

APPLIED GENETIC TECHNOLOGIES CORP

Form S-1/A

July 21, 2014

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As filed with the Securities and Exchange Commission on July 21, 2014.

Registration No. 333-197385

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Amendment No. 1**  
**to**  
**FORM S-1**  
**REGISTRATION STATEMENT**

*under*

*THE SECURITIES ACT OF 1933*

**APPLIED GENETIC TECHNOLOGIES CORPORATION**

(Exact Name of Registrant as Specified in Its Charter)

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<b>Delaware</b> (State or Other Jurisdiction of Incorporation or Organization)	<b>2836</b> (Primary Standard Industrial Classification Code No.) <b>11801 Research Drive, Suite D</b>  <b>Alachua, Florida 32615</b>  <b>(386) 462-2204</b>	<b>59-3553710</b> (I.R.S. Employer Identification No.)
--------------------------------------------------------------------------------------	-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	--------------------------------------------------------------

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

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**Approximate date of commencement of proposed sale to the public:** As soon as practicable after this Registration Statement is declared effective.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended (the Securities Act ) please check the following box. "

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

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 12b2 of the Exchange Act.

Large accelerated filer " Accelerated filer "  
Non-accelerated filer x (Do not check if a smaller reporting company) Smaller reporting company "

**The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.**

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**The information in this preliminary prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell nor does it seek an offer to buy these securities in any state where the offer or sale is not permitted.**

**Subject to completion, dated July 21, 2014**

**Prospectus**

**2,000,000 Shares**

**Common Stock**

# **Applied Genetic Technologies Corporation**

July , 2014.

Applied Genetic Technologies Corporation is offering 2,000,000 shares of its common stock. Our common stock is traded on The NASDAQ Global Market under the symbol AGTC. On July 18, 2014, the last reported sale price of our common stock was \$18.52 per share.

We have granted the underwriters the option to purchase up to 300,000 additional shares of common stock to cover over-allotments.

**Investing in our common stock involves risks. See Risk Factors beginning on page 11 of this prospectus.**

We are an emerging growth company as that term is used in the Jumpstart Our Business Startups Act of 2012 and, as such, we have elected to comply with certain reduced public company reporting requirements for this prospectus and future filings.

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed on the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.**

	<b>Per share</b>	<b>Total</b>
Public offering price	\$	\$
Underwriting discounts and commissions (1)	\$	\$
Proceeds to AGTC (before expenses)	\$	\$

(1) We refer you to Underwriting beginning on page 163 of this prospectus for additional information regarding total underwriter compensation.

The underwriters expect to deliver the shares to purchasers on or about \_\_\_\_\_, 2014 through the book-entry facilities of The Depository Trust Company.

**BMO Capital Markets   Stifel   Wedbush PacGrow Life Sciences**

**Cantor Fitzgerald & Co.   Roth Capital Partners**

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**You should rely only on the information contained in this prospectus and any free writing prospectus prepared by us or on our behalf or to which we have referred you. We and the underwriters have not authorized anyone to provide you with information that is different. We and the underwriters are offering to sell shares of our common stock, and seeking offers to buy shares of our common stock, only in jurisdictions where such offers and sales are permitted. Regardless of the time of delivery of this prospectus or any free writing prospectus or any sale of our common stock, the information in this prospectus is accurate only as of the date of this prospectus, and the information in any free writing prospectus that we may provide you in connection with this offering is accurate only as of the date of that free writing prospectus. Our business, financial condition, results of operations and future growth prospects may have changed since those dates.**

For investors outside the United States: Neither we nor any of the underwriters have taken any action to permit a public offering of the shares of our common stock or the possession or distribution of this prospectus in any jurisdiction where action for that purpose is required, other than the United States. You are required to inform yourselves about and to observe any restrictions relating to this offering and the distribution of this prospectus and any free writing prospectus outside of the United States.

Estimates in this prospectus of the patient populations for the diseases that we are targeting are based on published estimates of the rates of incidence of the diseases from scientific and general publications and research, surveys and studies conducted by third parties that we consider to be reliable, although such publications do not guarantee the accuracy or completeness of such information. We assume populations of approximately 300 million persons in the United States and approximately 500 million persons in Europe.

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### PROSPECTUS SUMMARY

*This summary highlights information contained elsewhere in this prospectus. You should read the following summary together with the more detailed information appearing in this prospectus, including our financial statements and related notes and the risk factors beginning on page 11 before deciding whether to purchase shares of our common stock. Unless the context otherwise requires, we use the terms "AGTC," "Company," "we," "us" and "our" in this prospectus to refer to Applied Genetic Technologies Corporation.*

#### Overview

We are a clinical-stage biotechnology company using our proprietary gene therapy platform to develop products designed to transform the lives of patients with severe inherited orphan diseases in ophthalmology. Our lead product candidates, which are each in the preclinical stage, focus on rare diseases of the eye, caused by mutations in single genes, that significantly affect visual function and currently lack effective medical treatments. We have also obtained preliminary evidence of the safety and efficacy of our gene therapy approach in clinical-stage programs involving other diseases outside our current area of focus that we believe provide proof of concept for our gene therapy platform.

Our gene therapy approach uses a viral vector to deliver a functional copy of a gene to the patient's own cells through a variety of delivery methods. A viral vector is a virus that has been modified to carry a gene and deliver it to a cell. Our viral vectors utilize a modified version of a non-replicating strain of virus known as an adeno-associated virus, or AAV, which is incapable of causing disease in humans. When an AAV vector containing a functional copy of a gene is administered, the functional genetic material resides in the nucleus of the patient's cell, providing safe, sustained expression of the therapeutic protein to treat the disease without modifying the existing DNA of the patient.

We have developed extensive internal expertise in viral vector design, delivery and manufacturing that is supported by a broad intellectual property estate. Our proprietary AAV vector manufacturing process is both reproducible and scalable. We have assembled an experienced management team and a world-class group of scientific advisors, and we have strong collaborative relationships with key opinion leaders in the field of gene therapy. Combining these attributes, we have built a gene therapy platform that we believe will provide patients with treatments that may have life-long clinical benefits, potentially based on a one-time therapeutic administration.

#### Our product pipeline

Our lead product candidates are designed to treat:

**X-linked retinoschisis, or XLRS.** XLRS is an inherited retinal disease caused by mutations in the RS1 gene, which encodes the retinoschisin protein. It is characterized by abnormal splitting of the layers of the retina, resulting in poor visual acuity in young boys, which can progress to legal blindness in adult men. In preclinical studies, treatment by injection of our XLRS product candidate in mice improved responses to light in the retina and visual acuity. In late 2014, we plan to submit an Investigational New Drug Application, or IND, to the United States Food and Drug Administration, or FDA, and thereafter to initiate a Phase 1/2 clinical trial in XLRS, with initial clinical data expected in mid-2015.

**Achromatopsia, or ACHM.** ACHM is an inherited retinal disease, which is present from birth and is characterized by the lack of cone photoreceptor function. The condition results in markedly reduced visual acuity, light sensitivity, day blindness and complete loss of color discrimination. Best-corrected visual acuity in persons affected by ACHM, even under subdued light conditions, is usually about 20/200, a level at which people are considered legally blind. Preclinical studies in both mouse and dog

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models of our ACHM product candidate have shown the ability to restore photoreceptor function, improve visual acuity and mitigate light sensitivity and day blindness. In early 2015, we plan to submit an IND, and thereafter to initiate a Phase 1/2 clinical trial in one form of ACHM, with initial clinical data expected in late 2015.

**X-linked retinitis pigmentosa, or XLRP.** XLRP is an inherited retinal dystrophy characterized by the progressive loss of vision, one form of which is caused by mutations in the RPGR gene, which encodes a protein essential for normal vision. It is commonly first observed in young men, who notice problems with vision under low light conditions, or night blindness, followed by tunnel vision, leading to poor central vision and eventual total blindness. A preclinical study in a dog model of XLRP caused by mutations in the RPGR gene demonstrated a delay in the rate of disease progression in dogs that received a subretinal injection of our XLRP product candidate. For our XLRP product candidate, we expect to file an IND in late 2016, and thereafter to initiate Phase 1/2 clinical trials in the United States, with clinical data expected in mid-2017.

We initially developed our gene therapy platform in clinical-stage proof-of-concept programs involving three other diseases:

Leber congenital amaurosis (type 2), or LCA2, an orphan eye disease caused by mutation in the RPE65 gene;

the wet form of age-related macular degeneration, or wet AMD, an eye disease affecting a large patient population; and

Alpha-1 antitrypsin deficiency, or AAT deficiency, an inherited orphan lung disease.

These proof-of-concept programs are important because they have provided initial evidence of safety and efficacy of our gene therapy approach in both preclinical studies and clinical trials. They have also enabled us to develop substantial experience in vector design, delivery and manufacturing, in clinical trial design and conduct, and in working with clinical investigators and regulatory agencies. In these proof-of-concept programs, our manufacturing process has been successfully vetted by regulatory agencies and partners and we have demonstrated our ability to produce clinical material for multiple studies.

In clinical trials conducted by our licensee Genzyme Corporation, or Genzyme, up to 34 patients with wet AMD were treated by intravitreal injection of an AAV vector, and in other trials conducted by us and others, more than 50 patients with LCA2 have been treated with subretinal injections of AAV vectors, in both cases without reports of serious adverse events attributed to the vector, and with promising indications of efficacy for LCA2 patients. See [Business Strategic collaborations and acquisitions Our license to Genzyme](#). We now plan to leverage our work with Genzyme on a first generation product for wet AMD, and our experience developing products in orphan ophthalmology more broadly, to develop new treatments for wet AMD on our own.

We believe our AAT deficiency program provides proof of concept for the use of our gene therapy platform in indications outside our focus area of orphan ophthalmology. We have conducted Phase 1 and Phase 2 clinical trials for our AAT deficiency product candidate in 30 patients and expect to start a Phase 2b trial in early 2015, with initial clinical data expected in mid-2015.



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The chart below summarizes our current gene therapy programs:

### **Our gene therapy platform**

Our gene therapy platform is built on our core competencies in three key areas: vector selection and design, vector manufacturing and vector delivery:

*Vector selection and design.* The success of a gene therapy platform is highly dependent on the vector selected. Our gene therapy platform is based on viral vectors that utilize a modified version of the non-replicating adeno-associated virus to deliver a functional copy of a gene to the patient's own cells. We believe that AAV vectors are particularly well-suited for treating our target diseases and offer advantages including safety, stability and sustained expression compared with viral vectors such as adenovirus, herpes virus and lentivirus used by others. AAV vectors can carry genes of up to 4,000 base pairs in length, a carrying capacity sufficient to accommodate more than 90% of human genes.

One of our key capabilities is our understanding of the complex interplay between the clinical disease, the cells in the patient's body that need treatment, the selection of the protein shell, or capsid, and a promoter, the design of the gene construct and the physical administration method. We have spent years

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conducting research on the best combinations of these elements with the aim of developing safe and effective gene therapy treatments.

*Vector manufacturing.* We have developed a proprietary, high-yield vector manufacturing process using scalable technologies, which addresses problems of low productivity and low efficacy that have historically plagued efforts to manufacture AAV vectors and enables us to produce vectors with improved potency, efficiency and safety over processes previously used by us and others.

Our manufacturing process has been reviewed by both the FDA and the European Medicines Agency, or EMA, has been authorized for production of product candidates for use in clinical trials in the United States and Europe and has been transferred successfully to Genzyme and to our contract manufacturing organization. We hold or have licensed 26 issued and 6 pending patents covering our manufacturing technology. We believe that our core competency and intellectual property estate in vector manufacturing differentiate us competitively and provide a key element of our gene therapy platform.

*Vector delivery.* Our gene therapy platform allows for vector delivery by a variety of methods, and we select the method that is most beneficial for the disease we are targeting. In ophthalmology, the product candidate can best be delivered to cells in the eye by injection. For other indications, such as AAT deficiency, we plan to administer the product candidate by intramuscular injection or vascular delivery. These methods of administration are well-established for the safe and effective delivery of other drugs and protein products.

Because our AAV vectors can be used to introduce functional genes into many different cell types and by a variety of delivery methods and have a carrying capacity sufficient to accommodate most of the individual genes in the human genome, our gene therapy platform has the potential to provide treatments for many other diseases outside of our current focus on orphan ophthalmology, including those with large dosing requirements or in larger markets. We have already conducted preclinical proof-of-concept studies and Phase 1 and Phase 2 clinical trials of a treatment for AAT deficiency. We expect to explore other therapeutic areas selectively, either alone or through partnerships.

### **Our focus on orphan ophthalmology**

We focus on orphan ophthalmology because we believe there is a significant unmet medical need in orphan eye diseases that provides an attractive business opportunity. The prevalence of the diseases we are pursuing is large by orphan standards, but small enough to permit clinical trials on a manageable scale and to provide markets that we believe can be served using a small, targeted commercial infrastructure. The diseases we are targeting are also of interest to us due to a number of factors that have enabled us to predict the potential safety and efficacy of our product candidates at an early stage of development:

these diseases involve well-understood disease mechanisms;

these are monogenic diseases, meaning they are caused by mutations in a single gene, which mitigates the uncertainty of disease biology;

highly predictive animal models are available;

local delivery of the therapeutic agent is possible via methods already widely used in ophthalmology;

these diseases have clearly defined clinical endpoints that have been accepted by regulatory agencies in review of other ophthalmology products; and

we anticipate a short time to meaningful clinical data.

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### **Our strategy**

Our objective is to become the world leader in developing and commercializing gene therapy treatments for eye diseases, for which in some cases there are no currently available treatments, and to thereby provide a better life for people with these diseases. Our strategy to accomplish this goal is to:

develop and commercialize drugs in orphan ophthalmology;

continue our leadership position in orphan ophthalmology;

expand our product offerings to wet AMD;

seek opportunities for strategic partnerships and acquisitions in ophthalmology gene therapy;

extend our expertise in AAV vector design, delivery and manufacturing;

expand our manufacturing capabilities and create a pilot manufacturing group;

pursue orphan indications with high unmet medical need and greater probability of clinical, regulatory and commercial success; and

evaluate opportunities to leverage our gene therapy platform to address indications outside ophthalmology.

