**OVERSTOCKED AND UNDERPERFORMED**

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Poor Overstock.com! The firm created an interesting business model but was buffeted left and right and libertarian. And the current vitals do not look good. Actually, as we shall see, that is an understatement.

Analysts for years have taken pot shots at the business enterprise. Sam Antar has long asserted that the company has been involved in some accounting hanky-panky and insider trading. For example, Antar claimed that the [CEO dumped some stock before a bad earnings report and misled investors as well](http://whitecollarfraud.blogspot.com/2010/08/overstockcom-ceo-patrick-dumped-stock.html). Antar currently thinks the firm is in a [death spiral and appears ready to write its obituary](http://whitecollarfraud.blogspot.com/2012/03/is-overstockcom-in-death-spiral.html).

Sam Antar is not alone. Writing for Seeking Alpha, Gary Weiss wrote about [Overstock’s apparent reliability to be unreliable in its accounting](http://seekingalpha.com/article/135259-the-reliable-unreliability-of-overstock-com-financial-statements). Greg Greenberg at TheStreet.com thought it dumb for Overstock’s CEO to say “[it was an ugly end to an ugly year](http://www.thestreet.com/story/11447878/1/the-5-dumbest-things-on-wall-street-this-week-march-9.html?cm_ven=GOOGLEN).” And these guys aren’t alone.

We decided to take a look and see what the fuss is about. We opened the [Overstock 2011 10-K](http://www.sec.gov/Archives/edgar/data/1130713/000104746912002034/a2207595z10-k.htm) and indeed it isn’t pretty. We’re traditionalists, so the first thing we did was to compute the Altman Z-score. After all, if you cannot find a pulse, there isn’t much use of doing any other research.

(We should point out that the original Altman Z-score was intended for manufacturing concerns, and so should not be applied to Overstock. We therefore applied his modified model for non-manufacturers. See his paper, “Corporate Distress Prediction Models in a Turbulent Economic and BASEL II Environment,” 2002).

Altman built the following model for non-manufacturers:

Z = 6.56 \* WC/TA + 3.26 \* RE/TA + 6.72 \* EBIT/TA + 1.05 \* BVE/TD

where WC = working capital, TA=total assets, RE=retained earnings, EBIT=earnings before interest and taxes, BVE=book value of equity, and TD=total debt.

The interpretation of the Z-score is straight-forward. If Z is greater than 2.60, then the firm has little financial distress and is healthy. The model predicts this firm will not fail. A Z-score between 1.10 and 2.60 is in the grey zone; it is indeterminate whether the firm will fail or not fail. The analyst should garner additional evidence to make this assessment. But, if the Z-score falls below 1.10, the model predicts corporate failure. And the lower the Z-score, the greater the amount of financial distress.

For Overstock, the metric has these values:

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| Year | Z-Score |
| 2006 | -9.4 |
| 2007 | -7.0 |
| 2008 | -6.8 |
| 2009 | -2.6 |
| 2010 | -3.1 |
| 2011 | -7.3 |

Driving these results are the negative earnings before interest and taxes and the negative retained earnings. Some improvement occurs in 2009 and 2010, but a significant worsening takes place by the end of 2011. In addition to the two ratios just mentioned, this is also driven by the erosion of shareholders’ equity. The debt/equity ratio rests at a staggering 12.56.

*In pace requiescat*: what more can we say?

*This essay reflects the opinion of the authors and not necessarily the opinions of The Pennsylvania State University, The American College, or Villanova University.*