2017, the President signed into law Public Law No. 115-97, commonly referred to as the Tax Cuts and Jobs Act ("TCJA"), following its passage by the United States Congress. The TCJA made significant changes to U.S. federal income tax laws, mostly effective for tax years beginning after December 31, 2017. Among many other changes, the new law lowers the corporate tax rate from 35% to 21% for tax years beginning in 2018, transitions U.S. international taxation from a worldwide tax system to a territorial system, and includes a one-time transition tax on the mandatory deemed repatriation of cumulative foreign earnings as of December 31, 2017. Staff Accounting Bulletin No. 118 ("SAB 118") was issued to address the application of US GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the TCJA. In accordance with SAB 118, we calculated our best estimate of the impact of the TCJA in accordance with our understanding of the law and guidance available and as a result recorded \$25.3 million as additional income tax expense in the fourth quarter of 2017. The amount related to the remeasurement of certain deferred tax assets and liabilities, based on the rates at which they are expected to reverse in the future, was \$25.2 million. Although the tax rate reduction was known, our analysis may also be affected by other analyses related to the TCJA, including, but not limited to, our calculation of the mandatory deemed repatriation of cumulative foreign earnings and the state tax effect of adjustments made to federal temporary differences, which are uncertain at this time. The provisional amount related to the one-time transition tax on the mandatory deemed repatriation of cumulative foreign earnings was \$41,000.

As of the date of this filing, our accounting for the TCJA has not been finalized. As noted at year-end, however, we were able to reasonably estimate certain effects and, therefore, recorded adjustments associated with the remeasurement of certain deferred tax assets and liabilities and the mandatory deemed repatriation of cumulative foreign earnings. We have not made any additional measurement-period adjustments related to these items during the quarter because additional time is needed to complete our analysis of the TCJA, collect and prepare necessary data, and interpret any additional guidance issued by the U.S. Treasury Department, Internal Revenue Service ("IRS"), FASB, and other standard-setting and regulatory bodies. Any subsequent adjustment to these amounts will be recorded to tax expense in the quarter when the analysis is complete. Our accounting for the tax effects of the TCJA will be completed during the measurement period, which should not extend beyond one year from the enactment date.

The TCJA includes a provision to tax global intangible low-taxed income ("GILTI") of foreign subsidiaries beginning in 2018. Under GAAP, we can make an accounting policy election to either treat taxes due on the GILTI inclusion as a current period expense, or factor such amounts into our measurement of deferred taxes. Due to the complexity of the new GILTI tax rules, we are continuing to evaluate this provision of the TCJA and the application of GAAP and we have not yet elected an accounting policy nor have we recorded any potential deferred tax effects related to GILTI in our financial statements. We have, however, included the estimated 2018 current GILTI impact in our annual effective tax rate for 2018. We expect to complete our accounting within the prescribed measurement period.

The TCJA included a mandatory deemed repatriation of cumulative foreign earnings for the year ended December 31, 2017, for which we accrued provisional tax expense. However, we would still need to accrue and pay various other taxes on this amount if repatriated. We are currently analyzing our global working capital and cash requirements and the potential tax liabilities attributable to a repatriation, but we have yet to determine whether we plan to change our prior assertion and repatriate earnings. Accordingly, we have not recorded any deferred taxes attributable to our investments in our foreign subsidiaries. We will record the tax effects of any change in our prior assertion in the period that we complete our analysis and are able to make a reasonable estimate, no later than December 2018.



We are subject to taxation in the United States and several state and foreign jurisdictions. Tax years beginning in 2013 are subject to examination by taxing authorities, although net operating loss and credit carryforwards from all years are subject to examinations and adjustments for at least three years following the year in which the attributes are used. We are under audit by the Ireland Revenue Agency for the calendar year 2016. We expect the audit to continue during 2018.

Net loss per share

In 2016, we issued shares of our Blockchain Voting Series A Preferred Stock and our Voting Series B Preferred Stock (collectively the "preferred shares"). These shares are considered participating securities, and as a result, net loss per share is

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calculated using the two-class method. Under this method, we give effect to preferred dividends and then allocate remaining net loss attributable to our stockholders to both common shares and participating securities (based on the percentages outstanding) in determining net loss per common share.

Basic net loss per common share is computed by dividing net loss attributable to common shares (after allocating between common shares and participating securities) by the weighted average number of common shares outstanding during the period.

Diluted net loss per share is computed by dividing net loss attributable to common shares (after allocating between common shares and participating securities) by the weighted average number of common and potential common shares outstanding during the period (after allocating total dilutive shares between our common shares outstanding and our preferred shares outstanding). Potential common shares, comprising incremental common shares issuable upon the exercise of stock options, warrants, and restricted stock awards are included in the calculation of diluted net loss per common share to the extent such shares are dilutive. Net loss attributable to common shares is adjusted for options and restricted stock awards issued by our subsidiaries when the effect of our subsidiary's diluted earnings per share is dilutive.

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

	Three months ended March 31,	
	2018	2017
Net loss attributable to stockholders of Overstock.com, Inc.	\$(50,909)	\$(5,903)
Less: Preferred stock dividends - declared and accumulated	27	27
Undistributed loss	(50,936 )	(5,930 )
Less: Undistributed loss allocated to participating securities	(1,186 )	(157 )
Net loss attributable to common shares	\$(49,750)	\$(5,773)
Net loss per common share—basic:		
Net loss attributable to common shares—basic	\$(1.74 )	\$(0.23 )
Weighted average common shares outstanding—basic	28,566	25,290
Effect of dilutive securities:		
Stock options and restricted stock awards	—	—
Weighted average common shares outstanding—diluted	28,566	25,290
Net loss attributable to common shares—diluted	\$(1.74 )	\$(0.23 )

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

	Three months ended March 31, 20182017	
Stock options and restricted stock units	685	199
Common shares issuable under stock warrant	83	—

Sales of warrants

On November 8, 2017, we issued warrants to purchase up to a combined aggregate of 3,722,188 shares of our common stock to two purchasers in privately negotiated transactions, for an aggregate purchase price of \$6.5 million, net of issuance costs. The exercise price for the warrants was \$40.45 per share of common stock. On December 29, 2017, one of the warrant holders exercised its warrant in full and purchased a total of 2,472,188 shares of common stock for \$100.0 million. On January 17, 2018, the other warrant holder exercised its warrant in full and purchased 1,250,000 shares of common stock for \$50.6 million.