### **Recent developments**

As of March 31, 2014, we had cash and cash equivalents and short-term investments of \$24.5 million. Based on our preliminary analysis of our financial results for the three months ended June 30, 2014, and giving effect to our receipt of the net proceeds from our initial public offering, at June 30, 2014, we had cash and cash equivalents and short-term investments of \$73.1 million. This amount is preliminary, unaudited, subject to change upon completion of our year-end audit for our fiscal year ended June 30, 2014, and may differ from what will be reflected in our audited financial statements as of and for our fiscal year ended June 30, 2014.

### **Risks associated with our business**

Our ability to implement our business strategy is subject to numerous risks that you should be aware of before making an investment decision. These risks are described more fully in the section entitled "Risk Factors" beginning on page 11 of this prospectus. You are encouraged to read that section in its entirety before making an investment decision. These risks include, but are not limited to, the following:

We have incurred significant losses since our inception and anticipate that we will continue to incur significant losses for the foreseeable future.

Our ability to generate revenue from product sales is highly uncertain and we may never achieve or sustain profitability.

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In order to obtain regulatory approval for and commercialize our product candidates, we will need to raise additional funding in the future, which may not be available on acceptable terms, or at all.

All of our product candidates are in preclinical or clinical development. Clinical drug development is expensive, time consuming and uncertain, and we may ultimately not be able to obtain regulatory approvals for the commercialization of some or all of our product candidates.

Our gene therapy product candidates are based on a novel technology, no gene therapy products have been approved in the United States and only one such product has been approved in Europe, which makes it difficult to predict the time and cost of product candidate development and regulatory approval.

Success in animal studies or early clinical trials may not be indicative of results obtained in later trials.

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We may encounter substantial delays in our clinical trials or we may fail to demonstrate safety and efficacy to the satisfaction of applicable regulatory authorities.

Even if we complete the necessary clinical trials, we cannot predict when or if we will obtain regulatory approval to commercialize a product candidate or the approval may be for a more narrow indication than we expect.

We expect to rely on third parties to conduct, supervise and monitor our clinical trials and to conduct certain aspects of our product manufacturing and protocol development, and if these third parties perform in an unsatisfactory manner, it may harm our business.

The insurance coverage and reimbursement status of our product candidates is uncertain, and failure to obtain or maintain adequate coverage and reimbursement for new or current products could limit our ability to market those products and decrease our ability to generate revenue.

Negative public opinion and increased regulatory scrutiny of gene therapy and genetic research may damage public perception of our product candidates or adversely affect our ability to conduct our business, raise additional funding, obtain regulatory approvals or achieve market acceptance for our product candidates.

If we are unable to obtain and maintain patent protection for our technology and products or if the scope of the patent protection obtained is not sufficiently broad, our competitors could develop and commercialize technology and products similar or identical to ours, and our ability to successfully commercialize our technology and products may be impaired.

## **Corporate information**

We were incorporated in Florida in January 1999 and reincorporated in Delaware in October 2003. On April 1, 2014, we completed our initial public offering of our common stock, which is traded on The NASDAQ Global Market under the symbol AGTC. Our principal executive offices are located at 11801 Research Drive, Suite D, Alachua, Florida 32615, and our telephone number is (386) 462-2204. Our corporate website address is [www.agtc.com](http://www.agtc.com). Information contained on or accessible through our website is not a part of this prospectus, and the inclusion of our website address in this prospectus is an inactive textual reference only.

We use AGTC and the double helix logo as trademarks in the United States and other countries. We have begun the registration process for these trademarks in the United States.

This prospectus contains references to our trademarks and to trademarks belonging to other entities. Solely for convenience, trademarks and trade names referred to in this prospectus, including logos, artwork, and other visual displays, may appear without the ® symbols, but such references are not intended to indicate that we will not assert, to the fullest extent under applicable law, our rights or the rights of the applicable licensor to these trademarks and trade names. We do not intend our use or display of other companies' trade names or trademarks to imply a relationship with, or endorsement or sponsorship of us by, any such companies.

## **Implications of being an emerging growth company**

As a company with less than \$1 billion in revenue during our last fiscal year, we qualify as an emerging growth company as defined in the Jumpstart Our Business Startups Act of 2012, or the JOBS Act. As an emerging growth company, we may take advantage of specified reduced disclosure and other requirements that are otherwise applicable generally to public companies. These provisions include:

only two years of audited financial statements, in addition to any required unaudited interim financial statements, with correspondingly reduced Management's Discussion and Analysis of Financial Condition and Results of Operations disclosure;

reduced disclosure about our executive compensation arrangements;

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no non-binding advisory votes on executive compensation or golden parachute arrangements; and

exemption from the auditor attestation requirement in the assessment of our internal controls over financial reporting.

We may take advantage of these exemptions for up to five years from the date of our initial public offering of common stock or such earlier time that we are no longer an emerging growth company. We would cease to be an emerging growth company if we have more than \$1 billion in annual revenue, we have more than \$700 million in market value of our stock held by non-affiliates or we issue more than \$1 billion of non-convertible debt over a three-year period. We may choose to take advantage of some, but not all, of the available exemptions. We have taken advantage of certain reduced reporting burdens in this prospectus. Accordingly, the information contained herein may be different than the information you receive from other public companies in which you hold stock.

In addition, the JOBS Act provides that an emerging growth company can take advantage of an extended transition period for complying with new or revised accounting standards. This allows an emerging growth company to delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have irrevocably elected not to avail ourselves of this exemption from new or revised accounting standards and, therefore, we will be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies.

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**The Offering**

Common stock offered by AGTC	2,000,000 shares
Common stock to be outstanding after this offering	16,082,091 shares (16,382,091 shares in the event the underwriters elect to exercise in full their over-allotment option to purchase additional shares from us)
Use of proceeds	We estimate that the net proceeds from this offering will be approximately \$34.4 million, or approximately \$39.6 million if the underwriters exercise in full their over-allotment option, based on an assumed public offering price of \$18.52 per share, which was the last reported price of our common stock on The NASDAQ Global Market on July 18, 2014, after deducting the estimated underwriting discounts and commissions and estimated offering expenses payable by us. We plan to use the net proceeds from this offering to fund our preclinical investigation and Phase 1/2 trials of potential product candidates for treatment of wet AMD, to expand our manufacturing capabilities, to in-license, acquire or invest in complementary gene therapy, technologies, products or assets, and for working capital and other general corporate purposes. At this time, we have no agreement or commitment for any specific in-license, acquisition or investment and we have not allocated any portion of the estimated net proceeds of this offering for these activities. See Use of Proceeds.
Risk factors	You should read the Risk Factors section and other information included in this prospectus for a discussion of factors to consider carefully before deciding to invest in shares of our common stock.

NASDAQ Global Market symbol

AGTC

The number of shares of our common stock to be outstanding after this offering set forth above is based on the 14,082,091 shares of our common stock outstanding as of June 30, 2014.

The number of shares of common stock to be outstanding after this offering excludes:

49,811 shares of common stock issuable upon the exercise of preferred stock warrants outstanding as of June 30, 2014, at a weighted average exercise price of \$6.56 per share;

1,043,748 shares of common stock issuable upon the exercise of stock options outstanding under our equity incentive plans as of June 30, 2014, at a weighted average exercise price of \$6.36 per share; and

768,492 shares of our common stock that were available for future issuance under our equity compensation plans as of June 30, 2014. Except as otherwise noted, all information in this prospectus:

gives effect to a 1-for-35 reverse split of our common stock effected on March 4, 2014;



assumes no exercise of outstanding options or warrants described above; and

gives effect to the automatic conversion of all outstanding shares of our preferred stock into 9,120,081 shares of our common stock upon the closing of our initial public offering in April 2014.

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The following summary financial data should be read together with our financial statements and accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere in this prospectus. Our summary statement of operations data for the fiscal years ended June 30, 2012 and 2013 are derived from our audited financial statements included elsewhere in this prospectus. Our summary statement of operations data for the nine months ended March 31, 2014 and 2014 and our summary balance sheet data as of March 31, 2014 have been derived from our unaudited financial statements included elsewhere in this prospectus. Our historical results are not necessarily indicative of results to be expected for any future period, and our interim results are not necessarily indicative of our results for the entire year or any future period. The summary financial data in this section are not intended to replace our financial statements and the related notes.

The pro forma balance sheet data as of March 31, 2014 gives effect to the completion of our initial public offering, including our issuance of an aggregate 4,791,667 shares of common stock for net proceeds of approximately \$51.8 million, after deducting underwriting discounts and offering expenses, the conversion of all of our preferred stock into 9,120,081 shares of common stock on April 1, 2014 in connection with the initial closing thereof and the conversion of all outstanding warrants exercisable for shares of Series A-1, Series A-1A and Series B-1 preferred stock into warrants exercisable for shares of common stock, resulting in our preferred stock warrant liability being reclassified to additional paid-in capital, as if each had occurred on March 31, 2014. The pro forma as adjusted balance sheet data as of March 31, 2014 gives effect to (1) the pro forma adjustments described above and (2) our receipt of estimated net proceeds of \$34.4 million from this offering, based on an assumed public offering price of \$18.52 per share, which was the last reported price of our common stock on The NASDAQ Global Market on July 18, 2014, after deducting estimated underwriting discounts and estimated offering expenses payable by us, also as if each had occurred as of March 31, 2014. The pro forma as adjusted summary financial data are not necessarily indicative of what our financial position would have been if this offering had been completed as of the date indicated, nor are these data necessarily indicative of our financial position for any future date or period.

	Fiscal Year Ended June 30,		Nine Months Ended March 31,	
	2012	2013	2013	2014
(in thousands except per share data)				
<b>Statement of Operations Data:</b>				
Revenue:				
Grant revenue	\$ 718	\$ 439	\$ 326	\$ 648
Sponsored research revenue	364	503	239	357
<b>Total revenue</b>	<b>1,082</b>	<b>942</b>	<b>565</b>	<b>1,005</b>
Operating expenses:				
Research and development	2,354	3,133	1,900	5,801
General and administrative	787	1,403	972	3,335
<b>Total operating expenses</b>	<b>3,141</b>	<b>4,536</b>	<b>2,872</b>	<b>9,136</b>
Loss from operations	(2,059)	(3,594)	(2,307)	(8,131)

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	Fiscal Year Ended June 30,		Nine Months Ended March 31,	
	2012	2013	2013	2014
	(in thousands except per share data)			
Other income (expense):				
Interest income		10	1	23
Interest expense	(69)	(191)	(172)	
Fair value adjustments to warrant liabilities (1)	204	(8)	8	(441)
Fair value adjustments to Series B purchase rights (1)		(1,207)	(1,092)	(2,838)
Total other income (expense), net	135	(1,396)	(1,255)	(3,256)
Net loss	\$ (1,924)	\$ (4,990)	\$ (3,562)	\$ (11,387)
Net loss per share, basic and diluted (2)	\$ (17.65)	\$ (45.78)	\$ (32.68)	\$ (95.69)
Weighted-average shares outstanding, basic and diluted (2)	109	109	109	119
Pro forma net loss per share, basic and diluted (unaudited) (2)		\$ (1.20)		
Weighted-average pro forma shares outstanding, basic and diluted (unaudited) (2)		4,146		

	As of March 31, 2014		
	Actual	Pro Forma (in thousands)	Pro Forma As Adjusted
<b>Balance Sheet Data:</b>			
Cash and cash equivalents	\$ 8,030	\$ 59,830	\$ 94,208
Short-term investments	\$ 16,500	\$ 16,500	\$ 16,500
Working capital	\$ 23,409	\$ 75,209	\$ 109,587
Total assets	\$ 29,270	\$ 81,520	\$ 115,898
Current liabilities	\$ 2,174	\$ 2,174	\$ 2,174
Total stockholders (deficit) equity	\$ (47,176)	\$ 78,896	\$ 113,274

- (1) See note 6 of the notes to financial statements appearing elsewhere in this prospectus for a description of the fair value adjustments to our warrant liabilities and Series B purchase rights.
- (2) See note 2 of the notes to financial statements appearing elsewhere in this prospectus for a description of the method used to calculate basic and diluted net loss per share and pro forma basic and diluted net loss per share.

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**RISK FACTORS**

*Investing in our common stock involves a high degree of risk. Before you decide to invest in our common stock, you should consider carefully the risks described below, together with the other information contained in this prospectus, including our financial statements and the related notes appearing at the end of this prospectus. We believe the risks described below are the risks that are material to us as of the date of this prospectus. If any of the following risks actually occur, our business, financial condition, results of operations and future growth prospects would likely be materially and adversely affected. In these circumstances, the market price of our common stock could decline, and you may lose part or all of your investment.*

**Risks related to our financial condition and capital requirements**

*We have incurred significant losses since our inception and anticipate that we will continue to incur significant losses for the foreseeable future.*

We are a clinical-stage biotechnology company, and we have not yet generated revenues from product sales. We have incurred losses from operations in each year since our inception in 1999, and net losses of \$11.4 million for the nine months ended March 31, 2014 and \$1.9 million and \$5.0 million for the years ended June 30, 2012 and 2013, respectively. As of March 31, 2014, we had an accumulated deficit of \$59.8 million. Our prior losses, combined with expected future losses, have had and may continue to have an adverse effect on our stockholders' equity and working capital.

We have devoted most of our financial resources to research and development, including our clinical and preclinical development activities. To date, we have financed our operations primarily through the sale of equity securities and, to a lesser extent, through research grants from third parties or milestone payments from a collaborator. The amount of our future net losses will depend, in part, on the rate of our future expenditures and our ability to obtain funding through equity or debt financings, strategic collaborations or additional grants. We have not begun clinical trials for our lead product candidates and it will be several years, if ever, before we have a product candidate ready for commercialization. Even if we obtain regulatory approval to market a product candidate, our future revenues will depend upon the size of any markets in which our product candidates have received approval, and our ability to achieve sufficient market acceptance, reimbursement from third-party payors and adequate market share for our product candidates in those markets.

