

FINAL TRANSCRIPT

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OSTK - Q3 2011 Overstock Com Inc Earnings Conference Call

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CORPORATE PARTICIPANTS

Jonathan Johnson

Overstock.com - President

Steve Chesnut

Overstock.com - SVP Finance & Risk Management

Patrick Byrne

Overstock.com - Chairman and CEO

CONFERENCE CALL PARTICIPANTS

Dan Kurnos

The Benchmark Co. - Analyst

PRESENTATION

Operator

Good afternoon. My name is Bonnie, and I will be your conference operator today. At this time, I would like to welcome everyone to the O.co, also known as Overstock.com, third-quarter 2011 earnings conference call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions). Thank you.

I would now like to turn the call over to Mr. Jonathan Johnson. Please go ahead sir.

Jonathan Johnson - *Overstock.com - President*

Thank you Bonnie. Good morning and welcome to our Q3 2011 earnings call.

Joining me today are Dr. Patrick Byrne, Chairman and CEO of the Company, and Steve Chesnut, Senior Vice President of Finance and Risk Management of the Company.

To begin with, let me remind you that the following discussion and our responses to your questions reflect management's views as of today, October 27, 2011, and may include forward-looking statements. Actual results may differ materially. Additional information about factors that could potentially impact our financial results is included in the press release and the Form 10-Q that were issued this morning and our Form 10-K filed earlier this year.

During this call, we'll discuss certain non-GAAP financial measures. The slides accompanying this website and filings with the SEC, each posted on our Investor Relations website, contain additional disclosures regarding these non-GAAP measures, including reconciliations of these measures to the most comparable GAAP measures.

With that preliminary -- those preliminary warnings out of the way, let me turn the call over to Steve to talk about some of our financial results.

Steve Chesnut - *Overstock.com - SVP Finance & Risk Management*

Thank you Jonathan.

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As we review our financial results during the call today, keep in mind that, unless otherwise stated, all of the comparisons are going to be against our Q3 2010 performance.

Revenue in the quarter decreased by \$5.7 million, or 2%. The primary reason for the decrease in revenue in the quarter were, while our visits to our website were up slightly, we had lower conversion rates and a decrease in new customers, which each resulted in fewer orders.

Gross profit decreased by 7%, and gross margin decreased by 90 basis points to 16%, primarily due to competitive pricing initiatives that we instituted. Contribution margin fell by 30 basis points to 10.2%.

Combined technology and G&A expense increased by 12%, largely due to increases in IT-related staffing and depreciation expense and the higher legal expenses in the quarter.

Declining revenue, declining contribution, rising operating expenses resulted in a net loss of \$7.8 million for the quarter. This is an increased loss of \$4.4 million compared to last year.

On a positive note, in the quarter, we retired the remaining \$24.5 million of senior convertible notes. We funded this through a \$17 million draw on our US Bank line of credit and \$7.5 million of operating cash.

We ended Q3 with \$79 million of cash and cash equivalents and \$18 million of working capital.

I would encourage you to review our Form 10-Q that we filed today for more detailed information on our results.

With that, let me turn the call over to Patrick.

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

Good morning. I'm starting on the slide deck Slide 5.

We have arrested the fall or the deceleration but we're basically flat, we have been for a few quarters. That is disappointing. We know exactly what it is; we know what channel it's in.

The brand morphed to O.co. We're measuring the responsiveness of those dollars spent, and that has dropped significantly our branding -- our branding responsiveness. Some customers are getting the O.co, some are finding it confusing, so you will see us decelerate that whole brand morph and keep -- maybe it's going to take two or three years to get people to understand what O.co is, but you'll be seeing Overstock. We'll be reminding people more of Overstock and just the shortcut O.co for the time being until we can get more people shifting.

The early shift to O.co surprised us by how quickly it happened. Then there seems to have been some confusion emerge, and so we know that's exactly the marketing channel that's been having the problems.

The other online channels are generally healthy, other than the affiliate channel, where of course we were hurt by all this affiliate tax nexus stuff. But hopefully, that has -- or that seems to be reversing.

