

OVERSTOCK.COM, INC  
Form 10-K  
March 03, 2017

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2016

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

(State or other jurisdiction of incorporation or organization)

87-0634302

(I.R.S. Employer Identification Number)

799 West Coliseum Way, Midvale, UT

(Address of principal executive offices)

84047

(Zip code)

(801) 947-3100

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Common Stock, \$0.0001 par value

Name of Each Exchange on Which Registered

Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting

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)

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

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant as of the last business day of the registrant's most recently completed second quarter (June 30, 2016), was approximately \$211.7 million based upon the last sales price reported by Nasdaq. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 5% of the outstanding shares of Common Stock and shares held by officers and directors of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination is not necessarily conclusive.

There were 24,895,038 shares of the Registrant's common stock, par value \$0.0001, outstanding on February 24, 2017.

#### DOCUMENTS INCORPORATED BY REFERENCE

Certain information required by Part III of Form 10-K is incorporated by reference to the Registrant's proxy statement for the 2017 Annual Stockholders

Meeting, which will be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates.

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## SPECIAL CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K 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 are therefore entitled to the protection of the safe harbor provisions of these laws. These forward-looking statements involve risks and uncertainties, and relate to future events or our future financial or operating performance. The forward-looking statements include all statements other than statements of historical fact, including, without limitation, all statements regarding:

- the anticipated benefits and risks of our business and plans;
- our beliefs regarding our ability to attract and retain customers in a cost-efficient manner;
- the anticipated effectiveness of 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 expectations regarding our new corporate headquarters and the risks relating to our new corporate headquarters;
- our beliefs and expectations regarding the adequacy of our new corporate headquarters and our leased warehouse facilities;
- our expectations regarding the benefits and risks of the credit facility we entered into for the purpose of, among other things, financing a portion of the costs of our new corporate headquarters;
- our future capital requirements and our ability to satisfy our capital needs;
- our expectations regarding the adequacy of our liquidity;
- our ability to retire or refinance any debt we may have or incur in the future;
- the competition we currently face and will face in our business as the ecommerce business continues to evolve and to become more competitive, and as additional competitors, including Amazon and competitors based in China or elsewhere, continue to increase their efforts in our primary markets;
- the effects of government regulation;
- our plans for international markets, our expectations for our international sales efforts and the anticipated results of our international operations;
- our plans and expectations regarding Supplier Oasis and our efforts to provide multi-channel fulfillment services;
- our plans and expectations regarding our insurance product offerings and consumer finance offerings;
- our plans for further changes to our business;
- our beliefs regarding current or future litigation or regulatory actions;
- our beliefs regarding the costs and benefits of our “spend and defend” policy under which we generally refuse to settle abusive patent suits brought against us;
- our beliefs and expectations regarding existing and future tax laws and related laws and the application of those laws to our business including any tax assessments we may receive;
- 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 cyberattacks and from data breaches;
- our belief regarding our ability to meet our published product shipping standards;
- our belief that we can 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 expectations regarding the costs and benefits of our other businesses, innovations and projects including our car listing service, our Worldstock Fair Trade offerings, our Main Street Revolution offerings and our ecommerce marketplace channel offerings;

our expectations regarding the costs, benefits and risks of our efforts to develop blockchain and financial technology and of the costs, benefits and risks of our acquisitions of the assets and operations of a financial technology company and two registered broker dealers affiliated with the financial technology business;

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our expectations regarding the benefits of our recent rights offering of shares of our Blockchain Voting Series A Preferred Stock and our Voting Series B Preferred Stock;

- our expectations regarding the costs and benefits of various programs we offer, including Club O and programs pursuant to which we may offer free or discounted participation in Club O or other programs we offer to members of the United States Armed Forces and/or to full-time, post-secondary students or others, and including our community site and our public service pet adoption program;
- our expectations regarding the costs and benefits of modifying our marketing efforts to deemphasize coupons;
- our belief that we and our partners will be able to maintain inventory levels at appropriate levels despite the seasonal nature of our business;
- our expectations regarding our emphasis on home and garden product offerings and our attempts to brand ourselves as a home and garden shopping destination;
- our belief that our sales through other ecommerce marketplace channels will be successful and will become an important part of our business; and
- our belief that we can successfully offer and sell a constantly changing mix of products and services.

Further, in some cases, you can identify forward-looking statements by terminology such as may, will, could, should, likely, expect, plan, seek, intend, anticipate, project, believe, estimate, predict, potential, goal, strategy, future or continue, the negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially from those contemplated by forward-looking statements for a variety of reasons, including among others:

- changes in U.S. and global economic conditions and consumer spending;
- any downturn in the U.S. housing industry;
- world events;
- the rate of growth of the Internet and online commerce, and the occurrence of any event that would discourage or prevent consumers from shopping online or via mobile apps;
- any failure to maintain our existing relationships or build new relationships with partners on acceptable terms;
- any difficulties we may encounter maintaining optimal levels of product quality and selection or in attracting sufficient consumer interest in our product offerings;
- any difficulties we may have with the quality or safety of the products we offer;
- 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;
- the mix of products purchased by our customers;
- any problems we may have with cyber security or data breaches or Internet or other infrastructure or communications impairment problems or the costs of preventing or responding to any such problems;
- any problems with or affecting our credit card processors, including cyber-attacks, Internet or other infrastructure or communications impairment or other events that could interrupt the normal operation of the credit card processors or any difficulties we may have maintaining compliance with the rules of the credit card processors;
- any problems we may encounter as a result of the implementation in the U.S. of the EMV (Europay, MasterCard and Visa) standards for credit cards, which generally became effective in the U.S. in 2015, including any problems that may result from any increase in online fraud as a result of the implementation of the EMV standards;
- 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;
- difficulties we may have in responding to technological changes;
- problems with the volume of fraudulent purchase orders we receive;
- problems we may encounter as a result of the listing or sale of pirated, counterfeit or illegal items by third parties;
- difficulties we may have financing our operations or our expansion with either internally generated funds or external sources of financing;
- any environmental or other difficulties we may encounter relating to the real estate we recently purchased or with our new corporate headquarters, or with our financing of a substantial portion of the costs of our new corporate headquarters or the interest rate swaps we entered into in connection with the financing;

any difficulties we may encounter in connection with Supplier Oasis or our efforts to provide multi-channel fulfillment services, our Farmers Market offerings, our insurance product offerings, our consumer finance offerings or other businesses or product or service offerings outside of our main shopping website offerings;

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any difficulties we may encounter as a result of our reliance on 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 ecommerce and online payments to mobile and multi-channel commerce and payments;

the extent to which we owe income or sales taxes or are 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;

any difficulties we may encounter as a consequence of accepting or holding bitcoins or other cryptocurrencies, whether as a result of regulatory, tax or other legal issues, technological issues, value fluctuations, lack of widespread adoption of bitcoins or other cryptocurrencies as an acceptable medium of exchange or otherwise;

increasing competition, including competition from well-established competitors including Amazon.com, competition from competitors based in China or elsewhere, competition from companies willing to incur substantial losses in order to build market share, and from others including competitors with business models that may include delivery capabilities that we may be unable to match;

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;

fluctuations in our operating results;

difficulties we may encounter in connection with our efforts to expand internationally;

difficulties we may encounter in connection with our efforts to offer additional types of services to our customers, including insurance products and consumer financing;

difficulties, including expense and any operational or regulatory issues we may encounter in connection with the integration or operation of the assets and operations of a financial technology company and two registered broker dealers affiliated with the financial technology business that we acquired;

technical, operational, regulatory or other difficulties we may encounter in connection with our efforts to develop blockchain and financial technology, or with the operation of tØ.com's system for the trading of securities, including our Blockchain Voting Series A Preferred Stock;

difficulties we may encounter with our Medici blockchain and financial technology initiatives due to lack of market acceptance or as a result of competition from any of the numerous other competitors seeking to develop competing technologies or systems or as a result of patents that may be granted to other companies or persons;

- any impairment we may recognize with respect to assets or businesses that we have acquired or may acquire, including with respect to our investments in companies that are in the startup or development stages;

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

the outcomes of legal proceedings, investigations and claims;

any difficulties we have optimizing our warehouse operations;

risks of inventory management and seasonality;

the cost and availability of traditional and online advertising, the rapid changes in the online advertising business and the longer-term changes in the traditional advertising business, and the results of our various brand building and marketing campaigns;

risks that the amount of deferred tax assets we consider realizable could be reduced if estimates of future taxable income during the carryforward period are reduced; and

the other risks described in this report or in our other public filings.

In evaluating all forward-looking statements, you should specifically consider the risks outlined above and in this Annual Report on Form 10-K in Item 1 - Business; Item 1A - Risk Factors; Item 3 - Legal Proceedings; Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this report. These factors may cause our actual results to differ materially from those contemplated by any forward-looking statement. Although we believe that our expectations reflected in the forward-looking statements are reasonable, we cannot guarantee or offer any assurance of future results, levels of activity, performance or achievements or other



future events.

Our forward-looking statements contained in this report speak only as of the date of this report and, except as required by law, we undertake no obligation to update forward-looking statements to reflect events or circumstances occurring after the date of this report or any changes in our expectations or any change in any events, conditions or circumstances on which any of our forward-looking statements are based.

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## PART I

### ITEM 1. BUSINESS

The following description of our business contains forward-looking statements relating to future events or our future financial or operating performance that involve risks and uncertainties, as set forth above under "Special Note Regarding Forward-Looking Statements." Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors described in this Annual Report on Form 10-K, including those set forth above in the Special Cautionary Note Regarding Forward-Looking Statements or in Section 1A under the heading "Risk Factors" or elsewhere in this Annual Report on Form 10-K.

#### Introduction

We are an online retailer and incubator of blockchain technology. Through our online retail business we offer a broad range of price-competitive brand name, non-brand name and closeout products, including furniture, home decor, bedding and bath, housewares, jewelry and watches, apparel and designer accessories, health and beauty products, electronics and computers, and sporting goods, among other products. We also sell hundreds of thousands of best seller and current run books, magazines, CDs, DVDs and video games ("BMMG"). We sell these products and services through our Internet websites located at [www.overstock.com](http://www.overstock.com), [www.o.co](http://www.o.co) and [www.o.biz](http://www.o.biz) (referred to collectively as the "Website"). Although our three websites are located at different domain addresses, the technology and equipment and processes supporting the Website and the process of order fulfillment described herein are the same for all three websites.

In late 2014, we began working on initiatives to develop and advance blockchain technology, which we refer to collectively as Medici, and which includes our majority-owned subsidiary tØ.com, Inc. (formerly Medici, Inc.). As part of our Medici initiatives, we have formed a wholly-owned subsidiary Medici Ventures, Inc. and acquired a majority interest in a financial technology company and two related registered broker-dealers. We have also made minority investments in several blockchain technology companies. In 2015, we were the first public company to issue a private security using blockchain technology and in December 2016, as a successful demonstration of our technology, we issued publicly traded blockchain preferred shares of Overstock.com, Inc.

Our company, based near Salt Lake City, Utah, was founded in 1997. We launched our initial website in March 1999 and were re-incorporated in Delaware in 2002. As used herein, "Overstock," "Overstock.com," "O.co," "we," "our" and similar terms include Overstock.com, Inc. and our majority-owned subsidiaries, unless the context indicates otherwise.

#### Our Business

In our retail business, we deal primarily in price-competitive, new and replenishable merchandise and use the Internet to aggregate both supply and demand to create an efficient marketplace for selling these products. We provide our customers an opportunity to conveniently shop for a broad range of price-competitive products. We continually add new, and sometimes limited, inventory to our Website in order to create an atmosphere that encourages customers to visit frequently and purchase products before our inventory sells out. We provide suppliers with access to a large customer base and convenient services for order fulfillment, customer service, returns handling, and other services. The merchandise offered on our Website is from a variety of sources including well-known, brand-name manufacturers. We have organized our retail business (sales of product offered through the Shopping Section of our Website) into two principal segments—a "direct" business and a "partner" business. We currently offer approximately 1.9 million non-BMMG products and approximately 742,000 BMMG products. Consumers and businesses are able to access and purchase our products 24 hours a day from the convenience of a computer, Internet-enabled mobile telephone or other Internet-enabled device. Our team of customer service representatives assists customers by telephone, instant online chat and e-mail. We also derive revenue from other businesses advertising products or services on our Website. Our sales are primarily to customers located in the United States. During the years ended December 31, 2016, 2015 and 2014 no single customer accounted for more than 1% of our total net revenue.

#### Retail direct business

Our direct business includes sales made to individual consumers and businesses from our owned inventory and that are fulfilled primarily from our warehouse in Salt Lake City, Utah. During the year ended December 31, 2016, approximately 6% of our order volume was generated through our direct business. Our warehouses primarily fulfill orders from our direct business, but also fulfill orders on behalf of our partners through our Supplier Oasis offering described below. Our warehouses generally ship between 2,000 and 5,000 packages per day and up to approximately

10,000 packages per day during peak periods.  
Retail partner business

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For our partner business, we sell merchandise from manufacturers, distributors and other suppliers ("partners") primarily through our Website. We are considered to be the primary obligor for the majority of these sales transactions and we record revenue from the majority of these sales transactions on a gross basis. Our use of the term "partner" does not mean that we have formed any legal partnerships with any of our partners. We currently have relationships with approximately 4,100 third parties who supply approximately 1.9 million non-BMMG products, as well as most of the BMMG products, on our Website. These third party partners generally perform the same fulfillment operations as our warehouses, such as order picking and shipping; however, we handle returns and customer service related to substantially all orders placed through our Website. Revenue generated from sales on our Shopping site from both the direct and partner businesses is recorded net of returns, coupons and other discounts.

Both direct and partner revenues are seasonal, with revenues historically being the highest in the fourth quarter, which ends December 31, reflecting higher consumer holiday spending. We anticipate this will continue for the foreseeable future. To the extent possible we maintain supplier relationships, and seek new supplier relationships, for both our direct and partner businesses, and also use our working capital, to ensure a continuous allotment of product offerings for our customers. Because a portion of our product offerings are closeout merchandise, some of our suppliers cannot supply products to us on a continuous basis.

Generally, we require verification of receipt of payment, or authorization from credit card or other payment vendors whose services we offer to our customers (such as PayPal), 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.

#### Medici business

Our Medici business initiatives leverage the security, transparency and immutability of cryptographically protected, distributed ledgers, such as the Blockchain, and are focused on solving important problems, including financial transaction issues, particularly in the area of securities settlement. Through our wholly-owned subsidiary, Medici Ventures Inc., we hold minority investments in several technology companies which, at December 31, 2016, included Peer Nova, Bitt, IdentityMind and Factom, whose focus include commercial blockchain applications, digital currency solutions, Know Your Customer and Anti Money Laundering compliance, voting and land titling. Medici Ventures also holds a majority interest in tØ.com, Inc., which includes a financial technology company and two related registered broker-dealers.

As described further in Item 15 of Part IV, "Financial Statements"—Note 21. Business Segments, contained in the "Notes to Consolidated Financial Statements" of this Annual Report on Form 10-K, we determined our segments based on how we manage our business, which, in our view, consists primarily of our Retail and Medici businesses. As described above, 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.

#### Other offerings

We offer additional products or services that may complement our primary offerings, but are not significant to our revenues. These include:

- Worldstock Fair Trade, a store within our Website that offers handcrafted products made by artisans all over the world to help improve the lives of people in emerging economies;
- Main Street Revolution, a store within our Website that features products from small businesses who offer their products using our national marketing and distribution channels;
- Farmers Market, a tab within our Website where our customers, in certain locations, can order locally grown fresh produce and other food products;
- Pet Adoptions, a free service and tab within our Website that leverages our technology to display pets available for adoption from shelters across the United States;
- Insurance, a tab within our Website where our customers can shop for insurance from major carriers for both personal and business insurance policies; and
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Supplier Oasis, a single integration point through which our partners can manage their products, inventory and sales channels, while tapping into our distribution network; and  
our international business where we offer products to customers outside the United States using third party logistics providers.

Manufacturer, Supplier and Distribution Relationships

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Generally, we do not enter into contracts with manufacturers or other suppliers that guarantee the availability of merchandise for a set duration. Our manufacturer and supplier relationships are based on historical experience with manufacturers and other suppliers and do not obligate or entitle us to receive merchandise on a long-term or short-term basis. In our direct business, we purchase the products from manufacturers or other suppliers using standard purchase orders. Generally, suppliers do not control the terms under which products are sold through our Website.

#### Products

Our Website Shopping section is organized into product and service lines or featured categories, including: Furniture, Rugs, Decor, Bed & Bath, Home Improvement, Kitchen, Outdoor, Jewelry, Watches, Women, Men, Kids & Baby, Worldstock, Main Street, Farmers Market, Pet Adoptions, o.info and Insurance. We frequently reorganize our departments and/or categories to better reflect our current product offerings.

For the years ended December 31, 2016, 2015 and 2014, the percentages of sales contributed by similar classes of products were as follows:

Product Lines	2016	2015	2014
Home and garden(1)			
Furniture	34 %	33 %	32 %
Home decor	22 %	19 %	18 %
Other	23 %	25 %	24 %
Total home and garden	79 %	77 %	74 %
Jewelry, watches, clothing and accessories	10 %	11 %	12 %
BMMG, electronics and computers	3 %	3 %	4 %
Other	8 %	9 %	10 %
Total	100%	100%	100%

(1) Home and garden includes furniture, home decor, garden and patio, kitchen and dining, bedding, home improvement, housewares and other related products.

#### Sales and Marketing

We use a variety of methods to target our retail consumer audience, including online campaigns, such as advertising through keywords, product listing ads, display ads, search engines, affiliate marketing programs, social coupon websites, portals, banners, e-mail, direct mail and viral and social media campaigns. We also do brand advertising through television, radio, print ads, and event sponsorships.

#### Customer Service

We are committed to providing superior customer service. We staff our customer service department with dedicated in-house and outsourced professionals who respond to phone, instant online chat and e-mail inquiries on products, ordering, shipping status, returns and other areas of customer inquiry.

#### Technology

We use our internally developed Website and a combination of proprietary technologies and commercially available licensed technologies and solutions to support our retail operations. We use the services of multiple telecommunications companies to obtain connectivity to the Internet. Currently, our primary computer infrastructure is located in a co-location facility in Utah. We also have other data centers which we use for backups, redundancy, development, testing, disaster recovery, and our corporate systems infrastructure.

#### Competition

Internet retail is intensely competitive and has relatively low barriers to entry. We believe that competition in this industry is based predominantly on:

- price;
- product quality and assortment;
- shopping convenience;
- website organization and load speed;
- order processing and fulfillment;
- order delivery time;



- customer service;
- website functionality on mobile devices;
- brand recognition; and
- brand reputation.

We compete with other online retailers, traditional retailers and liquidation "brokers," some of which may specifically adopt our methods and target our customers. We currently or potentially compete with a variety of companies that can be divided into several broad categories:

- online discount general retailers;
- online private sale sites;
- online specialty retailers;
- liquidation e-tailers;
- traditional general merchandise and specialty retailers and liquidators, many of which have a significant online presence; and
- online retailers who are developing significant "brick and mortar" capabilities.

Many of our current and potential competitors have greater brand recognition, longer operating histories, larger customer bases and significantly greater financial, marketing and other resources than we do. Further, any of them may enter into strategic or commercial relationships with larger, more established and well-financed companies, including exclusive distribution arrangements with our vendors or service suppliers that could deny us access to key products or needed services, or acquisitions of our suppliers or service providers, having the same effect. Many of them do or could devote greater resources to marketing and promotional campaigns and devote substantially more resources to their website and systems development than we do. Many have supply chain operations that decrease product shipping times to their customers, or have options for in-store product pick-up options or allow in-store returns and offer other delivery and returns options that we do not have. New technologies and the continued enhancement of existing technologies and developments in related areas, such as same-day product deliveries and the development of proprietary delivery systems, are also increasing competitive pressures on us. Our competitors include Amazon.com, Inc and Wayfair, Inc. We cannot ensure that we will be able to compete successfully against current or future competitors or address increased competitive pressures (see Item 1A—"Risk Factors").

#### Seasonality

Our retail business is affected by seasonality because of the holiday season, which historically has resulted in higher sales volume during our fourth quarter, which ends December 31. We recognized 29.2%, 29.0% and 31.4% of our annual revenue during the fourth quarter of 2016, 2015, and 2014, respectively.

#### Financial Information about Business Segments and Geographic Areas

See Item 15 of Part IV, "Financial Statements"—Note 21. Business Segments for information regarding our business segments and geographical areas.

#### Intellectual Property and Trade Secrets

We regard our domain names and other intellectual property as critical to our success. Included in our intellectual property is some of the financial technology we have developed as part of our Medici initiatives. We rely on a combination of laws and contractual restrictions with our employees, customers, suppliers, affiliates and others to establish and protect our proprietary rights, including the law pertaining to trade secrets. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our intellectual property or trade secrets without authorization. In addition, we cannot ensure that others will not independently develop similar intellectual property. Although we have registered and are pursuing the registration of our key trademarks in the United States and some other countries, some of our trade names may not be eligible to receive registered trademark protection. In addition, effective trademark protection may not be available or we may not seek protection in every country in which we market or sell our products and services, including in the United States. Additionally, our efforts to protect our trade secrets may not succeed.

Third parties have in the past recruited and may in the future recruit our employees who have had access to our proprietary technologies, processes and operations. These recruiting efforts expose us to the risk that such employees and those hiring them will misappropriate and exploit our intellectual property and trade secrets.

#### Legal and Regulatory Matters



From time to time, we receive claims and become subject to regulatory investigations or actions, consumer protection, employment, intellectual property and other commercial litigation related to the conduct of our business. We also prosecute lawsuits to enforce our legal rights. Such litigation is costly and time consuming and can divert our management and key

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personnel from our business operations. The uncertainty of litigation increases these risks. In connection with such litigation, we may be subject to significant damages, associated costs, or equitable remedies relating to the operation of our business and the sale of products on our Website. Any such litigation may materially harm our business, prospects, results of operations, financial condition or cash flows.

These and other types of claims could result in increased costs of doing business in the form of legal expenses, adverse judgments or settlements or require us to change our business practices in expensive and significant ways. In addition, litigation could result in interpretations of the law that may limit our current or future business, require us to change our business practices, or otherwise increase our costs.

Additional litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Any litigation, regardless of outcome or merit, could result in substantial costs and diversion of management and technical resources, any of which could materially harm our business (see Item 1A—"Risk Factors").

For further information, see the information set forth under Item 15 of Part IV, "Financial Statements"—Note 12. Commitments and Contingencies, Legal Proceedings, contained in the "Notes to Consolidated Financial Statements" of this Annual Report on Form 10-K.