We expect to continue to incur significant expenses and increasing operating losses for the foreseeable future. We anticipate that our expenses will increase substantially if and as we:

continue our research and preclinical and clinical development of our product candidates;

expand the scope of our current clinical trials for our product candidates;

initiate additional preclinical studies, clinical trials or other studies for our product candidates;

further develop our gene therapy platform, including the process for design, delivery and manufacturing of our vectors for our product candidates;

change or add additional manufacturers or suppliers;

seek regulatory and marketing approvals for our product candidates that successfully complete clinical trials;

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establish a sales, marketing and distribution infrastructure to commercialize any products for which we may obtain marketing approval;

seek to identify and validate additional product candidates;

acquire or in-license other product candidates and technologies;

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make milestone or other payments under any in-license agreements;

maintain, protect and expand our intellectual property portfolio;

attract and retain skilled personnel;

create additional infrastructure to support our operations as a public company and our product development and planned future commercialization efforts; and

experience any delays or encounter issues with any of the above.

The net losses we incur may fluctuate significantly from quarter to quarter and year to year, such that a period-to-period comparison of our results of operations may not be a good indication of our future performance. In any particular quarter or quarters, our operating results could be below the expectations of securities analysts or investors, which could cause our stock price to decline.

***Our ability to generate revenue from product sales is highly uncertain and we may never achieve or sustain profitability, which could depress the market price of our common stock, and could cause you to lose part or all of your investment.***

All of our revenue generated to date has come from research grants from third parties or license fees or milestone payments from a collaborator. Our ability to generate substantial revenue and achieve profitability depends on our ability, alone or with strategic collaboration partners, to successfully complete the development of, and obtain the regulatory approvals necessary to commercialize, our product candidates. We do not anticipate generating revenues from product sales for at least the next several years, if ever. If any of our product candidates fail in clinical trials or do not gain regulatory approval, or if any of our product candidates, if approved, fail to achieve market acceptance, we may never become profitable. Even if we achieve profitability in the future, we may not be able to sustain profitability in subsequent periods. Our ability to generate future revenues from product sales depends heavily on our success in:

completing research and preclinical and clinical development of our product candidates;

seeking and obtaining regulatory and marketing approvals for product candidates for which we complete clinical trials;

establishing and maintaining supply and manufacturing relationships with third parties that can provide adequate (in amount and quality) products and services to support clinical development and the market demand for our product candidates, if approved;

launching and commercializing product candidates for which we obtain regulatory and marketing approval, either by collaborating with a partner or, if launched independently, by establishing a sales, marketing and distribution infrastructure;

obtaining and maintaining adequate coverage and reimbursement from third-party payors for our product candidates;

obtaining market acceptance of our product candidates and gene therapy as a viable treatment option;

addressing any competing technological and market developments;

implementing additional internal systems and infrastructure, as needed;

identifying and validating new gene therapy product candidates;

negotiating favorable terms in any collaboration, licensing or other arrangements into which we may enter;

maintaining, protecting and expanding our portfolio of intellectual property rights, including patents, trade secrets and know-how; and

attracting, hiring and retaining qualified personnel.

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Even if one or more of the product candidates that we develop is approved for commercial sale, we anticipate incurring significant costs associated with commercializing any approved product candidate, particularly to the extent that we seek to commercialize any product for an indication, such as wet AMD, that has a patient population significantly larger than those addressed by our current lead product candidates. Our expenses could increase beyond expectations if we are required by the FDA, the EMA or other regulatory agencies, domestic or foreign, to perform clinical trials and other studies in addition to those that we currently anticipate. Even if we are able to generate revenues from the sale of any approved products, we may not become profitable and may need to obtain additional funding to continue operations. Our failure to become and remain profitable would depress the market price of our common stock and could impair our ability to raise capital, expand our business, diversify our product offerings or continue our operations.

***In order to obtain regulatory approval for and commercialize our product candidates, we will need to raise additional funding in the future, which may not be available on acceptable terms, or at all. Failure to obtain necessary capital when needed may force us to delay, limit or terminate our product development efforts or other operations.***

All of our lead programs in orphan ophthalmology are currently in preclinical development. Developing gene therapy products is expensive, and we expect our research and development expenses to increase substantially as we advance our current product candidates in clinical trials and as we undertake preclinical studies of new product candidates.

Our operations have consumed substantial amounts of cash since inception. As of March 31, 2014, our cash and cash equivalents and short-term investments were \$24.5 million, which does not include the net proceeds of approximately \$58.1 million we received in connection with our initial public offering. Our research and development expenses were \$2.4 million and \$3.1 million for the fiscal years ended June 30, 2012 and 2013, respectively, and \$1.9 million and \$5.8 million for the nine months ended March 31, 2013 and 2014, respectively. We estimate that the net proceeds from this offering will be approximately \$34.4 million, based on an assumed public offering price of \$18.52 per share, which was the last reported price of our common stock on The NASDAQ Global Market on July 18, 2014, after deducting estimated underwriting discounts and commissions and estimated offering expenses payable by us. We expect that the net proceeds from this offering and our existing cash and cash equivalents will be sufficient to enable us to complete planned preclinical studies and clinical trials for our lead product candidates for at least the next 24 months. See Use of Proceeds. In order to complete the process of obtaining regulatory approval for our lead product candidates and to build the sales, marketing and distribution infrastructure that we believe will be necessary to commercialize our lead product candidates, if approved, we will require substantial additional funding. Also, our current operating plan may change as a result of many factors currently unknown to us, and we may need to seek additional funds sooner than planned, through public or private equity or debt financings, government or other third-party funding, marketing and distribution arrangements and other collaborations, strategic alliances and licensing arrangements, or a combination of these approaches.

Any additional fundraising efforts may divert our management from their day-to-day activities, which may adversely affect our ability to develop and commercialize our product candidates. In addition, financing may not be available to us in the future in sufficient amounts or on terms acceptable to us, if at all. Moreover, the terms of any financing may adversely affect the holdings or the rights of our stockholders and the issuance of additional securities, whether equity or debt, by us, or the possibility of such issuance, may cause the market price of our shares to decline. The sale of additional equity or convertible securities would dilute all of our stockholders. The incurrence of indebtedness would result in increased fixed payment obligations and a portion of our operating cash flows, if any, being dedicated to the payment of principal and interest on such indebtedness, and we may be required to agree to certain restrictive covenants, such as limitations on our ability to incur additional debt, limitations on our ability to acquire, sell or license intellectual property rights and other operating restrictions that could adversely impact our ability to conduct our business. We could also be required to seek funds through arrangements with collaborative partners or otherwise at an earlier stage than otherwise would be desirable or on



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terms that are less favorable than might otherwise be available, and we may be required to relinquish or license on unfavorable terms rights to some of our technologies or product candidates or otherwise agree to terms unfavorable to us, any of which may have a material adverse effect on our business, financial condition, results of operations and prospects and cause the price of our common stock to decline.

If we are unable to obtain needed funding on a timely basis, we may be required to significantly curtail, delay or discontinue one or more of our research or development programs or the commercialization of any product candidates or be unable to expand our operations or otherwise capitalize on our business opportunities, as desired, which could materially affect our business, financial condition, results of operations and prospects and cause the price of our common stock to decline.

### **Risks related to the discovery and development of our product candidates**

*All of our product candidates are in preclinical or clinical development. Clinical drug development is expensive, time consuming and uncertain, and we may ultimately not be able to obtain regulatory approvals for the commercialization of some or all of our product candidates.*

The research, testing, manufacturing, labeling, approval, selling, marketing and distribution of drug products are subject to extensive regulation by the FDA and other regulatory authorities, which regulations differ from country to country. Our product candidates are in various stages of development and are subject to the risks of failure typical of drug development. The development and approval process is expensive and can take many years to complete, and its outcome is inherently uncertain. We have not submitted an application for or received marketing approval for any of our product candidates. We have limited experience in conducting and managing the later stage clinical trials necessary to obtain regulatory approvals, including approval by the FDA. To receive approval, we must, among other things, demonstrate with substantial evidence from clinical trials that the product candidate is both safe and effective for each indication for which approval is sought, and failure can occur in any stage of development. Satisfaction of the approval requirements typically takes several years and the time needed to satisfy them may vary substantially, based on the type, complexity and novelty of the pharmaceutical product. We cannot predict if or when we might receive regulatory approvals for any of our product candidates currently under development.

The FDA and foreign regulatory authorities also have substantial discretion in the drug approval process. The number and types of preclinical studies and clinical trials that will be required for regulatory approval varies depending on the product candidate, the disease or condition that the product candidate is designed to address, and the regulations applicable to any particular product candidate. Approval policies, regulations, or the type and amount of clinical data necessary to gain approval may change during the course of a product candidate's clinical development and may vary among jurisdictions, and there may be varying interpretations of data obtained from preclinical studies or clinical trials, either of which may cause delays or limitations in the approval or the decision not to approve an application. Regulatory agencies can delay, limit or deny approval of a product candidate for many reasons, including:

the FDA or comparable foreign regulatory authorities may disagree with the design or implementation of our clinical trials;

we may be unable to demonstrate to the satisfaction of the FDA or comparable foreign regulatory authorities that a product candidate is safe and effective for its proposed indication;

the results of clinical trials may not meet the level of statistical or clinical significance required by the FDA or comparable foreign regulatory authorities for approval;

the patients recruited for a particular clinical program may not be sufficiently broad or representative to assure safety in the full population for which we seek approval;

the results may not confirm the positive results from earlier preclinical studies or clinical trials;

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we may be unable to demonstrate that a product candidate's clinical and other benefits outweigh its safety risks;

the FDA or comparable foreign regulatory authorities may disagree with our interpretation of data from preclinical studies or clinical trials;

the data collected from clinical trials of our product candidates may not be sufficient to the satisfaction of FDA or comparable foreign regulatory authorities to support the submission of a biologics license application, or BLA, or other comparable submission in foreign jurisdictions or to obtain regulatory approval in the United States or elsewhere;

regulatory agencies might not approve or might require changes to our manufacturing processes or facilities; or

regulatory agencies may change their approval policies or adopt new regulations in a manner rendering our clinical data insufficient for approval.

Any delay in obtaining or failure to obtain required approvals could materially adversely affect our ability to generate revenue from the particular product candidate, which likely would result in significant harm to our financial position and adversely impact our stock price. Furthermore, any regulatory approval to market a product may be subject to limitations on the indicated uses for which we may market the product. These limitations may limit the size of the market for the product.

We are not permitted to market our product candidates in the United States or in other countries until we receive approval of a BLA from the FDA or marketing approval from applicable regulatory authorities outside the United States. Obtaining approval of a BLA can be a lengthy, expensive and uncertain process. If we fail to obtain FDA approval to market our product candidates, we will be unable to sell our product candidates in the United States, which will significantly impair our ability to generate any revenues. In addition, failure to comply with FDA and non-U.S. regulatory requirements may, either before or after product approval, if any, subject our company to administrative or judicially imposed sanctions, including:

restrictions on our ability to conduct clinical trials, including full or partial clinical holds on ongoing or planned trials;

restrictions on the products, manufacturers or manufacturing process;

warning letters;

civil and criminal penalties;

injunctions;

suspension or withdrawal of regulatory approvals;

product seizures, detentions or import bans;

voluntary or mandatory product recalls and publicity requirements;

total or partial suspension of production;

imposition of restrictions on operations, including costly new manufacturing requirements; and

refusal to approve pending BLAs or supplements to approved BLAs.

Even if we do receive regulatory approval to market a product candidate, any such approval may be subject to limitations on the indicated uses for which we may market the product. It is possible that none of our existing product candidates or any product candidates we may seek to develop in the future will ever obtain the appropriate regulatory approvals necessary for us or our collaborators to commence product sales. Any delay in obtaining, or an inability to obtain, applicable regulatory approvals would prevent us from commercializing our product candidates, generating revenues and achieving and sustaining profitability.

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***Our gene therapy product candidates are based on a novel technology, which makes it difficult to predict the time and cost of product candidate development and subsequently obtaining regulatory approval. At the moment, no gene therapy products have been approved in the United States and only one such product has been approved in Europe.***

We have concentrated our product research and development efforts on our gene therapy platform, and our future success depends on the successful development of this approach. There can be no assurance that any development problems we experience in the future related to our gene therapy platform will not cause significant delays or unanticipated costs, or that such development problems can be solved. We may also experience unanticipated problems or delays in expanding our manufacturing capacity or transferring our manufacturing process to commercial partners, which may prevent us from completing our clinical trials or commercializing our products on a timely or profitable basis, if at all.

In addition, the clinical trial requirements of the FDA, the EMA and other regulatory agencies and the criteria these regulators use to determine the safety and efficacy of a product candidate vary substantially according to the type, complexity, novelty and intended use and market of such product candidates. The regulatory approval process for novel product candidates such as ours can be more expensive and take longer than for other, better known or extensively studied pharmaceutical or other product candidates. At the moment, only one gene therapy product, uniQure B.V.'s Glybera, which received marketing authorization from the EMA in 2012, has been approved in Europe but has not yet been launched for commercial sale, which makes it difficult to determine how long it will take or how much it will cost to obtain regulatory approvals for our product candidates in either the United States or Europe. Approvals by the EMA may not be indicative of what the FDA may require for approval.

Regulatory requirements governing gene and cell therapy products have changed frequently and may continue to change in the future. For example, the FDA has established the Office of Cellular, Tissue and Gene Therapies within its Center for Biologics Evaluation and Research, or CBER, to consolidate the review of gene therapy and related products, and the Cellular, Tissue and Gene Therapies Advisory Committee to advise CBER on its review. Gene therapy clinical trials conducted at institutions that receive funding for recombinant DNA research from the United States National Institutes of Health, or the NIH, are also subject to review by the NIH Office of Biotechnology Activities' Recombinant DNA Advisory Committee, or the RAC. Although the FDA decides whether individual gene therapy protocols may proceed, the RAC review process can delay the initiation of a clinical trial, even if the FDA has reviewed the trial design and details and approved its initiation. Conversely, the FDA can put an IND on clinical hold even if the RAC has provided a favorable review of the drug. Also, before a clinical trial can begin at an NIH-funded institution, that institution's institutional review board, or IRB, and its Institutional Biosafety Committee have to review the proposed clinical trial to assess the safety of the trial. In addition, adverse developments in clinical trials of gene therapy products conducted by others may cause the FDA or other regulatory bodies to change the requirements for approval of any of our product candidates.