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### Recently adopted accounting standards

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. We adopted the new standard on January 1, 2018 with a cumulative adjustment that reduced Accumulated deficit by approximately \$5.0 million as opposed to retrospectively adjusting prior periods. The adjustment primarily relates to the unredeemed portion of our gift cards and loyalty program rewards, which we will recognize over the expected redemption period, rather than waiting until the likelihood of redemption becomes remote or the rewards expire. We have also updated revenue disclosures in the notes to our financial statements as required under the new standard.

The implementation did not impact our gross and net recognition for our revenue transactions. In addition, we continue to recognize revenue related to merchandise sales upon delivery to our customers. However, we now present breakage on our Club O Rewards and gift cards in Partner and other revenue in the consolidated statement of operations rather as a component of Other expense, net. Breakage revenue included in Partner and other revenue was \$1.7 million for the three months ended March 31, 2018.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which requires equity investments previously recognized under the cost method to be measured at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer. We adopted the changes under the new standard on January 1, 2018 on a prospective basis. The implementation of ASU 2016-01 did not have a material impact on our consolidated financial statements and related disclosures.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires amounts generally described as restricted cash be included with cash and cash equivalents when reconciling beginning-of-period and end-of-period total amounts shown in the statement of cash flows. We adopted the new standard on January 1, 2018 retrospectively to each period presented in the statement of cash flows. The implementation of ASU 2016-18 did not have a material impact on our consolidated financial statements and related disclosures.

### Recently issued accounting standards

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which, among other things, requires lessees to recognize most leases on their balance sheets related to the rights and obligations created by those leases. The new standard also requires new disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. The new standard becomes effective for us on January 1, 2019, with early adoption permitted. We plan to adopt this ASU beginning on January 1, 2019. The amendments in this update should be applied under a modified retrospective approach. We are evaluating the effect that ASU 2016-02 will have on our consolidated financial statements and related disclosures.

## 3. ACQUISITIONS, GOODWILL, AND ACQUIRED INTANGIBLE ASSETS

### Verify Investor, LLC

On February 12, 2018, tZERO acquired 1,351,367 voting units, or 81% of the total equity interests of Verify Investor, LLC, an accredited investor verification company, for a total purchase price of \$12.0 million in cash. With the acquisition of the majority interest in Verify Investor, LLC, tZERO plans to integrate the software and technology of Verify Investor, LLC with the Token Trading System that tZERO plans to develop and deploy. We estimated the fair

value of the acquired assets based on Level 3 inputs, which were unobservable (see Note 2—Accounting Policies, Fair value of financial instruments). These inputs included our estimate of future revenues, operating margins, discount rates, royalty rates and assumptions about the relative competitive environment.

Determination and allocation of the purchase price to net tangible and intangible assets is based upon preliminary estimates. These preliminary estimates and assumptions could change significantly during the measurement period as we finalize the valuations of the net tangible and intangible assets acquired and liabilities assumed. Any change could result in variances between our future financial results and the amounts recognized in the financial information presented below, including variances in fair values recorded, as well as expenses associated with these items.

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The preliminary estimated fair values of the assets acquired and liabilities assumed at the acquisition date are as follows (in thousands):

Purchase Price	Fair Value
Cash paid, net of cash acquired	\$11,769
Allocation	
Intangibles	\$7,400
Goodwill	7,360
Other assets acquired	3
Other liabilities assumed	(179 )
Total net assets, net of cash acquired	14,584
Less: noncontrolling interest	(2,815 )
Total net assets attributable to tZERO, net of cash acquired	\$11,769

The following table details the identifiable intangible assets acquired at their fair value and remaining useful lives as of March 31, 2018 (amounts in thousands):

Intangible Assets	Fair Value	Estimated Useful Life (in years)
Technology and developed software	\$6,300	10
Trade name	700	10
Customer relationships	400	0.5
Total acquired intangible assets at the acquisition date	7,400	
Less: accumulated amortization of acquired intangible assets	(187 )	
Total acquired intangible assets, net	\$7,213	

The expense for amortizing intangible assets acquired in connection with this acquisition was \$187,000 for the three months ended March 31, 2018.

Acquired intangible assets primarily include technology, trade name, and customer relationships. As described above, we determined the fair value of these assets using an income approach method to determine the present value of expected future cash flows for each identifiable intangible asset. This method was based on discount rates which incorporate a risk premium to take into account the risks inherent in those expected cash flows. The expected cash flows were estimated based on the company's historical operating results.

The acquired assets, liabilities, and associated operating results were consolidated into our financial statements at the acquisition dates, or the dates on which we obtained control of the acquired assets or interests.

#### 4. ACCRUED LIABILITIES

Accrued liabilities consist of the following (in thousands):

	March 31, 2018	December 31, 2017
Accrued marketing expenses	\$ 28,720	\$ 25,959
Accrued compensation and other related costs	16,752	10,716
Accounts payable accruals	16,222	16,614
Allowance for returns	15,423	17,391
Other accrued expenses	7,193	6,283
Accrued freight	7,187	5,040
Accrued loss contingencies	608	608

Total accrued liabilities	\$ 92,105	\$ 82,611
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5. BORROWINGS

PCL L.L.C. term loan agreement

On November 6, 2017, we entered into a loan agreement with PCL L.L.C., an entity directly or indirectly wholly-owned by the mother and brother of our Chief Executive Officer, Dr. Patrick Byrne. The agreement provides for a \$40.0 million term loan (the "PCL Loan") which carries an annual interest rate of 8.0% and a default rate of 18.0%. The PCL Loan is for a term of 18 months, subject to mandatory prepayment under certain circumstances, and is prepayable at our election at any time without penalty or premium. Interest only is due monthly. There are no financial covenants associated the PCL Loan.

The principal amount and any then unpaid interest will be due and payable on May 1, 2019 subject to mandatory prepayment in the event of a sale or encumbrance of the headquarters building or a change of ownership of Overstock or the occurrence of certain other events, including material changes to Overstock's business, the loss of management control of Overstock by Dr. Patrick Byrne and other events. The PCL Loan is secured by our corporate headquarters and the related land, fixtures and certain related personal property. Capitalized debt issuance costs with the new loan agreement are insignificant.

