OVERSTOCK.COM, INC
Form 10-Q
August 09, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018

Or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number: 000-49799
OVERSTOCK.COM, INC.
(Exact name of registrant as specified in its charter)

Delaware	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 ý No o

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

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 o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o

Emerging growth company o

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. o

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

There were 29,009,814 shares of the Registrant's common stock, par value $0.0001, outstanding on August 8, 2018.

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OVERSTOCK.COM, INC.
FORM 10-Q
For the quarterly period ended June 30, 2018

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

Overstock.com, Inc.
Consolidated Balance Sheets (Unaudited)
(in thousands)

	June 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$152,228	$ 203,215
Restricted cash	468	455
Accounts receivable, net	28,597	30,080
Inventories, net	15,355	13,703
Prepaid inventories, net	1,071	1,625
Prepaids and other current assets	25,419	16,119
Total current assets	223,138	265,197
Fixed assets, net	131,923	129,343
Intangible assets, net	26,343	7,337
Goodwill	22,058	14,698
Equity Investments	43,543	13,024
Other long-term assets, net	5,888	4,216
Total assets	$452,893	$ 433,815
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$92,712	$ 85,406
Accrued liabilities	109,732	82,611
Deferred revenue	42,644	46,468
Other current liabilities, net	468	178
Total current liabilities	245,556	214,663
Long-term debt, net	3,069	—
Long-term debt, net - related party	—	39,909
Other long-term liabilities	6,160	7,120
Total liabilities	254,785	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 - 32,203 and 30,632		
Outstanding shares - 29,007 and 27,497	3	3
Additional paid-in capital	553,112	494,732
Accumulated deficit	(365,472)	(254,692)
Accumulated other comprehensive loss	(591)	(599)
Treasury stock:		
Shares at cost - 3,196 and 3,135	(66,662)	(63,816)

Equity attributable to stockholders of Overstock.com, Inc.	120,390	175,628
Equity attributable to noncontrolling interests	77,718	(3,505)
Total equity	198,108	172,123
Total liabilities and stockholders' equity	$452,893	$ 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 June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Revenue, net				
Direct	$14,715	$22,099	$30,985	$44,927
Partner and other	468,418	409,925	897,479	819,532
Total net revenue	483,133	432,024	928,464	864,459
Cost of goods sold				
Direct(1)	14,672	21,147	29,444	42,110
Partner and other	376,718	326,706	713,408	651,271
Total cost of goods sold	391,390	347,853	742,852	693,381
Gross profit	91,743	84,171	185,612	171,078
Operating expenses:				
Sales and marketing(1)	94,416	43,297	171,630	80,915
Technology(1)	32,423	28,244	63,717	57,236
General and administrative(1)	31,440	22,361	71,195	44,971
Total operating expenses	158,279	93,902	306,542	183,122
Operating loss	(66,536)	(9,731)	(120,930)	(12,044)
Interest income	620	136	1,164	261
Interest expense	(395)	(716)	(1,269)	(1,426)
Other income (expense), net	368	593	359	(3,131)
Loss before income taxes	(65,943)	(9,718)	(120,676)	(16,340)
Benefit from income taxes	(27)	(1,975)	(304)	(2,315)
Consolidated net loss	$(65,916)	$(7,743)	$(120,372)	$(14,025)
Less: Net loss attributable to noncontrolling interests	(1,005)	(244)	(4,552)	(623)
Net loss attributable to stockholders of Overstock.com, Inc.	$(64,911)	$(7,499)	$(115,820)	$(13,402)
Net loss per common share—basic:				
Net loss attributable to common shares—basic	$(2.20)	$(0.29)	$(3.94)	$(0.52)
Weighted average common shares outstanding—basic	28,903	24,996	28,736	25,035
Net loss per common share—diluted:				
Net loss attributable to common shares—diluted	$(2.20)	$(0.29)	$(3.94)	$(0.52)
Weighted average common shares outstanding—diluted	28,903	24,996	28,736	25,035

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

Cost of goods sold — direct	$41	$39	$111	$88
Sales and marketing	315	113	1,188	209
Technology	621	150	1,142	310
General and administrative	1,996	743	6,967	1,378
Total	$2,973	$1,045	$9,408	$1,985

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 June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Consolidated net loss	$(65,916)	$(7,743)	$(120,372)	$(14,025)
Other comprehensive loss:				
Unrealized gain on cash flow hedges, net of expense for taxes of $0, $55, $0, and $(40)	4	(81)	8	68
Other comprehensive income	4	(81)	8	68
Comprehensive loss	$(65,912)	$(7,824)	$(120,364)	$(13,957)
Less: Comprehensive loss attributable to noncontrolling interests	(1,005)	(244)	(4,552)	(623)
Comprehensive loss attributable to stockholders of Overstock.com, Inc.	$(64,907)	$(7,580)	$(115,812)	$(13,334)