These regulatory review committees and advisory groups and the new guidelines they promulgate may lengthen the regulatory review process, require us to perform additional studies, increase our development costs, lead to changes in regulatory positions and interpretations, delay or prevent approval and commercialization of these product candidates or lead to significant post-approval limitations or restrictions. As we advance our product candidates, we will be required to consult with these regulatory and advisory groups, and comply with applicable guidelines. If we fail to do so, we may be required to delay or discontinue development of our product candidates. These additional processes may result in a review and approval process that is longer than we otherwise would have expected for orphan ophthalmology product candidates. Delay or failure to obtain, or unexpected costs in obtaining, the regulatory approval necessary to bring a potential product to market could decrease our ability to generate sufficient product revenue to maintain our business.

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### ***Success in animal studies or early clinical trials may not be indicative of results obtained in later trials.***

Trial designs and results from animal studies or previous clinical trials are not necessarily predictive of our future clinical trial designs or results, and interim results of a clinical trial are not necessarily indicative of final results. Our product candidates may also fail to show the desired safety and efficacy in clinical development despite demonstrating positive results in animal studies or having successfully advanced through initial clinical trials. For example, our animal studies of our AAT product candidate resulted in evidence of significant production of AAT levels, but early clinical trials of our product candidate showed significantly lower levels of AAT production in treated patients. There can be no assurance that the success we achieved in the animal studies for our lead product candidates will result in success in our clinical trials of those product candidates. In addition, we cannot assure you that we will be able to achieve the same or similar success in our preclinical studies and clinical trials of our wet AMD product candidate as those obtained by Genzyme in its studies for the treatment of wet AMD.

There is a high failure rate for drugs and biological products proceeding through clinical trials. A number of companies in the pharmaceutical and biotechnology industries have suffered significant setbacks in later stage clinical trials even after achieving promising results in earlier stage clinical trials. Data obtained from preclinical and clinical activities are subject to varying interpretations, which may delay, limit or prevent regulatory approval. In addition, we may experience regulatory delays or rejections as a result of many factors, including due to changes in regulatory policy during the period of our product candidate development.

### ***We may find it difficult to enroll patients in our clinical trials, which could delay or prevent clinical trials of our product candidates.***

Identifying and qualifying patients to participate in clinical trials of our product candidates is critical to our success. The timing of our clinical trials depends on the speed at which we can recruit patients to participate in testing our product candidates as well as completion of required follow-up periods. If patients are unwilling to participate in our gene therapy studies because of negative publicity from adverse events in the biotechnology or gene therapy industries or for other reasons, including competitive clinical trials for similar patient populations, the timeline for recruiting patients, conducting studies and obtaining regulatory approval of our product candidates may be delayed. For example, trials using early versions of lentiviral vectors, which integrate with, and thereby alter, the host cell's DNA, have led to several well-publicized adverse events, including reported cases of leukemia. If there are delays in accumulating the required number of clinical events in trials for our product candidates where clinical events are a primary endpoint, there may be delays in completing the trial. These delays could result in increased costs, delays in advancing our product candidates, delays in testing the effectiveness of our technology or termination of the clinical trials altogether.

We may not be able to identify, recruit and enroll a sufficient number of patients, or those with required or desired characteristics to achieve diversity in a trial, to complete our clinical trials in a timely manner. In particular, each of the conditions for which we plan to evaluate our product candidates are rare genetic disorders with limited patient pools from which to draw for clinical trials. The eligibility criteria of our clinical trials will further limit the pool of available trial participants.

Patient enrollment is affected by factors including:

severity of the disease under investigation;

design of the clinical trial protocol;

size and nature of the patient population;

eligibility criteria for the trial in question;

perceived risks and benefits of the product candidate under trial;

proximity and availability of clinical trial sites for prospective patients;

availability of competing therapies and clinical trials;

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clinicians and patients' perceptions as to the potential advantages of the drug being studied in relation to other available therapies, including any new drugs that may be approved for the indications we are investigating;

efforts to facilitate timely enrollment in clinical trials;

patient referral practices of physicians; and

our ability to monitor patients adequately during and after treatment.

If we have difficulty enrolling a sufficient number of patients to conduct our clinical trials as planned, we may be forced to delay, limit or terminate ongoing or planned clinical trials, any of which would have an adverse effect on our business. We could encounter delays if physicians encounter unresolved ethical issues associated with enrolling patients in clinical trials of our product candidates in lieu of prescribing existing treatments that have established safety and efficacy profiles.

We plan to seek initial marketing approval for our product candidates in the United States and the European Economic Area, or EEA. We may not be able to initiate or continue clinical trials if we cannot enroll a sufficient number of eligible patients to participate in the clinical trials required by the FDA, the EMA or other foreign regulatory authorities. Our ability to successfully initiate, enroll and complete a clinical trial in any foreign country is subject to numerous risks unique to conducting business in foreign countries, including:

difficulty in establishing or managing relationships with contract research organizations, or CROs, and physicians;

different standards for conducting clinical trials;

our inability to locate qualified local consultants, physicians and partners; and

the potential burden of complying with a variety of foreign laws, medical standards and regulatory requirements, including the regulation of pharmaceutical and biotechnology products and treatments.

***We may encounter substantial delays in our clinical trials or we may fail to demonstrate safety and efficacy to the satisfaction of applicable regulatory authorities.***

Before obtaining marketing approval from regulatory authorities for the sale of our product candidates, we must conduct extensive clinical trials to demonstrate the safety and efficacy of such product candidates in humans. Clinical testing is expensive, time-consuming and uncertain as to outcome. We cannot guarantee that any clinical trials will be conducted as planned or completed on schedule, if at all. A failure of one or more clinical trials can occur at any stage of testing. Events that may prevent successful or timely completion of clinical development include:

delays in raising, or inability to raise, sufficient capital to fund the planned clinical trials;

inability to generate sufficient preclinical, toxicology, or other data to support the initiation of human clinical trials;

delays in reaching a consensus with regulatory agencies on trial design;

identifying, recruiting and training suitable clinical investigators;

delays in reaching agreement on acceptable terms with prospective CROs and clinical trial sites, the terms of which can be subject to extensive negotiation and may vary significantly among different CROs and trial sites;

delays in obtaining required IRB approval at each clinical trial site;

delays in recruiting suitable patients to participate in our clinical trials;



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delays due to changing standard of care for the diseases we are targeting;

adding new clinical trial sites;

imposition of a clinical hold by regulatory agencies, after review of an IND application or equivalent application or an inspection of our clinical trial operations or trial sites;

failure by our CROs, other third parties or us to adhere to clinical trial requirements;

loss of product due to shipping delays or delays in customs in connection with delivery to foreign countries for use in clinical trials;

failure to perform in accordance with the FDA's good clinical practices, or GCP requirements or applicable regulatory guidelines in other countries;

inability to manufacture, test, release, import or export for use sufficient quantities of our product candidates for use in clinical trials;

failure to manufacture our product candidate in accordance with the FDA's good manufacturing practice, or GMP, requirements or applicable regulatory guidelines in other countries;

delays in the testing, validation and delivery of our product candidates to the clinical trial sites;

delays in having patients complete participation in a trial or return for post-treatment follow-up;

clinical trial sites deviating from trial protocol or clinical trial sites or patients dropping out of a trial;

occurrence of serious adverse events associated with the product candidate that are viewed to outweigh its potential benefits;

changes in regulatory requirements and guidance that require amending or submitting new clinical protocols;

the costs of clinical trials of our product candidates may be greater than we anticipate; or

clinical trials of our product candidates may produce negative or inconclusive results, and we may decide, or regulators may require us, to conduct additional clinical trials or abandon drug development programs.

Further, a clinical trial may be suspended or terminated by us, our collaborators, the IRBs, in the institutions in which such trials are being conducted, the Data Safety Monitoring Board, or DSMB, for such trial, or by the FDA or other regulatory authorities due to a number of factors, including failure to conduct the clinical trial in accordance with regulatory requirements or our clinical protocols, inspection of the clinical trial operations or trial site by the FDA or other regulatory authorities resulting in the imposition of a clinical hold, unforeseen safety issues or adverse side effects, failure to demonstrate a benefit from using a product candidate, changes in governmental regulations or administrative

actions or lack of adequate funding to continue the clinical trial. If we experience termination of, or delays in the completion of, any clinical trial of our product candidates, the commercial prospects of our product candidates will be harmed, and our ability to generate product revenues from any of these product candidates will be delayed. Furthermore, many of the factors that cause, or lead to, a delay in the commencement or completion of clinical trials may also ultimately lead to the denial of regulatory approval of our product candidates.

Any inability to successfully complete preclinical and clinical development could result in additional costs to us or impair our ability to generate revenues from product sales, regulatory and commercialization milestones and royalties. In addition, if we or our third-party collaborators make manufacturing or formulation changes to product candidates, we or they may need to conduct additional trial to bridge the modified product candidates to earlier versions. Clinical trial delays could also shorten any periods during which we may have the exclusive right to commercialize our product candidates or allow our competitors to bring products to market before we do, which could impair our ability to successfully commercialize our product candidates and may harm our business and results of operations.

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If the results of our clinical trials are inconclusive or if there are safety concerns or adverse events associated with our product candidates, we may:

be delayed in obtaining marketing approval for our product candidates, if at all;

obtain approval for indications or patient populations that are not as broad as intended or desired;

obtain approval with labeling that includes significant use or distribution restrictions or safety warnings;

be subject to changes with the way the product is administered;

be required to perform additional clinical trials to support approval or be subject to additional post-marketing testing requirements;

have regulatory authorities withdraw their approval of the product or impose restrictions on its distribution in the form of a modified risk evaluation and mitigation strategy;

be subject to the addition of labeling statements, such as warnings or contraindications;

be sued; or

experience damage to our reputation.

Any of these events could prevent us from achieving or maintaining market acceptance of our product candidates and impair our ability to commercialize our product candidates.

***Our product candidates may cause undesirable side effects or have other properties that could delay or prevent their regulatory approval, limit the commercial profile of an approved label, or result in significant negative consequences following any potential marketing approval.***

As with many pharmaceutical and biological products, treatment with our product candidates may produce undesirable side effects or adverse reactions or events. These adverse events may occur despite our belief that our AAV vectors have an improved safety profile over prior such treatments.

Known adverse side effects that could occur with treatment with AAV vectors include an immunologic reaction to the capsid protein or gene at early timepoints after administration. In previous clinical trials involving AAV viral vectors for gene therapy, some subjects experienced serious adverse events, including the development of T-cell response due to immune response against the vector capsid proteins. If our vectors demonstrate a similar effect, or other adverse events, we may be required to halt or delay further clinical development of our product candidates. In addition, theoretical adverse side effects of AAV vectors include replication and spread of the virus to other parts of the body and insertional oncogenesis, which is the process whereby the insertion of a functional gene near a gene that is important in cell growth or division results in uncontrolled cell division, also known as cancer, which could potentially enhance the risk of malignant transformation. Potential procedure-related events, including inflammation or injury to the eye, are similar to those associated with standard ophthalmic intervention procedures. There is also the potential risk of delayed adverse events following exposure to gene therapy products due to persistent biological activity of the genetic material or other components of products used to carry the genetic material.

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If any such adverse events occur, our clinical trials could be suspended or terminated and the FDA, the EMA or other foreign regulatory authorities could order us to cease further development of or deny approval of our product candidates for any or all targeted indications. The product-related side effects could affect patient recruitment or the ability of enrolled patients to complete the trial. If we elect or are required to delay, suspend or terminate any clinical trial of any of our product candidates, the commercial prospects of such product candidates will be harmed and our ability to generate product revenues from any of these product candidates will be delayed or eliminated. Any of these occurrences may harm our business, financial condition and prospects significantly.

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Additionally, if any of our product candidates receive marketing approval, the FDA could require us to adopt a Risk Evaluation and Mitigation Strategy, or REMS, to ensure that the benefits outweigh its risks, which may include, among other things, a medication guide outlining the risks of gene therapies for distribution to patients and a communication plan to health care practitioners. Furthermore, if we or others later identify undesirable side effects caused by our product candidate, a number of potentially significant negative consequences could result, including:

regulatory authorities may withdraw approvals of such product candidate;

regulatory authorities may require additional warnings on the label;

we may be required to create a medication guide outlining the risks of such side effects for distribution to patients;

we may be required to change the way a product candidate is administered or conduct additional clinical trials;

we could be sued and held liable for harm caused to patients; and

our reputation may suffer.

Any of these events could prevent us from achieving or maintaining market acceptance of our product candidates and could significantly harm our business, prospects, financial condition and results of operations.

***We may be unable to obtain orphan product designation or exclusivity for some of our product candidates. If our competitors are able to obtain orphan product exclusivity for their products that are the same as our product candidates, we may not be able to have competing products approved by the applicable regulatory authority for a significant period of time.***

Regulatory authorities in some jurisdictions, including the United States and Europe, may designate drugs for relatively small patient populations as orphan drugs. Under the Orphan Drug Act of 1983, the FDA may designate a product candidate as an orphan drug if it is intended to treat a rare disease or condition, which is generally defined as having a patient population of fewer than 200,000 individuals diagnosed annually in the United States, or a patient population greater than 200,000 in the United States where there is no reasonable expectation that the cost of developing the drug will be recovered from sales in the United States. In the European Union, the EMA's Committee for Orphan Medicinal Products, or COMP, grants orphan drug designation to promote the development of products that are intended for the diagnosis, prevention or treatment of a life-threatening or chronically debilitating condition affecting not more than 5 in 10,000 persons in the European Union Community. Additionally, designation is granted for products intended for the diagnosis, prevention or treatment of a life-threatening, seriously debilitating or serious and chronic condition and when, without incentives, it is unlikely that sales of the drug in the European Union would be sufficient to justify the necessary investment in developing the drug or biological product. Our product candidates for the treatment of LCA2, XLRS, ACHM (in the form caused by mutations in the CNGB3 gene) and AAT deficiency have been granted orphan drug designations by the FDA, but at this time we have neither requested nor obtained orphan drug designation for any of our other product candidates. Even if we request orphan drug designation for our other product candidates, there can be no assurances that the FDA will grant any of our product candidates such designation. Additionally, the designation by the FDA of any of our product candidates as an orphan drug does not guarantee that the FDA will accelerate regulatory review of or ultimately approve that product candidate.