At March 31, 2018 and December 31, 2017, our outstanding balance on the PCL Loan was \$40.0 million. Amounts outstanding under the loan are presented net of discount and issuance costs in our consolidated balance sheets. On May 8, 2018, our Board of Directors approved a prepayment of the PCL Loan and we repaid the entire outstanding balance under the loan plus accrued interest.

U.S. Bank letters of credit

At March 31, 2018 and December 31, 2017, letters of credit totaling \$280,000 and \$355,000, respectively, were issued on our behalf collateralized by compensating cash balances held at U.S. Bank, which are included in Restricted cash in our consolidated balance sheets.

U.S. Bank commercial purchasing card agreement

We have a commercial purchasing card (the "Purchasing Card") agreement with U.S. Bank. We use the Purchasing Card for business purpose purchasing and must pay it in full each month. At March 31, 2018, \$1.4 million was outstanding and \$3.6 million was available under the Purchasing Card. At December 31, 2017, \$822,000 was outstanding and \$4.2 million was available under the Purchasing Card.

Capital lease

During the year ended December 31, 2017, we entered into a capital lease arrangement of computer equipment for \$1.4 million. The arrangement will expire in 2020. At March 31, 2018, the outstanding balance under the capital lease was \$1.2 million and is included in Other current liabilities, net and Other long-term liabilities on our consolidated balance sheets. Future payment obligations, including interest, under the capital lease are \$372,000, \$496,000 and \$413,000 for the rest of 2018, 2019 and 2020, respectively.



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## 6. COMMITMENTS AND CONTINGENCIES

Summary of future minimum lease payments for all operating leases

Minimum future payments under all operating leases as of March 31, 2018, are as follows (in thousands):

Payments due by period

2018 (Remainder)	\$5,232
2019	6,733
2020	4,292
2021	4,335
2022	4,439
Thereafter	16,356
	\$41,387

Rental expense for operating leases totaled \$1.7 million and \$2.4 million for the three months ended March 31, 2018 and 2017, respectively.

#### Legal proceedings and contingencies

From time to time, we are involved in litigation concerning consumer protection, employment, intellectual property, claims under the securities laws, and other commercial matters related to the conduct and operation of our business and the sale of products on our Website. In connection with such litigation, we may be subject to significant damages. In some instances, other parties may have contractual indemnification obligations to us. However, such contractual obligations may prove unenforceable or non-collectible, and if we cannot enforce or collect on indemnification obligations, we may bear the full responsibility for damages, fees and costs resulting from such litigation. We may also be subject to penalties and equitable remedies that could force us to alter important business practices. Such litigation could be costly and time consuming and could divert or distract our management and key personnel from our business operations. Due to the uncertainty of litigation and depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect our business, results of operations, financial position, or cash flows. The nature of the loss contingencies relating to claims that have been asserted against us are described below.

On September 23, 2009, SpeedTrack, Inc. sued us along with 27 other defendants in the United States District Court in the Northern District of California. We are alleged to have infringed a patent covering search and categorization software. We believe that certain third-party vendors of products and services sold to us are contractually obligated to indemnify us, and we have tendered defense of the case to an indemnitor who accepted the defense. On April 21, 2016, the court entered an order partially dismissing the claims against us. On May 4, 2016, the plaintiff filed an amended complaint, and we have filed our answer. No estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On February 11, 2013, RPost Holdings, Inc., RPost Communications Limited, and RMail Limited, filed suit against us in the United States District Court in the Eastern District of Texas for infringement of patents covering products and services that verify the delivery and integrity of email messages. We tendered defense of the case to an indemnitor who accepted the defense. No estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

In June 2013, William French filed suit against us and 46 other defendants under seal in the Superior Court of the State of Delaware. The filing was unsealed on March 24, 2014. French brought the action on Delaware's behalf for

violations of Delaware's unclaimed property laws and for recovery of the unredeemed gift card value allegedly attributable to Delaware residents. French's complaint alleges that we, and other defendants, knowingly refused to fulfill obligations under Delaware's Abandoned Property Law by failing to report and deliver unclaimed gift card funds to the State of Delaware, and knowingly made, used or caused to be made or used, false statements and records to conceal, avoid or decrease an obligation to pay or transmit money to Delaware in violation of the Delaware False Claims and Reporting Act. The complaint seeks an injunction, monetary damages (including treble damages and penalties), and attorney's fees and costs. In the early stages of the case, we, along with others, filed motions to dismiss the case. The court dismissed one count, but allowed one count to remain. We filed two motions for summary judgment, along with other defendants, one of which was denied. The court has not yet ruled on the

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second motion. The court has set tentative trial date commencing September 12, 2018. We intend to vigorously defend this action.

On April 28, 2016, the State of South Dakota sued us along with three other defendants in the Sixth Judicial Circuit Court of South Dakota. South Dakota alleges that U.S. constitutional law should be revised to permit South Dakota to require out-of-state e-commerce websites to withhold and remit sales tax in South Dakota in accordance with South Dakota's sales tax statute. Pursuant to the statute, we would not be required to withhold and remit sales tax until there was a verdict in favor of South Dakota which was then upheld by the highest applicable appellate court. The statute does not require us to pay sales tax retroactively if we were to lose. The state court granted summary judgment in our favor, and on September 13, 2017 the South Dakota Supreme Court denied South Dakota's appeal and ruled in our favor. South Dakota appealed to the U.S. Supreme Court, and on April 17, 2018, the U.S. Supreme Court heard oral arguments in the case. We are awaiting a decision in the case.

On July 7, 2017, the State of Wyoming sued us along with five other defendants in the Second Judicial District Court of Wyoming. Wyoming alleges that U.S. constitutional law should be revised to permit Wyoming to require out-of-state e-commerce retailers to withhold and remit sales tax in Wyoming in accordance with Wyoming's sales tax statute. Pursuant to the statute, Wyoming is prohibited by an injunction from requiring us to withhold and remit sales tax until there is a verdict in favor of Wyoming or the court otherwise lifts or dissolves the injunction. The statute does not require us to pay sales tax retroactively if we were to lose. The outcome of this case is dependent upon the ruling of the U.S. Supreme Court in our case with South Dakota discussed above.