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)

	Six months ended June 30, 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	221
Common stock issued for asset purchase	100
Exercise of stock warrants	1,250
Balance at end of period	32,203
Number of treasury stock shares	
Balance at beginning of period	3,135
Tax withholding upon vesting of restricted stock	61
Balance at end of period	3,196
Total number of outstanding shares	29,007
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	5,368
Common stock issued for asset purchase	2,930
Exercise of stock warrants	50,562
Sale of stock warrants	25
Other	(505)
Balance at end of period	$553,112
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.	(115,820)
Balance at end of period	$(365,472)
Accumulated other comprehensive loss	
Balance at beginning of period	$(599)
Net other comprehensive income	8
Balance at end of period	$(591)

Treasury stock	
Balance at beginning of period	$(63,816)
Tax withholding upon vesting of restricted stock	(2,846)
Balance at end of period	(66,662)
Total equity attributable to stockholders of Overstock.com, Inc.	$120,390
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)	78,442
Stock-based compensation to employees and directors	4,040
Tax withholding upon vesting of restricted stock	(1,680)
Net loss attributable to noncontrolling interests	(4,552)
Fair value of noncontrolling interests at acquisition	4,468
Other	505
Total equity attributable to noncontrolling interests	$77,718
Total equity	$198,108

See accompanying notes to unaudited consolidated financial statements.

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Overstock.com, Inc.
Consolidated Statements of Cash Flows (Unaudited)
(in thousands)

	Six months ended June 30, 2018	Six months ended June 30, 2017	Twelve months ended June 30, 2018	Twelve months ended June 30, 2017
Cash flows from operating activities:				
Consolidated net loss	$(120,372)	$(14,025)	$(218,269)	$(14,656)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:				
Depreciation of fixed assets	12,983	14,909	26,922	29,896
Amortization of intangible assets	2,051	1,891	4,159	3,637
Stock-based compensation to employees and directors	9,408	1,985	11,500	4,161
Deferred income taxes, net	(298)	(2,796)	67,697	(2,445)
Gain on investment in precious metals	—	—	(1,971)	(201)
Impairment of cryptocurrencies	9,491	—	9,491	—
Gain on sale of cryptocurrencies	(8,348)	—	(10,343)	—
Impairment of equity securities	—	4,500	987	7,350
Early extinguishment costs of long term debts	283	—	2,747	—
Other	(609)	65	202	423
Changes in operating assets and liabilities, net of acquisitions:				
Accounts receivable, net	1,882	7,391	(7,447)	(1,446)
Inventories, net	120	3,785	1,569	2,366
Prepaid inventories, net	554	897	144	3
Prepaids and other current assets	(8,234)	(9,213)	(2,307)	(3,809)
Other long-term assets, net	(3,827)	(147)	(5,987)	(729)
Accounts payable	6,686	(30,601)	16,292	(3,127)
Accrued liabilities	26,911	(22,391)	36,991	3,578
Deferred revenue	1,216	(2,643)	8,547	(4,933)
Other long-term liabilities	(476)	136	(467)	194
Net cash (used in) provided by operating activities	(70,579)	(46,257)	(59,543)	20,262
Cash flows from investing activities:				
Purchases of intangible assets	(9,241)	—	(9,664)	—
Proceeds from sale of precious metals	—	—	11,917	1,610
Investment in precious metals	—	—	—	(1,633)
Disbursement of note receivable	(200)	(250)	(700)	(868)
Investment in equity securities	(29,570)	(3,188)	(31,570)	(3,938)
Acquisitions of businesses, net of cash acquired	(12,912)	—	(12,912)	28
Expenditures for fixed assets, including internal-use software and website development	(12,749)	(16,450)	(19,885)	(45,883)
Other	22	(115)	207	(118)
Net cash used in investing activities	(64,650)	(20,003)	(62,607)	(50,802)
Cash flows from financing activities:				
Payments on capital lease obligations	(248)	—	(331)	—
Payments on interest swap	—	—	(1,535)	(224)
Proceeds from finance obligations	—	—	—	5,325
Payments on finance obligations	—	(1,622)	(13,694)	(2,731)
Proceeds from long-term debt	—	—	40,000	12,621
Payments on long-term debt	(40,000)	(469)	(85,297)	(469)