Generally, if a product candidate with an orphan drug designation subsequently receives the first marketing approval for the indication for which it has such designation, the product is entitled to a period of marketing exclusivity, which precludes the EMA or the FDA from approving another marketing application for the same drug and indication for that time period, except in limited circumstances. The applicable period is seven years in the United States and 10 years in Europe. The European exclusivity period can be reduced to six years if a product no longer meets the criteria for orphan drug designation or if the product is sufficiently profitable so that

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market exclusivity is no longer justified. Orphan drug exclusivity may be lost if the FDA or EMA determines that the request for designation was materially defective or if the manufacturer is unable to assure sufficient quantity of the product to meet the needs of patients with the rare disease or condition.

Even if we obtain orphan drug exclusivity for a product candidate, that exclusivity may not effectively protect the product candidate from competition because different drugs can be approved for the same condition. In the United States, even after an orphan drug is approved, the FDA can subsequently approve another drug for the same condition if the FDA concludes that the later drug is clinically superior in that it is shown to be safer, more effective or makes a major contribution to patient care.

***Even if we complete the necessary clinical trials, we cannot predict when or if we will obtain regulatory approval to commercialize a product candidate or the approval may be for a more narrow indication than we expect.***

We cannot commercialize a product candidate until the appropriate regulatory authorities have reviewed and approved the product candidate. Even if our product candidates demonstrate safety and efficacy in clinical trials, the regulatory agencies may not complete their review processes in a timely manner, or we may not be able to obtain regulatory approval. Additional delays may result if an FDA Advisory Committee or other regulatory authority recommends non-approval or restrictions on approval. In addition, we may experience delays or rejections based upon additional government regulation from future legislation or administrative action, or changes in regulatory agency policy during the period of product development, clinical trials and the review process. Regulatory agencies also may approve a product candidate for fewer or more limited indications than requested, may not approve the price we intend to charge for our product candidate, may impose significant limitations in the form of narrow indications, warnings, precautions or contra-indications with respect to conditions of use or may grant approval subject to the performance of costly post-marketing clinical trials. In addition, regulatory agencies may not approve the labeling claims that are necessary or desirable for the successful commercialization of our product candidates. Any of the foregoing scenarios could materially harm the commercial prospects for our product candidates.

***Even if we obtain regulatory approval for a product candidate, our products will remain subject to regulatory scrutiny.***

Even if we obtain regulatory approval in a jurisdiction for our product candidates, they will be subject to ongoing regulatory requirements for manufacturing, labeling, packaging, storage, advertising, promotion, sampling, record-keeping, and submission of safety and other post-market information. Any regulatory approvals that we receive for our product candidates may also be subject to limitations on the approved indicated uses for which the product may be marketed or to the conditions of approval, or contain requirements for potentially costly post-marketing testing, including Phase 4 clinical trials, and surveillance to monitor the safety and efficacy of the product. For example, the holder of an approved BLA is obligated to monitor and report adverse events and any failure of a product to meet the specifications in the BLA. FDA guidance advises that patients treated with some types of gene therapy undergo follow-up observations for potential adverse events for as long as 15 years. The holder of an approved BLA must also submit new or supplemental applications and obtain FDA approval for certain changes to the approved product, product labeling or manufacturing process. Advertising and promotional materials must comply with FDA rules and are subject to FDA review, in addition to other potentially applicable federal and state laws.

In addition, product manufacturers and their facilities are subject to payment of user fees and continual review and periodic inspections by the FDA and other regulatory authorities for compliance with GMP requirements and adherence to commitments made in the BLA or foreign marketing application. If we or a regulatory agency discovers previously unknown problems with a product such as adverse events of unanticipated severity or frequency, or problems with the facility where the product is manufactured or disagrees with the promotion, marketing or labeling of that product, a regulatory agency may impose restrictions relative to that product, the manufacturing facility or us, including requiring recall or withdrawal of the product from the market or suspension of manufacturing.

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If we fail to comply with applicable regulatory requirements following approval of any of our product candidates, a regulatory agency may:

issue a warning letter asserting that we are in violation of the law;

seek an injunction or impose civil or criminal penalties or monetary fines;

suspend or withdraw regulatory approval;

suspend any ongoing clinical trials;

refuse to approve a pending BLA or comparable foreign marketing application (or any supplements thereto) submitted by us or our strategic partners;

restrict the marketing or manufacturing of the product;

seize or detain product or otherwise require the withdrawal of product from the market;

refuse to permit the import or export of products; or

refuse to allow us to enter into supply contracts, including government contracts.

Any government investigation of alleged violations of law could require us to expend significant time and resources in response and could generate negative publicity. The occurrence of any event or penalty described above may inhibit our ability to commercialize our product candidates and generate revenues.

In addition, the FDA's policies may change and additional government regulations may be enacted that could prevent, limit or delay regulatory approval of our product candidates. We cannot predict the likelihood, nature or extent of government regulation that may arise from future legislation or administrative action, either in the United States or abroad. If we are slow or unable to adapt to changes in existing requirements or the adoption of new requirements or policies, or if we are not able to maintain regulatory compliance, we may lose any marketing approval that we may have obtained and we may not achieve or sustain profitability, which would adversely affect our business, prospects, financial condition and results of operations.

***Even if we obtain and maintain approval for our product candidates from the FDA, we may never obtain approval for our product candidates outside of the United States, which would limit our market opportunities and adversely affect our business.***

Approval of a product candidate in the United States by the FDA does not ensure approval of such product candidate by regulatory authorities in other countries or jurisdictions, and approval by one foreign regulatory authority does not ensure approval by regulatory authorities in other foreign countries or by the FDA. Sales of our product candidates outside of the United States will be subject to foreign regulatory requirements governing clinical trials and marketing approval. Even if the FDA grants marketing approval for a product candidate, comparable regulatory authorities of foreign countries must also approve the manufacturing and marketing of the product candidates in those countries. Approval procedures vary among jurisdictions and can involve requirements and administrative review periods different from, and greater than, those in the United States, including additional preclinical studies or clinical trials. In many countries outside the United States, a product candidate must be approved for reimbursement before it can be approved for sale in that country. In some cases, the price that we intend to charge for our products, if approved, is also subject to approval. We intend to submit a marketing authorization application to the EMA for approval in the EEA, but obtaining such approval is a lengthy and expensive process and the EMA has its own procedures for approval of product candidates.

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Even if a product candidate is approved, the FDA or the EMA, as the case may be, may limit the indications for which the product may be marketed, require extensive warnings on the product labeling or require expensive and time-consuming clinical trials or reporting as conditions of approval. Regulatory authorities in countries outside of the United States and the EEA also have requirements for approval of product candidates with which we must comply prior to marketing in those countries. Obtaining foreign regulatory approvals and compliance with foreign regulatory requirements could result in significant delays, difficulties and costs for us and could delay or prevent the introduction of our product candidates in certain countries.

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Further, clinical trials conducted in one country may not be accepted by regulatory authorities in other countries and regulatory approval of a product candidate in one country does not ensure approval in any other country, while a failure or delay in obtaining regulatory approval in one country may have a negative effect on the regulatory approval process in others. Also, regulatory approval for any of our product candidates may be withdrawn. If we fail to comply with the regulatory requirements in international markets and/or receive applicable marketing approvals, our target market will be reduced and our ability to realize the full market potential of our product candidates will be harmed and our business will be adversely affected.

### **Risks related to our reliance on third parties**

*We expect to rely on third parties to conduct aspects of our product manufacturing and protocol development, and these third parties may not perform satisfactorily.*

We do not expect to independently conduct all aspects of our vector production, product manufacturing, protocol development, and monitoring and management of our ongoing and planned preclinical and clinical programs. Although we intend to use a portion of the proceeds of this offering to expand our manufacturing capabilities and, in particular, to develop a pilot program for the in-house manufacture of materials for our clinical trials, we currently rely, and expect to continue to rely, to a significant degree, on third parties for the production of our clinical trial materials. In such cases, we expect to control only certain aspects of their activities.

Under certain circumstances, these third parties may be entitled to terminate their engagements with us. If we need to enter into alternative arrangements, it could delay our product development activities. Our reliance on these third parties for research and development activities will reduce our control over these activities but will not relieve us of our responsibility to ensure compliance with all required regulations and study and trial protocols. If these third parties do not successfully carry out their contractual duties, meet expected deadlines or conduct our studies in accordance with regulatory requirements or our stated study and trial plans and protocols, or if there are disagreements between us and these third parties, we will not be able to complete, or may be delayed in completing, the preclinical studies and clinical trials required to support future IND submissions and approval of our product candidates. In some such cases we may need to locate an appropriate replacement third-party relationship, which may not be readily available or on acceptable terms, which would cause additional delay with respect to the approval of our product candidates and would thereby have a material adverse effect on our business, financial condition, results of operations and prospects.

In addition, reliance on third-party manufacturers entails risks to which we would not be subject if we manufactured the product candidates ourselves, including:

the inability to negotiate manufacturing agreements with third parties under commercially reasonable terms;

reduced control as a result of using third-party manufacturers for all aspects of manufacturing activities;

termination or nonrenewal of manufacturing agreements with third parties in a manner or at a time that is costly or damaging to us; and

disruptions to the operations of our third-party manufacturers or suppliers caused by conditions unrelated to our business or operations, including the bankruptcy of the manufacturer or supplier.

Any of these events could lead to clinical trial delays or failure to obtain regulatory approval, or impact our ability to successfully commercialize future product candidates. Some of these events could be the basis for FDA action, including injunction, recall, seizure or total or partial suspension of product manufacture.

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***We and our contract manufacturer are subject to significant regulatory oversight with respect to manufacturing our products. The manufacturing facilities on which we rely may not continue to meet regulatory requirements and may have limited capacity.***

All parties involved in the preparation of therapeutics for clinical trial or commercial sale, including our existing contract manufacturer for our product candidates, SAFC Pharma, are subject to extensive regulation. Components of a finished therapeutic product approved for commercial sale or used in late-stage clinical trials must be manufactured in accordance with GMP requirements. These regulations govern manufacturing processes and procedures (including record keeping) and the implementation and operation of quality systems to control and assure the quality of investigational products and products approved for sale. Poor control of production processes can lead to the introduction of adventitious agents or other contaminants, or to inadvertent changes in the properties or stability of our product candidates that may not be detectable in final product testing. We or our contract manufacturers must supply all necessary documentation in support of a BLA on a timely basis and must adhere to the FDA's GMP requirements enforced by the FDA through its facilities inspection program. Our facilities and quality systems and the facilities and quality systems of some or all of our third-party contractors must pass a pre-approval inspection for compliance with the applicable regulations as a condition of regulatory approval of our product candidates. In addition, the regulatory authorities may, at any time, audit or inspect a manufacturing facility involved with the preparation of our product candidates or the associated quality systems for compliance with the regulations applicable to the activities being conducted. If these facilities do not pass a pre-approval plant inspection, FDA approval of the products will not be granted.

The regulatory authorities also may, at any time following approval of a product for sale, audit our manufacturing facilities or those of our third-party manufacturers. If any such inspection or audit identifies a failure to comply with applicable regulations or if a violation of our product specifications or applicable regulations occurs independent of such an inspection or audit, we or the relevant regulatory authority may require remedial measures that may be costly and/or time-consuming for us or our third-party manufacturers to implement and that may include the temporary or permanent suspension of a clinical trial or commercial sales or the temporary or permanent closure of a manufacturing facility. Any such remedial measures imposed upon us or third parties with whom we contract could materially harm our business.

If we or any of our third-party manufacturers fail to maintain regulatory compliance, the FDA can impose regulatory sanctions including, among other things, refusal to approve a pending application for a new product candidate, or revocation of a pre-existing approval. Such an occurrence may cause our business, financial condition and results of operations to be materially harmed.

Additionally, if supply from an approved manufacturer is interrupted, there could be a significant disruption in commercial supply of our products. We do not currently have a backup manufacturer of our product candidate supply for clinical trials or commercial sale. An alternative manufacturer would need to be qualified through a BLA supplement which could result in further delay. The regulatory agencies may also require additional trials if a new manufacturer is relied upon for commercial production. Switching manufacturers may involve substantial costs and is likely to result in a delay in our desired clinical and commercial timelines.

These factors could cause the delay of clinical trials, regulatory submissions, required approvals or commercialization of our product candidates, cause us to incur higher costs and prevent us from commercializing our products successfully. Furthermore, if our suppliers fail to meet contractual requirements, and we are unable to secure one or more replacement suppliers capable of production at a substantially equivalent cost, our clinical trials may be delayed or we could lose potential revenue.

***We expect to rely on third parties to conduct, supervise and monitor our clinical trials, and if these third parties perform in an unsatisfactory manner, it may harm our business.***

We expect to rely on academic research institutions and other CROs along with clinical trial sites to ensure our clinical trials are conducted properly and on time. While we will have agreements governing their activities,

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we will have limited influence over their actual performance and will control only certain aspects of our CROs' activities. Nevertheless, we will be responsible for ensuring that each of our clinical trials is conducted in accordance with the applicable protocol, legal, regulatory and scientific standards, and our reliance on the CROs does not relieve us of our regulatory responsibilities.

We and our CROs are required to comply with the FDA's and other regulatory authorities' GCP, GMP and good laboratory practice, or GLP, requirements for conducting, recording and reporting the results of our preclinical studies and clinical trials to assure that the data and reported results are credible and accurate and that the rights, integrity and confidentiality of clinical trial participants are protected. The FDA enforces these requirements through periodic inspections of study sponsors, principal investigators and clinical trial sites. If we or our CROs fail to comply with applicable GCP requirements, the clinical data generated in our future clinical trials may be deemed unreliable and the FDA may require us to perform additional clinical trials before approving any marketing applications. Upon inspection, the FDA may determine that our clinical trials did not comply with GCP requirements, which may render the data generated in those trials unreliable. In addition, our future clinical trials will require a sufficient number of test subjects to evaluate the safety and effectiveness of our product candidates. Accordingly, if our CROs fail to comply with these regulations or fail to recruit a sufficient number of patients, we may be required to repeat such clinical trials, which would delay the regulatory approval process.

Our CROs are not our employees, and, except for remedies available to us under our agreements with such CROs, we are therefore unable to directly monitor whether or not they devote sufficient time and resources to our clinical and nonclinical programs. These CROs may also have relationships with other commercial entities, including our competitors, for whom they may also be conducting clinical trials or other drug development activities that could harm our competitive position. If our CROs do not successfully carry out their contractual duties or obligations, fail to meet expected deadlines, or if the quality or accuracy of the clinical data they obtain is compromised due to the failure to adhere to our clinical protocols or regulatory requirements, or for any other reasons, our clinical trials may be extended, delayed or terminated, and we may not be able to obtain regulatory approval for, or successfully commercialize our product candidates. As a result, our financial results and the commercial prospects for our product candidates would be harmed, our costs could increase, and our ability to generate revenues could be delayed.