On August 28, 2017, the State of Indiana sued us along with one other defendant in the Superior Court of Indiana, Marion County. Indiana alleges that U.S. constitutional law should be revised to permit Indiana to require out-of-state e-commerce retailers to withhold and remit sales tax in Indiana in accordance with Indiana's sales tax statute. Pursuant to the statute, we would not be required to withhold and remit sales tax until there is a verdict in favor of Indiana and the verdict is no longer subject to appeal. The statute does not require us to pay sales tax retroactively if we were to lose. The outcome of this case is dependent upon the ruling of the U.S. Supreme Court in our case with South Dakota discussed above.

In February 2018, the Division of Enforcement of the SEC informed tZERO and subsequently informed us that it is conducting an investigation and requested that we and tZERO voluntarily provide certain information and documents related to tZERO and the tZERO security token offering in connection with its investigation. We are cooperating fully with the SEC in connection with its investigation.

tZERO's broker-dealer subsidiaries are, and any broker-dealer subsidiaries that it acquires or forms in the future will be, subject to extensive regulatory requirements under federal and state laws and regulations and self-regulatory organization ("SRO") rules. Each of SpeedRoute and PRO Securities is registered with the SEC as a broker-dealer under the Exchange Act and in the states in which it conducts securities business and is a member of FINRA and other SROs. In addition, PRO Securities owns and operates the PRO Securities ATS, which is registered with the SEC as an alternative trading system. Each of SpeedRoute and PRO Securities is subject to regulation, examination and disciplinary action by the SEC, FINRA and state securities regulators, as well as other governmental authorities and SROs with which it is registered or licensed or of which it is a member. On February 22, 2018, the SEC's New York Regional Office notified PRO Securities that it is conducting an examination of PRO Securities, and on March 6, 2018 the SEC's Boston Regional Office notified tZERO Advisors that it is conducting an examination of tZERO Advisors.

As a result of tZERO's projects seeking to apply distributed ledger technologies to the capital markets, tZERO's subsidiaries have been, and remain involved in, ongoing discussions with regulatory authorities. While certain of the discussions have been relatively informal, tZERO's broker-dealer subsidiaries have also received and responded to several written inquiries from FINRA relating to such projects. While tZERO considers these continuing inquiries to

be ordinary course in light of the non-traditional nature of tZERO's distributed ledger projects, any failure by tZERO's broker-dealer subsidiaries to satisfy their regulatory authorities that they are in compliance with all applicable rules and regulations could have a material adverse effect on tZERO and on us.

In addition, in December 2017, SpeedRoute received a letter from FINRA stating that the Department of Enforcement at FINRA has received a referral from the staff of FINRA's Department of Market Regulation relating to rules applicable to supervision and required supervisory procedures for review of certain potential trading activity, such as pre-arranged trades or wash trades. In addition, SpeedRoute continues to have discussions with FINRA about several matters, including a matter related to potential violations of FINRA rules relating to Order Audit Trail System reporting and trading practice matters, and has received document requests from FINRA in connection with certain ongoing matters. SpeedRoute has received and

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responded to inquiries from FINRA and the SEC. In an unrelated matter, SpeedRoute and PRO Securities have been named in a FINRA investigatory matter in which FINRA has conducted on the record interviews of two senior officers of SpeedRoute and PRO Securities, who are also senior officers of tZERO.

On March 9, 2018, a purported securities class action lawsuit was filed against us and two of our executives in the United States District Court in the Central District of Utah. The lawsuit alleges violations of the Securities Exchange Act of 1934 ("Exchange Act") in connection with allegedly false and misleading statements made by the Company relating to tZERO's security token offering and the announcement of an SEC investigation. The plaintiffs seek class certification, an award of unspecified compensatory damages, and other further relief as the Court may deem just and proper. On April 6, 2018, a substantially similar lawsuit was filed in the same court also naming the Company, and two of our executives as defendants, bringing the same claims under the Exchange Act, and seeking substantially similar relief. Based on a review of the allegations, the Company believes that the plaintiffs' allegations are without merit, and intends to vigorously defend against the lawsuits. An unfavorable outcome could have a material adverse effect on the Company's results of operations for the period in which such a loss is recognized. The Company cannot reasonably estimate the possible loss or range of loss that may arise from this lawsuit.

We have recognized liabilities for contingencies deemed probable and estimable totaling \$608,000 at March 31, 2018 and December 31, 2017, which are included in Accrued liabilities in our consolidated balance sheets. It is reasonably possible that the actual losses may exceed our accrued liabilities.

## 7. INDEMNIFICATIONS AND GUARANTEES

During our normal course of business, we have made certain indemnities, commitments, and guarantees under which we may be required to make payments in relation to certain transactions. These indemnities include, but are not limited to, indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease, the environmental indemnity we entered into in favor of the lenders under our loan agreement with PCL L.L.C., and indemnities to our directors and officers to the maximum extent permitted under the laws of the State of Delaware. The duration of these indemnities, commitments, and guarantees varies, and in certain cases, is indefinite. In addition, the majority of these indemnities, commitments, and guarantees do not provide for any limitation of the maximum potential future payments we could be obligated to make. As such, we are unable to estimate with any reasonableness our potential exposure under these items. We have not recorded any liability for these indemnities, commitments, and guarantees in the accompanying consolidated balance sheets. We do, however, accrue for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is both probable and reasonably estimable.

## 8. STOCK-BASED AWARDS

We have equity incentive plans that provide for the grant to employees and board members of stock-based awards, including stock options and restricted stock. Stock-based compensation expense was as follows (in thousands):

	Three months ended March 31,	
	2018	2017
Overstock restricted stock awards	\$2,384	\$940
Medici Ventures stock options	11	—
tZERO equity awards	4,040	—
Total stock-based compensation expense	\$6,435	\$940

Overstock restricted stock awards

During the three months ended March 31, 2018, the Compensation Committee of the Board of Directors approved grants of 322,092 restricted stock awards to our officers, board members and employees. The restricted stock awards generally vest over three years at 33.3% at the end of the first year, 33.3% at the end of the second year and 33.3% at the end of the third year and are subject to the recipient's continuing service to us. At March 31, 2018, 688,830 unvested restricted stock awards remained outstanding.