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 and exercise of stock warrants	50,587	—	157,049	—
Proceeds from security token offering, net of offering costs	78,442	—	79,347	—
Purchase of treasury stock	—	(10,000)	—	(10,000)
Payments of taxes withheld upon vesting of restricted stock	(4,526)	(1,085)	(4,670)	(1,323)
Payment of debt issuance costs	—	(251)	(419)	(251)
Net cash provided by (used in) financing activities	84,255	(12,773)	170,351	12,012
Net increase (decrease) in cash, cash equivalents and restricted cash	(50,974)	(79,033)	48,201	(18,528)
Cash, cash equivalents and restricted cash, beginning of period	203,670	183,528	104,495	123,023
Cash, cash equivalents and restricted cash, end of period	$152,696	$104,495	$152,696	$104,495

Continued on the following page

Overstock.com, Inc.
Consolidated Statements of Cash Flows (Unaudited)
(Continued)
(in thousands)

	Six months ended June 30,		Twelve months ended June 30,	
	2018	2017	2018	2017
Supplemental disclosures of cash flow information:				
Cash paid during the period:				
Interest paid, net of amounts capitalized	$1,113	$1,308	$2,745	$2,238
Income taxes paid, net of refunds	7	183	311	977
Non-cash investing and financing activities:				
Fixed assets, including internal-use software and website development, costs financed through accounts payable and accrued liabilities	$735	$690	$735	$690
Equipment acquired under capital lease obligations	—	—	1,421	—
Capitalized interest cost	—	—	—	27
Change in fair value of cash flow hedge	—	(100)	(1,638)	(3,044)
Note receivable converted to equity investment	200	869	699	3,719
Acquisition of assets through stock issuance	2,930	—	2,930	—

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

Overstock.com, Inc. is an online retailer and advancer of blockchain technology. As used herein, "Overstock," "the Company," "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, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) have been omitted in accordance with the rules and regulations of the SEC.
These financial statements should be read in conjunction with 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. The results of operations for the three and six months ended June 30, 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. The financial results of Verify Investor, LLC have been included in our consolidated financial statements from the date of acquisition on February 12, 2018. The financial results of Mac Warehouse, LLC have been included in our consolidated financial statements from the date of acquisition on June 25, 2018.

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 our 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. Although these estimates are based on our best knowledge of current events and actions that we may undertake in the future, actual results may 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 $31.2 million and $25.5 million at June 30, 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, which fair values 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. 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.

The following tables summarize our assets and liabilities measured at fair value on a recurring basis using the fair value hierarchy as of June 30, 2018 and December 31, 2017 as indicated (in thousands):

p	Fair Value Measurements at June 30, 2018:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	$ 31,188	$ 31,188	$ —	$ —
Investments in equity securities, at fair value	4,336	4,336	—	—
Trading securities held in a "rabbi trust" (1)	83	83	—	—
Total assets	$ 35,607	$ 35,607	$ —	$ —
Liabilities:				
Deferred compensation accrual "rabbi trust" (2)	$ 90	$ 90	$ —	$ —
Total liabilities	$ 90	$ 90	$ —	$ —

	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 our consolidated balance sheets.

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

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Accounts receivable, net

Accounts receivable consist primarily of trade amounts due from customers in the United States, uncleared credit card transactions at period end, and carrier rebates. Accounts receivable are recorded at invoiced amounts and do not bear interest. 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 $1.5 million and $1.3 million at June 30, 2018 and December 31, 2017, respectively.

Concentration of credit risk

Three banks held the majority of our cash and cash equivalents at June 30, 2018. Two banks held the majority of our cash and cash equivalents at December 31, 2017. 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. Inventory valuation requires us to make judgments, based on currently available information, about the likely method of disposition, such as through sales to individual customers, returns to product vendors, or liquidations, and expected recoverable values of each disposition category.

Prepaid inventories, net

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

Prepaids and other current assets

Prepaids 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

Cryptocurrency holdings are included in Prepaids and other current assets in our consolidated balance sheets and totaled $3.0 million and $1.5 million at June 30, 2018 and December 31, 2017, respectively. Cryptocurrency holdings are recorded at cost less impairment.

We recognize impairment on these assets caused by decreases in market value based upon Level 1 inputs. See Fair value of financial instruments above. 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 $702,000 and $9.5 million for the three and six months ended June 30, 2018. There was no impairment on cryptocurrencies during the three and six months ended June 30, 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 statements of cash flows. Realized gains on sale of cryptocurrencies were $6.8 million and $8.3 million for the three and six months ended June 30, 2018. There were no realized gains or losses on sale of cryptocurrencies during the three and six months ended June 30, 2017.

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Fixed assets, net

Fixed assets are recorded at cost and stated net of depreciation and amortization. Fixed assets are 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, including internal-use software and website development	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. Costs incurred related to design or maintenance of internal-use software are expensed as incurred.