#### Government Regulation

Our main business is subject to general business regulations and laws, as well as regulations and laws specifically governing the Internet, e-commerce and other services. Existing and future laws and regulations may result in increasing expense and may adversely affect our business. These regulations and laws may cover taxation, privacy, data protection, pricing, content, copyrights, distribution, supply chain monitoring and transparency, mobile communications, electronic device certification, electronic waste, energy consumption, environmental regulation, electronic contracts and other communications, competition, consumer protection, information reporting requirements, the design and operation of websites, and the characteristics and quality of products and services. New state tax regulations in states where we do not now collect state and local taxes may subject us to the obligation to collect and remit state and local taxes, or subject us to additional state and local sales and income taxes, or to requirements intended to assist states with their tax collection efforts. New legislation or regulations, the application of laws and regulations from jurisdictions whose laws do not currently apply to our business or the application of existing laws and regulations to the Internet and commercial online services could result in significant additional taxes on our business. These taxes or tax collection obligations could have an adverse effect on us. Further, there is a possibility that we may be subject to significant fines or other payments for any past failures to comply with these requirements. In addition, it is not clear how existing laws governing issues such as property ownership, libel, and personal privacy apply to the Internet, e-commerce and digital content. Laws and regulations may diminish the demand for our products and services and increase our cost of doing business. Certain of our services are subject to federal and state consumer protection laws, including laws protecting the privacy of consumer information and regulations prohibiting unfair and deceptive trade practices. In particular, under federal and state financial privacy laws and regulations, we must provide notice to consumers of our policies on sharing non-public information with third parties, advance notice of any changes to our policies and, with limited exceptions, we must give consumers the right to prevent sharing of their non-public personal information with unaffiliated third parties. Further, the growth and demand for online commerce could result in more stringent consumer protection laws that could impose additional compliance burdens on us. These consumer protection laws could result in substantial compliance costs.

In addition, the broker-dealers in which we hold a majority interest are subject to additional extensive regulatory requirements under federal and state laws and regulations and self-regulatory organization ("SRO") rules.

Broker-dealers are 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 they are registered or licensed or of which they are members. See Item 1A - "Risk Factors - Medici has acquired registered broker-dealers, which are subject to extensive regulation."

Our efforts to expand our sales outside of the U.S. expose us to additional U.S. and foreign laws and regulations, including but not limited to, laws and regulations relating to taxation, business licensing or certification requirements,

advertising practices, online services, the use of cryptocurrency, the importation of specified or proscribed items, importation quotas, consumer protection, intellectual property rights, consumer and data protection, data transfer across borders, privacy, encryption, restrictions on pricing or discounts, and the U.S. Foreign Corrupt Practices Act and other applicable U.S. and foreign laws prohibiting corrupt payments to government officials and other third parties.

Employees

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At December 31, 2016, we had approximately 1,800 full-time employees. We seasonally augment our workforce with temporary employees during our fourth quarter to handle increased workload in both our warehouse and customer service operations. We have never had a work stoppage, and none of our employees are represented by a labor union. We consider our employee relationships to be good. Competition for qualified personnel in our industry is intense, particularly for software engineers and other technical staff.

Executive Officers of the Registrant

The following persons were executive officers of Overstock as of February 24, 2017:

Executive Officers	Age	Position
Patrick M. Byrne	54	Chief Executive Officer and Director
Saum Noursalehi	37	President, Retail
Jonathan E. Johnson III	50	President, Medici
Amit Goyal	38	Senior Vice President, Software Engineering
Robert P. Hughes	57	Senior Vice President, Finance and Risk Management
Vidya R. Jwala	44	Senior Vice President, Demand Fulfillment
John Paul "J.P." Knab	37	Senior Vice President, Marketing
Carter P. Lee	47	Senior Vice President, Technology and People Care
Seth A. Moore	34	Senior Vice President, Analytics and OLABs
Brian L. Popelka	50	Senior Vice President, Customer and Partner Care
Vikram R. Raghavan	35	Senior Vice President, Product Development

Dr. Patrick M. Byrne has served as our Chief Executive Officer (principal executive officer) and as a Director since 1999, and as Chairman of the board of directors from 2001 through 2005 and 2006 through 2014. Dr. Byrne founded Overstock in 1999. From 1994 to the present, Dr. Byrne has served as a Manager of the Haverford Group, an investment company and an affiliate of Overstock. Dr. Byrne holds a bachelor's degree in Chinese studies from Dartmouth College, a master's degree from Cambridge University as a Marshall Scholar, and a doctorate in philosophy from Stanford University.

Mr. Saum Noursalehi has served as our President, Retail since August 2016. He previously served as Chief Revenue Officer and Senior Vice President. Prior to his appointment as Senior Vice President in 2015, Mr. Noursalehi served as Vice President of OLABs, Vice President Product Development, and held roles in website, mobile and search engine optimization. Mr. Noursalehi joined Overstock in 2005 and holds a bachelor's degree in Computer Science from the University of Utah.

Mr. Jonathan E. Johnson III has served as President, Medici since August 2016 and as a Director since 2013. Mr. Johnson also serves as our Chairman of the Board of Directors. Mr. Johnson previously served as our President, as a Senior Vice President and as our General Counsel since joining Overstock in 2002. Mr. Johnson holds a bachelor's degree in Japanese from Brigham Young University and received his law degree from the J. Reuben Clark, Jr. Law School at Brigham Young University.

Mr. Amit Goyal was appointed as our Senior Vice President of Software Engineering in February 2017. He had previously served as Vice President of Product Development. Since joining Overstock in 2006, Mr. Goyal has held roles including Senior Director of Software Development and Software Development Lead. Mr. Goyal holds a bachelor's degree in Engineering from Punjab Technical University.

Mr. Robert P. Hughes (principal financial and accounting officer) has served as our Senior Vice President, Finance and Risk Management since 2013. He had previously served as Vice President and Controller since joining Overstock in 2008. Mr. Hughes holds a bachelor's degree in Business Administration with an emphasis in Accounting and Finance from the University of California Berkeley, Haas School of Business, and is a certified public accountant (CA - inactive status).

Mr. Vidya R. Jwala has served as our Senior Vice President of Demand Fulfillment since joining Overstock in August 2016. Prior to joining Overstock, Mr. Jwala served as Vice President, Merchandising / Operations at Walmart from 2009 to 2016 and previously held similar roles at Tractor Supply Company, Lowe's, and Jo-Ann Stores. Mr. Jwala holds a master's degree in Industrial and Systems Engineering from Virginia Polytechnic Institute and State University.

Mr. John Paul "J.P." Knab has served as our Senior Vice President of Marketing since March 2016, having returned to Overstock after serving for one-year as the Senior Vice President of Marketing, Merchandising and Business Development for U.S. Water Filters in St. Paul, Minnesota. Prior to this, Mr. Knab had served as our Vice President of Marketing and held other roles including Director of Merchandising and Director of Analytics. Mr Knab joined Overstock in 2005 and holds an MBA with a Marketing emphasis and a bachelor's degree in Finance from Brigham Young University.

Mr. Carter P. Lee has served as our Senior Vice President, Technology and People Care since 2015. Mr. Lee previously served as Vice President, Technology Operations and held other roles including Director of Internal Systems. Prior to joining Overstock in 2001, Mr. Lee was a Systems Engineer for Hospice of the Valley and Vice President of Technology for Motherboard Discount Center in Phoenix, AZ.

Mr. Seth A. Moore was appointed as our Senior Vice President of Analytics and OLABs in February 2017. He had previously served in roles including Vice President of OLABs, Vice President of Analytics and Vice President of Website Marketing. Mr. Moore joined Overstock in 2006 and holds a bachelor's degree in Political Science from Brigham Young University.

Mr. Brian L. Popelka has served as a Senior Vice President of Customer and Partner Care since 2013. Mr. Popelka previously served as Vice President of Customer Care. Since joining Overstock in 2002, Mr. Popelka has held roles including Director of Books, Media, Movies and Games Department, and Manager of the Business-to-Business Department. Mr. Popelka holds a bachelor's degree in Journalism, Broadcasting, Film and History from the University of Nebraska.

Mr. Vikram R. Raghavan was appointed as our Senior Vice President of Product Development in February 2017. He had previously served in roles including Vice President of Product Development and Vice President of Marketing since returning to Overstock in 2015. Mr. Raghavan originally joined Overstock in 2008 and held roles including Senior Director of Marketing. From 2011 through 2015 Mr. Raghavan served as the co-founder of Rental Roost, an online apartment listing service. Mr. Raghavan holds an MBA with a Finance and Marketing emphasis from Temple University.

#### Available Information

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge through the Investor Relations section of our main website, [www.overstock.com](http://www.overstock.com), as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Our Internet Website and the information contained therein or connected thereto are not a part of or incorporated into this Annual Report on Form 10-K.

## ITEM 1A. RISK FACTORS

Please consider the following risk factors carefully. If any one or more of the following risks were to occur, it could have a material adverse effect on our business, prospects, financial condition and results of operations, and the market price of our securities could decrease significantly. Statements below to the effect that an event could or would harm our business (or have an adverse effect on our business or similar statements) mean that the event could or would have a material adverse effect on our business, prospects, financial condition and results of operations, which in turn could or would have a material adverse effect on the market price of our securities. Although we have organized the risk factors below under headings to make them easier to read, many of the risks we face involve more than one type of risk. Consequently you should read all of the risk factors below carefully before making any decision to acquire or hold our securities.

Any investment in our securities involves a high degree of risk. Investors should consider carefully the risks and uncertainties described below, and all other information in this Form 10-K and in any reports we file with the SEC after we file this Form 10-K, before deciding whether to purchase or hold our securities. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also become important factors that may harm our business. The occurrence of any of the risks described in this Form 10-K could harm our business. The trading price of our securities could decline due to any of these risks and uncertainties, and investors may lose part or all of their investment.

#### Risks Related to Our Infrastructure, Cyber Security, Data Breach and Related Matters

Our business depends on our Website, our mobile app, our network infrastructure and transaction-processing systems.

As an e-commerce company, we are completely dependent on our infrastructure and on the availability and reliability of the Internet and related systems. Any system interruption that results in the unavailability of our Website or our mobile app or reduced performance of our transaction systems could interrupt or substantially reduce our ability to conduct our business. We have experienced periodic systems interruptions due to server failure, power failure and intentional cyberattacks in the past, which we expect will continue to occur from time to time. Any failure or impairment of our infrastructure or of the availability of the Internet and related systems could have a material adverse effect on our business.

If the facility where substantially all of our computer and communications hardware is located fails, our business, prospects, financial condition and results of operations could be harmed.

Substantially all of our computer and communications hardware is located at a single facility. Our systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunications failure, terrorist attacks, cyber-attacks, acts of war, break-ins, earthquake and similar events. Our back-up facility is not adequate to support sales at a high level. Our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, the occurrence of any of which could lead to interruptions, delays, loss of critical data or the inability to accept and fulfill customer orders. The occurrence of any of the foregoing risks could have a material adverse effect on our business.

Natural disasters, pandemics, and geo-political events could adversely affect our business.

Natural disasters, weather conditions, pandemics, and geo-political events, including civil unrest or terrorist attacks, that affect us or our delivery services, suppliers, credit card processors or other service providers could have a material adverse effect on our business.

We are subject to cyber security risks and risks of data loss or other security breaches, and may incur increasing costs in an effort to minimize those risks and to respond to cyber incidents.

Our business is entirely dependent on the secure operation of our Website and systems as well as the operation of the Internet generally. Our business involves the storage and transmission of users' proprietary information, and security breaches could expose us to a risk of loss or misuse of this information, and to resulting claims, fines, and litigation. We have been subjected to a variety of cyberattacks. We may not have the resources or technical sophistication to defend against rapidly evolving types of cyber-attacks. Cyber-attacks may target us, our customers, our suppliers, banks, credit card processors, delivery services, e-commerce in general or the communication infrastructure on which we depend. Actual or anticipated attacks and risks may cause us to incur substantial and increasing costs, including costs to deploy additional personnel and protection technologies, train employees, and engage third party experts and consultants. Any compromise of our security could result in a violation of applicable privacy and other laws, significant legal and financial exposure, damage to our reputation, and a loss of confidence in our security measures, which could have a material adverse effect on our business. The occurrence of any of the foregoing could have a material adverse effect on our business.

Our dependence on credit or debit card payments increases our risks.

Most of our customers use credit cards to pay for their purchases. Under payment card rules and our contracts with our card processors, if we experience a breach of payment card information or fail to follow payment card industry security standards, even if there is no compromise of customer information, we could incur significant fines, higher transaction costs or lose our ability to give customers the option of using payment cards. If we were unable to accept payment cards, it would have a material adverse effect on our business.

Our expansion into financial technology businesses and our acquisitions of registered broker dealers and related businesses increases our infrastructure, cyber security, data breach and related risks.

As we have expanded into financial technology businesses and have acquired registered broker dealers and related businesses, our infrastructure, cyber security, data breach and related risks have increased. See "Risks Relating to Certain Specific Businesses, Investments in Businesses and Recent or Planned Changes to Our Business."

#### Risks Related to Competition

We face intense competition and may not be able to compete successfully against existing or future competitors.



The online retail market is evolving rapidly and intensely competitive. Barriers to entry are minimal, and current and new competitors can launch new websites at a relatively low cost. We currently compete with numerous competitors, including:

- online retailers with or without discount departments, including AliExpress (part of the Alibaba Group), Amazon.com, eBay, and Rakuten.com (formerly Buy.com);
- online specialty retailers such as Blue Nile, Bluefly, Houzz, Jet.com, Wayfair, Zappos.com, and Zulily;
- private sale sites such as Groupon, Living Social and Rue La La;
- furniture specialists including Ashley Furniture, Bob's Discount Furniture, Havertys, Raymour & Flanigan and Rooms To Go;

traditional general merchandise and specialty retailers and liquidators including Barnes and Noble, Bed, Bath & Beyond, Best Buy, Costco Wholesale Corporation, Crate and Barrel, Ethan Allen, Gilt, Home Depot, HomeGoods, Hudson's Bay Company, IKEA, J.C. Penny Company, Kirkland's, Kohl's, Lands' End, Lowe's, Macy's, Nordstrom, Pier 1 Imports, Pottery Barn, Restoration Hardware, Ross Stores, Saks Fifth Avenue, Sears Holding Corporation, T.J. Maxx, Target Corporation, Wal-Mart and Williams-Sonoma, all of which also have an online presence; and liquidation e-tailers such as SmartBargains.

The intense and increasing competition we face from a wide variety of competitors, many of which have substantially greater resources than we do, and some of which are willing to incur losses in order to increase revenues, may result in our pricing of products or services below prices at which we can make a profit, may cause us to lose sales entirely, and may have a material adverse effect on our business.

Our competitors are rapidly developing a wide variety of services and other offerings, and we may be unable to provide more competitive offerings.

The online retail market has become far more competitive as traditional and online retailers continue to develop and improve services that compete with our services. Many traditional manufacturers and retailers have added or improved their e-commerce offerings, and we expect that more will do so and that they will all continue to improve their offerings. Traditional and predominantly online retailers may create proprietary, store-based distribution and returns channels that we may be unable to match, and may also be able to create their own traditional distribution and delivery services. Amazon continues to open additional fulfillment centers and to increase its same-day delivery capabilities in an increasing number of metro areas as well as one and two-hour delivery capability on certain items in an increasing number of metro areas, and staffed pickup locations in certain high-density locations. Competitive pressures, including same-day and one and two-hour delivery capabilities, from Amazon and from any of our other competitors, many of whom have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing and other resources than we do, affect us and could have a material adverse effect on our business.

In addition to the types of retailers described above, we are competing with specialty firms in several areas, many of which focus exclusively or primarily on the business in which we are competing.

In addition to the types of retailers described above, in many areas we face competition from numerous other businesses, many of which may specialize in the type of business in which we are competing. Our furniture offerings compete with more than 100 online retail furniture websites, in addition to many more traditional furniture retail specialists. We face the risk that potential furniture and other customers will choose traditional retailers where they can physically examine products prior to purchase. Our Supplier Oasis service faces substantial competition from third party logistics providers as well as from Amazon and eBay and other e-commerce service providers having substantially greater experience and resources than we have. We are currently offering insurance products, and as such face competition from small and large established businesses with substantially more experience. An inability to compete in these areas could have a material adverse effect on our business.

Our tØ.com subsidiary is competing with a rapidly-growing group of companies in the financial industry as well as new entrants with significant resources from venture capital firms and other funding sources.

Our majority-owned subsidiary tØ.com, Inc. (formerly Medici, Inc.) is competing against a variety of companies with substantially greater financial resources and experience in financial technology. The number of competitors in this area and the resources being devoted to the area by competitors are growing rapidly. We may be unable to compete successfully against these competitors or others that may not yet have publicly announced their business plans in this area, which could have a material adverse effect on our business. See "Risks relating to Certain Specific Businesses, Investments in Businesses and Recent or Planned Changes to our Business," below.

### Risks Related to Our Dependence on Third Parties

As an e-commerce company, we depend on a large number of other companies to perform functions critical to our ability to deliver products to our customers and to perform many of the related functions.

We depend on a large number of other companies, including a large number of independent partners whose products we offer for sale on our Website, to perform functions critical to our ability to deliver products to our customers and to perform many of the related functions. We depend on these partners to perform a number of traditional retail operations such as maintaining inventory, preparing merchandise for shipment to our customers and delivering purchased merchandise on a timely

basis, and also on the delivery services that we and they utilize. Difficulties with our significant partners or with any of the delivery services, regardless of the reason, could have a material adverse effect on our business.

We depend upon our payment card processors and payment card associations.

Our customers primarily use credit cards to buy from us. We are completely dependent upon our payment card processors to process the sales transactions and remit the proceeds to us. The payment card processors have the right to withhold funds otherwise payable to us to establish or increase reserves based on their assessment of the inherent risks of payment card processing and their assessment of the risks of processing our customers' payment cards at any time, and have done so from time to time in the past. We are also subject to payment card associations' operating rules, certification requirements and rules governing electronic funds transfers. If we fail to comply with these rules or requirements, we may be subject to fines and higher transaction fees and lose our ability to accept credit and debit card payments from our customers, process electronic funds transfers, or facilitate other types of online payments. In addition, events 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, could have a material adverse effect on our business.

Implementation of the EMV credit card standards in the U.S. may increase fraud efforts against U.S. online retailers, including us.

Credit card issuers in the United States began replacing traditional credit cards with credit cards meeting the EMV (Europay, MasterCard and Visa) standards during 2015. Cards meeting the EMV standards contain a chip which makes the cards more difficult to counterfeit than the traditional magnetic stripe-only cards widely used in the U.S. However, to the extent that the EMV standards make physical card-duplication fraud more difficult, the new standards may drive more fraud efforts against online retailers, including us. Consequently, as an online retailer, we may be subject to increasing levels of fraudulent orders and other types of criminal activities. Increased levels of fraud and other criminal activities could have a material adverse effect on our business.

Risks associated with the suppliers from whom we or our fulfillment partners source products and the safety of those products could adversely affect our financial performance.

We depend on our ability to access products from qualified suppliers in a timely and efficient manner. We rely primarily on our suppliers' representations of product content and quality. Concerns regarding product content or quality, or the safety of products that we offer, could adversely affect our financial performance. Further, if any product we sell were to cause physical injury or injury to property, the injured party or parties might bring claims against us. Any indemnity agreement we may have with the supplier may be inadequate or inapplicable, and any insurance coverage we may carry may not be adequate to cover claims that could be asserted. Even unsuccessful claims could result in the expenditure of funds and management time and could have a negative impact on our business. The occurrence of any of the foregoing could have a material adverse effect on our business.

We and many of our suppliers and fulfillment partners depend upon products manufactured internationally, and tariffs or other measures that increase the effective price of products imported into the United States could have a material adverse effect on our business.

We and many of our suppliers and fulfillment partners source a portion of the products we offer on our website from China and other countries. If the United States imposes tariffs or other measures that increase the price of products we or they import and that we offer on our website, the increased prices could have a material adverse effect on our business.

We depend upon third parties for all or substantially all of the services we offer.

In addition to the many third parties we rely on in connection with our sale and the delivery of products to our customers, we depend upon third parties for all or substantially all of the services we offer, including our insurance

offerings, our consumer financing offerings, our car listings and our car-related services. Services offerings are inherently different from product offerings, and we may encounter difficulties with our services offerings that may be different from the types of issues we face with our product offerings. Any such difficulties could have a material adverse effect on our business.

#### Risks Related to Marketing

Our business depends on effective marketing.

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We depend on effective marketing and high customer traffic. From time to time, competitors may bid up the cost of certain marketing channels, such as paid keywords. At such times, we may reduce the amounts we spend in those marketing channels, which may lead to decreased visitors to our site, or we may pay the increased rates, which increases our expenses. If we are unable to develop, implement and maintain effective and efficient advertising and marketing programs, it could have a material adverse effect on our business.

We rely upon paid and natural search engines including Google, Bing, and Yahoo! to rank our product offerings. Our financial results may suffer if search engines change their ranking algorithms and our product offerings are ranked lower, and we may at times be subject to ranking penalties if the operators of search engines believe we are not in compliance with their guidelines.

We rely on paid and natural search engines to attract consumer interest in our product offerings. Potential and existing customers use search engines provided by search engine companies, including, but not limited to, Google, Bing, and Yahoo!, which use algorithms and other devices to provide users a natural ranked listing of relevant Internet sites matching a user's search criteria and specifications. Search engine companies change their natural search engine algorithms periodically, and our ranking in natural searches may be adversely affected by those changes, as has occurred from time to time. In addition, large marketplace websites and sites which aggregate marketplace sellers with a large product selection are becoming increasingly popular, and we may not be able to place our products on these sites to take advantage of their internal search platforms. Further, some shoppers may begin their searches at a competitor's website, and may not utilize traditional search engines at all. Our inability to place products on or access these sites may have a material adverse effect on our business.

Our business relies heavily on email, and reduced utilization of email in general and any restrictions on the sending of commercial email could have a material adverse effect our business.

We depend on email to promote our site and offerings. We provide daily emails to potential customers about our offerings, and email promotions are an important part of our marketing and help generate a substantial portion of our net revenue. If a significant portion of our target customers no longer utilize email, or if we are unable to effectively deliver email to our potential customers, our business, financial condition and operating results would be harmed. Anything, including legal or regulatory restrictions, that blocks, imposes restrictions on or imposes charges for the delivery of email could also harm our business. We also rely on social networking messaging services to send communications and to encourage customers to send communications, and anything that limits our ability or our customers' ability to utilize social networking services could have a material adverse effect on our business.

We are experimenting with various ways to reduce the number of coupons we offer to our customers, which may have adversely affected our revenue growth and may continue to do so.

Although our business has historically relied heavily on coupons to generate sales, we are experimenting with modifications to our coupon marketing. We believe that changes we have made to our coupon marketing in the past adversely affected our revenue growth, and that these and other changes we may make may continue to adversely affect our revenue growth. We have not yet achieved the results we are seeking, and there can be no assurance that we will be able to do so. If we are unable to generate sales using other marketing approaches at rates equal to or better than the rates we were generating through our coupon marketing, our revenue growth could be adversely affected or reversed, and our business, financial condition and operating results could be materially adversely affected.

#### Fraud Related Risks

Credit card fraud and our response to it could adversely affect our business.

We routinely receive orders placed with fraudulent credit card data. If we fail to adequately control fraudulent credit card transactions it could reduce our net revenues and our gross profit or cause credit card or payment system

companies to disallow their cards' use for customer payments on our website. We may suffer losses as a result of orders placed with fraudulent credit card data even if the associated financial institution approved payment of the orders. Under current credit card practices, we may be liable for fraudulent credit card transactions because we do not obtain a cardholder's signature. If we are unable to detect or control credit card fraud, claims against us for these transactions could harm our business, prospects, financial condition and results of operation. Further, to the extent that our efforts to prevent fraudulent orders result in our inadvertent refusal to fill legitimate orders, we would lose the benefit of legitimate potential sales and risk the alienation of legitimate customers. The occurrence of any of the foregoing could have a material adverse effect on our business.

## Tax and Regulatory Risks

If one or more states successfully assert that we should collect sales or other taxes on the sale of our merchandise or the merchandise of third parties that we offer for sale on our Website, or that we should pay commercial activity taxes, our business could be harmed.