The cost of restricted stock awards is determined using the fair value of our common stock on the date of the grant, and compensation expense is either recognized on a straight-line basis over the three-year vesting schedule or on an accelerated schedule when vesting of restricted stock awards exceeds a straight-line basis. The cumulative amount of compensation

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expense recognized at any point in time is at least equal to the portion of the grant date fair value of the award that is vested at that date. The weighted average grant date fair value of restricted stock awards granted during the three months ended March 31, 2018 was \$73.22.

The following table summarizes restricted stock award activity during the three months ended March 31, 2018 (in thousands):

	Three months ended March 31, 2018	Weighted Average Grant Date Fair Value
Units		
Outstanding—beginning of year	540	\$ 17.05
Granted at fair value	322	73.22
Vested	(166)	15.55
Forfeited	(7 )	52.75
Outstanding—end of period	689	\$ 43.35

## Medici Ventures stock options

In July 2017, the Board of Directors of Medici Ventures approved the Medici Ventures, Inc. 2017 Stock Option Plan, which provides for the grant of options to employees and directors of and consultants to Medici Ventures to acquire up to a total of 10% of the authorized shares of Medici Ventures' common stock. Pursuant to the plan, the Board of Directors approved grants of 74,750 stock options to certain Medici Ventures and Overstock employees during the year ended December 31, 2017. The stock options were valued in total at \$91,000 and subject to two vesting schedules, and compensation expense is recognized on a straight-line basis over the vesting schedules.

## tZERO equity awards

In December 2017, the Board of Directors of tZERO approved the tZERO.com 2017 Equity Incentive Plan pursuant to which it may grant compensatory options to acquire up to 5% of tZERO's common stock. In January 2018, tZERO granted stock awards under the equity incentive plan for an aggregate of approximately 1.0% of tZERO's common stock all of which vested on January 23, 2018. In January 2018, tZERO recognized \$4.0 million in compensation expense associated with these awards, which was the entire estimated fair value at the grant date. Accordingly, there is no expense to be recognized in future periods related to these awards. As a result of these vested awards, our indirect ownership interest in tZERO was reduced from 81% to approximately 80%.

## 9. BUSINESS SEGMENTS

Segment information has been prepared in accordance with ASC Topic 280 Segment Reporting. We determined our segments based on how we manage our business, which, in our view, consists primarily of our Retail and Medici businesses. Our Retail business consists of our Direct and Partner reportable segments. We use gross profit as the measure to determine our reportable segments because there is not discrete financial information available below gross profit for our Direct and Partner segments. As a result, our Medici business is not significant as compared to our Direct and Partner segments and is included in Other. Our Other segment consists of Medici Ventures and its subsidiaries, including tZERO. Although our Direct and Partner segments both relate to our Retail business, we do not

combine these segments because they have dissimilar economic characteristics, such as gross profit margins. We do not allocate assets between our segments for our internal management purposes, and as such, they are not presented here. There were no significant inter-segment sales or transfers during the three months ended March 31, 2018 and 2017.



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The following table summarizes information about reportable segments for three months ended March 31, 2018 and 2017 (in thousands):

	Three months ended March 31,				
	Direct	Partner	Retail Total	Other	Total
2018					
Revenue, net	\$ 16,270	\$423,726	\$439,996	\$ 5,335	\$445,331
Cost of goods sold (1)	14,772	332,808	347,580	3,882	351,462
Gross profit	\$ 1,498	\$90,918	\$92,416	\$ 1,453	\$93,869
Operating expenses (1) (2)			125,532	22,731	148,263
Interest and other income (expense), net (3)			(455 )	116	(339 )
Pre-tax loss			(33,571 )	(21,162 )	(54,733 )
Benefit from income taxes			(88 )	(189 )	(277 )
Net loss (4)			\$(33,483 )	\$(20,973 )	\$(54,456 )
2017					
Revenue, net	\$22,828	\$405,261	\$428,089	\$ 4,346	\$432,435
Cost of goods sold (1)	20,963	321,297	342,260	3,268	345,528
Gross profit	\$ 1,865	\$83,964	\$85,829	\$ 1,078	\$86,907
Operating expenses (1) (2)			84,538	4,682	89,220
Interest and other income (expense), net (3)			102	(4,411 )	(4,309 )
Pre-tax income (loss)			1,393	(8,015 )	(6,622 )
Provision for (benefit from) income taxes			889	(1,229 )	(340 )
Net income (loss) (4)			\$504	\$(6,786 )	\$(6,282 )

(1) — The above amounts include Retail depreciation and amortization expense of \$6.4 million and \$7.4 million for the three months ended March 31, 2018 and 2017, respectively.

(2) — The above amounts include Other depreciation and amortization expense of \$1.1 million and \$1.2 million for the three months ended March 31, 2018 and 2017, respectively.

(3) — The above amounts exclude intercompany transactions eliminated in consolidation, which consist primarily of service fees and interest. The net amounts of these intercompany transactions were \$2.0 million and \$306,000 for the three months ended March 31, 2018 and 2017, respectively.

(4) — Net income (loss) presented for segment reporting purposes is before any adjustments attributable to noncontrolling interests.

Our Direct segment includes revenues, direct costs, and cost allocations associated with sales of inventory we own. Costs for this segment include product costs, freight, warehousing and fulfillment costs, credit card fees and customer service costs.

Our Partner segment includes revenues, direct costs and cost allocations associated with sales of inventory owned by our partners. Costs for this segment include product costs, outbound freight and fulfillment costs, credit card fees and customer service costs.

For the three months ended March 31, 2018 and 2017, substantially all of our sales revenues were attributable to customers in the United States. At March 31, 2018 and December 31, 2017, substantially all our fixed assets were located in the United States.

## 10. BROKER DEALERS

As part of our Medici blockchain and fintech technology initiatives, we hold a controlling interest in each of two broker dealers, SpeedRoute LLC ("SpeedRoute") and Pro Securities LLC ("Pro Securities").

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SpeedRoute is an electronic, agency-only FINRA-registered broker dealer that provides connectivity for its customers to U.S. equity exchanges as well as off-exchange sources of liquidity such as dark pools. All of SpeedRoute's customers are registered broker dealers. SpeedRoute does not hold, own or sell securities.