During the three months ended June 30, 2018 and 2017, we capitalized $8.3 million and $2.4 million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally. Amortization of costs for the same periods associated with internal-use software and website development was $3.2 million and $4.1 million, respectively. During the six months ended June 30, 2018 and 2017, we capitalized $10.6 million and $5.9 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 $6.7 million and $8.3 million, respectively.

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

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Cost of goods sold - direct	$83	$75	$167	$158
Technology	5,296	6,177	10,772	12,862
General and administrative	1,023	959	2,044	1,889
Total depreciation, including internal-use software and website development	$6,402	$7,211	$12,983	$14,909

Total accumulated depreciation of fixed assets was $198.4 million and $186.4 million at June 30, 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 our consolidated statements of operations.

Fixed assets included assets under capital leases were $1.8 million and $1.8 million at June 30, 2018 and December 31, 2017. Accumulated depreciation related to assets under capital leases was $722,000 and $458,000 at June 30, 2018 and December 31, 2017, respectively.

Depreciation expense of assets recorded under capital leases was $120,000 and $1.1 million for the three months ended June 30, 2018 and 2017, respectively, and $264,000 and $2.4 million for the six months ended June 30, 2018 and 2017, respectively.

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Equity investments under ASC 321

At June 30, 2018, we held minority interests (less than 20%) in twelve privately held entities accounted for under ASC Topic 321, Investments - Equity Securities ("ASC 321"), which are included in Equity investments in our consolidated balance sheets. One of these equity investments is carried at fair value based on Level 1 inputs. See Fair value of financial instruments above. The remaining equity investments lack readily determinable fair values and therefore the investments are measured at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar equity securities of the same issuer. Dividends received 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. 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 $18.6 million and $6.5 million at June 30, 2018 and December 31, 2017, respectively. We recognized unrealized gains of $1.8 million on investments carried at fair value during the three and six months ended June 30, 2018. There was no impairment loss during the six months ended June 30, 2018. We recognized $4.5 million impairment loss during the six months ended June 30, 2017. The impairment loss or other adjustment to our investments are recorded in Other expense, net on our consolidated statements of operations.

Equity method investments under ASC 323

At June 30, 2018, we held minority interests in six privately held entities accounted for as equity method investments under ASC Topic 323, Investments - Equity Method and Joint Ventures ("ASC 323"), which are included in Equity investments in our consolidated balance sheets. 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.

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 our consolidated statements of operations with corresponding adjustments to the carrying value of the investment.

The carrying amount of our equity method investments was approximately $25.0 million and $6.5 million at June 30, 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 six months ended June 30, 2018 and the six months ended June 30, 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 in the future, tZERO Preferred Equity Tokens (the "tZERO Security Token") through a Simple Agreement for Future Equity ("SAFE"). At June 30, 2018, the SAFEs were classified as equity by tZERO. At June 30, 2018, cumulative proceeds, net of withdrawals, from the security token offering totaling $95.9 million, have been classified as a component of noncontrolling interest within our consolidated financial statements. As of June 30, 2018, tZERO has incurred $16.5 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. The security token offering closed on August 6, 2018 and we received an additional $7.5 million of proceeds, before deducting additional offering costs, prior to the close.

During the first quarter of 2018, tZERO purchased 65.8% of ES Capital Advisors, LLC ("ES Capital"), a registered investment advisor under the Investment Advisers Act of 1940, which was accounted for 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 six months ended June 30, 2018 and 2017.

For six months ended June 30, 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 Medici Ventures' portfolio company in the blockchain property titling 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

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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 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):

	June 30, 2018	December 31, 2017
Intangible assets subject to amortization, gross (1)	$28,004	$ 17,779
Less: accumulated amortization of intangible assets subject to amortization	(12,494)	(10,442)
Intangible assets subject to amortization, net	15,510	7,337
Intangible assets not subject to amortization	10,833	—
Total intangible assets, net	$26,343	$ 7,337

(1) — At June 30, 2018, the weighted average remaining useful life for intangible assets subject to amortization, excluding fully amortized intangible assets, was 5.70 years.

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

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Technology	$895	$905	$1,650	$1,810
Sales and marketing	204	20	323	40
General and administrative	34	21	78	41
Total amortization	$1,133	$946	$2,051	$1,891

Estimated amortization expense for the next five years is: $2.9 million for the remainder of 2018, $5.1 million in 2019, $2.7 million in 2020, $2.4 million in 2021, $1.1 million in 2022, and $1.3 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 six months ended June 30, 2018 and 2017.

Other long-term assets, net

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

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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 six months ended June 30, 2018, we recognized $36.8 million of net revenue included in Deferred revenue at December 31, 2017.

The allowance for returns was $15.5 million and $17.4 million at June 30, 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 gross amount of consideration that we expect to receive on securities transactions (commission revenue) on a trade date 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.