We do not currently collect sales or other similar taxes on sales of goods into states where we have no duty to do so under federal court decisions construing applicable constitutional law. Certain jurisdictions are seeking payment of sales tax for sales we have made to customers in such jurisdictions or for payment of similar taxes or to impose sales tax collection obligations on us. To date we have been able to settle these claims without incurring material expenses. However, if any jurisdiction where we do not or did not collect sales or other taxes successfully asserts that we should do so or should have done so, or should otherwise have collected or paid other types of taxes, it could have a material adverse effect on our business.

In 2013 the United States Senate passed the Marketplace Fairness Act of 2013 (“MFA”), but it failed to pass in the House of Representatives. Efforts continue to enact similar legislation, which would permit qualifying states to force remote sellers like us to collect taxes in states where we have no physical presence. The enactment of legislation similar to the MFA could have a material adverse effect on our business.

Several states have enacted laws requiring remote vendors to notify resident purchasers in those states of their obligation to pay a use tax on their purchases and, in some instances, to report untaxed purchases to the state tax authorities. Other states have enacted legislation to require retailers without a physical presence in the state to collect and remit state sales taxes if they engage in any activity in connection with the selling, leasing or delivery of tangible personal property or taxable services within the state. Additional states have recently introduced legislation, and we anticipate that additional states may enact similar laws, or other laws to force or encourage through economic pressures remote retailers to collect and remit sales tax. Such laws could harm our business by imposing notice burdens upon us, by requiring transaction notices that would adversely affect sales, or by discouraging customer purchases by requiring detailed purchase reporting. The occurrence of any of the foregoing could have a material adverse effect on our business.

Existing or future government regulation could harm our business.

We are subject to regulation at the federal, state, local and international levels, including regulation relating to privacy, security, retention, transfer and use of personal user information and telemarketing laws. Increasing regulation may increase the cost of our business and may further restrict our marketing efforts. Existing laws, including those governing advertising, product labeling, product content requirements and product safety, may cause us to incur expenses. We may be subject to claims related to personal injury, death, environmental or property damage. We are periodically required to participate in product recalls. We may incur expense in connection with any of the foregoing or other matters or actions which may not be covered by any liability insurance we may carry. These current and future laws and regulations could have a material adverse effect on our business.

See “Risks relating to Certain Specific Businesses, Investments in Businesses and Recent or Planned Changes to our Business,” and “Risks Related to our Preferred Stock,” below.

Public statements we or our Chief Executive Officer, Patrick M. Byrne, have made or may make in the future may antagonize regulatory officials or others.

We and our Chief Executive Officer, Dr. Patrick M. Byrne, have from time to time made public statements regarding our or his beliefs about matters of public interest, including statements regarding naked short selling and regulatory capture. Some of those public statements have been critical of the Securities and Exchange Commission and other regulatory agencies. These public statements may have consequences for us, whether as a result of increased regulatory scrutiny or otherwise. Additionally, other officers may make public statements that could have adverse



consequences and these statements could have a material adverse effect on our business.

#### Macroeconomic Risks

Economic factors, including our increasing exposure to the U.S. housing industry, may adversely affect our financial performance.

Economic conditions, particularly any weakness in the United States housing market, may adversely affect our financial performance. Over the last few years the percentage of our sales from home and garden products has increased

substantially. We believe that our sales of home and garden products are affected by the strength of the U.S. housing industry, and that downturns in the U.S. housing industry would have a material adverse effect on our business.

Decreases in discretionary consumer spending may have an adverse effect on us.

A substantial portion of the products and services we offer are products or services that consumers may view as discretionary items rather than necessities. As a result, our results of operations are sensitive to changes in macro-economic conditions that impact consumer spending, including discretionary spending. Difficult macro-economic conditions, particularly high levels of unemployment or underemployment, also impact our customers' ability to obtain consumer credit. Other factors, including consumer confidence, employment levels, interest rates, tax rates, consumer debt levels, and fuel and energy costs could reduce consumer spending or change consumer purchasing habits. Slowdowns in the U.S. or global economy, or an uncertain economic outlook, could materially adversely affect consumer spending habits and could have a material adverse effect on our business.

#### Risks of Changes and Unpredictability in the Industry and in Our Business

If we do not respond to rapid technological changes, our services could become obsolete, and we could lose customers.

The Internet and the online commerce industry are changing rapidly. To remain competitive, we must continue to enhance and improve the functionality and features of our e-commerce businesses. If we fail to do so, or if we fail to remain competitive when our competitors develop new technologies or new industry standards and practices emerge, our Website, our mobile app and our proprietary technology and systems could become obsolete. Our failure to respond to technological change and to remain competitive would have a material adverse effect on our business.

We have an evolving business model, which increases the complexity of our business.

Our business model has evolved in the past and continues to do so. In prior years we have added additional types of services and product offerings and in some cases we have modified or discontinued those offerings. We intend to continue to try to offer additional types of products or services, and we do not know whether any of them will be successful. From time to time we have also modified aspects of our business model relating to our product mix and the mix of direct/partner sourcing of the products we offer. We do not know whether these or any other modifications will be successful. The additions and modifications to our business have increased the complexity of our business and placed significant strain on our management, personnel, operations, systems, technical performance, financial resources, and internal financial control and reporting functions. Future additions to or modifications of our business are likely to have similar effects. Further, any new business or website we launch that is not favorably received by consumers could damage our reputation or our brand. The occurrence of any of the foregoing could have a material adverse effect on our business.

Any acquisitions we make will increase costs and regulatory and integration risks.

From time to time we may acquire other businesses. Integrating an acquired business involves a number of risks and financial, managerial and operational challenges. We have incurred significant expenses in connection with acquisitions we have made in the past, and may incur additional expenses in connection with those acquisitions or in connection with other acquisitions we may make in the future. Our overall profitability would be adversely affected if our investments and expenses associated with any investments we have made or may make in the future are not justified by the revenues and profits, if any, that are derived from such investments. Further, acquisitions may also create a need for additional accounting, tax, compliance, documentation, risk management and internal control procedures, and may require us to hire additional personnel to implement, perform and/or monitor such procedures. To the extent our procedures are not adequate to appropriately implement, perform and/or monitor all necessary

procedures relating to any new or expanded business, we could be exposed to a material loss or regulatory sanction.

#### International Risks

We are attempting to expand our international business, which may cause our business to become increasingly susceptible to numerous risks and challenges that could affect our profitability.

We sell products in international markets, and are attempting to expand into some of these markets. International sales and transactions, and our efforts to expand them, are subject to inherent risks and challenges that could adversely affect our profitability, including:

- the need to develop new supplier and manufacturer relationships;
- the need to comply with additional U.S. and foreign laws and regulations to the extent applicable, including but not limited to, restrictions on advertising practices, regulations governing online services, regulations governing or prohibiting the use of cryptocurrency such as bitcoin, restrictions on importation of specified or proscribed items, importation quotas, consumer protection laws, laws regarding intellectual property rights, laws dealing with consumer and data protection, privacy, encryption, and restrictions on pricing or discounts;
- changes in international laws, regulatory requirements, taxes and tariffs;
- geopolitical events, such as war and terrorist attacks;
- our limited experience with different local cultures and standards;
- the risk that the products we offer may not appeal to customers in international markets; and
- the additional resources and management attention required for such expansion.

To date, most of our international sales have been denominated in U.S. dollars, and we have not had significant foreign currency risk on those sales. However, in the future, gains and losses on the conversion of foreign payments into U.S. dollars may contribute to fluctuations in our results of operations and fluctuating exchange rates could cause reduced gross revenues and/or gross profit percentages from non-dollar-denominated international sales. Additionally, penalties for non-compliance with laws applicable to international business and trade, including the U.S. Foreign Corrupt Practices Act, could have a material adverse effect on our business.

Foreign data protection, privacy and other laws and regulations are different and often more restrictive than those in the United States. Our risk of non-compliance with applicable foreign data protection laws and regulations increases as we continue our international expansion. We may need to change and limit the way we use consumer information in operating our business and may have difficulty maintaining a single operating model that is compliant. Compliance with such laws and regulations will result in additional costs and may necessitate changes to our business practices and divergent operating models, which may adversely affect our business and financial condition.

In July 2016, the European Commission adopted the EU-US Privacy Shield, which provides a new compliance framework for US organizations that import personal data from Europe. We have complied with the Privacy Shield self-certification procedures. Among other things, Privacy Shield certification requires that we amend our existing contracts with third parties involved with the transfer of personal data to bring them into compliance within a nine-month grace period after our certification date. If we are unable to do so or are otherwise unable to comply with the Privacy Shield requirements, we could incur additional costs and operational difficulties relating to our efforts in Europe.

Our foreign brand domain name may cause confusion.

In 2010, we attempted to associate our brand globally with the domain address: [www.O.co](http://www.O.co). Following a period of testing for the O.co brand and domain address, we returned to the Overstock.com name as our primary brand domestically because domestic consumer acceptance did not occur as quickly as we had hoped. We continue to use the O.co address and brand outside of the United States and plan to use it or another domain address and brand domestically as well. The use of Overstock.com or O.co may not gain acceptance or have success in foreign markets, and other domain addresses or brands we may use domestically may not be successful. Any such difficulties with any of our brands could have a material adverse effect on our business.

#### Risks Related to Our Headquarters

We own the land on which we built our new headquarters, and consequently have environmental and other risks, and may incur environmental expense and liabilities under the environmental indemnity agreement we entered into in connection with our credit facility.

In 2014 our wholly-owned subsidiary O.com Land, LLC purchased land near Salt Lake City, Utah on which we have built our new headquarters. The land is part of the Midvale SLAG Superfund Site (“Site”), a former Comprehensive

Environmental Response, Compensation and Liability Act ("CERCLA") superfund site that was remediated pursuant to CERCLA prior to O.com Land's purchase. O.com Land, LLC is required to follow certain requirements of CERCLA and the consent decree governing remediation of the Site, and its failure to do so could expose us to material environmental liabilities. Further, in connection with the credit facility we entered into with U.S. Bank and other banks, we entered into a broad environmental indemnity agreement pursuant to which we agreed to indemnify U.S. Bank and other banks and other persons against a broad array of potential environmental claims, liabilities and exposures relating to the property. Any such environmental liabilities, and any liabilities under the environmental indemnity agreement, could be material and could have a material adverse effect on our business.

## Risks Related to Indebtedness and Potential Stock Repurchases

In connection with the construction of our new headquarters, we have entered into a syndicated senior secured credit facility, which requires us to maintain compliance with financial and other covenants.

In connection with the construction of our new headquarters we entered into a syndicated senior secured credit facility with U.S. Bank and other banks that provided us with construction financing of \$45.8 million. The facility converted to an approximately 6.75-year term loan on January 1, 2017. We will need to maintain compliance with the requirements governing the facility, including compliance with financial and other covenants, certain of which may be subject to events outside of our control. We have pledged substantially all of our assets to secure our obligations under the credit facility. If we fail to comply with the terms of the credit facility, the failure could have a material adverse effect on our liquidity and business.

We have entered into long-term interest rate swaps that expire in October 2023.

In connection with the syndicated senior secured credit facility described above, we entered into interest rate swaps with U.S. Bank and Compass Bank. The interest rate swaps are intended to manage the interest rate risk on the indebtedness we incurred under the credit agreement. Regardless of the status of that indebtedness, we will remain liable for payments due under the swaps unless we settle them. If we were to settle the swaps at a time when interest rates have fallen (relative to the swaps' inception), the price to settle the swaps could be material. Any such adverse developments could result in material liabilities and expense and could have a material adverse effect on our business.

We have incurred substantial indebtedness.

At December 31, 2016, we had incurred secured indebtedness of approximately \$45.8 million under our syndicated senior secured credit facility, and we had total liabilities of \$312.1 million. This indebtedness increases our business risks substantially, including our vulnerability to industry downturns and competitive pressures. Further, the loan agreement and related agreements governing the credit facility contain numerous requirements, including financial and other covenants. If we are unable to maintain compliance with all of them, we will be in default, the consequences of which could materially harm our business. Further, to the extent that we incur additional indebtedness, we may be subject to additional requirements. The degree to which we are ultimately leveraged could materially and adversely affect our ability to obtain additional financing for working capital, acquisitions or other purposes. Our ability to meet our debt service obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control.

Our Board has authorized a stock repurchase program and repurchases under the program would reduce our liquidity and increase our risks.

In May 2015, our Board authorized a stock repurchase program. In January 2017, we repurchased approximately 604,000 shares of our common stock for \$10 million. We may repurchase additional shares of our outstanding common stock for up to \$15 million at any time through December 31, 2017 under our existing repurchase program. Further, our Board could authorize additional repurchases. Any such repurchases would reduce our liquidity and could increase our vulnerability to industry downturns and competitive pressures. A material decrease in our liquidity could have a material adverse effect on our business.

We may be unable to generate sufficient cash flow to satisfy our debt service obligations.

Our ability to generate cash flow from operations to make interest and principal payments on our debt obligations will depend on our future performance, which will be affected by a range of economic, competitive and business factors. We cannot control many of these factors, including general economic conditions and the health of the Internet retail industry. If our operations do not generate sufficient cash flow from operations to satisfy our debt service obligations and all of our other obligations, we may need to borrow additional funds to make these payments or undertake

alternative financing plans, such as refinancing or restructuring our debt, or reducing or delaying capital investments and other expenses. Additional funds or alternative financing may not be available to us on favorable terms, or at all. Our inability to generate sufficient cash flow from operations or obtain additional funds or alternative financing on acceptable terms could have a material adverse effect on our business.

Risks Related to our Finance and Accounting Systems and Estimates

We may need to implement additional finance and accounting systems, procedures and controls as we grow our business and organization and to satisfy new reporting requirements.

We are required to comply with a variety of reporting, accounting and other rules and regulations. Compliance with existing requirements is expensive. We will have to ensure that the reporting, accounting, records maintenance and other systems in place at the financial technology company and broker dealers we acquired are compliant and adequate. These and future requirements may increase our costs and require additional management time and resources. We may need to implement additional finance and accounting systems, procedures and controls to satisfy our reporting requirements. If our internal control over financial reporting is determined to be ineffective, such failure could cause investors to lose confidence in our reported financial information, negatively affect the market price of our common stock, subject us to regulatory investigations and penalties, and could have a material adverse effect on our business.

Changes in accounting standards and subjective assumptions, estimates and judgments by management related to complex accounting matters could significantly affect our financial results.

Generally accepted accounting principles and related accounting pronouncements, implementation guidelines and interpretations with regard to a wide range of matters that are relevant to our business, including but not limited to revenue recognition, estimating valuation allowances and accrued liabilities (including allowances for returns, credit card chargebacks, doubtful accounts and obsolete and damaged inventory), internal-use software and website development (acquired and developed internally), accounting for income taxes, valuation of intangible assets and goodwill, stock-based compensation and loss contingencies, are complex and involve many subjective assumptions, estimates and judgments by our management. Changes in these rules or their interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance, and could have a material adverse effect on our business.

Our income tax provisions and the amounts we reserve for tax contingencies are estimates and are subject to variations and adjustments. The amounts we ultimately pay may exceed the amounts estimated or accrued.

Our quarterly tax provision, and our quarterly estimate of our annual effective tax rate, is subject to significant variation due to several factors, including variability in accurately predicting our pre-tax and taxable income and loss and the mix of jurisdictions to which they relate, changes in how we do business, changes in law, regulations, and administrative practices, and relative changes of expenses or losses for which tax benefits are not recognized. Additionally, our effective tax rate can be more or less volatile based on the amount of pre-tax income. For example, the impact of discrete items and non-deductible expenses on our effective tax rate is greater when our pre-tax income is relatively low. We are subject to audits by a number of tax authorities. The timing of the resolution of income, sales and other tax examinations is highly uncertain, and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ from the amounts we have accrued. It is possible that within the next 12 months we will receive assessments by various tax authorities or possibly reach resolution of income tax examinations in one or more jurisdictions. These assessments or settlements may result in changes to our contingencies related to positions on prior years' tax filings. The volatility of our quarterly tax provision or the resolution of matters related to our tax contingencies could have a material adverse effect on our financial results.

We have reversed the valuation allowance for our deferred tax assets, and we may not be able to realize these assets in the future. Our deferred tax assets may also be subject to additional valuation allowances, which could adversely affect our operating results.

From our inception to December 31, 2013, we established a valuation allowance for our deferred tax assets, primarily due to realized losses and uncertainty regarding our future taxable income. Determining whether a valuation allowance for deferred tax assets is appropriate requires significant judgment and an evaluation of all positive and



negative evidence. At each reporting period, we assess the need for, or the sufficiency of, a valuation allowance against deferred tax assets. At December 31, 2013, based on the weight of all the positive and negative evidence (primarily our estimate of future taxable income), we concluded that it was more likely than not that we would realize our net deferred tax assets based upon future taxable income, and we reversed the valuation allowance at December 31, 2013. Our estimates of future taxable income are based primarily on historical performance, but also include estimates and assumptions and external data, some of which are subject to significant judgment. If our actual taxable income differs significantly from our estimates, we may need to reestablish a valuation allowance for some or all of our deferred tax assets, which could have a material adverse effect on our financial condition and operating results.

Risks Related to our Holdings of Precious Metals, Cryptocurrencies, Cash and Short-Term Investments

We may be adversely affected by fluctuations in precious metal prices.

At December 31, 2016 our investment in precious metals was \$9.9 million. Our financial results may be adversely affected by declines in the price of precious metals. Our investment consists of actual precious metals, rather than financial instruments. We store our precious metals off-site in a third party facility. Consequently, we are also subject to the risks of physical storage with a third party that we do not control. Any loss of these assets or substantial decline in their value could have a material adverse effect on our business.

Our decision to accept and hold cryptocurrency, such as bitcoins, may subject us to exchange risk and additional tax and regulatory requirements.

In January 2014, we began accepting bitcoins as a form of payment for purchases on our Website. Bitcoin is not considered legal tender or backed by any government, and it has experienced price volatility, technological glitches and various law enforcement and regulatory interventions. In September 2014, we began accepting bitcoin internationally. The use of cryptocurrency such as bitcoin has been prohibited or effectively prohibited in some countries. If we fail to comply with regulations or prohibitions applicable to us, we could face regulatory or other enforcement actions and potential fines and other consequences. From time to time we also hold bitcoin and other cryptocurrencies directly, and we have exchange rate risk on the amounts we hold as well as the risks that regulatory or other developments may adversely affect the value of the cryptocurrencies we hold. The uncertainties regarding legal and regulatory requirements relating to cryptocurrencies or transactions utilizing cryptocurrencies, as well as potential accounting and tax issues, or other requirements relating to cryptocurrencies could have a material adverse effect on our business.

Our cash, cash equivalents and short-term investments are subject to a risk of loss based upon the solvency of the financial institutions in which they are maintained.

We maintain the majority of our cash, cash equivalents and short-term investments in accounts with a small number of major financial institutions within the United States, in the form of demand deposits, money market accounts, time deposits, U.S. Treasury Bills and other short-term investments. Our deposits in these institutions are generally substantially in excess of the amounts of insurance provided by the FDIC, and some deposits may not be covered by insurance at all. If any of these institutions were to become insolvent or subject to regulatory action, we could lose some, or all, of such deposits, which would have a material adverse effect on our business.

#### Risks Related to Intellectual Property Rights and Disputes

We may be unable to protect our proprietary technology and to obtain trademark protection for our marks.

Our success depends to a significant degree upon the protection of our software and other proprietary intellectual property rights. We may be unable to protect it, which could have a material adverse effect on our business. Further, we may not be able to secure protection for our service marks or trademarks in the United States or elsewhere as we expand internationally. Our competitors might adopt product or service marks similar to our marks, or might try to prevent us from using our marks. Any claim by another party against us or customer confusion related to our trademarks, or our failure to obtain trademark registration, could have a material adverse effect on our business.

We may not be able to enforce protection of our intellectual property rights under the laws of other countries.

We sell products internationally and consequently we are subject to risks of doing business internationally, including uncertainty regarding liability for the listings and other content provided by our users, and differing intellectual property laws, which may provide insufficient protection for our intellectual property. Any such difficulties could have a material adverse effect on our business.

We may be accused of infringing intellectual property rights of third parties.

We have been and will continue to be subject to claims that we have infringed the intellectual property rights of others. Any such claims may result in significant expenditure of financial and managerial resources, and the payment of damages or settlement amounts. Additionally, we may be prohibited from using software or business processes we currently use or may need to use in the future, or required to obtain licenses from third parties, even though such licenses may not be available on terms acceptable to us or at all. Any such difficulties could have a material adverse effect on our business.



Our business and reputation may be harmed by the offering or sale of pirated, counterfeit or illegal items by third parties, and by intellectual property litigation.

We routinely receive allegations that items we offer or sell infringe third party intellectual property rights. Further, we may be unable to prevent third parties from offering and selling unlawful goods or goods that are improperly labelled or otherwise not compliant with applicable regulations, and we may be subject to allegations of civil or criminal liability for unlawful or noncompliant offerings by third parties through our Website. Costs we incur relating to allegations of infringement or the sale of unlawful goods could harm our business and could require us to change our methods of doing business or require us to enter into costly royalty or licensing agreements, if available. Any of the foregoing could damage our reputation, diminish the value of our brand name, and have a material adverse effect on our business.

#### Risks Related to Certain Specific Businesses, Investments in Businesses and Recent or Planned Changes to our Business

We have acquired the assets and business of a financial technology company and two registered broker-dealers; we have limited experience with the operation of a fintech company or of a registered broker-dealer, and the businesses that we are pursuing through our Medici initiatives are novel and could result in material write-offs.

In August 2015, we acquired the assets and business of a financial technology ("fintech") company and in January 2016, after receiving FINRA approval, we acquired two registered broker-dealers (our "broker-dealer subsidiaries") that were affiliated with the fintech company. We subsequently hired all or substantially all of the employees of the fintech company. However, we have limited experience with the operation of a fintech company or of registered broker-dealers, and are dependent upon the employees for the expertise necessary to operate the fintech company and the broker-dealer subsidiaries. Further, we have recently issued publicly-traded securities traded exclusively on a registered alternative trading system operated by one of our majority-owned subsidiaries, the ownership of which is tracked on a distributed ledger. See "Risks Related to our Preferred Stock," below. We are also working on other potential financial applications of distributed ledger, or blockchain, technology. All of these are areas in which we do not have substantial experience, and all of them are subject to the risks of new and novel businesses, including technical and operational risk, financial risk, regulatory and legal risk, and reputational risk. In addition, we face the risk that we may be unable to market, license or sell our technology successfully or profitably. Any significant problems we encounter with these projects could have a material adverse effect on our business. Further, we review our acquired assets for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. As described further in Item 15 of Part IV, "Financial Statements"—Note 2. Accounting Policies, contained in the "Notes to Consolidated Financial Statements," we will write off these amounts as necessary. Any such write-offs could be material.

We have acquired registered broker-dealers, which are subject to extensive regulation.

The broker-dealers we acquired in January 2016 are subject to regulation, examination and disciplinary action by the SEC, the Financial Industry Regulatory Authority ("FINRA") and state securities regulators, as well as other governmental authorities and self-regulatory organizations ("SROs") with which they are registered or licensed or of which they are members. The broker-dealers are also subject to rules and regulations relating to the prevention and detection of money laundering, privacy and data protection laws and regulations, and substantial other regulatory requirements. Any failure to comply with all applicable regulations, and any regulatory proceeding or civil or criminal action against any of the broker-dealers that we have acquired, or any of their associated persons, could have a material adverse effect on our business. Further, any failure to identify and successfully manage conflicts of interest or to implement appropriate policies or procedures could subject the broker-dealers or us to disciplinary sanctions or litigation or could harm our reputation. Any of the foregoing could have a material adverse effect on our business.