Pro Securities is a FINRA-registered broker dealer that owns and operates the Pro Securities alternative trading system ("ATS"), which is registered with the SEC. An ATS is a trading system that is not regulated as an exchange, but is a licensed venue for matching buy and sell orders. The Pro Securities ATS is a closed system available only to its broker dealer subscribers. Pro Securities does not accept orders from non-broker dealers, nor does it hold, own or sell securities.

SpeedRoute and Pro Securities are subject to the SEC's Uniform Net Capital Rule (SEC Rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1 and that equity capital may not be withdrawn or cash dividends paid if the resulting net capital ratio would exceed 10 to 1. At March 31, 2018, SpeedRoute had net capital of \$451,585, which was \$345,100 in excess of its required net capital of \$106,485 and SpeedRoute's net capital ratio was 3.54 to 1. At March 31, 2017, Pro Securities had net capital of \$105,101 which was \$100,101 in excess of its required net capital of \$5,000 and Pro Securities net capital ratio was 0.16 to 1. At December 31, 2017, SpeedRoute had net capital of \$334,848, which was \$233,485 in excess of its required net capital of \$101,363 and SpeedRoute's net capital ratio was 4.5 to 1. At December 31, 2017, PRO Securities had net capital of \$24,175, which was \$19,175 in excess of its required net capital of \$5,000 and PRO Securities net capital ratio was 1.3 to 1.

SpeedRoute and Pro Securities did not have any securities owned or securities sold, not yet purchased at March 31, 2018 and December 31, 2017, respectively.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Special Note Regarding Forward-Looking Statements

This Report on Form 10-Q and the documents incorporated herein by reference, as well as our other public documents and statements our officers and representatives may make from time to time, contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements relate to our financial condition, liquidity, results of operations, earnings outlook and prospects. You can find many of these statements by looking for words such as "may," "would," "could," "should," "will," "expect," "anticipate," "predict," "project," "potential," "continue," "contemplate," "seek," "assume," "plan," "forecast," "goal," "estimate," or other similar expressions which identify these forward-looking statements. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry and business, and on management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, you are cautioned that any such forward-looking statements are not guarantees of future performance and are subject to assumptions, risks and uncertainties that are difficult to predict, and that actual results may be materially different from the results expressed or implied by any of our forward-looking statements. We claim the protection of the safe harbor provided by the Private Securities Litigation Reform Act of 1995, as amended, for all such forward-looking statements. Unless otherwise required by law, we also disclaim any obligation to update our view of any such risks or uncertainties or to announce publicly any revisions to any forward-looking statements made or incorporated by reference in this report. A number of important factors could cause actual results to differ materially from those indicated by the forward-looking statements, including the risks set forth in the "Risk Factors" section of this report, and the risks described in our Annual Report on Form 10-K for the year ended December 31, 2017. Our forward-looking statements include all statements other than statements of historical fact including, without limitation, all statements

regarding:

our strategies and plans for our e-commerce business and our Medici businesses, including our tZERO initiatives; the possibility that we will pursue or attempt to pursue a strategic alternative that could change our business dramatically, including the possibility and potential effects of a sale of our e-commerce business, as well as the possibility that we will determine not to pursue any strategic alternative at all in the foreseeable future; our expectation that if we sell our e-commerce business for cash and retain some or all of the after-tax proceeds of the sale, we would return a significant portion of the after-tax proceeds to our stockholders within 12 months after

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any such sale, by means of a stock repurchase program, dividend, one or more issuer tender offers or other means to our stockholders;

- our expectations regarding the effects on us of the recent Tax Cuts and Jobs Act;
- our expectations regarding the costs, benefits and risks of Medici Ventures' efforts to develop blockchain applications and tZERO's efforts to develop financial technology ("fintech") applications, including applications using blockchain technology and how effectively that technology will be adopted, and including our expectations regarding the costs, benefits and risks of the operations of tZERO;
- all statements regarding the plans of tZERO or Medici Ventures;
- our expectations regarding the costs, benefits and risks of tZERO's ownership of SpeedRoute and PRO Securities, each of which is a registered broker dealer;
- our expectations regarding the costs, benefits and risks of having less than wholly-owned subsidiaries, including our indirect 80% owned subsidiary tZERO and our currently wholly-owned subsidiary Medici Ventures, which has issued stock options to employees and consequently may not be wholly-owned in the future;
- our discussion of the security token offering currently being conducted by tZERO, including the possibility that the proceeds of the security token offering might be treated as income to us for federal income tax purposes, which would increase our income tax expense, and might be treated as a liability rather than equity for accounting purposes, which would reduce tZERO's net book value compared to equity treatment, and the possibility that the security token offering will not raise a significant amount of funds or might not be completed at all;
- our expectations regarding the costs, benefits and risks of our efforts and plans to advertise or offer financial product and services offerings on our website, including our intention to continue to advertise discount stock brokerage trading services, and our expectations regarding the costs, benefits and risks of other additional businesses, innovations and projects that we or our subsidiaries may engage in, offer or advertise in the near future;
- our expectations regarding Medici Ventures' ownership interest in DeSoto Inc., a newly-formed public benefit corporation formed for the purpose of carrying out our collaboration with economist Hernando de Soto, and our plans and expectations regarding DeSoto Inc.;
- our plans to increase our branding and marketing expenditures significantly despite our decision not to proceed with the equity offering we launched in late March 2018;
- our beliefs regarding our ability to attract and retain customers in a cost-efficient manner;
  - the anticipated effectiveness of or potential improvements in our marketing;
- our future operating and financial results, including any projections of revenue, profits or losses, contribution, technology expense, general and administrative expense, cash flow, capital expenditures or other financial measures or amounts or non-GAAP financial measures or amounts or anticipated changes in any of them;
- our beliefs and expectations regarding the adequacy of our facilities, including leased and third-party operated warehouse facilities, as well as the possibility that we may add distribution centers or other distribution facilities to our distribution system or our expectations regarding the results of any such additions;
- our expectations that we can comply with the requirements of our term loan agreement and related agreements, and that we will be able to retire or refinance the debt we have or incur in the future;
- our future capital requirements and our ability to satisfy our capital needs;
- the adequacy of our liquidity and our ability, if any, to increase our liquidity or capital resources through traditional capital raising, tZERO's security token offering or otherwise;
- any possibility that we may purchase tZERO Security Tokens from tZERO;
- any possibility that tZERO may repay any or all of the amounts we have advanced to tZERO, or that we may accept tZERO Security Tokens to be issued by tZERO in satisfaction of any or all of such amounts;
- tZERO's plans, including without limitation its plans to develop its Token Trading System;
- whether the Token Trading System will be able to comply with SEC rules and regulations;
- our plans and expectations regarding the costs, benefits, and risks of attempting to develop technology applications including applications using or relating to blockchain technology and our plans to commercialize any of these potential applications;