Switching or adding CROs involves substantial cost and requires extensive management time and focus. In addition, there is a natural transition period when a new CRO commences work. As a result, delays occur, which can materially impact our ability to meet our desired clinical development timelines. Though we carefully manage our relationships with our CROs, there can be no assurance that we will not encounter similar challenges or delays in the future or that these delays or challenges will not have a material adverse impact on our business, prospects, financial condition and results of operations.

We also expect to rely on other third parties to store and distribute our vectors and products for any clinical trials that we may conduct. Any performance failure on the part of our distributors could delay clinical development, regulatory review or marketing approval of our product candidates or commercialization of our products, if approved, producing additional losses and depriving us of potential product revenue.

***Collaborations with third parties may be important to our business. If these collaborations are not successful, our business could be adversely affected.***

We entered into a collaboration with Genzyme relating to a wet AMD product candidate, which subsequently was modified to take the form of a license to Genzyme. Under our modified relationship, Genzyme became responsible for all future clinical and commercial development of the licensed wet AMD product candidate. Genzyme recently informed us that it no longer intends to use our HSV-based manufacturing technology to produce the AAV vector being used for the wet AMD product. Our license agreement with Genzyme was further amended in December 2013 to reflect this fact. We do not currently expect to derive

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substantial revenue from our license arrangement with Genzyme, but an unsuccessful outcome in pending and future clinical trials for which Genzyme is responsible could be harmful to the public perception and prospects of our gene therapy platform. Our license relationship with Genzyme, and any future collaboration we enter into in the future, may pose a number of risks, including the following:

collaborators have significant discretion in determining the efforts and resources that they will apply to these collaborations;

collaborators may not perform their obligations as expected;

collaborators may not pursue development and commercialization of any product candidates that achieve regulatory approval or may elect not to continue or renew development or commercialization programs based on clinical trial results, changes in the collaborators strategic focus or available funding, or external factors, such as an acquisition, that divert resources or create competing priorities;

collaborators may delay clinical trials, provide insufficient funding for a clinical trial program, stop a clinical trial or abandon a product candidate, repeat or conduct new clinical trials or require a new formulation of a product candidate for clinical testing;

collaborators could independently develop, or develop with third parties, products that compete directly or indirectly with our products or product candidates if the collaborators believe that competitive products are more likely to be successfully developed or can be commercialized under terms that are more economically attractive than ours;

product candidates discovered in collaboration with us may be viewed by our collaborators as competitive with their own product candidates or products, which may cause collaborators to cease to devote resources to the commercialization of our product candidates;

a collaborator with marketing and distribution rights to one or more of our product candidates that achieve regulatory approval may not commit sufficient resources to the marketing and distribution of any such product candidate;

disagreements with collaborators, including disagreements over proprietary rights, contract interpretation or the preferred course of development of any product candidates, might cause delays or termination of the research, development or commercialization of such product candidates, might lead to additional responsibilities for us with respect to such product candidates, or might result in litigation or arbitration, any of which would be time-consuming and expensive;

collaborators may not properly maintain or defend our intellectual property rights or may use our proprietary information in such a way as to invite litigation that could jeopardize or invalidate our intellectual property or proprietary information or expose us to potential litigation;

collaborators may infringe the intellectual property rights of third parties, which may expose us to litigation and potential liability; and

collaborations may be terminated for the convenience of the collaborator and, if terminated, we could be required to raise additional capital to pursue further development or commercialization of the applicable product candidates.

If our collaborations do not result in the successful development and commercialization of products or if one of our collaborators terminates its agreement with us, we may not receive any future research funding or milestone or royalty payments under the collaboration. If we do not

receive the funding we expect under these agreements, our development of our gene therapy platform and product candidates could be delayed and we may need additional resources to develop product candidates and gene therapy platform. All of the risks relating to product development, regulatory approval and commercialization described in this prospectus also apply to the activities of our therapeutic program collaborators, if any.

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Our license to Genzyme contains a restriction on our engaging in activities that are the subject of that collaboration. However, as a result of the December 2013 amendment of our agreement with Genzyme, these restrictions no longer apply to the field of treatments for ocular neovascularization disorders, including AMD. In addition, under that collaboration agreement, Genzyme has options, which expire in 2015 and 2017, to license our manufacturing technology as it existed at the time of the license for specified genes implicated in diseases outside our current area of focus. These restrictions, and any similar restrictions contained in future collaborations, may have the effect of preventing us from undertaking development and other efforts that may appear to be attractive to us.

Additionally, subject to its contractual obligations to us, if one of our collaborators is involved in a business combination, the collaborator might deemphasize or terminate the development or commercialization of any product candidate licensed to it by us. If one of our collaborators terminates its agreement with us, we may find it more difficult to attract new collaborators and our perception in the business and financial communities could be adversely affected.

We may in the future determine to collaborate with pharmaceutical and biotechnology companies for development and potential commercialization of our product candidates. These relationships or those like them may require us to incur non-recurring and other charges, increase our near- and long-term expenditures, issue securities that dilute our existing stockholders or disrupt our management and business. In addition, we could face significant competition in seeking appropriate collaborators and the negotiation process is time-consuming and complex. Our ability to reach a definitive collaboration agreement will depend, among other things, upon our assessment of the collaborator's resources and expertise, the terms and conditions of the proposed collaboration and the proposed collaborator's evaluation of a number of factors. Moreover, we may not be successful in our efforts to establish a strategic partnership or other alternative arrangements for our product candidates because our research and development pipeline may be insufficient, our product candidates may be deemed to be at too early of a stage of development for collaborative effort and third parties may not view our product candidates as having the requisite potential to demonstrate safety and efficacy. If we license product candidates, we may not be able to realize the benefit of such transactions if we are unable to successfully integrate them with our existing operations and company culture. We cannot be certain that, following a strategic transaction or license, we will achieve the revenues or specific net income that justifies such transaction.

If we are unable to reach agreements with suitable collaborators on a timely basis, on acceptable terms, or at all, we may have to curtail the development of a product candidate, reduce or delay its development program or one or more of our other development programs, delay its potential commercialization or reduce the scope of any sales or marketing activities, or increase our expenditures and undertake development or commercialization activities at our own expense. If we elect to fund and undertake development or commercialization activities on our own, we may need to obtain additional expertise and additional capital, which may not be available to us on acceptable terms or at all. If we fail to enter into collaborations and do not have sufficient funds or expertise to undertake the necessary development and commercialization activities, we may not be able to further develop our product candidates or bring them to market or continue to develop our gene therapy platform and our business may be materially and adversely affected.

***Our reliance on third parties requires us to share our trade secrets, which increases the possibility that a competitor will discover them or that our trade secrets will be misappropriated or disclosed.***

Because we rely on third parties to manufacture our viral vectors and our product candidates, and because we collaborate with various organizations and academic institutions on the advancement of our gene therapy platform, we must, at times, share trade secrets with them. We seek to protect our proprietary technology in part by entering into confidentiality agreements and, if applicable, material transfer agreements, collaborative research agreements, consulting agreements or other similar agreements with our collaborators, advisors, employees and consultants prior to beginning research or disclosing proprietary information. These agreements typically limit the rights of the third parties to use or disclose our confidential information, such as trade secrets.

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Despite the contractual provisions employed when working with third parties, the need to share trade secrets and other confidential information increases the risk that such trade secrets become known by our competitors, are inadvertently incorporated into the technology of others, or are disclosed or used in violation of these agreements. Given that our proprietary position is based, in part, on our know-how and trade secrets, a competitor's discovery of our trade secrets or other unauthorized use or disclosure would impair our competitive position and may have a material adverse effect on our business.

In addition, these agreements typically restrict the ability of our collaborators, advisors, employees and consultants to publish data potentially relating to our trade secrets. Our academic collaborators typically have rights to publish data, provided that we are notified in advance and may delay publication for a specified time in order to secure our intellectual property rights arising from the collaboration. In other cases, publication rights are controlled exclusively by us, although in some cases we may share these rights with other parties. We also conduct joint research and development programs that may require us to share trade secrets under the terms of our research and development partnerships or similar agreements. Despite our efforts to protect our trade secrets, our competitors may discover our trade secrets, either through breach of these agreements, independent development or publication of information including our trade secrets in cases where we do not have proprietary or otherwise protected rights at the time of publication. A competitor's discovery of our trade secrets would impair our competitive position and have an adverse impact on our business.

### **Risks related to commercialization of our product candidates**

***If we are unable to establish sales and marketing capabilities or enter into agreements with third parties to market and sell our product candidates, we may be unable to generate any revenues.***

We currently have no sales and marketing organization and have no experience selling and marketing our product candidates. To successfully commercialize any products that may result from our development programs, we will need to develop these capabilities, either on our own or with others. The establishment and development of our own sales force or the establishment of a contract sales force to market any products we may develop will be expensive and time-consuming, particularly to the extent that we seek to commercialize any product for an indication, such as wet AMD, that has a patient population significantly larger than those addressed by our current lead product candidates, and could delay any product launch. Moreover, we cannot be certain that we will be able to successfully develop this capability. We may enter into collaborations with other entities to utilize their mature marketing and distribution capabilities, but we may be unable to enter into marketing agreements on favorable terms, if at all. If our future collaborators do not commit sufficient resources to commercialize our future products, if any, and we are unable to develop the necessary marketing capabilities on our own, we will be unable to generate sufficient product revenue to sustain our business. We will be competing with many companies that currently have extensive and well-funded marketing and sales operations to recruit, hire, train and retain marketing and sales personnel. We also face competition in our search for third parties to assist us with the sales and marketing efforts of our product candidates. Without an internal team or the support of a third party to perform marketing and sales functions, we may be unable to compete successfully against these more established companies.

***We face intense competition and rapid technological change and the possibility that our competitors may develop therapies that are more advanced or effective than ours, which may adversely affect our financial condition and our ability to successfully commercialize our product candidates.***

The biotechnology and pharmaceutical industries are characterized by intense and rapidly changing competition to develop new technologies and proprietary products, and any product candidates that we successfully develop and commercialize will have to compete with existing therapies and new therapies that may become available in the future. While we believe that our proprietary technology estate and scientific expertise in the gene therapy field provide us with competitive advantages, we face potential competition from many different sources, including larger and better-funded pharmaceutical, specialty pharmaceutical and biotechnology

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companies, as well as from academic institutions and governmental agencies and public and private research institutions that may develop potentially competitive products or technologies.

Currently there are no approved products for any of our lead orphan ophthalmology indications of XLR5, ACHM and XLRP. We believe the key competitive factors that will affect the success of our product candidates, if approved, are likely to be their efficacy, safety, convenience of administration and delivery, price, the level of generic competition and the availability of reimbursement from government and other third-party payors.

We believe a number of companies are working on AAV-based gene therapy technology, including Genzyme and its parent company Sanofi S.A., BioMarin Pharmaceutical Inc., uniQure B.V., Celladon Corp., Audentes Therapeutics, GenSight Biologics, ReGenX Biosciences, LLC, or ReGenX, Avalanche Biotechnologies, Inc., or Avalanche, Regeneron Pharmaceuticals, Inc., Spark Therapeutics, LLC, or Spark, Voyager Therapeutics, Inc., Dimension Therapeutics, Inc., Sangamo Biosciences, Inc. and Hemera Biosciences, Inc., or Hemera. We believe that companies developing gene therapies in the field of orphan ophthalmology on which we are currently focused include Genzyme and Spark, whose programs are at the clinical stage, Avalanche, GenSight, Hemera, Neurotech Pharmaceuticals, Inc. and ReGenX, as well as two smaller, early-stage companies, RetroSense Therapeutics, LLC and Eos Neuroscience, Inc., all of whose programs we believe are in the pre-clinical stage. Other companies could also seek to enter this field.

Many of our potential competitors, alone or with their strategic partners, have substantially greater financial, technical and human resources than we do and significantly greater experience in the discovery and development of product candidates, obtaining FDA and other regulatory approvals of treatments and the commercialization of those treatments. Mergers and acquisitions in the biotechnology and pharmaceutical industries may result in even more resources being concentrated among a smaller number of our competitors. Our commercial opportunity could be reduced or eliminated if our competitors develop and commercialize products that are safer, more effective, have fewer or less severe side effects, are more convenient or are less expensive than any products that we may develop. Our competitors also may obtain FDA or other regulatory approval for their products more rapidly than we may obtain approval for ours, which could result in our competitors establishing a strong market position before we are able to enter the market.

***The insurance coverage and reimbursement status of newly-approved products is uncertain. Failure to obtain or maintain adequate coverage and reimbursement for our product, if approved, could limit our ability to market those products and decrease our ability to generate revenue.***

We expect the cost of a single administration of gene therapy products such as those we are developing to be substantial, when and if they achieve regulatory approval. We expect that coverage and reimbursement by governmental and private payors will be essential for most patients to be able to afford these treatments. Accordingly, sales of our product candidates will depend substantially, both domestically and abroad, on the extent to which the costs of our product candidates will be paid by health maintenance, managed care, pharmacy benefit and similar healthcare management organizations, or reimbursed by government authorities, private health coverage insurers and other third-party payors. Coverage and reimbursement by a third-party payor may depend upon a number of factors, including the third-party payor's determination that use of a product is:

a covered benefit under its health plan;

safe, effective and medically necessary;

appropriate for the specific patient;

cost-effective; and

neither experimental nor investigational.

Obtaining coverage and reimbursement approval for a product from governmental and private payors is a time-consuming and costly process that could require us to provide to the payor supporting scientific, clinical and





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cost-effectiveness data for the use of our products. We may not be able to provide data sufficient to gain acceptance with respect to coverage and reimbursement. If coverage and reimbursement are not available, or is available only to limited levels, we may not be able to successfully commercialize our product candidates. Even if coverage is provided, the approved reimbursement amount may not be high enough to allow us to establish or maintain pricing sufficient to realize a sufficient return on our investment.