Our investment in Bitt Inc. may expose us to risks under laws and regulations with which we do not have significant experience.

In 2016, we acquired an approximately 11% equity interest in Bitt, Inc., a startup company based in Barbados, that is pursuing a variety of digital currency transfer and payment businesses in the Caribbean. Virtually every state in the

U.S. regulates money transmitters and money services businesses. In some states the licensing requirements and regulations expressly cover companies engaged in digital currency activities; in other states it is not clear whether or how the existing laws and regulations apply to digital currency activities. Further, U.S. federal law requires registration of most such businesses with the Financial Crimes Enforcement Network ("FinCEN"). These licenses and registrations subject companies to various anti-money laundering, know-your-customer, record-keeping, reporting and capital and bonding requirements, limitations on the investment of customer funds, and inspection by state and federal regulatory agencies. Under U.S. federal law, it is a crime for a person, entity or business that is required to be registered with FinCEN or licensed in any state to fail to do so, even if the

person, entity or business was unaware of the licensing requirement. Further, under U.S. federal law, anyone who owns all or part of an unlicensed money transmitting business is subject to civil and criminal penalties. The business in which we have invested has represented to us that it has not taken any action that could subject it to registration with FinCEN or to the licensing requirements in any state and has agreed that it will not do so until it has become properly licensed in all required states and registered with FinCEN. However, if the business makes an error, even inadvertently, we could be subject to potential civil and criminal penalties as a result. Any such penalties, or even the allegation of criminal activities, could have a material adverse effect on us and our business. Further, as described under Governmental Regulation, all of our foreign business activities expose us to a variety of risks, including risks under the Foreign Corrupt Practices Act.

We may be required to write off amounts relating to our investments in startup businesses.

At December 31, 2016, we had invested approximately \$14.6 million in several companies that are in the startup or development stages. During 2016, we recognized a \$2.9 million impairment loss on one of these investments, which decreased the carrying amount of our cost method investments to \$11.8 million. These investments are inherently risky because the markets for the technologies or products these companies are developing are typically in the early stages and may never materialize. Additionally, since several of our investments are in the early startup or development stages, even if their technology or products are viable, they may not be able to obtain the capital or resources necessary to successfully bring their technology or products to market. Furthermore, we have no assurance that the technology or products of our investees would be successful, even if they were brought to market. We will write off additional amounts related to these investments as necessary, and any such write-offs could be material.

Our car listing service may be subject to a variety of regulatory requirements and risks.

Many states and other jurisdictions, including Utah, where we are located, have regulations governing the conduct of car sellers and public advertising for car sales. Generally, these regulations apply to the sellers rather than to a company through which the advertising is done. Sellers are often subject to “truth in advertising” laws. We have no ability to know whether the information sellers provide is correct. While our site terms and conditions of usage prohibit unlawful acts, we cannot assure that sellers will comply with all laws and regulations applicable to them and their transactions. Further, like our shopping business, our car listing service is subject to most of the same laws and regulations that apply to other companies conducting business on and off the Internet. Any negative publicity we receive regarding any allegations of unlawful or deceptive conduct may damage our reputation, our ability to attract new customers to our main shopping site, and our brand name generally. The occurrence of any of the foregoing could have a material adverse effect on our business.

Our Supplier Oasis offering, including its fulfillment services, faces competition from other distribution networks and will require substantial resources.

We offer Supplier Oasis, a single integration point through which partners can manage their products, inventory and sales channels, which includes multi-channel fulfillment services to sellers, suppliers, and partners. The marketplace for these services is highly competitive, and many of our current and potential competitors in this area have greater brand recognition, longer operating histories, larger customer bases and significantly greater financial, marketing and other resources than we do. Our continued development of Supplier Oasis may require substantial investments over a lengthy period of time. Further, most of the risks applicable to our business generally are also applicable to the business of Supplier Oasis. If we are unable to generate sufficient revenues and gross profits from Supplier Oasis, it could have a material adverse effect on our business.

Our Farmers Market offering faces competition from a variety of competitors.

We offer Farmers Market, a tab within our Website from which our customers, in certain locations, can order locally grown fresh produce and other food products. Farmers Market competes with a wide variety of businesses nationwide, many of which have greater brand recognition, longer operating histories, larger customer bases and significantly greater financial, marketing and other resources than we do. Our continued development of Farmers Market may involve delivery and other issues that may be different from those we face in connection with the sale and delivery of non-perishable products. The sale of food products is highly regulated, both by health and safety regulations and by regulations governing labeling. Further, most of the risks applicable to our business generally are also applicable to our Farmers Market business. Any significant difficulties we encounter with our Farmers Market offering could have

a material adverse effect on our business.

Our insurance offerings face competition from traditional insurance brokers and direct insurance marketing organizations.

We offer a tab within our website that connects our customers to live quotes for insurance for vehicle, residential and small businesses on our Website. The insurance business is highly competitive, and many of our current and potential

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competitors in this area have greater brand recognition, longer operating histories, larger customer bases and significantly greater financial, marketing and other resources than we do. Further, most of the risks applicable to our business generally are also applicable to our insurance offerings business. Any significant difficulties we encounter with our insurance offerings could have a material adverse effect on our business.

#### Risks Related to Litigation

We are routinely involved in substantial litigation.

From time to time we receive claims and become subject to lawsuits involving consumer protection, employment, intellectual property and other matters related to the conduct and operation of our business and the sale of products on our Website, including claims by regulators and by customers. In addition, we have in the past been and in the future may be, involved in substantial litigation, including litigation regarding the constitutionality of certain state tax laws, in which we are the plaintiff. Any such litigation, whether as plaintiff or defendant, may be costly and time consuming and could divert management and key personnel from our regular business operations. An unfavorable resolution of any such matter could have a material adverse effect on our business.

#### Risks Related to our Common Stock

The issuance of our Series A Preferred Stock and our Series B Preferred Stock could adversely affect the holders of our common stock in some circumstances.

Our issuance in December 2016 of our Series A Preferred Stock and our Series B Preferred Stock (collectively sometimes called the “Preferred Stock”) could adversely affect the holders of our common stock in some circumstances. See “Risks Related to our Preferred Stock - The issuance of our Series A Preferred Stock and our Series B Preferred Stock could adversely affect the holders of our common stock in some circumstances,” below.

The price of our common stock and any other securities may be volatile and you may lose all or a part of your investment.

The market price of our common stock historically has been subject to significant fluctuations. These fluctuations could continue. It is possible that in future periods our results of operations may be below the expectations of investors and any analysts. If this occurs, the market price of our securities may decline substantially. Any of the foregoing could have a material adverse effect on our business and particularly on our ability to raise capital. Our quarterly operating results are volatile and may adversely affect the market price of our securities.

Our future revenues and operating results have varied in the past and may continue to vary significantly from quarter to quarter due to a number of factors, many of which are outside our control, and any of which could harm our business. As a result, we believe that quarterly comparisons of our operating results are not necessarily meaningful and that you should not rely on the results of one quarter as an indication of our future performance. In addition to the other risk factors described in this report, additional factors that have caused and/or could cause our quarterly operating results to fluctuate and in turn affect the market price of our securities include:

- increases in the cost of advertising and changes in our sales and marketing expenditures;
- our inability to retain existing customers or encourage repeat purchases;
- the extent to which our existing and future marketing campaigns are successful;
- price competition that results in losses or lower profit margins;
- the amount and timing of operating costs and capital expenditures relating to the expansion of our business operations and infrastructure;
- the amount and timing of our purchases of inventory;
- our inability to manage distribution operations or provide adequate levels of customer service;
- increases in the cost of fuel and transportation;
- our ability to successfully implement technology changes or to integrate operations and technologies from acquisitions or other business combinations;
- our efforts to offer new lines of products and services; and
- our ability to attract users to our shopping and other sites.



Any of the foregoing could have a material adverse effect on our business.

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Our operating results may fluctuate depending on the season, and such fluctuations may affect the market price of our securities.

We have experienced and expect to continue to experience significant fluctuations in our operating results because of seasonal fluctuations in traditional retail patterns. Our gross revenues have historically been significantly higher in the fourth calendar quarter of each year than in the following quarters due primarily to increased shopping activity during the holiday season. Further, we generally increase our inventories substantially in anticipation of holiday season shopping activity, which has a negative effect on our cash flow. Securities analysts and investors may inaccurately estimate the effects of seasonality on our results of operations in one or more future quarters and, consequently, our operating results may fall below expectations, causing the market price of our securities to decline. Any of the foregoing could have a material adverse effect on our business.

Sales by our significant stockholders could have an adverse effect on the market price of our stock.

Several of our stockholders own significant percentages of our common stock. If one or more of our large stockholders were to sell all or a portion of their holdings of our common stock, the market price of our common stock could be negatively impacted. The effect of such sales, or of significant percentages of our stock being offered or made available for sale, could result in strong downward pressure on our stock price. Investors should be aware that they could experience significant volatility in our stock if any one or more of such stockholders were to decide to sell all or a portion of their holdings of our common stock at once or within a short period of time. In addition, the transfer of ownership of a significant portion of our outstanding shares within a three-year period could adversely affect our ability to use our net operating losses to offset future taxable net income. Any of the foregoing could have a material adverse effect on our business.

We do not intend to pay dividends on our common stock and you may lose the entire amount of your investment in our common stock.

We have never declared or paid any cash dividends on our common stock and do not intend to pay dividends on our common stock for the foreseeable future. We intend to invest our future earnings, if any, to fund our growth. Therefore, you will not receive any funds without selling your shares. We cannot assure that you will receive a positive return on your investment when you sell your shares or that you will not lose the entire amount of your investment.

Provisions in our amended and restated certificate of incorporation and bylaws and Delaware law might discourage, delay or prevent a change of control of our company or changes in our management.

Our amended and restated certificate of incorporation and bylaws contain provisions that could discourage, delay or prevent a change in control of our company or changes in our management that the stockholders of our company may deem advantageous. These provisions among other things:

- permit the board of directors to establish the number of directors;
- provide that only one-third of our board of directors is elected at each of our annual meetings of stockholders (and our amended and restated certificate of incorporation prohibits cumulative voting in the election of directors);
- mean that directors may be removed by the affirmative vote of the holders of the outstanding shares of common stock only “for cause;”
- authorize the issuance of “blank check” preferred stock that our board could use to implement a stockholder rights plan (also known as a “poison pill”);
- eliminate the ability of our stockholders to call special meetings of stockholders;
- prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- provide that the board of directors is expressly authorized to make, alter or repeal our bylaws;
- establish advance notice requirements, including specific requirements as to the timing, form and content of a stockholder’s notice, for nominations for election to our board or for proposing matters that can be acted upon by stockholders at annual stockholder meetings;
- provide that special meetings of our stockholders may be called only by the board of directors, the chairman of the board, the chief executive officer or the president; and
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provide that stockholders are permitted to amend the bylaws only with the approval of the holders of sixty-six and two-thirds percent (66-2/3%) of the voting power of outstanding capital stock entitled to vote at an election of directors.

In addition, Section 203 of the Delaware General Corporation Law may discourage, delay or prevent a change in control of our company. In general, Section 203 prohibits a publicly held Delaware corporation from engaging in a “business combination” with an “interested stockholder” for a period of three years following the date the person became an interested stockholder, subject to certain exceptions.

Our board of directors could accelerate the vesting of outstanding restricted stock units upon a sale of the company or otherwise, which could result in an increase in the number of shares outstanding.

Our board has granted, and in the future expects to make additional grants, of restricted stock units (“RSUs”) to certain of our employees and directors. Upon vesting, one share of our common stock is issued for every RSU held. Under the terms of these grants, the board could determine to accelerate the vesting of RSUs in the event of a sale of our company or otherwise, which would result in an increase in the number of shares outstanding, and would dilute shareholders’ ownership of our company. Although the number of RSUs outstanding changes frequently, the aggregate amount outstanding as of December 31, 2016 was 2.2% of the number of shares of common stock outstanding.

We have issued and in the future may again issue preferred stock as authorized by our amended and restated certificate of incorporation without further stockholder approval for purposes unrelated to any stockholder rights plan, and any such preferred stock could entitle the holders to rights superior to those of the holders of our common stock.

Our amended and restated certificate of incorporation authorizes our Board to designate and issue preferred stock on such terms as may be approved by the Board without further stockholder approval. In addition to the possibility that the Board could do so in connection with the adoption of a stockholder rights plan as described above, the Board has done so and could do so again for a variety of other purposes. See “Risks Related to our Preferred Stock,” below.

The price of our stock may be vulnerable to manipulation.

The practice of “abusive naked short selling” places our stock at risk for manipulative attacks by large investment pools and prime brokers. Abusive naked short selling is the practice by which short sellers place large short sell orders for shares without first borrowing the shares to be sold, or without having first adequately located such shares and arranged for a firm contract to borrow such shares prior to the delivery date set to close the sale. While selling broker-dealers are by rule required to deliver shares to close a transaction by a certain date, and while purchasing broker-dealers are obligated by rule to purchase the sold quantity of shares when they are not delivered to close the sale, these rules are often ignored. Abusive naked short selling has a depressive effect on share prices when it is allowed to persist because the economic effect of abusive naked short selling is the oversupply of counterfeit stock to the market. We believe the regulations designed to address this abusive practice are both inadequately structured and inadequately enforced. Consequently, we believe that without the enactment of adequate regulations and the enforcement necessary to curb these abuses, the manipulations achieved through abusive naked short selling are likely to continue. We believe that our stock has been subject to these abusive practices by those attempting to manipulate its price downward. To the extent that our stock is subject to these practices in the future, our stock may be more volatile than it might otherwise be and/or may trade at prices below those that might prevail in the absence of such abuses.

In the past, our stock has consistently been on the Regulation SHO threshold list.

Regulation SHO requires the stock exchanges to publish daily a list of companies whose stock has failures-to-deliver above a certain threshold. It also requires mandatory close-outs for open fail-to-deliver positions in threshold securities persisting for over 13 days. In the past our common stock frequently appeared on the Regulation SHO threshold list for extended and continuous periods and in the past our stock has been on the list for more trading days than any other company.

We generally have not received significant coverage by securities analysts, and the lack of coverage may adversely affect our share price and trading volume.

We generally have not received significant coverage by securities analysts, and the lack of coverage may adversely affect our share price and trading volume. The lack of coverage may cause our share price or trading volume to be lower than they might be if more analysts covered us.

#### Risks Related to our Preferred Stock

The issuance of our Series A Preferred Stock and our Series B Preferred Stock could adversely affect the holders of our common stock in some circumstances.



In December 2016, we issued shares of our Blockchain Voting Series A Preferred Stock (the “Series A Preferred”) and our Voting Series B Preferred Stock (the “Series B Preferred,” and together with the Series A Preferred, collectively sometimes called the “Preferred Stock”) in a registered rights offering (the “rights offering”). The Preferred Stock could adversely affect the holders of our common stock in some circumstances. Except as required by law, the Preferred Stock will vote with the common stock on all matters submitted to a vote of the common stock, with holders of the Preferred Stock having one vote for each share of Preferred Stock held. As of February 2, 2017, the 695,898 issued shares of Preferred Stock constituted approximately 2.7% of the total number of shares of the Preferred Stock and the common stock, taken together. The Preferred Stock ranks senior to the common stock with respect to dividends. Holders of the Preferred Stock will be entitled to an annual cash dividend equal to \$0.16 per share of Preferred Stock, in preference to any dividend payment to the holders of the common stock. Holders of the Preferred Stock are also entitled to participate in any cash dividends we pay to the holders of the common stock and are also entitled to participate in any non-cash dividends we pay to holders of the common stock, subject to different treatment if we effect a stock dividend, stock split or combination of the common stock. The Preferred Stock will rank on a parity with the common stock with respect to rights upon our liquidation, winding up or dissolution. If we are a party to any merger or consolidation in which the common stock is changed into or exchanged for stock or other securities of any other person (or the Company) or cash or any other property (or a right to receive the foregoing), we will be required to use all commercially reasonable efforts to cause each outstanding share of the Preferred Stock to be treated as if such share were an additional outstanding share of common stock in connection with any such transaction.

The Series A Preferred and the tØ Platform are novel, and the use of the PRO Securities ATS utilizing the tØ Platform for trading public digital securities was untested prior to the December 2016 closing of the offering of the Series A Preferred.

Trades in non-digital publicly traded securities currently take place through the continuous net settlement system operated by The Depository Trust Company (“DTC”) and generally settle on the third day following the day on which the purchase and sale commitments are made. This delayed settlement model is the current standard in the United States for the sale and settlement of publicly traded securities, all of which are currently non-digital. The Series A Preferred does not trade or settle through the traditional system; rather, shares of Series A Preferred trade exclusively on a registered alternative trading system (the “PRO Securities ATS”) operated by our indirect majority-owned subsidiary PRO Securities LLC (“PRO Securities”) utilizing technology known as the tØ Issuance and Trading Platform (the “tØ Platform”). Unlike trades through the traditional system, trades of the Series A Preferred settle on the trade date. The tØ Platform is a recent development, licensed by PRO Securities from our majority-owned subsidiary tØ.com, Inc., formerly named Medici, Inc. (“tØ.com”), and the tØ Platform had not been tested with public trading of digital securities prior to the closing of the offering of the Series A Preferred in December 2016. Consequently, investors in the Series A Preferred bear the risks of investing in a novel type of security that trades exclusively on a novel type of trading platform and that is subject to a number of unusual restrictions, as well as the risks of investing in our business. Any failure of the PRO Securities ATS or of the tØ Platform to perform as expected could have a material adverse effect on holders’ ability to sell the Series A Preferred.

The technology on which the tØ Platform depends has been developed by our majority-owned subsidiary, tØ.com, and is licensed by its subsidiary, PRO Securities, and the Series A Preferred depends on both tØ.com and on PRO Securities, neither of which has substantial resources.

tØ.com is a majority-owned subsidiary of ours and owns 100% of the equity interest in PRO Securities. tØ.com licenses the tØ Platform to PRO Securities, and PRO Securities operates the PRO Securities ATS. tØ.com also licenses the tØ Platform to the Company for the Company’s use in connection with the Series A Preferred. Neither tØ.com nor PRO Securities has substantial resources. PRO Securities had net capital of approximately \$24,141 at December 31, 2016. Neither tØ.com nor PRO Securities has any legally binding commitment from any person, including the Company, to contribute additional capital or to make any loan to either of them. If any one or more of the Company, tØ.com or PRO Securities were to be unable to fund its operations in the future, or if any one or more of the Company, tØ.com or PRO Securities were to become the subject of a bankruptcy or other insolvency proceeding, PRO Securities might be unable to continue to operate the tØ Platform, and the Series A Preferred could be materially adversely affected. In any such event, holders of our capital stock, including the Series A Preferred,

could lose their entire investment in our capital stock, including all amounts invested in the Series A Preferred. The requirement that each prospective purchaser of Series A Preferred open and maintain an online brokerage account with Keystone may initially limit the number of potential trading market purchasers of Series A Preferred to the purchasers of Series A Preferred in the rights offering.

In order to trade in the Series A Preferred, a prospective purchaser is required to open an online brokerage account with Keystone Capital Corporation (“Keystone”) and holders of Series A Preferred will be unable to access their shares of Series A Preferred except through that account. We anticipate that it will take time for persons who were not investors in the rights offering to make the decision to open the required account with Keystone in anticipation of trading in the Series A

Preferred, and it is possible that very few will ever do so. Consequently, we expect liquidity in the Series A Preferred to be very limited, which could have a material adverse effect on holders' ability to trade the Series A Preferred.

Prior to the rights offering there was no trading market for the Series A Preferred or the Series B Preferred, and active trading markets may not develop.

The Series A Preferred is a new issue of securities that may be traded only on an unprecedented trading platform. Prior to the rights offering there was no established trading market for the Series A Preferred, and no digital security had ever been publicly traded on the PRO Securities ATS or utilizing the tØ Platform. As of February 1, 2017 only 140 persons had opened online brokerage account with Keystone for the purpose of acquiring and holding shares of Series A Preferred, including persons who opened accounts in order to participate in the rights offering, and a very small number of trades in the Series A Preferred had taken place since the closing of the rights offering in December 2016. The Series A Preferred is not and will not be listed on any securities exchange or any other market of any kind, other than the PRO Securities ATS utilizing the tØ Platform. Even if a trading market for the Series A Preferred does develop on the PRO Securities ATS utilizing the tØ Platform, the depth and liquidity of that market and the ability of the holders to sell the Series A Preferred may nevertheless be very limited, which may have a material adverse effect on holders of the Series A Preferred.

The Series B Preferred is a new issue of securities, and prior to the rights offering there was no trading market for the Series B Preferred. The Series B Preferred is not and will not be listed on any securities exchange. The Series B Preferred is traded in the over-the-counter market and we expect it to be quoted on the OTCQB market operated by OTC Markets Group. We have encountered an unexpected delay in the quotation of the Series B Preferred on the OTCQB. OTC Markets is unable to publicly provide quotation or trade data until FINRA clears a Form 211 filed by a broker dealer. We understand that one or more broker dealers have made Form 211 filings with FINRA, but to date FINRA has not cleared any of them. In any case, we continue to expect that the depth and liquidity of trading and the ability of the holders to sell Series B Preferred may be very limited, which may have a material adverse effect on holders of Series B Preferred.

We do not intend to issue any additional shares of either Series A Preferred or Series B Preferred, which is expected to result in very limited trading in each series.

Although we have the right to convert the outstanding shares of Series A Preferred into Series B Preferred, we do not intend to issue any additional shares of Series A Preferred or any additional shares of Series B Preferred.

Consequently, we expect trading of the Series A Preferred and the Series B Preferred to be limited to the shares we issued in the rights offering. As a result, trading in the Series A Preferred and the Series B Preferred may be very limited.

We do not expect there to be any market makers to develop a trading market in the Series A Preferred.

Most securities that are publicly traded in the United States have one or more broker-dealers acting as "market makers" for the security. A market maker is a firm that stands ready to buy and sell the security on a regular and continuous basis at publicly quoted prices. We do not believe that the Series A Preferred will have any market makers, which could contribute to a lack of liquidity in the Series A Preferred, and could have a material adverse effect on holders' ability to trade the Series A Preferred.

Accounts for the Series A Preferred will be held directly in the customer's name, rather than in "street name."

Each investor in the Series A Preferred is required to open an online brokerage account in his, her or its name with Keystone. Investors are not permitted to hold their Series A Preferred in "street name." The Series A Preferred shares are not held at a central securities depository. Instead, the shares are directly recorded on our stockholder books and records maintained by Computershare Trust Company, N.A. ("Computershare"). As a very substantial portion of U.S. publicly traded securities currently are held in "street name," we expect that many potential investors in the Series A Preferred may not be interested in holding securities in their own names and therefore will not invest in the Series A Preferred. In addition, as a result of this requirement, individual retirement accounts and other fiduciary or nominee accounts including 401(k) accounts are unable to acquire shares of Series A Preferred (although custodial accounts for minors are permitted if the custodian would qualify to purchase shares of Series A Preferred on its own behalf, subject to certain restrictions). We expect that these limitations will further limit liquidity in the Series A Preferred, and the



limitations may have a material adverse effect on the development of any trading market in the Series A Preferred. The complete trading history of each digital wallet will be available to the general public and it may be possible for members of the public to determine the identity of the holders of wallets.