Slide 6, gross profits have come down a little bit with the 2% decline.

Slide 7, this is problematic. We really think, as I said before, I think 11.5%, 12% is the right contribution. And maybe it's 11.5%, 12% is what -- or I think now. This is obviously too low and this is a function of us having to gun marketing harder than we would to support this level of sales, were it not for what I've just described.



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Page 8. Quarterly contribution growth basically falls out of the previous two numbers.

Slide 9. We remain -- cash flow from operations are basically \$32 million, trailing 12 months are \$32 million. That's about where it's been for a while.

Slide 10, GAAP inventory turns, 31. It's more like 6 on a real basis, but on a GAAP basis, 31.

GMROI, Slide 11. This actually on of course the total basis it counts the partner program which is not infinite, but very high. We do have some partner inventory due to returns, but the 650% is acceptable. The 58% isn't. It's really an expression of overcapacity. We have overcapacity in our logistics, and that's what the actual -- on a -- the overcapacity hits us and hits this number hard. The actual -- on a product basis, things are doing much better than this, but it's the capacity that weighs this number down.

Slide 12, net promoter score. We actually don't think it's -- we've gotten it to 60% and again -- or 59%. Again it's -- this is just for people who contact us. It's actually better for people who don't even contact customer service, customer care. This is I think an extraordinary number, although I do think that it's asymptotically has -- it has asymptotically approached its limit at around 60%-ish as far as we can tell.

Slide 13, unique customers. We're up to almost 26 million people in our history, a slight decrease in unique customers this quarter.

Slide 14, we remain at about \$20 CPA, but again there was a slight decrease in new customers.

Average order size, Slide 15. There has been a slight decrease, as Steve said, that the traffic was up a bit, the conversion was down a little bit, but the average order size is back up. So the actual revenue per visitor is about flat.

Slide -- we're on gross profit per transaction. Slide 18, corporate employees were down about 2% and remain very focused, extremely focused on financial discipline. In fact, in sort of all kinds of ways, we feel we're doing -- internally things feel good in the sense of how quickly we're getting certain things done and the way our development teams are working with the business teams in a very agile like way.

There is really one big fly in the ointment, and that is the marketing. We're spending -- we've had this marketing problem. As a result, we've had to spend much too much to support this level of sales, or put differently, with this much spending, we should've seen significant growth return. So that's the problem. We know exactly -- it's not sort of an overall problem in the sense of our online marketing. Various channels are growing nicely, but it's really just the brand morph. We switched into third gear on it. We probably should've run in second gear for six months longer than we did. Okay.

Jonathan Johnson - *Overstock.com - President*

That's our presentation. If there are folks that want to ask questions, we're prepared to answer them.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Dan Kurnos, Benchmark.

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Dan Kurnos - *The Benchmark Co. - Analyst*

Good afternoon guys. How are you doing? Just a couple of questions, maybe broader picture here.

The second quarter, you mentioned that it was really -- you're really focusing on O.co as the center of your -- center of the rebranding effort and Club O to be specific within that. That strategy has continued into this quarter.

I guess the question is you realize now that maybe the marketing spend on that side was too high. But why not push the promotional side, the coupon side, which seems to be sort of where most of the other e-commerce players are spending a significant chunk of their dollars?

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

Great question. It's like you're reading our e-mail. The truth is my second mistake to how fast I pushed O.co would be I probably cut the coupon too hard. I felt that, over the years, we had trained our customers too hard -- too much to wait for coupons, and so we aggressively reduced those. We found the same thing, that turns out to be very effective spend. So we are coming back with the coupon spend.

I've told you about O.co. Club O is actually working well, I think. We won't really understand the full economics until we get through this Christmas season, but it's -- we see the power of getting people to join Club O and it makes them much more valuable. So in lots of ways, the Club O is being successful. We're not getting as many members as I hoped, but we have -- we're getting lots of members. But it's going to take another year or so before that moves the needle for the Company as a whole.

So really to fully understand, we have some predictions about how they're going to behave this Christmas season and such, but we won't know for sure until early January. So we're actually good with Club O. It's the other two things. The O.co and the coupons that you mentioned are the problem.