There is significant uncertainty related to third-party coverage and reimbursement of newly approved products. In the United States, third-party payors, including private and governmental payors, such as the Medicare and Medicaid programs, play an important role in determining the extent to which new drugs and biologics will be covered and reimbursed. The Medicare and Medicaid programs increasingly are used as models for how private payors and other governmental payors develop their coverage and reimbursement policies for drugs and biologics. Currently, no gene therapy products have been approved for coverage and reimbursement by the Centers for Medicare & Medicaid Services, or CMS, the agency responsible for administering the Medicare program, and it is difficult to predict what CMS will decide with respect to coverage and reimbursement for fundamentally novel products such as ours, as there is no body of established practices and precedents for these new products. Moreover, reimbursement agencies in Europe may be more conservative than CMS. For example, a number of cancer drugs have been approved for reimbursement in the United States and have not been approved for reimbursement in certain European countries. It is difficult to predict at this time what third-party payors will decide with respect to the coverage and reimbursement for our product candidates.

Outside the United States, international operations are generally subject to extensive governmental price controls and other market regulations, and we believe the increasing emphasis on cost-containment initiatives in Europe, Canada, and other countries has and will continue to put pressure on the pricing and usage of our product candidates. In many countries, the prices of medical products are subject to varying price control mechanisms as part of national health systems. In general, the prices of medicines under such systems are substantially lower than in the United States. Other countries allow companies to fix their own prices for medical products, but monitor and control company profits. Additional foreign price controls or other changes in pricing regulation could restrict the amount that we are able to charge for our product candidates. Accordingly, in markets outside the United States, the reimbursement for our products may be reduced compared with the United States and may be insufficient to generate commercially reasonable revenues and profits.

Moreover, increasing efforts by governmental and third-party payors in the United States and abroad to cap or reduce healthcare costs may cause such organizations to limit both coverage and the level of reimbursement for new products approved and, as a result, they may not cover or provide adequate payment for our product candidates. We expect to experience pricing pressures in connection with the sale of any of our product candidates, due to the trend toward managed healthcare, the increasing influence of health maintenance organizations and additional legislative changes. The downward pressure on healthcare costs in general, particularly prescription drugs and surgical procedures and other treatments, has become very intense. As a result, increasingly high barriers are being erected to the entry of new products.

***Negative public opinion and increased regulatory scrutiny of gene therapy and genetic research may damage public perception of our product candidates or adversely affect our ability to conduct our business or obtain regulatory approvals for our product candidates.***

Gene therapy remains a novel technology, with no gene therapy product approved to date in the United States and only one gene therapy product approved to date in Europe. Public perception may be influenced by claims that gene therapy is unsafe, and gene therapy may not gain the acceptance of the public or the medical community. In particular, our success will depend upon physicians specializing in the treatment of those diseases that our product candidates target prescribing treatments that involve the use of our product candidates in lieu of, or in addition to, existing treatments they are already familiar with and for which greater clinical data may be available. More restrictive government regulations or negative public opinion would have a negative effect on our business or financial condition and may delay or impair the development and

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commercialization of our product candidates or demand for any products we may develop. For example, trials using early versions of lentiviral vectors, which integrate with, and thereby alter, the host cell's DNA, have led to several well-publicized adverse events, including reported cases of leukemia. Although none of our current product candidates utilize lentiviral vectors, our product candidates use a viral delivery system. Adverse events in our clinical trials, even if not ultimately attributable to our product candidates, and the resulting publicity could result in increased governmental regulation, unfavorable public perception, potential regulatory delays in the testing or approval of our product candidates, stricter labeling requirements for those product candidates that are approved and a decrease in demand for any such product candidates.

### ***Healthcare legislative reform measures may have a material adverse effect on our business and results of operations.***

In the United States, there have been and continue to be a number of legislative initiatives to contain healthcare costs. For example, in March 2010, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act, or PPACA, was passed, which substantially changes the way health care is financed by both governmental and private insurers, and significantly impacts the U.S. pharmaceutical industry. The PPACA, among other things, subjects biologic products to potential competition by lower-cost biosimilars, addresses a new methodology by which rebates owed by manufacturers under the Medicaid Drug Rebate Program are calculated for drugs that are inhaled, infused, instilled, implanted or injected, increases the minimum Medicaid rebates owed by manufacturers under the Medicaid Drug Rebate Program and extends the rebate program to individuals enrolled in Medicaid managed care organizations, establishes annual fees and taxes on manufacturers of certain branded prescription drugs, and subjects additional drugs to lower pricing under the 340B drug pricing program by adding new entities to the program.

In addition, other legislative changes have been proposed and adopted in the United States since the PPACA was enacted. On August 2, 2011, the Budget Control Act of 2011 among other things, created measures for spending reductions by Congress. A Joint Select Committee on Deficit Reduction, tasked with recommending a targeted deficit reduction of at least \$1.2 trillion for the years 2013 through 2021, was unable to reach required goals, thereby triggering the legislation's automatic reduction to several government programs. This includes aggregate reductions of Medicare payments to providers up to 2% per fiscal year, which went into effect on April 1, 2013. We expect that additional state and federal healthcare reform measures will be adopted in the future, any of which could limit the amounts that federal and state governments will pay for healthcare products and services, which could result in reduced demand for our product candidates or additional pricing pressures.

### ***The commercial success of any of our product candidates will depend upon its degree of market acceptance by physicians, patients, third-party payors and others in the medical community.***

Ethical, social and legal concerns about gene therapy and genetic research could result in additional regulations restricting or prohibiting the products and processes we may use. Even with the requisite approvals from the FDA in the United States and other government bodies internationally, the commercial success of our product candidates will depend in part on the medical community's, patients', and third-party payors' acceptance of gene therapy products in general, and our product candidates in particular, as medically necessary, cost-effective, and safe. Any product that we bring to the market may not gain market acceptance by physicians, patients, third-party payors and others in the medical community. If these products do not achieve an adequate level of acceptance, we may not generate significant product revenue and may not become profitable. The degree of market acceptance of our product candidates, if approved for commercial sale, will depend on a number of factors, including:

the efficacy and safety of such product candidates as demonstrated in clinical trials;

the potential and perceived advantages of product candidates over alternative treatments;

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the clinical indications for which the product candidate is approved;

the safety of product candidates seen in a broader patient group, including its use outside the approved indications;

the prevalence and severity of any side effects;

product labeling or product insert requirements of the FDA or other regulatory authorities, including any limitations or warnings contained in a product's approved labeling;

the cost of treatment relative to alternative treatments;

relative convenience and ease of administration;

the willingness of the target patient population to try new therapies and of physicians to prescribe these therapies;

the strength of marketing and distribution support;

the timing of market introduction of competitive products;

publicity concerning our products or competing products and treatments; and

sufficient third-party insurance coverage and reimbursement.

Even if a potential product displays a favorable efficacy and safety profile in preclinical studies and clinical trials, market acceptance of the product will not be fully known until after it is launched. Our efforts to educate the medical community and third-party payors on the benefits of the product candidates may require significant resources and may never be successful. Such efforts to educate the marketplace may require more resources than are required by the conventional technologies marketed by our competitors. If any of our product candidates is approved but fails to achieve market acceptance among physicians, patients, or health care payors, we will not be able to generate significant revenues from such product, which could have a material adverse effect on our business, prospects, financial condition and results of operations.

***If we obtain approval to commercialize our product candidates outside of the United States, a variety of risks associated with international operations could materially adversely affect our business.***

If any of our product candidates are approved for commercialization, we may enter into agreements with third parties to market them on a worldwide basis or in more limited geographical regions. We expect that we will be subject to additional risks related to entering into international business relationships, including:

different regulatory requirements for approval of drugs and biologics in foreign countries;

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the potential for so-called parallel importing, which is what happens when a local seller, faced with high or higher local prices, opts to import goods from a foreign market (with low or lower prices) rather than buying them locally;

challenges enforcing our contractual and intellectual property rights, especially in those foreign countries that do not respect and protect intellectual property rights to the same extent as the United States;

unexpected changes in tariffs, trade barriers and regulatory requirements;

economic weakness, including inflation, or political instability in particular foreign economies and markets;

compliance with tax, employment, immigration and labor laws for employees living or traveling abroad;

foreign currency fluctuations, which could result in increased operating expenses and reduced revenues, and other obligations incident to doing business in another country;

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difficulties staffing and managing foreign operations;

workforce uncertainty in countries where labor unrest is more common than in the United States;

potential liability under the Foreign Corrupt Practices Act of 1977 or comparable foreign regulations;

production shortages resulting from any events affecting raw material supply or manufacturing capabilities abroad; and

business interruptions resulting from geopolitical actions, including war and terrorism, or natural disasters including earthquakes, typhoons, floods and fires.

These and other risks associated with our international operations may materially adversely affect our ability to attain or maintain profitable operations.

### ***We may not be successful in our efforts to identify or discover additional product candidates.***

The success of our business depends primarily upon our ability to identify, develop and commercialize product candidates based on our gene therapy platform. Although certain of our product candidates are currently in clinical or preclinical development, we may fail to identify other potential product candidates for clinical development for a number of reasons. For example, our research methodology may be unsuccessful in identifying potential product candidates or our potential product candidates may be shown to have harmful side effects or may have other characteristics that may make the products unmarketable or unlikely to receive marketing approval.

If any of these events occur, we may be forced to abandon our development efforts with respect to a particular product candidate, which would have a material adverse effect on our business and could potentially cause us to cease operations. Research programs to identify new product candidates require substantial technical, financial and human resources. We may focus our efforts and resources on potential programs or product candidates that ultimately prove to be unsuccessful.

### **Risks related to our business operations**

#### ***We incur significant increased costs as a result of operating as a public company, and our management devotes substantial time to new compliance initiatives.***

As a public company, we have incurred and will continue to incur significant legal, accounting and other expenses that we did not incur as a private company. In addition, the Sarbanes-Oxley Act, as well as rules subsequently implemented by the Securities and Exchange Commission, or SEC, and The NASDAQ Global Market impose various requirements on public companies. In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, was enacted. There are significant corporate governance and executive compensation related provisions in the Dodd-Frank Act that require the SEC to adopt additional rules and regulations in these areas such as say on pay and proxy access. Recent legislation permits us, as a smaller emerging growth company, to implement many of these requirements over a longer period and up to five years from the date of our initial public offering, which was March 26, 2014. We are taking advantage of the flexibility accorded to us by this legislation but cannot guarantee that we will not be required to implement these requirements sooner than budgeted or planned and thereby incur unexpected expenses. Stockholder activism, the current political environment and the current high level of government intervention and regulatory reform may lead to substantial new regulations and disclosure obligations, which may lead to additional compliance costs and impact the manner in which we operate our business in ways we cannot currently anticipate.

We may not be successful in complying with these obligations, and compliance with these obligations could be time-consuming and expensive. If these requirements divert the attention of our management and personnel from other business concerns, they could have a material adverse effect on our business, financial condition and

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results of operations. Moreover, these rules and regulations will increase our legal and financial compliance costs and will make some activities more time-consuming and costly. For example, we expect that these rules and regulations may make it more difficult and more expensive for us to obtain director and officer liability insurance, which in turn could make it more difficult for us to attract and retain qualified members of our board of directors. The increased costs will decrease our net income or increase our consolidated net loss, and may require us to reduce costs in other areas of our business or increase the prices of our products or services.

***We have identified material weaknesses in our internal control over financial reporting, and if we are unable to achieve and maintain effective internal control over financial reporting, investors could lose confidence in our financial statements and our company which could have a material adverse effect on our business and our stock price.***

Our management has determined that as of June 30, 2013, we had material weaknesses in our internal control over financial reporting, which relate to the design and operation of our closing and financial reporting processes and our accounting for debt, equity and convertible instruments. We have concluded that these material weaknesses in our internal control over financial reporting are due to the fact that we do not have the appropriate resources with the appropriate level of experience and technical expertise to oversee our closing and financial reporting processes and to address the accounting and financial reporting requirements related to our issuances of convertible notes, preferred stock warrants, stock options, preferred stock and preferred stock purchase rights. These material weaknesses have not yet been remediated.

If we fail to fully remediate these material weaknesses or fail to maintain effective internal controls in the future, it could result in a material misstatement of our financial statements that would not be prevented or detected on a timely basis, which could cause investors to lose confidence in our financial information or cause our stock price to decline. Our independent registered public accounting firm has not assessed the effectiveness of our internal control over financial reporting and, under the JOBS Act, will not be required to provide an attestation report on the effectiveness of our internal control over financial reporting so long as we qualify as an emerging growth company, which may increase the risk that weaknesses or deficiencies in our internal control over financial reporting go undetected.

***If we are unable to manage expected growth in the scale and complexity of our operations, our performance may suffer.***

If we are successful in executing our business strategy, we will need to expand our managerial, operational, financial and other systems and resources to manage our operations, continue our research and development activities, and, in the longer term, build a sales force and commercial infrastructure to support commercialization of any of our product candidates that are approved for sale. Future growth would impose significant added responsibilities on members of management. It is possible that our management, finance, development personnel, systems and facilities currently in place may not be adequate to support this future growth. Our need to effectively manage our operations, growth and products requires that we continue to develop more robust business processes and improve our systems and procedures in each of these areas and to attract and retain sufficient numbers of talented employees. We may be unable to successfully implement these tasks on a larger scale and, accordingly, may not achieve our research, development and growth goals.

***We may enter into or seek to enter into business partnerships, combinations and/or acquisitions which may be difficult to integrate, disrupt our business, divert management attention or dilute stockholder value.***

A key element of our strategy is to enter into business partnerships, combinations and/or acquisitions. We have limited experience in making acquisitions, which are typically accompanied by a number of risks, including:

the difficulty of integrating the operations and personnel of the acquired companies;

the potential disruption of our ongoing business and distraction of management;

potential unknown liabilities and expenses;

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the failure to achieve the expected benefits of the combination or acquisition;

the maintenance of acceptable standards, controls, procedures and policies; and

the impairment of relationships with employees as a result of any integration of new management and other personnel.

If we are not successful in completing acquisitions that we may pursue in the future, we would be required to reevaluate our business strategy and we may have incurred substantial expenses and devoted significant management time and resources in seeking to complete the acquisitions. In addition, we could use substantial portions of our available cash as all or a portion of the purchase price, or we could issue additional securities as consideration for these acquisitions, which could cause our stockholders to suffer significant dilution.