The tØ Platform makes trade data publicly available shortly after each trade. Although the trade data that the tØ Platform makes publicly available is anonymous, the publicly available information includes the digital wallet address (the location where records of transactions and balances involving the series A Preferred are stored) of each holder transacting in Series A Preferred, and the entire trading history of each digital wallet (including the number of securities traded by each digital wallet, the price of each trade and the balance of the securities held in each digital wallet). As a result, the trading history of each digital wallet is available to the general public. It may be possible for members of the public to determine the identity of the holders of certain wallets based on the information that the tØ Platform makes publicly available and other publicly available information, including any ownership reports required to be filed with the SEC regarding the Series A Preferred.

In addition, Delaware law provides that any stockholder of the Company has the right upon written demand under oath stating the purpose of the demand to inspect and copy the Company's stock ledger and a list of its stockholders for any proper purpose. Delaware law also requires the Company to make lists of its stockholders, including the number of shares held, available for inspection by stockholders of the Company in connection with stockholder meetings. These lists disclose the identity of stockholders of record, but not stockholders who hold their shares in "street name." Because all holders of the Series A Preferred will be holders of record, all of them will be subject to the risk of loss of their anonymity.

Potential investors who desire to execute their trades in relative anonymity may find these aspects of the tØ Platform unattractive, which may further limit liquidity in the Series A Preferred, and may have a material adverse effect on the development of any trading market in the Series A Preferred.

Only certain persons and entities are able to acquire Series A Preferred.

Only certain persons and entities may purchase Series A Preferred. We expect that these limitations will limit liquidity in the Series A Preferred, and the limitations may have a material adverse effect on the development of any trading market in the Series A Preferred.

The Series A Preferred and the development of a trading market for the Series A Preferred will depend on both Keystone and its clearing broker, ETC.

The Series A Preferred will depend on the continuing business operations of both Keystone and Electronic Transaction Clearing, Inc. ("ETC"). Keystone is the only broker-dealer authorized to provide the accounts required to acquire, hold and trade shares of Series A Preferred, and ETC is the clearing broker for Keystone with respect to the Series A Preferred. Any failure of either Keystone or ETC to continue operating its business in the ordinary course or to satisfactorily perform their respective obligations could require PRO Securities to engage a substitute broker-dealer to perform the functions we expect Keystone to perform, and Keystone or such substitute broker-dealer might need to engage a substitute clearing broker. PRO Securities or Keystone may not be able to do so on a timely basis or at all. A transition from Keystone to a replacement broker-dealer or from ETC to a replacement clearing broker would be a lengthy process, during which time it would be impossible to trade Series A Preferred.

A violation of privacy or data protection laws could have a material adverse effect on PRO Securities, tØ.com or other entities, the tØ Platform and the Series A Preferred.

PRO Securities, tØ.com and other entities relevant to the operation of the PRO Securities ATS utilizing the tØ Platform, including Keystone, ETC and Computershare, are subject to applicable privacy and data protection laws and regulations. Any violations of laws and regulations relating to the safeguarding of private information could subject us or any of them to fines, penalties or other regulatory actions, as well as to civil actions by affected parties. Any such violations could adversely affect the ability of PRO Securities to operate the PRO Securities ATS or to use the tØ Platform, either of which could have a material adverse effect on holders' ability to trade Series A Preferred.

PRO Securities, tØ.com, the PRO Securities ATS, the tØ Platform and the other entities relevant to the operation of the PRO Securities ATS are subject to cyberattacks, security risks and risks of security breaches.

PRO Securities, tØ.com, the PRO Securities ATS, the tØ Platform and the other entities relevant to the operation of the PRO Securities ATS utilizing the tØ Platform, including Keystone, ETC and Computershare, are all subject to cyberattacks, security risks and risks of security breaches. An attack on any of them or a breach of security of any of them could result in a loss of private data, unauthorized trades, and an interruption of trading for an extended period of time. Any such attack or breach could adversely affect the ability of PRO Securities to operate the PRO Securities ATS or to utilize the tØ Platform, or both, any of which could have a material adverse effect on holders' ability to trade

the Series A Preferred. Any breach of data security that exposes or compromises the security of any of the private digital keys used to authorize or validate transaction

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orders, or that enables any unauthorized person to generate any of the private digital keys, could result in unauthorized trades and would have a material adverse effect on the Series A Preferred. Because trades on the PRO Securities ATS utilizing the tØ Platform settle on the trade date, it could be impossible to correct unauthorized trades.

In the event of the insolvency of Keystone or ETC, the Securities Investor Protection Corporation would be unable to cause the return of shares of Series A Preferred until a substitute for Keystone or ETC, as applicable, was in place.

The Securities Investor Protection Corporation (“SIPC”) oversees the liquidation of member broker-dealers that close when the broker-dealer is bankrupt or in financial trouble, and customer assets are missing. In a liquidation under the Securities Investor Protection Act, SIPC and a court-appointed trustee typically work to return customers’ securities and cash. Within limits, SIPC expedites the return of missing customer property by protecting each customer up to \$500,000 for securities and cash (including a \$250,000 limit for cash only). If Keystone or ETC were to become insolvent, the structure of the trading system for the Series A Preferred could cause delays in the return of Series A Preferred until a substitute for Keystone or ETC, as applicable, was in place, which could have a material adverse effect on holders of Series A Preferred.

Certain transactions involving the Series A Preferred will require manual intervention, which could result in errors. All ordinary course Series A Preferred purchase and sale transactions initiated by purchasers and sellers through their Keystone accounts are executed on the PRO Securities ATS utilizing the automated processes of the tØ Platform, without separate manual intervention by any of the relevant parties. Extraordinary transactions, however, may require manual intervention, which would be initiated by employees of ETC through the tØ Platform. For example, a unilateral transfer to a specific transferee, such as gift to a family member or charity, or an involuntary transfer pursuant to a court order, will require such manual intervention. In any situation involving manual intervention, there is a risk of human error. The same-day settlement of trades on the PRO Securities ATS utilizing the tØ Platform also means that any error not detected promptly on the trade date may be impossible to correct. See “The same-day settlement of trades on the PRO Securities ATS utilizing the tØ Platform may make it impossible to correct trading errors in the Series A Preferred” below.

The same-day settlement of trades on the PRO Securities ATS utilizing the tØ Platform may make it impossible to correct trading errors in the Series A Preferred.

Trades on the PRO Securities ATS utilizing the tØ Platform settle on the trade date rather than on a three-day (or T+3) basis. This may make it impossible to correct trading errors that might have been corrected prior to settlement under a T+3 system. Consequently, persons acquiring shares of Series A Preferred must accept the risk that correction of any trading errors may be impossible. The occurrence of any such trading error could have a material adverse effect on any affected holder of Series A Preferred. Further, in the future ETC’s custody and settlement systems may be able to move funds between customer accounts in near real-time after order executions are recorded by the PRO Securities ATS on the electronic data store in which the ownership and transfer of the Series A Preferred are recorded (the “Proprietary Ledger”), which would result in near-real time settlement, which would further increase the risk that correction of trading errors may be impossible.

The technology on which the tØ Platform depends is in an area in which tØ.com and PRO Securities have limited experience.

Neither tØ.com nor PRO Securities has significant experience with the technology on which the tØ Platform depends or the operation of the tØ Platform. The creation and operation of a digital system for the public trading of securities utilizing a distributed ledger to enable members of the public to confirm that the public copies of the Proprietary Ledger have not been altered are subject to technical, legal and regulatory constraints. Portions of the technology utilized by the tØ Platform have been developed by tØ.com very recently. Any problems tØ.com or PRO Securities encounters with the operation of the tØ Platform, including technical, legal and regulatory problems, could have a material adverse effect on the Series A Preferred.

The tØ Platform has been developed by key technology employees of tØ.com and its affiliates, and its operation and further development depend on the continued availability of those key employees.

The tØ Platform, including the technology and intellectual property involved in its creation and operation, has been developed primarily by a small number of key technology employees of tØ.com and its affiliates. The loss of the services of any of those key employees could have a material adverse effect on the ability of tØ.com to maintain the tØ Platform, which could have a material adverse effect on PRO Securities’ ability to use the tØ Platform. If tØ.com

were to lose the services of any such key employees, it could be difficult or impossible to replace them, and the loss of any of them could have a material adverse effect on the Series A Preferred.

tØ.com may continue to modify the tØ Platform, and any such modifications could require periods of downtime during which trading on the PRO Securities ATS might be suspended.

tØ.com developed the tØ Platform recently and intends to continue to work on enhancements to the tØ Platform. The continued development of enhancements to the tØ Platform or other modifications of the tØ Platform could cause service interruptions and interruptions in trading on the PRO Securities ATS, which could make it impossible to trade the Series A Preferred from time to time. Any such interruptions could occur with little or no notice.

Our use of the Bitcoin blockchain to enable members of the public to confirm that the public copies of the Proprietary Ledger have not been altered depends on the continued availability and functioning of the Bitcoin blockchain.

The Series A Preferred trade exclusively on the PRO Securities ATS utilizing the tØ Platform. The tØ Platform embeds a digital fingerprint in the Bitcoin blockchain that may be used to confirm that the public copies of the Proprietary Ledger have not been altered. No person, business, governmental authority or other entity or authority of any kind has any obligation to provide any financial, technical or other support to the continued operation or development of blockchain technology. If the Bitcoin blockchain were to become unavailable to us in its current form and functionality for any reason, we would need to use a different publicly distributed ledger, which could make it more difficult for members of the public to confirm that the public copies of the Proprietary Ledger have not been altered, which could have a material adverse effect on the Series A Preferred.

Investors may not have the skills necessary to confirm that the public copies of the Proprietary Ledger have not been altered.

In order to confirm that the public copies of the Proprietary Ledger have not been altered, a person must have the technical skills required to do so. If an investor does not have those technical skills, the investor will be unable to personally confirm that the public copies of the Proprietary Ledger have not been altered.

Trading in the Series A Preferred depends on the operation and functionality of the PRO Securities ATS, on tØ.com's proprietary tØ Platform and on the Proprietary Ledger.

The Series A Preferred trades exclusively on the PRO Securities ATS utilizing the tØ Platform. The ATS is operated and maintained by PRO Securities, and the tØ Platform is maintained by tØ.com. Each of PRO Securities and tØ.com is a direct or indirect majority-owned subsidiary of the Company, and neither of them has substantial resources. If the PRO Securities ATS or the tØ Platform were to fail to operate as intended for any reason, trading in the Series A Preferred could be impossible until the failure were corrected and full functionality of the affected system or systems were restored and tested. Further, if the Proprietary Ledger were to fail to operate as intended, or were to become unavailable to us in its current form and functionality for any reason, the tØ Platform might be unable to publish trade data or to provide trade data to ETC and to the transfer agent. Any of the foregoing could have a material adverse effect on our ability to execute or settle trades of Series A Preferred, to maintain accurate records of the ownership of the Series A Preferred and to comply with our obligations relating to records of the ownership of the Series A Preferred and a material adverse effect on the holders of the Series A Preferred.

The Series A Preferred depends on Computershare as the transfer agent for the Series A Preferred.

Computershare serves as the transfer agent for both the Series A Preferred and the Series B Preferred. If Computershare were unable or unwilling for any reason to serve as the transfer agent for the Series A Preferred, trading in the Series A Preferred would be impossible unless we were able to locate another transfer agent able and willing to serve as a replacement transfer agent for the Series A Preferred. We estimate that a transition from Computershare to a replacement transfer agent would take approximately three months; however, any such transition could take longer, during which time it would be impossible to trade in the Series A Preferred.

The tØ Platform relies on technology and intellectual property rights licensed from tØ.com to PRO Securities.

The ability of PRO Securities to operate the PRO Securities ATS utilizing the tØ Platform depends on technology and intellectual property rights that PRO Securities licenses from our majority-owned subsidiary tØ.com. Keystone, ETC and Computershare, in the performance of their respective obligations, also depend on the technology and intellectual property rights that they license (or have licensed on their behalf) from tØ.com. If for any reason tØ.com were to fail to comply with its obligations under the applicable license agreement, or were unable to provide or were to fail to provide the technology and intellectual property that PRO Securities requires, PRO Securities would be unable to operate the PRO Securities ATS utilizing the tØ Platform, which would have a material adverse effect on the Series A Preferred.



If the rights of tØ.com to the technology or intellectual property it licenses to PRO Securities were invalidated or limited, PRO Securities might not be able to operate the PRO Securities ATS utilizing the tØ Platform.

tØ.com has filed both provisional and non-provisional patent applications covering numerous aspects of the technology relating to the tØ Platform, none of which have been granted. If third parties obtain patents covering any or all of the technology relating to the tØ Platform, or if the rights of tØ.com to the technology or intellectual property necessary for the operation of the tØ Platform were otherwise invalidated or limited, PRO Securities could become unable to operate the PRO Securities ATS utilizing the tØ Platform, which would have a material adverse effect on the Series A Preferred and could have a material adverse effect on the Company.

The tØ Platform may face substantial competition from a number of known and unknown competitors as well as the risk that one or more of them may obtain patents covering technology critical to the operation of the tØ Platform. We believe that a number of organizations are or may be working to develop trading systems utilizing distributed ledger or blockchain technologies that may be competitive with the tØ Platform. Some or all of such organizations and/or their respective investors have substantially greater resources than tØ.com or we have, and many of them appear to be attempting to patent technologies that may be competitive with or similar to the technology tØ.com has developed. We do not have access to detailed information about the technologies these organizations and/or their respective investors may be attempting to patent. If one or more other persons, companies or organizations obtains a valid patent covering technology critical to the tØ Platform, tØ.com and we and the other entities that need the relevant technology in order to enable the tØ Platform to operate as intended might be unable or unwilling to license the technology, and it could become impossible for the tØ Platform to operate, which would have a material adverse effect on the Series A Preferred and could have a material adverse effect on the Company.

Some market participants may oppose the development of distributed ledger or blockchain-based systems like the tØ Platform.

Many participants in the system currently used for trading public securities in the United States may oppose the development of alternative systems such as the tØ Platform. The market participants who may oppose such a system may include market participants with significantly greater resources, including financial resources and political influence, than we have. The ability of PRO Securities to operate the tØ Platform could be adversely affected by any actions of any such market participants that result in additional regulatory requirements or other activities that make it more difficult for PRO Securities to operate the tØ Platform, which could have a material adverse effect on the Series A Preferred.

Current regulations could require the PRO Securities ATS to be registered as an exchange under the Securities Exchange Act of 1934 and may effectively limit trading on the PRO Securities ATS utilizing the tØ Platform. Under current law, an organization, including an alternative trading system, generally is exempt from the definition of an “exchange” under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), if it is in compliance with Regulation ATS. However, an organization, including a registered ATS, can lose the exemption if it fails to maintain compliance with Regulation ATS or if (1) during three of the preceding four calendar quarters such an organization had (A) 50% or more of the average daily dollar trading volume in any security and 5% or more of the average daily dollar trading volume in any class of securities or (B) 40% or more of the average daily dollar trading volume in any class of securities; and (2) the SEC determines, after notice to the organization and an opportunity for the organization to respond, that such an exemption would not be necessary or appropriate in the public interest or consistent with the protection of investors taking into account the requirements for exchange registration under section 6 of the Exchange Act and the objectives of the national market system under the Exchange Act. Consequently, even if PRO Securities and the PRO Securities ATS are in compliance with Regulation ATS, the SEC could determine that the PRO Securities ATS should not be exempt from the requirements to register as an exchange. Any such determination, and the process leading up to any such determination, would result in substantial costs and would have an adverse effect on PRO Securities, the PRO Securities ATS and the Company. PRO Securities may not have the resources, ability or willingness to register the PRO Securities ATS as an exchange. This potential limitation may effectively limit trading on the PRO Securities ATS and the tØ Platform, which could have a material adverse effect on the Series A Preferred.

The potential application of U.S. laws regarding investment securities to the Series A Preferred is unclear.



The commercial law regarding investment securities in the United States is well-developed. Article 8 of the Uniform Commercial Code as adopted in most states, including Delaware, provides a set of rules that governs common aspects of securities transfers and related matters. Because of the differences between the Series A Preferred and traditional investment securities, there is a risk that issues that might easily be resolved by existing law if traditional securities were involved may not

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be easily resolved for the Series A Preferred. The occurrence of any such issue or dispute could have a material adverse effect on the holders of Series A Preferred.

The potential application of U.S. laws regarding virtual currencies and money transmission to PRO Securities' use of the Bitcoin blockchain is unclear.

Existing state and federal laws applicable to various activities of persons exchanging or otherwise using virtual currencies, in some cases expressly including Bitcoin, impose prohibitions and require licensing or registration requirements and impose substantive regulations on such persons. Many more states impose licensing and substantive regulation on persons engaging in various activities relating to money transmission, some of which do or may apply to the transmission of virtual currencies such as Bitcoin. The failure to be properly licensed and registered if required under any of these state or federal laws can be a criminal offense. The tØ Platform will use the Bitcoin blockchain for the purpose of enabling members of the public to confirm that the public copies of the Proprietary Ledger have not been altered. The tØ Platform will not use the Bitcoin blockchain for any purpose of transmitting value; the tØ Platform will simply transmit nominal amounts of Bitcoin to itself in order to embed data relating to Series A Preferred transactions into the Bitcoin blockchain. We estimate that the value of the Bitcoin to be transmitted will total approximately \$5.00 or less per trading day. The tØ Platform is not licensed under the virtual currency or money transmission regulations of any state in the United States, and is not registered with the Financial Crimes Enforcement Network ("FinCEN") of the U.S. Department of the Treasury. Although we do not believe that the tØ Platform's proposed use of the Bitcoin blockchain requires licensing or registration by any state or registration with FinCEN, if any regulatory authority were to assert otherwise, it could have a material adverse effect on the ability of the tØ Platform to publish Series A Preferred trade data to the Bitcoin blockchain.

The potential application of foreign laws to the tØ Platform is unclear.

Any person opening an account with Keystone will be required to represent that doing so and acquiring shares of Series A Preferred will not cause a violation of any law, rule or regulation of any jurisdiction outside of the United States and will not subject us or PRO Securities or the tØ Platform to regulation by any authority in any jurisdiction outside of the United States. We are also limiting purchasers of Series A Preferred to certain U.S. residents, entities and trusts. If we became subject to any law, rule or regulation of any jurisdiction outside of the United States, it could have a material adverse effect on the ability of PRO Securities to operate the tØ Platform and on the Series A Preferred.

Regulatory or factual developments may adversely affect the tØ Platform, its future development, or both.

Neither PRO Securities nor tØ.com is registered as a transfer agent under the Exchange Act. If PRO Securities or tØ.com were required to register as a transfer agent, the process would be expensive and one or both entities might be unable to do so. Further, future regulatory developments could otherwise affect the tØ Platform or the ability of PRO Securities to operate the tØ Platform. To the extent that any current or future regulatory requirements adversely affect the ability of PRO Securities to operate the tØ Platform or its ability to utilize the Bitcoin blockchain, such regulatory requirements would have a material adverse effect on the Series A Preferred.

PRO Securities and SpeedRoute are registered broker-dealers and are subject to extensive regulation.

Broker-dealers are subject to extensive regulatory requirements under federal and state laws and regulations and self-regulatory organization ("SRO") rules. PRO Securities and SpeedRoute are registered with the SEC as broker-dealers under the Exchange Act and in the states in which they conduct securities business and are members of the Financial Industry Regulatory Authority ("FINRA") and other SROs. PRO Securities and SpeedRoute are 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. Any failure of PRO Securities or SpeedRoute to comply with all applicable rules and regulations could have a material adverse effect on the Series A Preferred.

PRO Securities is involved in an ongoing dialog with regulatory authorities.

PRO Securities has been and remains involved in ongoing discussions with regulatory authorities about the operation of the PRO Securities ATS utilizing the tØ Platform and various matters relating to the regulated entities involved.

While many of the discussions have been relatively informal, PRO Securities has also received and responded to written inquiries, and most recently received and responded to additional written inquiries from FINRA. While we consider these continuing inquiries to be ordinary course in light of the non-traditional nature of the registered

alternative trading system operated by PRO Securities utilizing the tØ Platform, any failure of PRO Securities to satisfy FINRA or any other regulatory authority that PRO Securities is in compliance with all applicable rules and regulations could have a material adverse effect on the Series A Preferred.

PRO Securities and Computershare may experience operational or other difficulties with the role Computershare is expected to perform, and our strategic interests and objectives and those of Computershare may not be completely aligned and may diverge over time.

The Company has engaged Computershare to serve as transfer agent for the Series A Preferred. Computershare uses the tØ software to receive new and updated shareholder personal identifying information from Keystone and transaction information recorded on the Proprietary Ledger in order to update and maintain the share register. To our knowledge, our relationship with Computershare is the first of its kind, and there are risks of difficulties with both the operational aspects of the relationship and the strategic aspects of the relationship. Even if the operational aspects of the relationship work as anticipated, our strategic interests and objectives and those of Computershare are different, and they may diverge further over time. Any difficulties we encounter with either the operational aspects of our relationship with Computershare or with the alignment of our respective strategic interests and objectives, or any other difficulties we may encounter in our business relationship with Computershare, could have a material adverse effect on the ability of PRO Securities to operate the PRO Securities ATS utilizing the tØ Platform and have a material adverse effect on holders' ability to trade the Series A Preferred.

The requirement that each prospective purchaser of our Series A Preferred open and maintain an online brokerage account with Keystone may subject customers to the risk of fee and commission increases by Keystone.

At present the tØ Platform does not allow more than a single broker-dealer to provide access to the system. The lack of an alternative broker-dealer to provide access to the tØ Platform may subject customers to the risk of fee and commission increases by Keystone. Keystone has agreed to limits on the fees and commissions it will charge to customers who trade shares of the Series A Preferred; however, if PRO Securities and tØ.com agree to amend the relevant agreements to permit increases to those limits, or if such agreements or the provisions regarding such matters were ineffective for any reason, it could have a material adverse effect on holders of the Series A Preferred.

Due to the unavailability of Rule 144 for resales of Series A Preferred and anticipated low volume restrictions for sales by affiliates of the Company of Series B Preferred under Rule 144, Company affiliates may elect not to acquire Series A Preferred or Series B Preferred.

Rule 144 is not available for resales of Series A Preferred. In addition, because the number of shares of Series B Preferred outstanding may be very small, Rule 144 may permit public resales of Series B Preferred by our affiliates only in very small amounts. As a result, affiliates of the Company may have difficulty reselling Series A Preferred and Series B Preferred unless we register their sales. To make it easier for affiliates of the Company to publicly resell Series A Preferred and Series B Preferred, we intend to register their resales. We have entered into a registration rights agreement pursuant to which we have agreed to file a registration statement for resales of Series A Preferred and Series B Preferred by our affiliates; however, such registration statement may not become or remain effective. Further, a seller under a registration statement may have liabilities that a seller under Rule 144 does not have. Very few of our affiliates subscribed for shares of Preferred Stock in the rights offering, and any or all of these matters may cause affiliates of the Company to elect not to acquire shares of Series A Preferred or Series B Preferred after the rights offering, which could limit liquidity in the Series A Preferred or Series B Preferred or depress the trading prices of the Series A Preferred or Series B Preferred.

Affiliates of the Company may incur substantially greater risks in selling shares of Series A Preferred or Series B Preferred under a registration statement than they would if they were able to sell under Rule 144.

Because Rule 144 is not available for public resales of Series A Preferred, and because Rule 144 likely will permit resales of Series B Preferred by affiliates only in very small amounts, affiliates may be unable to sell Series A Preferred or Series B Preferred except pursuant to a registration statement that we expect to file for their resales.