- the competition we currently face and anticipate;
- the effects of current and future government regulation;
- our expectations for our international sales efforts and the anticipated results of our international operations;
- our efforts to provide multi-channel fulfillment services;
- our plans for further changes to our business;
- our expectations regarding our ability to successfully adopt a high-growth, high-cash flow strategy, and our beliefs regarding our ability to effectively change business strategies and scale the growth of our business;

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our beliefs regarding current or future litigation or regulatory actions or fines, including our expectations regarding the investigation the Division of Enforcement of the Securities and Exchange Commission is conducting and its request that we voluntarily provide certain information and documents related to tZERO and the tZERO security token offering, and our expectations regarding the purported class action lawsuits that were filed against us shortly after we publicly announced the SEC's investigation;

our beliefs and expectations regarding existing and future tax laws and related laws and the application of those laws to our business including the results of tax assessments we receive periodically;

our beliefs regarding the adequacy of our insurance coverage;

our beliefs regarding the adequacy and anticipated functionality of our infrastructure, including our backup facilities and beliefs regarding the adequacy of our disaster planning and our ability to recover from a disaster or other interruption of our ability to operate our Website;

our beliefs regarding our cybersecurity efforts and measures and our efforts to prevent data breaches and the costs we will incur in our ongoing efforts to avoid interruptions to our product offerings and other business processes from cyber-attacks and from data breaches;

our ability to maintain or improve upon customer service levels that we and our customers consider acceptable;

our beliefs regarding the adequacy of our order processing systems and our fulfillment and distribution capabilities;

our belief that we and our partners will be able to maintain inventory levels at appropriate levels despite the seasonal nature of our business and the rapid changes we encounter in customer demand for various products;

our expectations regarding our emphasis on home and garden product offerings;

our belief that we can successfully offer and sell a constantly changing mix of products and services; and

our other statements about the anticipated benefits and risks of our business and plans.

Our forward-looking statements are only predictions. Actual events or results may differ materially from those contemplated by our forward-looking statements for a variety of reasons, including among others:

any changes we may make to our business as a result of our current ongoing review of potential strategic alternatives, which could involve a sale of our e-commerce business, a sale of, or business combination involving, Overstock in its entirety, a management-led buyout, and/or additional equity or debt financings;

the possibility that we may sell our e-commerce business for cash and retain some or all of the after-tax proceeds of the sale for use in our blockchain initiatives, which would result in our stockholders owning equity interests in a publicly-held corporation seeking to develop entirely new businesses and revenue streams, without the benefits of our current e-commerce business and the approximately \$1.7 billion it generates in annual net revenues;

the potentially substantial corporate level income tax expense we could incur if we were to sell our e-commerce business in a taxable transaction;

the possibility that a sale of our e-commerce business would leave us without the revenues generated by the e-commerce business but with most if not all of the expenses of operating a publicly-held corporation regardless of the sale of the e-commerce business;

the possibility that our publicly-disclosed review of potential strategic alternatives may distract our management and other employees, may cause members of our management and/or other employees to seek employment elsewhere, and may have adverse effects on our business and financial results;

the technical, operational, financial, regulatory, legal, reputational, marketing and other obstacles we would face in trying to create a profitable business with significant revenues from our blockchain initiatives;

the possibility that the recent Tax Cuts and Jobs Act will have adverse effects on us in addition to those we have already identified;

the possibility that the proceeds of the security token offering currently being conducted by tZERO might be treated as income to us for federal income tax purposes;

the possibility that the security token offering currently being conducted by tZERO could result in claims against tZERO and/or us;

the probability that we will continue to incur substantially higher levels of sales and marketing expenditures than we have in the past, which could continue to have an adverse effect on our near-term financial results as it did in the first

quarter of 2018;

the costs of, and any difficulties we may encounter with, the implementation of our growth strategies for our e-commerce business, including our plans to invest more heavily in sales and marketing activities, new distribution facilities, our technology platforms, our Club O rewards program and our private label strategy, especially in light of our decision not to proceed with the equity offering we launched in late March 2018;

the efficiency of our e-commerce marketing and its effect on our business strategy;

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the cost and availability of online and traditional advertising, and the results of our various brand building and marketing campaigns;

difficulties we have encountered and continue to encounter with changes that Google has made to its natural search engine algorithms, which have periodically resulted in lower rankings of our products and may continue to do so, and future changes that Google and other search engine companies may make to their natural search engine algorithms, which may have similar effects on us;

increasing competition, including competition from well-established competitors including Amazon.com, competition from competitors based in China or in other relatively low-cost jurisdictions, competition from well-funded companies, including Wayfair, apparently willing to incur substantial losses in order to build market share, and from others including Amazon and other competitors with business models that include delivery capabilities that we cannot currently match and do not expect to be able to match in the foreseeable future;

difficulties we may encounter in connection with our efforts to offer services to our customers outside of our e-commerce business, including the credit, insurance, discount brokerage trading services and automated investment advisory services we advertise;

difficulties, including expense and any operational or regulatory issues we may encounter in connection with tZERO or its subsidiaries, including its two registered broker-dealers, SpeedRoute and PRO Securities;

technical, operational, regulatory or other difficulties we may encounter with our Medici or tZERO blockchain or financial technology initiatives, including any difficulties we or tZERO may have marketing any products or services tZERO may offer, whether due to lack of market size or acceptance or as a result of competition from any of the numerous competitors seeking to develop competing technologies or systems or as a result of patents that may be granted to other companies or persons; and losses we may continue to incur in connection with our Medici and tZERO blockchain and financial technology initiatives;

the possibility that blockchain technology may be adopted more slowly than we anticipate;

the difficulties tZERO will face in attempting to market its DLR Software, and the possibility that we and/or tZERO have overestimated the demand for, and/or the size of the intended market for the DLR Software or may face regulatory issues relevant to the DLR Software;

the difficulties tZERO will face in attempting to generate revenues from blockchain-based applications of any nature;