Dan Kurnos - *The Benchmark Co. - Analyst*

So sticking with the marketing theme for a second, I have noticed a few TV ads lately, so I'm glad you guys are getting your brand out there. I did notice, in one of the ads, that there was an offer for some specific items accompanied by free shipping. Is that -- on the free -- is free shipping something you guys are looking at for maybe split shift items or items over a certain price? Is that something that's entered your thought process?

Jonathan Johnson - *Overstock.com - President*

This is Jonathan. We are being a little bit more product-centric on our ads, so when you saw products on there, I think you'll continue to see that. We will have lots of free shipping promotions during the fourth quarter as part of the Christmas promotion, so you'll see that on sometimes for orders of a certain size and at some point for all orders.

Dan Kurnos - *The Benchmark Co. - Analyst*

That's great. Patrick, if you wouldn't mind, I know you said it's early to sort of determine what you think the spending habits are going to be, but if you wouldn't mind sharing your outlook for the holiday season and how it's sharing -- how it's shoring up right now, even if it's just sort of broad color.

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

I can't really say anything about the holiday season, but I can just say we -- a lot of people build up points in Club O in their Club O account. Some of them, like Jonathan, come and every visit they spend all their points. Some of them, like others, like Stormy for example, she saves it all up and then wants to come at Christmas and have it for Christmas. So we've built up quite a lot of Club O points. Our customers have built up quite a lot of Club O points. It's just going to -- and we don't really have a full understanding of which person they're like at Christmas. Do they come in and spend them all? Do they come in -- and so forth? So we'll have a better -- a bigger sample this year than last year and a better sort of our first really full analysis, I would say, at the end of this year.

Dan Kurnos - *The Benchmark Co. - Analyst*

Has your view of the broader economy improved at all? I know you've been bearish for a while now.

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

I'm very bearish, but in a much deeper way. I just don't think this is an ordinary recession, and so I think that the -- we're just being propped up. We're just being propped up. So I do expect someday a real crack. It's like seeing a bridge that was built to hold 1000 cars, and I see 4000 cars on it. You can ask, well, is the next car that drives across it going to break it? The answer is I really don't know. I wouldn't have thought it held 4000 cars. But until then, things are going to look like a bottom-bouncing recovery, not a good recovery, but we're going to be up one quarter in growth -- I'm talking about the country -- and then down a little bit more than expected. But I think all of that is kind of Fugazi as we would say in the clear closeout industry. I think that ultimately that's all just being done by cheap money propping up and various actions of the federal government. They're just postponing their -- it's morphine shots for cancer patients. They're not addressing the actual problem. So -- and I don't know when that problem manifests. So I think that what we're in now is this bottom-bouncing. I think -- did I hear on the way in that some numbers came out this morning that showed a little --?

Steve Chesnut - *Overstock.com - SVP Finance & Risk Management*

GDP was up -- up mid 2%

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

I think that that's all just -- the bottom -- we're not going to have a -- I can't imagine us ever getting to a strong recovery before we go through a deeper crisis first.

Dan Kurnos - *The Benchmark Co. - Analyst*

Just one final one from me, just sort of a one-off. I know you guys reset the trial date. Was there any particulars as to why the date was shifted from December?

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

We certainly didn't reset it. We want to go to trial. Jonathan?



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Jonathan Johnson - *Overstock.com - President*

We very much wanted to keep the December 5 date. The court schedule was backed up, and the judge asked if we would push it back. In order to push it back as far as it did, we actually have to waive a provision that says all cases in California need to be tried within five years of the filing date. We're going to miss that by a month, but we intend to do all we can to keep that March 5 trial date.

Dan Kurnos - *The Benchmark Co. - Analyst*

Got it. Great. Thanks a lot guys. Appreciate it.

Operator

(Operator Instructions).

Jonathan Johnson - *Overstock.com - President*

Thank you. If there's no other calls, we will get back to work and talk to our owners next quarter.

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

Thank you.

Operator

Thank you. This concludes today's conference call. You may now disconnect.

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