However, a seller under a registration statement may have liabilities that a seller under Rule 144 does not have. Consequently, affiliates of the Company who acquire shares of Series A Preferred or Series B Preferred and subsequently sell them under any such registration statement could incur material liabilities that they would not have risked incurring in sales under Rule 144.

Rule 144 also will not be available for resales of "restricted shares" of Series A Preferred.

Persons, including non-affiliates of a public company such as the Company, who acquire shares directly or indirectly from the public company, or from an affiliate of the public company, in a transaction or chain of transactions not involving any public offering, acquire "restricted shares" for purposes of Rule 144. Although Rule 144 permits public

sales of “restricted shares” subject to certain conditions, we do not expect Rule 144 ever to be available for any sales of Series A Preferred. Because all of the shares of Series A Preferred and Series B Preferred were issued in a registered public offering, and because we expect to register the resale of shares of Series A Preferred and Series B Preferred by our affiliates, we do not anticipate that

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any outstanding shares of Series A Preferred or Series B Preferred will be “restricted” for purposes of Rule 144. However, any person who acquires any shares of Series A Preferred or Series B Preferred directly or indirectly from us, or directly or indirectly from any person who is then an affiliate of ours, in either case in a transaction or chain of transactions not involving any public offering (which term generally means registered offerings and sales under Rule 144), or who acquires shares of Series A Preferred or Series B Preferred in any other manner described in the definition of “restricted securities” in Rule 144, will acquire “restricted” shares. We do not expect Rule 144 ever to be available for public resales of any such shares of Series A Preferred, and the sale of any such shares may be difficult or impossible.

We will have an economic incentive to repurchase Series A Preferred and Series B Preferred at prices below the redemption price, and our doing so could cause the trading prices of Series A Preferred and Series B Preferred, as applicable, to decrease further.

We do not currently intend to repurchase any of the Series A Preferred or Series B Preferred. However, we could do so, subject to applicable laws and regulations regarding issuer repurchases of their capital stock. If we repurchase any shares, we would do so only at prices lower than the prices at which we might be entitled to redeem the shares.

Because our right to redeem the Series A Preferred and the Series B Preferred will be at prices that will vary with the price of our common stock as well as the prices of the Series A Preferred and the Series B Preferred, respectively, and in any case would be no less than the Subscription Price, we will have an economic incentive to repurchase the shares at their trading prices from time to time if those prices are lower than the prices at which we would be entitled to redeem the shares. If we repurchase (or redeem) shares of either Series A Preferred or Series B Preferred, the trading market for the shares would become less liquid, which could cause the trading prices to decrease further, giving us an economic incentive to repurchase additional shares. The occurrence of the foregoing could have a material adverse effect on holders of Series A Preferred, the holders of Series B Preferred, or holders of both series, and on the liquidity in and trading prices of the Series A Preferred, the Series B Preferred or both.

We do not expect to register either the Series A Preferred or the Series B Preferred as a class of securities under the Exchange Act. Consequently investors may be unaware of holders of significant percentages of the Series A Preferred, the Series B Preferred, or both.

We do not expect to register either the Series A Preferred or the Series B Preferred under the Exchange Act.

Consequently, the provisions of the Exchange Act requiring beneficial holders of more than 5% of a registered class of securities to report such beneficial holdings are unlikely to apply, and investors may be unaware of holders who may hold significant percentages of either the Series A Preferred or the Series B Preferred or both. Although the tØ Platform makes the holdings and trading histories of all digital wallets public, the information so provided is not a substitute for the types of information required by these securities laws.

In certain circumstances, we may be required to register the Series A Preferred or the Series B Preferred under Section 12(g) of the Exchange Act, which would subject significant stockholders to the reporting requirements of Regulation 13D-G.

Although we do not expect to register either the Series A Preferred or the Series B Preferred under the Exchange Act, we could be required to register one or both series in the future, including as a result of factors outside of our control, such as the number of record holders of the Series A Preferred or the Series B Preferred. Registration would mean, among other things, that a holder of shares of the applicable series could be required to file beneficial ownership reports with the SEC, generally to the extent such holder beneficially owns more than 5% of the shares of such series. Such holders therefore would become subject to additional obligations and liabilities under the Exchange Act, which could include monetary penalties for failure to file the required reports.

Decreases in the trading prices of our common stock could adversely affect the Series A Preferred, the Series B Preferred or both.

Decreases in the trading price of our common stock, which could occur as the result of developments in our business or from future sales of common stock by us or by holders of the common stock or for other reasons, may cause decreases in the trading prices of the Series A Preferred, the Series B Preferred, or both. For example, in the future, we may sell shares of our common stock to raise capital or to acquire interests in other companies. Any of these events may dilute an investor’s ownership interest in the Company and adversely affect the trading price of our common stock and, in turn, the trading prices of the Series A Preferred, the Series B Preferred, or both.

In addition, we have reserved shares of our common stock for issuance upon the exercise of stock options and upon vesting of restricted stock units granted under our equity incentive plan. We also intend to grant additional restricted stock units, and may grant other types of equity awards, under our equity incentive plans in the future. Any of these events, and any other

event that results in sales of a substantial amount of our common stock in the public market, or the perception that any such sales may occur, could reduce the trading price of our common stock and, in turn, the trading prices of the Series A Preferred, the Series B Preferred, or both. This could also impair our ability to raise additional capital through the sale of our securities. Decreases in the trading price of the Series A Preferred or Series B Preferred could also adversely affect the price of the other series. Any of the foregoing events could have a material adverse effect on holders of the Series A Preferred and holders of the Series B Preferred and on the trading prices of the Series A Preferred, the Series B Preferred, or both.

Although the Series A Preferred and the Series B Preferred have characteristics similar to those of our common stock, the differences may adversely affect the trading prices of the Series A Preferred and of the Series B Preferred.

Each share of Series A Preferred and each share of Series B Preferred is intended to have voting and dividend rights and rights upon liquidation substantially similar to those of one share of our common stock, except that the Series A Preferred and the Series B Preferred will have a dividend preference over the common stock, the ownership of the Series A Preferred will be tracked on a publicly distributed ledger and we will have the right to redeem shares of Series A Preferred and/or Series B Preferred and to convert the Series A Preferred into Series B Preferred. The Series A Preferred will also be subject to other restrictions, particularly restrictions on ownership. These provisions may have a material adverse effect on the trading price of the Series A Preferred.

We will have the right to convert the outstanding shares of Series A Preferred into shares of Series B Preferred at any time, and the Series B Preferred might be trading for substantially less than the Series A Preferred at the time.

We will have the right to cause the conversion of all outstanding shares of Series A Preferred into shares of Series B Preferred at any time. If we were to do so at a time when the Series B Preferred were trading at a price lower than the trading price of the Series A Preferred, holders of Series A Preferred would likely experience an immediate and potentially material decrease in the market value of the Series A Preferred they hold and of the Series B Preferred they would receive upon the conversion. Investors should not purchase shares of Series A Preferred unless they are willing to hold shares of Series B Preferred in lieu of shares of Series A Preferred.

The terms of the Series B Preferred could be amended after the issuance of the Series B Preferred without the consent of the holders of the Series A Preferred.

The terms of the Series B Preferred may be amended without the consent of the holders of the Series A Preferred.

Nevertheless, we will have the right to cause the conversion of all outstanding shares of Series A Preferred into shares of Series B Preferred at any time. Consequently, holders of Series A Preferred will be subject to the risk that their shares could be converted into shares of Series B Preferred having terms different from those of the Series B Preferred at the date of issuance or at the date of a holder's acquisition. Investors should not purchase shares of Series A Preferred unless they are willing to hold shares of the Series B Preferred in lieu of the Series A Preferred and are willing to accept the risk that the terms of the Series B Preferred could be amended prior to conversion without the consent of the holders of the Series A Preferred.

Even if the Series A Preferred and the Series B Preferred were to have characteristics identical to those of our common stock, a share of Series A Preferred and/or Series B Preferred might nevertheless have a substantially lower market value than a share of our common stock.

The trading prices of the Series A Preferred and the Series B Preferred may be substantially lower than the trading price of our common stock at any time. The market for the Series B Preferred is expected to have substantially less liquidity than the market for our common stock, which is traded on the Nasdaq Global Market, and the market for the Series A Preferred may be even more limited. The Series B Preferred trades in the over-the-counter market rather than on any securities exchange, and the Series A Preferred trades exclusively on the PRO Securities ATS utilizing the tØ Platform, which is a closed trading platform that had not experienced public trading in any security prior to the issuance of the Series A Preferred. Consequently, the trading prices of the Series A Preferred and the Series B Preferred may both be substantially lower than the trading price of our common stock, which could have a material adverse effect on holders of Series A Preferred and holders of Series B Preferred.

Holders of Preferred Stock have no rights with respect to our common stock, but they may be adversely affected by certain events or changes made with respect to our common stock.

Holders of Preferred Stock have no rights with respect to our common stock, and no right to convert their Series A Preferred or Series B Preferred into shares of common stock or to exchange their Series A Preferred or Series B



Preferred for shares of common stock, except that such holders have the right to vote with the common stock (together with the holders of the

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other series of Preferred Stock) on any matter submitted to a vote of the holders of the common stock, the right to receive payments upon liquidation *pari passu* with the holders of the common stock (together with the holders of the other series of Preferred Stock) and the right to receive dividends (together with the holders of the other series of Preferred Stock) in preference to the holders of the common stock and to participate in cash dividends, if any, paid on the common stock. Holders of Preferred Stock do not have other rights of the holders of the common stock, including the right to respond to common stock tender offers, if any, and their investment in the Series A Preferred and/or the Series B Preferred may be materially negatively affected by any such event. Holders' lack of any such rights, or the occurrence of any such event, could have a material adverse effect on holders of Series A Preferred and holders of Series B Preferred and on the trading prices of the Series A Preferred and the Series B Preferred.

Voting rights of holders of Preferred Stock generally will be limited to voting together with the holders of the common stock as a single class, and the holders of the Series A Preferred and the holders of the Series B Preferred collectively will have only a small percentage of the voting power on any matter submitted to the holders of the common stock and the Series A Preferred and Series B Preferred, voting together as a single class.

Voting rights of holders of Preferred Stock generally will be limited to voting together with the holders of the common stock as a single class. As of February 2, 2017, the 695,898 shares of Preferred Stock outstanding represented approximately 2.7% of the combined voting power of the Series A Preferred, the Series B Preferred and the common stock, voting together as a single class. If an amendment requiring stockholder approval is proposed to our Amended and Restated Certificate of Incorporation or our Amended and Restated Bylaws, the holders of the Series A Preferred and the holders of the Series B Preferred will vote together with the holders of the common stock as a single class, but neither the holders of the Series A Preferred nor the holders of the Series B Preferred will be entitled to a class vote on the amendment, unless the proposed amendment would adversely affect the special rights, preferences, privileges and voting powers of the Series A Preferred or Series B Preferred, respectively. Holders' limited voting rights and any of the foregoing events could have a material adverse effect on holders of Series A Preferred and holders of Series B Preferred and on the trading prices of the Series A Preferred and the Series B Preferred.

Neither the holders of the Series A Preferred nor the holders of the Series B Preferred have any right, either together or as separate classes, to elect any members of our board of directors.

Neither the holders of the Series A Preferred nor the holders of the Series B Preferred have any right by themselves, either together or as separate classes, to elect any members of our board of directors. The holders of the Series A Preferred and the holders of the Series B Preferred are entitled only to vote with the holders of the common stock (and with the holders of the other class of preferred stock) as a single class in the election of directors and on any other matter coming before a vote of the holders of the common stock. Holders' lack of such rights could have a material adverse effect on holders of the Series A Preferred and the holders of the Series B Preferred and the trading prices of the Series A Preferred and the Series B Preferred.

The Series A Preferred and the Series B Preferred rank junior to all of our and our subsidiaries' liabilities, as well as the capital stock of our subsidiaries held by third parties, in the event of a bankruptcy, liquidation or winding up of our or our subsidiaries' business.

In the event of our bankruptcy, liquidation or winding up, our assets will be available to make payments to holders of Series A Preferred and to holders of Series B Preferred only after all of our liabilities have been paid, and neither the Series A Preferred nor the Series B Preferred will have any preference over the common stock in the event of our bankruptcy, liquidation or winding up. In addition, the Series A Preferred and Series B Preferred will rank structurally junior to all existing and future liabilities of our subsidiaries, as well as the capital stock of our subsidiaries held by third parties, including employees holding shares of our majority-owned subsidiary tØ.com and employees holding shares of any other direct or indirect subsidiary of ours, whether now existing or created in the future, which issues shares or other equity interests to employees. We intend to adopt an employee equity incentive plan pursuant to which tØ.com or a subsidiary of tØ.com would issue shares or other equity interests or awards having the economic effects of equity interests to employees. The rights of holders of Preferred Stock to participate in the assets of our subsidiaries upon any liquidation or reorganization of any subsidiary will rank junior to the claims of creditors and third party equity holders of tØ.com and our other subsidiaries, whether now existing or created in the future, including our

employees holding shares of any of them. In the event of our bankruptcy, liquidation or winding up, there may not be sufficient assets remaining, after paying our and our subsidiaries' liabilities, to pay any amounts to the holders of Series A Preferred or Series B Preferred then outstanding. As of December 31, 2016, we had liabilities of approximately \$312.1 million. We may incur significant additional debt or other liabilities in the future. Any bankruptcy, liquidation or winding up of the Company or any of its wholly or partially owned subsidiaries would have a material adverse effect on holders of Series A Preferred and holders of Series B Preferred and the trading prices of the Series A Preferred and the Series B Preferred.

Our obligation to pay dividends on the Series A Preferred or on the Series B Preferred is limited, and our ability to pay dividends on the Series A Preferred and on the Series B Preferred may be limited.

Our obligation to pay preferential dividends on the Series A Preferred and the Series B Preferred is subject to our board of directors declaring such dividend payments. Further, although we will be contractually restricted from paying a dividend on the common stock unless we have paid preferential cumulative 1.0% annual dividends on the Series A Preferred and the Series B Preferred, we have never paid a dividend on the common stock and we have no intention of doing so. Consequently, our failure to pay preferential dividends on the Series A Preferred and on the Series B Preferred might have no legal effect on us at all, although it could adversely affect the trading prices of the Series A Preferred and of the Series B Preferred. Further, our payment of any dividends will be subject to contractual and legal restrictions and other factors the board deems relevant. Our current credit agreement contains financial covenants that could limit our ability to pay dividends. The calculations that go into the financial covenants cannot necessarily be estimated in advance, and we are unable to give any assurance that we would be able to pay dividends on the Series A Preferred, the Series B Preferred or both without violating our current credit agreement. Further, we may elect not to pay dividends on the Series A Preferred, the Series B Preferred or both rather than limiting other proposed expenditures, including expenditures that may not be contractually required, to avoid violating, or avoid the risk of violating, our current credit agreement. Moreover, agreements governing any future indebtedness of ours may further limit our ability to pay dividends on our capital stock, including the Series A Preferred and the Series B Preferred. In addition, our ability to pay dividends is limited by applicable law. Any of the foregoing facts or events could have a material adverse effect on the holders of the Series A Preferred and the holders of the Series B Preferred and on the trading prices of the Series A Preferred and the Series B Preferred.

Purchasers of the Series A Preferred and of the Series B Preferred may be adversely affected by our issuance of any subsequent series of preferred stock.

Neither the terms of the Series A Preferred nor the terms of the Series B Preferred restrict our ability to issue one or more additional new series of preferred stock, any or all of which may rank equally with or have preferences over the Series A Preferred and the Series B Preferred as to dividend payments, voting rights, rights upon liquidation or other types of rights. We will have no obligation to consider the specific interests of the holders of Series A Preferred or the specific interests of the holders of Series B Preferred in creating any such new series of preferred stock or engaging in any such offering or transaction. Our creation of any such new series of preferred stock or our engaging in any such offering or transaction could have a material adverse effect on the holders of Series A Preferred and the holders of Series B Preferred and the trading prices of the Series A Preferred and the Series B Preferred.

It is uncertain whether the IRS will treat the Series A Preferred and Series B Preferred as common stock or preferred stock for U.S. federal income tax purposes.

We intend to treat the Series A Preferred and Series B Preferred as common stock for U.S. federal income tax purposes. Nevertheless, it is unclear whether the IRS will treat the Series A Preferred and Series B Preferred as common stock for U.S. federal income tax purposes. If the IRS were not to treat either the Series A Preferred or the Series B Preferred as common stock for U.S. federal income tax purposes, it could have a material adverse effect on the holders of Series A Preferred and the holders of Series B Preferred, respectively, and on the trading prices of the Series A Preferred and the Series B Preferred, respectively.

No guidance has been issued with respect to the effect of the PRO Securities ATS or the tØ Platform on the U.S. federal income tax treatment of the Series A Preferred.

The PRO Securities ATS and the tØ Platform are novel and no guidance has been issued regarding the effect of the tØ Platform (or, to our knowledge, any other similar platform) on the U.S. federal income tax treatment of any shares traded utilizing it. Therefore, the effect of the tØ Platform, if any, on the U.S. federal income tax treatment of the Series A Preferred is still unclear.

The restrictions on the tax reporting of holder's cost basis in shares of Series A Preferred will not allow normal tax planning in the sale of shares of Series A Preferred, and may result in disadvantageous tax consequences to a seller of Series A Preferred.

Taxpayers must report gains and losses on sales of securities, and related cost basis information when they file their income tax returns. Brokers, including Keystone, also have a requirement to report sales information to the IRS on Form 1099-B. Taxpayers typically can elect one of several methods permitted by the IRS for their reporting of their

cost basis in securities. However, only one method of cost basis reporting (the first-in, first-out, or FIFO, method) will be available for the Series A

Preferred. Depending on an investor's circumstances, FIFO may not be the best method for holders of Preferred Stock. In some cases, it might be more beneficial for holders of Series A Preferred to report average cost or use another permitted method of cost basis reporting. However, holders of Series A Preferred will not be able to elect any method other than FIFO to report their sales information to the IRS. As a result, sellers of Series A Preferred may be required to pay more tax on their sales or to pay taxes earlier than might have been required if other methods of cost basis reporting had been available.

#### Additional Specific Risks We Face

We have a history of significant losses. If we do not maintain profitability, our financial condition and our stock price could suffer.

We have a history of losses, and we may incur operating and net losses in the foreseeable future. At December 31, 2016, our accumulated deficit was \$153.9 million. We need to generate significant revenues to maintain profitability, and we may not be able to do so. Although we have generated positive net income in recent years, we incurred a net loss for 2011, and interim net losses during 2015 and 2016. We may be unable to maintain profitability in the future. If our revenues grow more slowly than we anticipate or decline, or if our expenses exceed our expectations, our financial results would be harmed and our business, prospects, financial condition and results of operations could fall below the expectations of public market analysts and investors. The occurrence of any of the foregoing could have a material adverse effect on our business.

If we fail to accurately forecast our expenses and revenues, our business, prospects, financial condition and results of operations may suffer and the price of our securities may decline.

The rapidly evolving nature of our industry and the constantly evolving nature of our business make forecasting operating results difficult. We periodically implement large, complex and expensive infrastructure upgrades in order to increase our ability to handle larger volumes of sales and to develop or increase our ability to perform a variety of analytical procedures relating to our business. We are continuing to upgrade and further expand these and other components of our infrastructure, and are in the process of integrating infrastructure relating to the fintech company and broker-dealers we recently acquired. In the past, we have experienced difficulties with upgrades of our infrastructure, and have incurred increased expenses as a result of these difficulties. As a result of expenditures on our infrastructure and headquarters, our ability to reduce our expenditures is and will be limited. Therefore, any significant shortfall in the revenues for which we have built and are continuing to build our business could have a material adverse effect on our business.

Our insurance coverage and indemnity rights may not adequately protect us against loss.

The types, coverage, or the amounts of any insurance coverage we may carry from time to time may not be adequate to compensate us for any losses we may actually incur in the operation of our business. Further, any insurance we may desire to purchase may not be available to us on terms we find acceptable or at all. We are not indemnified by all of our suppliers, and any indemnification rights we may have may not be enforceable or adequate to cover actual losses we may incur as a result of our sales of their products. Actual losses for which we are not insured or indemnified, or which exceed our insurance coverage or the capacity of our indemnitors or our ability to enforce our indemnity agreements, could have a material adverse effect on our business.

We face risks relating to our inventory.

In our direct business, we sell merchandise that we have purchased and hold in inventory. We assume the risks of inventory damage, theft and obsolescence, as well as risks of price erosion for these products. These risks are especially significant because some of the merchandise we sell is characterized by seasonal trends, fashion trends, rapid technological change, obsolescence and price erosion, and because we sometimes make large purchases of particular types of inventory. Demand for our products is generally highly sensitive to price. If we fail to meet our customers' price expectations, or if we are unable to compete effectively with our competitors when they engage in aggressive pricing strategies or other competitive activities, it could have a material adverse effect on our business. Subject to our returns policies, we accept returns of products sold through our partners as well as products we sell in our direct business, and we have the risk of reselling the returned products. In the past we have recorded charges for obsolete inventory and have had to sell certain merchandise at a discount or loss. To the extent that we rely on purchased inventory, our success will depend on our ability to sell our inventory rapidly, the ability of our buying staff to purchase inventory at attractive prices relative to its resale value and our ability to manage customer returns and

other costs. If we are unsuccessful in any of these areas, we may be forced to sell our inventory at a discount or loss. Further, we purchase some of our inventory from foreign suppliers and pay for inventory with U.S. dollars. If the dollar weakens with respect to foreign currencies, foreign

suppliers may require us to pay higher prices for products, which could negatively affect our profit margins. The occurrence of any of the foregoing could have a material adverse effect on our business.

If we do not successfully optimize and operate our warehouse and customer service operations, our business could be harmed.

We have expanded, contracted and otherwise modified our warehouse and customer service operations from time to time in the past, and expect that we will continue to do so. We also contract with third parties to receive returns and process orders. If we or our third party providers do not successfully optimize and operate our warehouse and customer service operations, it could significantly limit our ability to meet customer demand, customer shipping or return time expectations, or result in excessive costs and expenses for the size of our business. Because it is difficult to predict demand, we may not manage our facilities in an optimal way, which may result in excess or insufficient inventory or warehousing capacity. We may also fail to staff our fulfillment and customer service centers at optimal levels. Our failure to do so could negatively impact our operating results and customer experience, and could have a material adverse effect on our business.

The seasonality of our business places increased strain on our operations.

A disproportionate amount of our sales normally occur during our fourth quarter. If we do not stock or are otherwise unable to source products sufficient to meet customer demand, our business would be adversely affected. We may experience an increase in our net shipping cost due to complimentary upgrades, split-shipments, and additional long-zone shipments necessary to ensure timely delivery for the holiday season. In addition, we may be unable to adequately staff our fulfillment and customer service centers during peak periods, and delivery services and other fulfillment companies and customer service providers may be unable to meet the seasonal demand. The occurrence of any of the foregoing could have a material adverse effect on our business.

Significant merchandise returns could harm our business.

We allow our customers to return products, subject to our returns policies. If merchandise returns are higher than we anticipate, our business, prospects, financial condition and results of operations could be harmed. Further, we modify our policies relating to returns from time to time, and policies intended to reduce the number of product returns may result in customer dissatisfaction and/or fewer repeat customers. The occurrence of any of the foregoing could have a material adverse effect on our business.

Changes in management roles and responsibilities, the loss of key personnel, or any inability to attract and retain additional personnel could affect our ability to successfully grow our business.