Medici Ventures' current business model of providing the services of its developers at Medici Ventures' cost to companies in which Medici Ventures owns an interest;

any difficulties we may have with the assets or interests in other companies that we or our subsidiaries Medici Ventures or tZERO may have made or may make in the future, including any impairment we may recognize with respect to assets or businesses that we, Medici Ventures or tZERO have acquired or may acquire, including with respect to our interests in companies that are in startup or development stages;

any difficulties DeSoto Inc. may have with its business plan, including any difficulties it may have in developing or implementing a plan to generate revenues or profits, and any difficulties it or we may have as a result of DeSoto Inc.'s status as a public benefit corporation under Delaware law;

any liability or expense we may incur as a result of our interests in other companies, whether as a result of regulatory issues or otherwise;

any downturn in the U.S. housing industry or other changes in U.S. and global economic conditions or U.S. consumer spending;

the imposition of tariffs or occurrence of other events or circumstances that increase the price of importing into the U.S. the types of merchandise we sell in our e-commerce business or make it more difficult to import or obtain such merchandise;

our failure to maintain our existing relationships with our fulfillment partners or build new relationships with fulfillment partners on acceptable terms;

our failure to maintain optimal levels of product quality, quantity and assortment or to attract sufficient consumer interest in our product offerings;

any claims we may face regarding the quality, safety or labelling of the products we offer;

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modifications we may make to our business model from time to time, including aspects relating to our product mix and the mix of direct/partner sourcing of the products we offer, and difficulties we may encounter as a result of our efforts to change various aspects of our business model frequently and rapidly;

the mix of products purchased by our customers and changes to that mix;

any claims we may face regarding cyber security issues or data breaches or difficulties we encounter regarding Internet or other infrastructure or communications impairment problems or the costs of preventing or responding to any such problems;

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any problems with or affecting our payment card processors, including cyber-attacks, Internet or other infrastructure or communications impairment or other events that could interrupt the normal operation of the payment card processors or any difficulties we may have maintaining compliance with the rules of the payment card processors;

any substantial decrease in our liquidity, whether as a result of our business operations, including our implementation of our growth strategies for our e-commerce business, which include our plans to invest more heavily in sales and marketing activities, new distribution facilities, our technology platforms, our Club O rewards program and our private label strategy, or as a result of any mandatory or voluntary repayment we may make of our term loan, or as a result of the expenses or results of governmental inquiries or investigations or litigation or other claims against us, and the possibility that we will be unable to obtain financing or any other source of liquidity adequate to enable us to continue our operations;

problems with or affecting the facility where substantially all of our computer and communications hardware is located or other problems that result in the unavailability of our Website or reduced performance of our transaction systems;

the extent to which we may owe income or sales taxes or may be required to collect sales taxes or report sales or to modify our business model in order to avoid being required to collect sales taxes or report sales or avoid the application of other types of taxes, and any liabilities that may ultimately be imposed upon us for not having collected sales tax in jurisdictions in which we have not done so;

the possibility that the United States Supreme Court may overturn the sales and use tax physical presence nexus requirement previously upheld by the Supreme Court in 1992 in *Quill v. North Dakota*;

any losses or issues we may encounter as a consequence of accepting or holding bitcoin or other cryptocurrencies, whether as a result of regulatory, tax or other legal issues, technological issues, value fluctuations, including the substantial decrease in cryptocurrency values in the first quarter of 2018, which resulted in an \$8.8 million impairment, lack of widespread adoption of bitcoin or other cryptocurrencies as an acceptable medium of exchange or otherwise;

difficulties we may have in responding to technological changes;

losses we may incur due to fraud or our inability to prevent or limit fraud;

claims or other problems we may encounter as a result of the listing or sale on our Website of pirated, counterfeit or illegal items;

difficulties we may have financing our operations or our expansion with either internally generated funds or external sources of financing, especially considering we recently announced a public equity offering on March 26, 2018 but terminated the offering shortly thereafter following a significant decline in the price of our common stock;

any failure by us to maintain compliance with the requirements of our current loan agreement or any future loan agreement or related agreements;

- any environmental liabilities we may incur relating to the real estate owned by one of our wholly-owned subsidiaries and on which our corporate headquarters is located;

any failure of any of our product or service offerings outside of our main shopping Website offerings to provide the benefits we expect from them;

any difficulties we may encounter as a result of our reliance on numerous third parties that we do not control for the performance of critical functions material to our business;

any difficulties we may encounter in connection with the rapid shift of e-commerce and online payments to mobile and multi-channel commerce and payments;

our inability to increase market share or revenue in accordance with our plans;

difficulties with the management of our growth and any periods in which we fail to grow in accordance with our plans;

- difficulties we may encounter in connection with our efforts to emphasize our home and garden product offerings and to brand ourselves as a home and garden shopping destination, including the risk that our sales of home and garden product offerings could decrease substantially as a result of a significant downturn in some or all of the U.S. housing market;

fluctuations in our operating results;

difficulties we may encounter in connection with our efforts to expand internationally, including claims we may face and liabilities we may incur in connection with those efforts; adverse results in legal proceedings, investigations or other claims, and costs we may incur in connection with any of them, including the costs of responding to the investigation the Division of Enforcement of the Securities and Exchange Commission is conducting and the costs of litigating the purported class action lawsuit(s) that were filed against us shortly after we publicly announced the SEC's investigation;

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- any difficulties we may have optimizing our warehouse operations;
- the risks of inventory management and seasonality, particularly with inventory subject to rapid price declines;
- any decrease in the rate of growth of e-commerce, particularly in home goods, and the occurrence of any event that would adversely affect e-commerce or discourage or prevent consumers from shopping online or via mobile apps;
- the possibility that we will suffer adverse consequences as a result of one or more of the related party transactions we have entered into or other related party transactions that we may enter into in the future; and
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