Our performance is substantially dependent on the continued services and on the performance of our senior management and other key personnel. Our performance also depends on our ability to retain and motivate our officers and key employees. Changes in the roles and responsibilities of certain members of management or the loss of the services of any of our executive officers or other key employees for any reason could harm our business.

Occasionally, members of senior management or key employees may find it necessary to take a leave of absence due to medical or other causes. In early 2013 our Chief Executive Officer and then Chairman of the Board, Dr. Patrick M. Byrne, took a two-month personal leave of absence for medical reasons, and in April 2016 he took a three-month personal leave of absence for medical reasons. We do not have employment agreements with any of our key personnel and we do not maintain “key person” life insurance policies. Our future success also depends on our ability to identify, attract, hire, train, retain and motivate other highly-skilled technical, managerial, editorial, merchandising, marketing and customer service personnel. Competition for such personnel is intense. Our failure to attract and retain the necessary personnel could have a material adverse effect on our business.

In order to obtain future revenue growth and sustain profitability, we must attract and retain customers on cost-effective terms.

Our success depends on our ability to attract and retain customers on cost-effective terms. We have relationships with online services, search engines, affiliate marketing websites, directories and other website and e-commerce businesses to provide content, advertising and other links that direct customers to our Website. We rely on these relationships as significant sources of traffic to our Website and to generate new customers. In the past we have terminated affiliate marketing websites as a result of efforts by certain states to require us to collect sales taxes based on the presence of those third party Internet advertising affiliates in those states, and we are likely to do so again in the future if necessary. If we are unable to develop or maintain these relationships, or develop and maintain new relationships for



newly developed and necessary marketing services on acceptable terms, our ability to attract new customers and our financial condition would suffer. In addition, certain of our

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online marketing agreements may require us to pay upfront fees and make other payments prior to the realization of the sales, if any, associated with those payments. Current or future relationships or agreements may fail to produce the sales that we anticipate. We periodically conduct television and radio branding and advertising campaigns. Such campaigns are expensive and may not result in the cost-effective acquisition of customers. Other means of utilizing social media campaigns to attract or retain customers are expensive and may not result in cost-effective acquisition or retention of customers. The occurrence of any of the foregoing risks or our inability to attract and retain customers on cost-effective terms could have a material adverse effect on our business.

Mobile commerce and our Club O offerings are becoming increasingly significant to us.

Mobile commerce and our Club O offerings are becoming increasingly significant to us. Customers who use mobile devices and customers who join Club O may behave differently from our other customers. For example, the conversion rate of purchases from mobile devices is lower than from other sources. If our mobile customers or our Club O customers are less profitable to us than our other customers, it could have a material adverse effect on our business.

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

#### ITEM 2. PROPERTIES

As of December 31, 2016, we operated the following facilities:

Corporate office space

• We own approximately 232,000 square feet of office space in Midvale, Utah, which consists of our corporate headquarters.

• We lease approximately 12,000 square feet of additional office space in the United States for our Medici initiatives.

Warehouse, fulfillment and customer service space

• We lease approximately 1.2 million square feet in the United States for warehouse, fulfillment, customer service, and other operations.

Data centers

• We lease approximately 9,700 square feet in the United States for various data centers.

Unless otherwise indicated, we use the above facilities in our direct and partner business segments and we believe that these facilities will be sufficient for our needs for at least the next twelve months.

#### ITEM 3. LEGAL PROCEEDINGS

The information set forth under Item 15 of Part IV, "Financial Statements—Note 12. Commitments and Contingencies, subheading Legal Proceedings," contained in the "Notes to Consolidated Financial Statements" of this Annual Report on Form 10-K is incorporated by reference in answer to this Item.

#### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

## Market information

Our common stock is traded on the Nasdaq Global Market under the symbol "OSTK." The following table sets forth, for the periods indicated, the high and low close prices per share for our common stock as reported by Nasdaq.

	Common Stock Price	
	High	Low
Year Ended December 31, 2015		
First Quarter	24.22	21.33
Second Quarter	25.79	20.68
Third Quarter	23.24	17.16
Fourth Quarter	17.66	12.04
Year Ended December 31, 2016		
First Quarter	15.25	10.36
Second Quarter	17.68	14.30
Third Quarter	17.18	14.48
Fourth Quarter	19.10	13.10

## Stock Performance Graph

The stock performance graph is included in Part III, Item 12.

## Securities Authorized for Issuance under Equity Compensation Plans

Disclosure relating to our equity compensation plans will be incorporated by reference into Part III, Item 12 from our Proxy Statement for the 2017 annual meeting of stockholders.

## Holders

As of February 24, 2017, there were 143 holders of record of our common stock. Many of our shares of common stock are held by brokers and other institutions on behalf of the beneficial owners.

## Dividends

We have never declared or paid any cash dividends on our common stock. We currently intend to retain any earnings for future growth and do not anticipate paying any cash dividends on our common stock in the foreseeable future. Any future determination to pay dividends on our common stock will be at the discretion of our board of directors and will depend on our results of operations, financial conditions, contractual and legal restrictions and other factors the board of directors deems relevant. Our loan agreement with U.S. Bank and other banks contains financial covenants that may restrict our ability to pay dividends.

## Recent sales of unregistered securities

During 2016, we maintained a Non-Qualified Deferred Compensation plan for senior management. The plan allows eligible members of senior management to defer their receipt of compensation, subject to the restrictions contained in the plan. To the extent that interests in the plan constitute securities, we believe that any issuance of interests was

exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(a)(2) thereof and/or Rule 506 of Regulation D thereunder as a transaction not involving a public offering. Any interests issued were not sold for cash or other consideration, and there were no proceeds to us.

Issuer purchases of equity securities

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We had no purchases made by us or on our behalf or any "affiliated purchaser" as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934, as amended, of shares of our common stock during the fourth quarter of 2016.

On January 27, 2017 we entered into and consummated an agreement to purchase 604,229 shares of our common stock from Fairfax Financial Holdings Limited ("Fairfax") at \$16.55 per share, for an aggregate purchase price of \$10 million. Prior to the sale of the shares, Fairfax was the beneficial owner of approximately 12.5% of the Company's common stock. After the sale Fairfax was the beneficial owner of approximately 10.4% of our common stock.

#### Preferred Stock

In December 2016, we issued 695,898 shares of our preferred stock, consisting of 126,565 shares of our Blockchain Voting Series A Preferred Stock (the "Series A Preferred") and 569,333 shares of our Voting Series B Preferred Stock (the "Series B Preferred" and together with the Series A Preferred, the "Preferred Stock"). Neither the Series A Preferred Stock nor the Series B Preferred Stock is registered under the Securities Exchange Act of 1934, as amended. The Series A Preferred are digital securities that trade exclusively on a registered alternative trading system ("ATS") operated by our majority-owned subsidiary, PRO Securities, LLC (the "PRO Securities ATS"), utilizing software technology known as the tØ® Issuance and Trading Platform (the "tØ Platform"). Keystone Capital Corporation ("Keystone") is the sole broker-dealer authorized to provide investors with access to the Series A Preferred through the PRO Securities ATS utilizing the tØ Platform. The Series B Preferred are non-digital securities that trade in the over-the-counter market and we expect the securities to be quoted on the OTCQB market operated by OTC Markets Group. We have encountered an unexpected delay in the quotation of the Series B Preferred on the OTCQB. OTC Markets is unable to publicly provide quotation or trade data until FINRA clears a Form 211 filed by a broker dealer. We understand that one or more broker dealers have made Form 211 filings with FINRA, but to date FINRA has not cleared any of them.

Except as required by law, the Preferred Stock vote with the common stock on all matters. Holders of the Preferred Stock have one vote for each share held. As of February 2, 2017, the 695,898 shares of Preferred Stock constituted approximately 2.7% of the total number of shares of the Preferred Stock and the common stock, taken together. The Preferred Stock ranks senior to the common stock with respect to dividends. Holders of the Preferred Stock will be entitled to an annual cash dividend equal to 1.0% of the subscription price for the Preferred Stock, rounded to the nearest \$0.01, in preference to any dividend payment to the holders of the common stock, out of funds legally available for payment of dividends and subject to declaration by our board of directors. Holders of the Preferred Stock are also entitled to participate in any cash dividends we pay to the holders of the common stock and are also entitled to participate in non-cash dividends we pay to holders of the common stock, subject to different treatment if we effect a stock dividend, stock split or combination of the common stock. The Preferred Stock ranks on a parity with the common stock with respect to rights upon the liquidation, winding up or dissolution of the Company. If we are party to any merger or consolidation in which our common stock is changed into or exchanged for stock or other securities of any other person (or the Company) or cash or any other property (or a right to receive the foregoing), we will use all commercially reasonable efforts to cause each outstanding share of the Preferred Stock to be treated as if such share were an additional outstanding share of common stock in connection with any such transaction.

#### Stock based compensation

##### Stock options

Our board of directors adopted the 2005 Equity Incentive Plan and it was most recently amended and restated and re-approved by the stockholders on May 3, 2012 (as so amended and restated, the "Plan"). Under the Plan, the board of directors may issue incentive stock options to our employees and directors and non-qualified stock options to consultants, as well as restricted stock units and other types of equity awards of the Company. Options granted under

the Plan generally expire at the end of ten years and vest in accordance with a vesting schedule determined by our board of directors, usually over four years from the grant date. We did not grant any options during the years ended December 31, 2016, 2015 and 2014. At December 31, 2016, 2.1 million shares of stock remained available for future grants under the Plan.

The following is a summary of stock option activity (amounts in thousands, except per share data):

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	2016	2015	2014
	Shares	Shares	Shares
	Weighted Average Exercise Price	Weighted Average Exercise Price	Weighted Average Exercise Price
Outstanding—beginning of year	204 \$ 17.27	224 \$ 17.27	273 \$ 17.30
Exercised	(42 ) 17.08	(16 ) 16.94	(30 ) 17.08
Expired/Forfeited	(6 ) 17.08	(4 ) 18.26	(19 ) 18.00
Outstanding—end of year	156 \$ 17.33	204 \$ 17.27	224 \$ 17.27
Options exercisable at year-end	156 \$ 17.33	204 \$ 17.27	224 \$ 17.27

Stock options vest over four years at 28% at the end of the first year and 2% each month thereafter. The most recent stock options were granted in May 2008 and have fully vested. There was no stock based compensation related to stock options recorded during the years ended December 31, 2016, 2015 and 2014.

#### Restricted stock units activity

During the years ended December 31, 2016, 2015 and 2014, we granted 541,000, 239,000 and 242,000 restricted stock units, respectively, under the Plan. The cost of restricted stock units 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 vesting schedule or on an accelerated schedule when vesting of restricted stock awards exceeds a straight line basis. The weighted average grant date fair value of restricted stock units granted during the years ended December 31, 2016, 2015 and 2014 was \$14.52, \$24.60 and \$28.24, respectively.

The following is a summary of restricted stock unit activity (amounts in thousands, except per share data):

	2016	2015	2014
	Units	Units	Units
	Weighted Average Grant Date Fair Value	Weighted Average Grant Date Fair Value	Weighted Average Grant Date Fair Value
Outstanding—beginning of year	349 \$ 24.80	578 \$ 16.70	704 \$ 10.79
Granted at fair value	541 14.52	239 24.60	242 28.24
Vested	(219) 22.57	(377) 12.34	(302) 11.87
Forfeited	(111) 16.52	(91 ) 24.35	(66 ) 17.70
Outstanding—end of year	560 \$ 17.46	349 \$ 24.80	578 \$ 16.70

Restricted stock units granted in 2016, 2015 and 2014 vest over three years at 33.3% at the end of each of the first, second and third year. Each restricted stock unit represents the right to one share of common stock upon vesting. During the years ended December 31, 2016, 2015 and 2014, we recorded stock based compensation expense related to restricted stock units of \$4.9 million, \$3.5 million and \$4.0 million, respectively.

## ITEM 6. SELECTED FINANCIAL DATA

The selected consolidated financial data presented below should be read in conjunction with the consolidated financial statements of Overstock.com, Inc. and related footnotes included elsewhere in this Annual Report on Form 10-K and the discussion under Item 7—"Management's Discussion and Analysis of Financial Condition and Results of Operations." The selected consolidated financial data has been derived from our audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K. The historical financial and operating information may not be indicative of our future performance.

	Year ended December 31,				
	2016	2015	2014	2013 (1)	2012
	(in thousands, except per share data)				
Consolidated Statement of Income Data:					
Revenue, net					
Direct	\$ 101,578	\$ 137,783	\$ 147,460	\$ 156,032	\$ 155,516
Partner and other	1,698,385	1,520,055	1,349,643	1,148,185	943,773
Total net revenue	1,799,963	1,657,838	1,497,103	1,304,217	1,099,289
Cost of goods sold					
Direct	96,271	128,077	129,253	136,282	140,536
Partner and other	1,372,343	1,225,107	1,088,791	920,275	760,323
Total cost of goods sold	1,468,614	1,353,184	1,218,044	1,056,557	900,859
Gross profit	331,349	304,654	279,059	247,660	198,430
Operating expenses:					
Sales and marketing	147,896	124,468	109,461	91,609	63,467
Technology	106,760	98,533	86,258	71,788	65,467
General and administrative	89,298	82,187	71,777	68,169	57,259
Litigation settlement	(19,520)	—	—	—	—
Restructuring (2)	—	—	(360)	(471)	76
Total operating expenses	324,434	305,188	267,136	231,095	186,269
Operating income (loss)	6,915	(534)	11,923	16,565	12,161
Interest income	326	155	152	127	116
Interest expense	(877)	(140)	(39)	(113)	(809)
Other income (expense), net	14,181	3,634	1,169	(235)	3,686
Income before income taxes	20,545	3,115	13,205	16,344	15,154
Provision (benefit) for income taxes	9,297	1,895	4,404	(68,034)	485
Consolidated net income	\$ 11,248	\$ 1,220	\$ 8,801	\$ 84,378	\$ 14,669
Less: Net loss attributable to noncontrolling interests	(1,274)	(1,226)	(53)	—	—
Net income attributable to stockholders of Overstock.com, Inc.	\$ 12,522	\$ 2,446	\$ 8,854	\$ 84,378	\$ 14,669
Net income per common share—basic:					
Net income attributable to common shares—basic	\$ 0.49	\$ 0.10	\$ 0.37	\$ 3.56	\$ 0.63
Weighted average common shares outstanding—basic	25,342	24,612	23,999	23,714	23,387
Net income per common share—diluted:					
Net income attributable to common shares—diluted	\$ 0.49	\$ 0.10	\$ 0.36	\$ 3.47	\$ 0.62
Weighted average common shares outstanding—diluted	25,426	24,703	24,317	24,294	23,672

See the footnotes beneath the balance sheet data on the following page.



As of December 31,  
 2016 2015 2014 2013 (1) 2012  
 (in thousands)

## Balance Sheet Data:

Cash and cash equivalents	\$ 183,098	\$ 170,262	\$ 181,641	\$ 148,665	\$ 93,547
Restricted cash	430	430	580	1,580	1,905
Working capital	11,425	(10,308 )	15,260	25,425	7,497
Total assets	485,076	428,389	376,865	315,636	181,985
Total liabilities	312,116	279,028	247,645	196,876	151,023
Stockholders' equity	172,960	149,361	129,220	118,760	30,962

(1) Our consolidated financial statements for the year ended December 31, 2013 include an immaterial revision to current and long-term deferred tax assets and our provision (benefit) for income taxes in the fourth quarter of 2013. The effect of the revision was to reduce current and long-term deferred tax assets by \$284,000 and \$3.8 million, respectively, with an offsetting increase of \$4.1 million to our provision (benefit) for income taxes in 2013. We evaluated these changes in accordance with Staff Accounting Bulletin No. 99, Materiality ("SAB 99"), and Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements ("SAB 108"), and determined that the revisions are not material to the prior period.

(2) During the fourth quarter of 2006, we commenced implementation of a facilities consolidation and restructuring program designed to reduce the overall expense structure in an effort to improve future operating performance.

## Redeemable preferred stock

In December 2016, we issued 695,898 shares of our preferred stock, consisting of 126,565 shares of our Blockchain Voting Series A Preferred Stock (the "Series A Preferred") and 569,333 shares of our Voting Series B Preferred Stock (the "Series B Preferred" and together with the Series A Preferred, the "Preferred Stock").

Neither the Series A Preferred or Series B Preferred is convertible into or exchangeable for shares of our common stock or any other entity, however, at our sole discretion, we may convert the Series A Preferred shares into Series B Preferred shares at any time on a one-to-one basis. Until the third anniversary of the Original Issuance Date, we may redeem, at our discretion, both the Series A and Series B Preferred shares for an amount equal to the highest of the following: (1) the subscription price plus any accrued but unpaid dividends, (2) 105% of the average trading price of our common stock during a five-trading-day period and (3) 105% of the average trading price of the series of preferred shares during the same five-day-trading period. In the event of any liquidation, any amount available for distribution to stockholders after payment of all liabilities will be distributed proportionately, with each share of Series A Preferred and each share of Series B Preferred being treated as though it were a share of our common stock.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis contains forward-looking statement relating to future events or our future financial or operating performance that involve risks and uncertainties, as set forth above under "Special Cautionary Note Regarding Forward-Looking Statements." Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors described in this Annual Report on Form 10-K, including those set forth above under "Special Cautionary Note Regarding Forward-Looking Statements" or in Item 1A under the heading "Risk Factors" or elsewhere in this Annual Report on Form 10-K.

### Introduction

We are an online retailer and incubator of blockchain technology. Through our online retail business we offer a broad range of price-competitive brand name, non-brand name and closeout products, including furniture, home decor, bedding and bath, housewares, jewelry and watches, apparel and designer accessories, health and beauty products, electronics and computers, and sporting goods, among other products. We also sell hundreds of thousands of best seller and current run books, magazines, CDs, DVDs and video games ("BMMG"). We sell these products and services through our Internet websites located at [www.overstock.com](http://www.overstock.com), [www.o.co](http://www.o.co) and [www.o.biz](http://www.o.biz) (referred to collectively as the "Website"). Although our three websites are located at different domain addresses, the technology and equipment and processes supporting the Website and the process of order fulfillment described herein are the same for all three websites.

In late 2014, we began working on initiatives to develop and advance blockchain technology, which we refer to collectively as Medici, and which includes our majority-owned subsidiary tØ.com, Inc. (formerly Medici, Inc.). As part of our Medici initiatives, we have formed a wholly-owned subsidiary Medici Ventures, Inc. and acquired a majority interest in a financial technology company and two related registered broker-dealers. We have also made minority investments in several blockchain technology companies. In 2015, we were the first public company to issue a private security using blockchain technology and in December 2016, as a successful demonstration of our technology, we issued publicly traded blockchain preferred shares of Overstock.com, Inc.

Our company, based near Salt Lake City, Utah, was founded in 1997. We launched our initial website in March 1999 and were re-incorporated in Delaware in 2002. As used herein, "Overstock," "Overstock.com," "O.co," "we," "our" and similar terms include Overstock.com, Inc. and our majority-owned subsidiaries, unless the context indicates otherwise.

### Our Business

In our retail business, we deal primarily in price-competitive, new and replenishable merchandise and use the Internet to aggregate both supply and demand to create an efficient marketplace for selling these products. We provide our customers an opportunity to conveniently shop for a broad range of price-competitive products. We continually add new, and sometimes limited, inventory to our Website in order to create an atmosphere that encourages customers to visit frequently and purchase products before our inventory sells out. We provide suppliers with access to a large customer base and convenient services for order fulfillment, customer service, returns handling, and other services. The merchandise offered on our Website is from a variety of sources including well-known, brand-name manufacturers. We have organized our retail business (sales of product offered through the Shopping Section of our Website) into two principal segments—a "direct" business and a "partner" business. We currently offer approximately 1.9 million non-BMMG products and approximately 742,000 BMMG products. Consumers and businesses are able to access and purchase our products 24 hours a day from the convenience of a computer, Internet-enabled mobile telephone or other Internet-enabled device. Our team of customer service representatives assists customers by telephone, instant online chat and e-mail. We also derive revenue from other businesses advertising products or services on our Website. Our sales are primarily to customers located in the United States. During the years ended December 31, 2016, 2015 and 2014 no single customer accounted for more than 1% of our total net revenue.

### Retail direct business

Our direct business includes sales made to individual consumers and businesses from our owned inventory and that are fulfilled primarily from our warehouse in Salt Lake City, Utah. During the year ended December 31, 2016, approximately 6% of our order volume was generated through our direct business. Our warehouses primarily fulfill orders from our direct business, but also fulfill orders on behalf of our partners through our Supplier Oasis offering described below. Our warehouses generally ship between 2,000 and 5,000 packages per day and up to approximately 10,000 packages per day during peak periods.

Retail partner business

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For our partner business, we sell merchandise from manufacturers, distributors and other suppliers ("partners") primarily through our Website. We are considered to be the primary obligor for the majority of these sales transactions and we record revenue from the majority of these sales transactions on a gross basis. Our use of the term "partner" does not mean that we have formed any legal partnerships with any of our partners. We currently have relationships with approximately 4,100 third parties who supply approximately \$1.9 million non-BMMG products, as well as most of the BMMG products, on our Website. These third party partners generally perform the same fulfillment operations as our warehouses, such as order picking and shipping; however, we handle returns and customer service related to substantially all orders placed through our Website. Revenue generated from sales on our Shopping site from both the direct and partner businesses is recorded net of returns, coupons and other discounts.

Both direct and partner revenues are seasonal, with revenues historically being the highest in the fourth quarter, which ends December 31, reflecting higher consumer holiday spending. We anticipate this will continue for the foreseeable future. To the extent possible we maintain supplier relationships, and seek new supplier relationships, for both our direct and partner businesses, and also use our working capital, to ensure a continuous allotment of product offerings for our customers. Because a portion of our product offerings are closeout merchandise, some of our suppliers cannot supply products to us on a continuous basis.

Generally, we require verification of receipt of payment, or authorization from credit card or other payment vendors whose services we offer to our customers (such as PayPal), 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.

#### Medici business

Our Medici business initiatives leverage the security, transparency and immutability of cryptographically protected, distributed ledgers, such as the Blockchain, and are focused on solving important problems, including financial transaction issues, particularly in the area of securities settlement. Through our wholly-owned subsidiary, Medici Ventures Inc., we hold minority investments in several technology companies which, at December 31, 2016, included Peer Nova, Bitt, IdentityMind and Factom, whose focus include commercial blockchain applications, digital currency solutions, Know Your Customer and Anti Money Laundering compliance, voting and land titling. Medici Ventures also holds a majority interest in tØ.com, Inc., which includes a financial technology company and two related registered broker-dealers.

As described further in Item 15 of Part IV, "Financial Statements"-Note 21. Business Segments, contained in the "Notes to Consolidated Financial Statements" of this Annual Report on Form 10-K, we determined our segments based on how we manage our business, which, in our view, consists primarily of our Retail and Medici businesses. As described above, 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.

#### Other offerings

We offer additional products or services that may complement our primary offerings, but are not significant to our revenues. These include:

- Worldstock Fair Trade, a store within our Website that offers handcrafted products made by artisans all over the world to help improve the lives of people in emerging economies;
- Main Street Revolution, a store within our Website that features products from small businesses who offer their products using our national marketing and distribution channels;
- Farmers Market, a tab within our Website where our customers, in certain locations, can order locally grown fresh produce and other food products;

- Pet Adoptions, a free service and tab within our Website that leverages our technology to display pets available for adoption from shelters across the United States;
- Insurance, a tab within our Website where our customers can shop for insurance from major carriers for both personal and business insurance policies; and
- Supplier Oasis, a single integration point through which our partners can manage their products, inventory and sales channels, while tapping into our distribution network; and
- our international business where we offer products to customers outside the United States using third party logistics providers.

## Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes. The Securities and Exchange Commission ("SEC") has defined a company's critical accounting policies as the ones that are most important to the portrayal of the company's financial condition and results of operations, and which require the company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we have identified the critical accounting policies, estimates and judgments addressed below. We also have other key accounting policies, which involve the use of estimates, judgments, and assumptions that are significant to understanding our results. For additional information, see Item 15 of Part IV, "Financial Statements"—Note 2. Accounting Policies. Although we believe that our estimates, assumptions, and judgments are reasonable, they are based upon information presently available. Actual results may differ significantly from these estimates. Our critical accounting policies are as follows:

- revenue recognition;
- estimating valuation allowances and accrued liabilities (specifically, the allowances for returns and obsolete and damaged inventory);
- internal use software and website development (acquired and developed internally);
- accounting for income taxes;
- the valuation and impairment evaluation of long-lived assets including goodwill, intangible assets other than goodwill and cost method investments; and
- loss contingencies.

### 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 retail operations into two principal reporting segments based on the primary source of revenue: direct revenue and partner and other revenue (see Item 15 of Part IV, "Financial Statements"—Note 21. Business Segments).

Revenue is recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or the service has been provided; (3) the selling price or fee revenue earned is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. Revenue related to merchandise sales is recognized upon delivery to our customers. 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.

Based upon our historical experience, revenue typically increases during the fourth quarter because of the holiday retail season and decreases in the following quarter(s).



The following table shows the effect that hypothetical changes in the estimate of average shipping transit times would have had on the reported amount of revenue and income before taxes for the year ended December 31, 2016 (in thousands):

Change in the Estimate of Average Transit Times (Days)	Year Ended December 31, 2016	
	Increase (Decrease) Revenue	Increase (Decrease) Income Before Tax
2	\$(14,068)	\$(1,830 )
1	\$(10,692)	\$(1,396 )
As reported	As reported	As reported
(1)	\$6,280	\$ 822
(2)	\$11,162	\$ 1,461

When we are the primary obligor in a transaction, are subject to inventory risk, have latitude in establishing prices and selecting suppliers, or have several but not all of these indicators, revenue is recorded gross. If we are not the primary obligor in the transaction and amounts earned are determined using a fixed percentage, revenue is recorded on a net basis. Currently, the majority of both direct revenue and partner revenue is recorded on a gross basis, as we are the primary obligor. In our statements of income, we present revenue net of sales taxes.

We periodically provide incentive offers to our customers to encourage purchases. Such offers include current discount offers, such as percentage discounts off current purchases and other similar offers, which, when used by our customers, are treated as a reduction of revenue.

#### Deferred revenue

Customer orders are recorded as deferred revenue prior to delivery of products or services ordered. We record amounts received for Club O Gold membership fees as deferred revenue and we recognize it ratably over the membership period. We record Club O Reward dollars earned from purchases as deferred revenue at the time they are earned and we recognize it as revenue upon redemption. If reward dollars are not redeemed, we recognize other income upon expiration. In addition, we sell gift cards and record related deferred revenue at the time of the sale. We sell gift cards without expiration dates and we recognize revenue from a gift card upon redemption of the gift card. If a gift card is not redeemed, we recognize other income when the likelihood of its redemption becomes remote based on our historical redemption experience. We consider the likelihood of redemption to be remote after 36 months.

We periodically enter into agreements with other parties to jointly market ancillary products or services on our website. As a result of those agreements, we sometimes receive payments in advance of performing our obligations under those agreements. Such payments received before we perform our obligations are initially recorded as deferred revenue and then recognized over our service period.

#### Sales returns allowance

We inspect returned items when they arrive at our processing facility. We refund the full cost of the merchandise returned and all original shipping charges if the returned item is defective or we or our partners have made an error, such as shipping the wrong product.

If the return is not a result of a product defect or a fulfillment error and the customer initiates a return of an unopened item within 30 days of delivery, for most products we refund the full cost of the merchandise minus the original



shipping charge and actual return shipping fees. However, we reduce refunds for returns initiated more than 30 days after delivery or that are received at our returns processing facility more than 45 days after initial delivery.

If our customer returns an item that has been opened or shows signs of wear, we issue a partial refund minus the original shipping charge and actual return shipping fees.

Revenue is recorded net of estimated returns. 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.

The allowance for returns was \$18.2 million and \$17.9 million at December 31, 2016 and 2015, respectively.

#### Valuation of inventories

Inventories, consisting of merchandise purchased for resale, 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 or market. We write down our inventory for estimated obsolescence and to lower of cost or market value based upon assumptions about future demand and market conditions. 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.

#### Internal-use software and website development

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.

#### Accounting for income taxes

We are subject to taxation from federal, state and international jurisdictions. A significant amount of judgment is involved in preparing our provision for income taxes and the calculation of resulting deferred tax assets and liabilities. We account for income taxes in accordance with ASC Topic 740, Income Taxes (“ASC 740”), which requires the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between tax and financial reporting. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. We use the with-and-without approach for determining the period in which tax benefits for excess share-based deductions are recognized.

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 concluded based on all available evidence that it is more likely than not that our deferred tax assets as of December 31, 2016 arising from ordinary income and deductions and tax credits will be realized in the future, with the exception of operating losses generated by separate tax-filing subsidiaries in domestic and foreign jurisdictions. We have also concluded that it is unlikely that our deferred tax asset arising from capital losses will be realized in the future. Therefore, it is appropriate to record a valuation allowance related to the deferred tax assets for net operating losses and credits generated in domestic and foreign separate filing jurisdictions and capital losses. In reaching these conclusions we considered, among other things, our recent financial and operating results (three years of cumulative income and revenue growth during those periods), along with our forecasted growth rates, projected future taxable income, and prudent and feasible tax planning strategies. We perform sensitivity analyses to address how potential changes in significant assumptions would impact our ability to generate the minimum amount of taxable income required. We give the most weight to objective evidence related to our more recent financial results. Based upon the level of historical taxable income and projections for future taxable income, and planned tax strategies over the periods in which the deferred tax assets are deductible, we believe it is more likely than not that we will realize the benefits of these deduction differences, net of existing valuation allowances.

However, it is possible that certain state tax credits could ultimately expire unused if estimates of future apportioned taxable income during the carryforward period are reduced. We will continue to monitor the need for a valuation allowance against our federal and state deferred tax assets on a quarterly basis.

ASC 740 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with GAAP. ASC 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This statement also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, and disclosure.

The calculation of our tax liabilities is subject to legal and factual interpretation, judgment, and uncertainty in a multitude of jurisdictions. This includes addressing uncertainties in the application of complex tax regulations. We recognize liabilities for uncertain tax positions in the U.S. and other tax jurisdictions based on recognition and measurement criteria prescribed by ASC 740. The liabilities are periodically reviewed for their adequacy and appropriateness. Changes to our assumptions could cause us to find a revision of estimates appropriate. Such a change in measurement would result in the recognition of a tax benefit or an additional charge to the tax provision.

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. We recognize potential liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional taxes and interest will be due. We record an amount as an estimate of probable additional income tax liability at the largest amount that we determine is more likely than not, based upon the technical merits of the position, to be sustained upon audit by the relevant tax authority.

As of December 31, 2016, we are not under audit by any income tax authorities. As of December 31, 2015, we were under audit by the Internal Revenue Service for our 2013 federal income tax return. The audit concluded in 2016 with no changes to the return. Tax periods within the statutory period of limitations not previously audited are potentially open for examination by the tax authorities. Potential liabilities associated with these years will be resolved when an event occurs to warrant closure, primarily through the completion of audits by the tax jurisdictions and/or the expiration of the statutes of limitation. To the extent audits or other events result in a material adjustment to the accrued estimates, the effect would be recognized during the period of the event. We believe that an appropriate estimated liability has been established for potential exposures.

Our uncertain tax positions related to state income taxes represent a cash settlement contingency and are recorded as a liability in our consolidated balance sheets. To the extent interest and penalties would be assessed by taxing authorities on any underpayment of income taxes, such amounts are accrued and classified as a component of income tax expense on our consolidated statements of income and comprehensive income. Realization of the unrecognized tax benefits results in a favorable impact to the effective tax rate.

#### 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 its fair value 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.

In accordance with this guidance, we test for impairment of goodwill in the fourth quarter or when we deem that a triggering event has occurred. Goodwill totaled \$14.7 million and \$15.4 million at December 31, 2016 and 2015, respectively. There were no impairments to goodwill recorded during the years ended December 31, 2016, 2015 and 2014.

For the year ended December 31, 2016, we recognized a \$689,000 adjustment in goodwill related to a business combination as described in Item 15 of Part IV, "Financial Statements"—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 21—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. Intangible assets other than goodwill 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. These 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.

During the years ended December 31, 2015 and 2016, we acquired \$16.0 million of intangible assets other than goodwill related to a business combination as described in Note 3—Acquisitions, Goodwill, and Acquired Intangible Assets. Aggregate amortization expense for intangible assets other than goodwill was \$4.0 million and \$1.6 million for the years ended December 31, 2016 and 2015, respectively. Aggregate amortization expense for intangible assets other than goodwill was not significant for the year ended December 31, 2014.

Intangible assets consist of the following (in thousands):

	December 31,	
	2016	2015
Acquired intangible assets	\$16,000	\$15,776
Intangible assets, other	1,356	1,355
	17,356	17,131
Less: accumulated amortization of intangible assets	(6,443 )	(2,475 )
Total intangible assets, net	\$10,913	\$14,656

#### Impairment of long-lived assets

We review property and equipment and other long-lived assets, including 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 years ended December 31, 2016, 2015 and 2014.

#### Cost method investments

At December 31, 2016, we held minority interests (less than 20%) in six privately held entities, which include PeerNova, Bitt, IdentityMind, Factom, MarkaVIP and View Glass. The total aggregate amount of these investments (excluding any adjustments for impairment) was approximately \$14.6 million. Based on the nature of one of our investments, we have a variable interest. However, because we do not have power to direct the investee's activities, and therefore we are not the investee's primary beneficiary, we do not consolidate the investee in our financial statements. In June 2016, in order to maintain our proportional interest, we made a \$200,000 convertible loan to an investee. The loan will convert to an equity interest no later than January 2018. In October 2016, we made a \$618,000 convertible loan to an investee. The loan will convert to an equity interest no later than April 2017.

These investments are recognized as cost method investments included in Other long-term assets, net in our consolidated balance sheets. Earnings from the investments are recognized to the extent of dividends received, and we will recognize subsequent impairments to the investment if they are other than temporary. We review these investments individually for impairment by evaluating if events or circumstances have occurred that may have a significant adverse effect on their fair value. If such events or circumstances have occurred, we will estimate the fair value of the investment and determine if any decline in the fair value of the investment below its carrying value is other-than-temporary. In such cases, the estimated fair value of the investment is determined using unobservable inputs including assumptions by the investee's management. 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. We have an investment of approximately \$5.6 million that may be at risk of impairment in the near-term that we expect to continue to monitor closely.

At December 31, 2016, the carrying amount of our cost method investments was \$11.8 million. We recognized a \$2.9 million impairment loss during the year ended December 31, 2016, which consisted of the entire carrying amount of the related investment. The impairment loss was recorded in Other income, net on the consolidated statements of income. We recognized no impairment losses during the years ended December 31, 2015 and 2014.

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 Item 15 of Part IV, "Financial Statements"—Note 12. Commitments and Contingencies).

## Recently issued accounting standards

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, 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. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. In July 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which deferred the effective date for us of ASU No. 2014-09 to January 1, 2018. Early adoption of ASU No. 2014-09 is permitted, but not before its original effective date. In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers - Principal versus Agent Considerations. This ASU clarifies the implementation guidance for principal versus agent considerations in ASU No. 2014-09 and provides indicators that assist in the assessment of control. ASU No. 2016-08 is effective for us beginning January 1, 2018. In 2016, the FASB issued additional implementation guidance for the new revenue recognition standards. These standards permit the use of either the retrospective or cumulative effect transition method. We have initiated an assessment of our revenue streams and a project plan for implementing these standards. We have not yet selected a transition method nor have we completed our assessment of the effect that ASU No. 2014-09 will have on our consolidated financial statements and related disclosures. At this stage in our assessment, we have identified gross versus net revenue recognition (principal versus agent considerations) and the timing of revenue recognition (FOB shipping points versus FOB destination) as critical issues in our analysis.

In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory, which requires inventory to be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The new standard becomes effective for us on January 1, 2017. The standard requires entities to apply this change prospectively to the measurement of inventory after the date of adoption. We do not expect that ASU No. 2015-11 will have a significant impact on our consolidated financial statements and related disclosures.

In November 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes, which requires that deferred tax assets and liabilities be classified as noncurrent in a classified balance sheet. The new standard becomes effective for us on January 1, 2017. The standard requires entities to apply this change on either a prospective or retrospective basis for the periods presented and we expect to apply the standard retrospectively. The adoption of this standard will cause us to reclassify our current deferred tax assets and liabilities as noncurrent in our consolidated financial statements.

In February 2016, the FASB issued ASU No. 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. Early adoption is permitted. The amendments in this update should be applied under a modified retrospective approach. We are evaluating the effect that ASU No. 2016-02 will have on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-04, Liabilities - Extinguishment of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products, which specifies how prepaid stored-value product liabilities, such as gift cards, should be derecognized. The standard, among other things, requires derecognition of such liabilities through expected breakage in proportion to the pattern of rights expected to be exercised by the holder, but only to the extent that it is probable that a significant reversal of the recognized breakage amount will not subsequently occur. The new standard becomes effective for us on January 1, 2018. The amendments in this update should be applied under a modified retrospective approach or a retrospective approach to each period presented. We are evaluating the effect that ASU No. 2016-04 will have on our consolidated financial statements and related disclosures.



In March 2016, the FASB issued ASU No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The new standard becomes effective for us on January 1, 2017. The standard specifies various transition methods for the individual amendments in this Update. The adoption of this standard will primarily cause us to recognize approximately \$9.4 million in deferred tax assets related to excess tax benefits through a cumulative effect adjustment in retained earnings as of January 1, 2017.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force), which provides guidance on the presentation of restricted cash or

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restricted cash equivalents in the statement of cash flows, thereby reducing the diversity in practice. The new standard becomes effective for us on January 1, 2018. The standard requires entities to apply this standard using the retrospective transition method to each period presented. The adoption of this standard will require that amounts generally described as restricted cash and restricted cash equivalents should 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 do not expect that ASU No. 2016-18 will have a material impact on our consolidated financial statements and related disclosures.

#### Comparison of Years Ended December 31, 2016 and 2015

##### Executive Commentary

This executive commentary is intended to provide investors with a view of our business through the eyes of our management. As an executive commentary, it necessarily focuses on selected aspects of our business. This executive commentary is intended as a supplement to, but not a substitute for, the more detailed discussion of our business included elsewhere herein. Investors are cautioned to read our entire “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” as well as our interim and audited financial statements, and the discussion of our business and risk factors and other information included elsewhere or incorporated in this report. This executive commentary includes forward-looking statements, and investors are cautioned to read “Special Cautionary Note Regarding Forward-Looking Statements.”

Revenues in 2016 increased 9% compared to 2015. The growth in revenue was primarily due to a 6% increase in average order size, coupled with a 4% increase in orders. These increases were partially offset by increased promotional activities, including coupons and site sales (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions. Our average order size has increased in recent years due primarily to a sales mix shift into home and garden products. We are uncertain how long this trend will continue.

Gross profit in 2016 increased 9% compared to 2015 primarily as a result of revenue growth. Gross margin was flat at 18.4% in 2016 compared to 2015. Gross margin increased due to a continued shift in sales mix into higher margin home and garden products, but that increase was offset by increased promotional activities.

Sales and marketing expenses as a percentage of revenue increased from 7.5% to 8.2% during 2016 as compared to 2015, primarily due to increased spending in the sponsored search marketing channels and increased staff related costs.

As a result of these factors, our Contribution increased 8% in 2016 compared to 2015 (see Non-GAAP Financial Measures below for a reconciliation of Contribution to Gross Profit). Contribution margin was 11.1% in 2016 compared to 11.2% in 2015.

Technology expenses in 2016 increased \$8.2 million compared to 2015, primarily due to an increase in depreciation of \$5.9 million, an increase in staff-related costs of \$2.5 million, and an increase of \$1.6 million in technology licenses and maintenance. These increases were partially offset by a \$1.3 million decrease in outside consulting services.

General and administrative expenses in 2016 increased \$7.1 million compared to 2015, primarily due to an increase of \$7.6 million in staff related costs and \$1.1 million in bad debt expense for accounts receivable due from a marketplace in which we also have a minority investment. These increases were partially offset by a \$1.9 million decrease in legal fees and a \$1.3 million decrease in consulting and outside services.

During Q3 2016, we recognized an impairment charge of \$2.9 million in Other income, net related to an international marketplace company in which we hold a minority investment that has historically been recorded at cost.

In Q1 2016, we entered into a settlement agreement in our prime broker litigation which concluded the litigation in its entirety and we recognized settlement proceeds of \$19.5 million. Related costs associated with the litigation and settlement of approximately \$1.0 million were included in G&A expenses during Q1 2016.

In December 2016, as a successful demonstration of the platform and technology developed by our majority-owned subsidiary tØ.com, Inc., we issued publicly traded preferred shares of Overstock.com, Inc. for proceeds of \$7.6 million, net of offering costs. Additionally, as part of our Medici initiatives to develop this technology, in Q1 2016, we completed the acquisition of two registered broker-dealers. In 2015 we acquired a related financial technology company.

We continue to seek opportunities for growth, in our retail business and through our Medici blockchain and financial technology initiatives and through other means. As a result of these initiatives, we may continue to incur additional expenses or make investments in, or acquisitions of other technologies and businesses. We also anticipate that our Medici initiatives will incur losses in the near term. These losses, additional expenses, acquisitions or investments may be material, and, coupled with the seasonality of our business, may lead to reduced consolidated income in some periods, and to reduced liquidity. Additionally, we may recognize impairment charges from our investments as we did during Q3 2016. We are also considering other alternatives for Medici, including a spin-off or raising capital.

During Q3 2016, we completed the construction of our new corporate headquarters near Salt Lake City, Utah and we began to occupy the building. Total projects costs were approximately \$99.2 million. The related financing is discussed in further detail in the Liquidity and Capital Resources, Borrowings section below.

The balance of our Management's Discussion and Analysis of Financial Condition and Results of Operations provides further information about the matters discussed above and other important matters affecting our business.

## Results of Operations

The following table sets forth our results of operations expressed as a percentage of total net revenue for the years ended December 31, 2016, 2015 and 2014:

	Year ended December 31		
	2016	2015	2014
	(as a percentage of total revenue)		
Revenue, net			
Direct	5.6	% 8.3	% 9.8
Partner and other	94.4	91.7	90.2
Total net revenue	100.0	100.0	100.0
Cost of goods sold			
Direct	5.3	7.7	8.6
Partner and other	76.2	73.9	72.7
Total cost of goods sold	81.5	81.6	81.3
Gross profit	18.4	18.4	18.7
Operating expenses:			
Sales and marketing	8.2	7.5	7.3
Technology	5.9	5.9	5.8
General and administrative	5.0	5.0	4.8
Litigation settlement	(1.1 )	—	—
Total operating expenses	18.0	18.4	17.9
Operating income	0.4	—	0.8
Interest income	—	—	—
Interest expense	—	—	—
Other income, net	0.8	0.2	0.1
Income before income taxes	1.2	0.2	0.9
Provision for income taxes	0.5	0.1	0.3
Consolidated net income	0.7	% 0.1	% 0.6

## Revenue

The following table reflects our net revenue for the years ended December 31, 2016 and 2015 (in thousands):

	Year ended		\$ Change	% Change
	December 31,			
	2016	2015		
Revenue, net				
Direct	\$ 101,578	\$ 137,783	\$(36,205 )	(26.3 )%
Partner and other	1,698,385	1,520,055	178,330	11.7 %
Total revenue, net	\$ 1,799,963	\$ 1,657,838	\$ 142,125	8.6 %

The primary reason for increased total net revenue for the year ended December 31, 2016, as compared to the same period in 2015, was a 6% increase in average order size, coupled with a 4% increase in orders. These increases were partially offset by increased promotional activities, including coupons and site sales (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions. Our average order size has increased in recent years due primarily to a sales mix shift into home and garden products. We are uncertain how long this trend will continue.

The primary reason for decreased direct revenue for the year ended December 31, 2016, as compared to the same period in 2015, was a decrease in sales of home and garden products (primarily due to a shift from our direct segment to our partner segment) in addition to increased promotional activities, including coupons and site sales (which we recognize as a reduction of

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revenue) due to our driving a higher proportion of our sales using such promotions. Also, the percentage of revenue we defer from orders taken but not delivered was higher due to the timing of year end.

The increase in partner revenue for the year ended December 31, 2016, as compared to the same period in 2015, was primarily due to an increase in sales of home and garden products. This increase was partially offset by increased promotional activities, including coupons and site sales (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions.

Since mid-2015 through the first half of 2016, we experienced some slowing of our overall revenue growth, which we believe was due in part to changes that Google made in its natural search engine algorithms. While we worked to adapt to Google's changes, we increased our emphasis on other marketing channels, such as sponsored search, which generated revenue growth but with higher associated marketing expenses than natural search.

We continue to seek increased participation in our Club O loyalty program, including, in certain instances, by increasing Club O Rewards to our Club O members in lieu of coupons we offer to all customers. For additional information regarding our Club O loyalty program see Item 15 of Part IV, "Financial Statements"—Note 2. Accounting Policies, Club O loyalty program.

The shift of business from direct to partner (or vice versa) is an economic result based on the economics of each particular product offering at the time and we generally do not have particular goals for an "appropriate" mix or percentage for the size of either. Although we have experienced a trend from direct revenue to partner revenue in recent years, we believe that the mix of the business between direct and partner remains consistent with our strategic objectives for our business model in the current economic environment and we do not currently foresee any material shifts in this trend.

The products and product lines we offer, and their respective percentages of our revenue, are based on many factors including customer demand, our marketing efforts, promotional pricing, joint-marketing offered by our suppliers, the types of inventory we are able to obtain and the number of SKUs we offer. These factors change frequently and can affect the mix of the product lines we sell. We have experienced a trend toward our home and garden category in recent years and we have recently focused our marketing and branding efforts towards our home and garden product line. We are also working to increase the number of SKUs we offer. While we do not currently expect any material shifts in our product line mix, the relative amounts of the product lines we sell, and the revenue we earn from those product lines, is generally an economic result of the factors described above, which may change from time to time.

International sales were less than 2% of total net revenues for 2016 and 2015.

#### Gross profit and gross margin

Our overall gross margins fluctuate based on our sales volume mix between our direct business and partner business; changes in supplier cost and / or sales price, including competitive pricing; inventory management decisions within the direct business; sales coupons and promotions; product mix of sales; and operational and fulfillment costs.

The following table reflects our net revenues, cost of goods sold and gross profit for the years ended December 31, 2016 and 2015 (in thousands):

	Year ended December 31,		\$ Change	% Change	
	2016	2015			
Revenue, net					
Direct	\$101,578	\$137,783	\$(36,205)	(26.3)	)%
Partner and other	1,698,385	1,520,055	178,330	11.7	%
Total net revenue	1,799,963	1,657,838	142,125	8.6	%