***Our future success depends on our ability to retain key employees, consultants and advisors and to attract, retain and motivate qualified personnel.***

We are highly dependent on our executive officers, the loss of whose services may adversely impact the achievement of our objectives. Recruiting and retaining other qualified employees, consultants and advisors for our business, including scientific and technical personnel, will also be critical to our success. There is currently a shortage of skilled executives and scientific personnel in our industry, which is likely to continue. As a result, competition for skilled personnel is intense and the turnover rate can be high. We may not be able to attract and retain personnel on acceptable terms given the competition among numerous pharmaceutical and biotechnology companies for individuals with similar skill sets. In addition, failure to succeed in preclinical studies or clinical trials may make it more challenging to recruit and retain qualified personnel. The inability to recruit or loss of the services of any executive, key employee, consultant or advisor may impede the progress of our research, development and commercialization objectives.

In order to induce valuable employees to remain at AGTC, in addition to salary and cash incentives, we have provided stock options that vest over time. The value to employees of stock options that vest over time may be significantly affected by movements in our stock price that are beyond our control, and may at any time be insufficient to counteract more lucrative offers from other companies.

Despite our efforts to retain valuable employees, members of our management, scientific and development teams may terminate their employment with us. The loss of the services of any of our executive officers or other key employees and our inability to find suitable replacements could potentially harm our business, prospects, financial condition or results of operations. We do not maintain key man insurance policies on the lives of these individuals or any of our other employees. Our success also depends on our ability to continue to attract, retain and motivate highly skilled junior, mid-level, and senior managers as well as junior, mid-level, and senior scientific and medical personnel.

Many of the other biotechnology and pharmaceutical companies that we compete against for qualified personnel have greater financial and other resources, different risk profiles and a longer history in the industry than we do. They may also provide more diverse opportunities and better chances for career advancement. Some of these characteristics may be more appealing to high quality candidates than what we can offer. If we are unable to continue to attract and retain high quality personnel, the rate and success at which we can discover, develop and commercialize product candidates will be limited.

***Our employees, principal investigators, consultants and commercial partners may engage in misconduct or other improper activities.***

We are exposed to the risk that our employees, CROs, principal investigators, consultants and commercial partners may engage in fraudulent conduct or other illegal activity or may fail to disclose unauthorized



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activities to us. Misconduct by these parties could include intentional, reckless and/or negligent failures to comply with:

the laws and regulations of the FDA and non-U.S. regulators, including those laws requiring the reporting of true, complete and accurate information to such regulatory bodies;

manufacturing standards we have established;

healthcare fraud and abuse laws and regulations in the United States and similar foreign laws; or

laws requiring the accurate reporting of financial information or data or the disclosure of unauthorized activities to us.

In particular, sales, marketing and business arrangements in the healthcare industry are subject to extensive laws and regulations intended to prevent fraud, misconduct, kickbacks, self-dealing and other abusive practices. These laws and regulations may restrict or prohibit a wide range of pricing, discounting, marketing and promotion, sales commission, customer incentive programs and other business arrangements. Such misconduct could also involve the improper use of information obtained in the course of clinical trials, which could result in regulatory sanctions and cause serious harm to our reputation. We have adopted a code of conduct applicable to all of our employees, but it is not always possible to identify and deter employee misconduct, and the precautions we take to detect and prevent this activity may not be effective in controlling unknown or unmanaged risks or losses or in protecting us from governmental investigations or other actions or lawsuits stemming from a failure to comply with these laws or regulations. If any such actions are instituted against us, and we are not successful in defending ourselves or asserting our rights, those actions could have a significant impact on our business, including the imposition of significant fines or other sanctions.

***We may be subject, directly or indirectly, to federal and state healthcare fraud and abuse laws, false claims laws and health information privacy and security laws. If we are unable to comply, or have not fully complied, with such laws, we could face substantial penalties.***

Our operations may be directly, or indirectly through our prescribers, customers and purchasers, subject to various federal and state fraud and abuse laws. If we obtain FDA approval for any of our product candidates and begin commercializing those products in the United States, many of these laws will become more directly applicable to our operations, including, without limitation, the federal Health Care Program Anti-Kickback Statute, the federal civil and criminal False Claims Acts and Physician Payments Sunshine Act and regulations. These laws may impact, among other things, our proposed sales, marketing and educational programs. In addition, we may be subject to patient privacy laws by both the federal government and the states in which we conduct our business. The laws that may affect our ability to operate include, but are not limited to:

the federal Health Care Program Anti-Kickback Statute, which prohibits, among other things, persons or entities from knowingly and willfully soliciting, receiving, offering or paying any remuneration (including any kickback, bribe, or rebate), directly or indirectly, overtly or covertly, in cash or in kind in return for, the purchase, recommendation, leasing or furnishing of an item or service reimbursable under a federal healthcare program, such as the Medicare and Medicaid programs;

federal civil and criminal false claims laws and civil monetary penalty laws, which prohibit, among other things, individuals or entities from knowingly presenting, or causing to be presented, claims for payment or approval from Medicare, Medicaid, or other government payers that are false or fraudulent;

the federal Health Insurance Portability and Accountability Act of 1996, or HIPAA, which created new federal criminal statutes that prohibit a person from knowingly and willfully executing a scheme or from making false or fraudulent statements to defraud any healthcare benefit program, regardless of the payor (e.g., public or private);

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HIPAA, as amended by the Health Information Technology for Economic and Clinical Health Act, or HITECH, and its implementing regulations, and as amended again by the final HIPAA omnibus rule, Modifications to the HIPAA Privacy, Security, Enforcement, and Breach Notification Rules Under

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HITECH and the Genetic Information Nondiscrimination Act; Other Modifications to HIPAA, published in January 2013, which imposes certain requirements relating to the privacy, security and transmission of individually identifiable health information without appropriate authorization by entities subject to the rule, such as health plans, health care clearinghouses and health care providers;

federal transparency laws, including the federal Physician Payment Sunshine Act that requires disclosure of payments and other transfers of value provided to physicians and teaching hospitals, and ownership and investment interests held by physicians and other healthcare providers and their immediate family members and applicable group purchasing organizations;

the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act, or the Affordable Care Act, and its implementing regulations, which may impact, among other things, reimbursement rates by federal health care programs and commercial insurers;

federal consumer protection and unfair competition laws, which broadly regulate marketplace activities and activities that potentially harm consumers;

federal government price reporting laws, which require us to calculate and report complex pricing metrics to government programs, where such reported prices may be used in the calculation of reimbursement and/or discounts on our marketed drugs, when and if approved; participation in these programs and compliance with the applicable requirements may subject us to potentially significant discounts on our products, when and if approved, increased infrastructure costs and potentially limit our ability to offer certain marketplace discounts; and

state law equivalents of each of the above federal laws, such as anti-kickback and false claims laws which may apply to items or services reimbursed by any third-party payor, including commercial insurers; state laws that require pharmaceutical companies to comply with the industry's voluntary compliance guidelines and the applicable compliance guidance promulgated by the federal government, or otherwise restrict certain payments that may be made to healthcare providers and other potential referral sources; state laws that require drug manufacturers to report information related to payments and other transfers of value to physicians and other healthcare providers or marketing expenditures; and state laws governing the privacy and security of health information in certain circumstances, many of which differ from each other in significant ways and may not have the same effect, thus complicating compliance efforts in certain circumstances, such as specific disease states.

In addition, any sale of our products or product candidates, if commercialized outside of the United States, may also subject us to foreign laws governing prescription drug marketing and fraud and abuse, including laws similar to the U.S. healthcare laws mentioned above. Because of the breadth of these laws and the narrowness of the statutory exceptions and safe harbors available, it is possible that some of our business activities could be subject to challenge under one or more of such laws. In addition, recent health care reform legislation has strengthened these laws. For example, the PPACA, among other things, amends the intent requirements of the federal Anti-Kickback Statute and the criminal statute governing healthcare fraud. A person or entity can now be found guilty of violating the Anti-Kickback Statute and the federal criminal healthcare fraud statute without actual knowledge of the statute or specific intent to violate it. In addition, the PPACA provides that the government may assert that a claim including items or services resulting from a violation of the federal Anti-Kickback Statute constitutes a false or fraudulent claim for purposes of the federal False Claims Act.

If our operations are found to be in violation of any of the laws described above or any other governmental regulations that apply to us, we may be subject to penalties, including civil and criminal penalties, damages, fines, exclusion from participation in government health care programs, such as Medicare and Medicaid, disgorgement, contractual damages, reputational harm, diminished profits and future earnings, imprisonment, and the curtailment or restructuring of our operations, any of which could adversely affect our ability to operate our business and our results of operations.

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*If the use of our product candidates harms patients, we could be subject to costly and damaging product liability claims.*

The use of our product candidates in clinical trials and the sale of any products for which we obtain marketing approval exposes us to the risk of product liability claims. Product liability claims might be brought against us by consumers, healthcare providers, pharmaceutical companies or others selling or otherwise coming into contact with our products. For example, we may be sued if any product candidate we develop allegedly causes injury or is found to be otherwise unsuitable during clinical testing, manufacturing, marketing or sale. Any such product liability claims may include allegations of defects in manufacturing, defects in design, a failure to warn of dangers inherent in the product, negligence, strict liability, and a breach of warranties. Claims could also be asserted under state consumer protection acts. If we cannot successfully defend against product liability claims, we could incur substantial liability and costs. In addition, regardless of merit or eventual outcome, product liability claims may result in:

impairment of our business reputation;

withdrawal of clinical trial participants;

initiation of investigations by regulators;

costs due to related litigation;

distraction of management's attention from our primary business;

substantial monetary awards to trial participants, patients or other claimants;

loss of revenue;

exhaustion of any available insurance and our capital resources;

the inability to commercialize our product candidates; and

decreased demand for our product candidates, if approved for commercial sale.

Our inability to obtain and retain sufficient product liability insurance at an acceptable cost to protect against potential product liability claims could prevent or inhibit the commercialization of products we develop. While we believe our product liability insurance coverage is sufficient in light of our current clinical programs, the amount of the product liability coverage that we carry varies from time to time, depending on a number of factors, the most significant of which are the nature and scope of the clinical trials in which we are engaged and the number of patients being treated with our product candidates in these trials. The amount of our product liability coverage as of March 31, 2014 was \$10.0 million. This amount may increase or decrease in the future. We may not be able to maintain insurance coverage at a reasonable cost or in sufficient amounts to protect us against losses due to liability and any claim that may be brought against us could result in a court judgment or settlement in an amount that is not covered, in whole or in part, by our insurance or that is in excess of the limits of our insurance coverage. If and when we obtain marketing approval for product candidates, we intend to expand our insurance coverage to include the commercial sale of our products; however, we may be unable to obtain product liability insurance on commercially reasonable terms or in adequate amounts. Our insurance policies also have various exclusions, and we may be subject to a product liability claim for which we have no coverage. A successful product liability claim or series of claims brought against us could cause our stock price to decline and, if judgments exceed our insurance coverage, could adversely affect our results of operations and business.

*If we fail to comply with environmental, health and safety laws and regulations, we could become subject to fines or penalties or incur costs that could have a material adverse effect on the success of our business.*

We are subject to numerous environmental, health and safety laws and regulations, including those governing laboratory procedures and the handling, use, storage, treatment, manufacture and disposal of hazardous materials and wastes. Our operations involve the use of hazardous and flammable materials, including chemicals and biological materials. Our operations also produce hazardous waste products. We generally

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contract with third parties for the disposal of these materials and wastes. Although we believe that our procedures for using, handling, storing and disposing of these materials comply with legally prescribed standards, we cannot eliminate the risk of contamination or injury from these materials. In the event of contamination or injury resulting from our use of hazardous materials, we could be held liable for any resulting damages, and any liability could exceed our resources. We also could incur significant costs associated with civil or criminal fines and penalties.

Although we maintain workers' compensation insurance to cover us for costs and expenses we may incur due to injuries to our employees resulting from the use of hazardous materials or other work-related injuries, this insurance may not provide adequate coverage against potential liabilities. In addition, we may incur substantial costs in order to comply with current or future environmental, health and safety laws and regulations. These current or future laws and regulations may impair our research, development or production efforts. Failure to comply with these laws and regulations also may result in substantial fines, penalties or other sanctions.

***We rely on our relationship with a professional employer organization for our human relations function and as a co-employer of our personnel, and if that party failed to perform its responsibilities under that relationship, our relations with our employees could be damaged and we could incur liabilities that could have a material adverse effect on our business.***

All of our personnel, including our executive officers, are co-employees of AGTC and a professional employer organization, TriNet HR Corporation, or TriNet. Under the terms of our arrangement, TriNet is the formal employer of all of our personnel, and is responsible for administering all payroll, including tax withholding, and providing health insurance and other benefits for these individuals. We reimburse TriNet for these costs, and pay TriNet an administrative fee for its services. If TriNet fails to comply with applicable laws, or its obligations under this arrangement, our relationship with our employees could be damaged. We could, under certain circumstances, be held liable for a failure by TriNet to appropriately pay, or withhold and remit required taxes from payments to, our employees. In such a case, our potential liability could be significant and could have a material adverse effect on our business.

***We or the third parties upon whom we depend may be adversely affected by natural disasters and our business continuity and disaster recovery plans may not adequately protect us from a serious disaster.***

Substantially all of our operations are conducted from our headquarters located near Gainesville, Florida. Hurricanes or other natural disasters could severely disrupt our operations, damage our research facilities or destroy stored research materials that could be difficult to replace, and otherwise have a material adverse effect on our business, results of operations, financial condition and prospects. In addition, despite the implementation of security measures, our internal computer systems and those of our current and any future CROs and other contractors and consultants and collaborators are vulnerable to damage from computer viruses, unauthorized access, natural disasters, terrorism, war and telecommunication and electrical failures. If such an event were to occur and cause interruptions in our operations, it could result in a material disruption of our development programs and our business operations. If a natural disaster, power outage or other event occurred that prevented us from using all or a significant portion of our headquarters, that damaged critical infrastructure or that otherwise disrupted our operations or the operations of our third-party contract manufacturer, it may be difficult or, in certain cases, impossible for us to continue our business for a substantial period of time. For example, the loss of clinical trial data from our clinical trials could result in delays in our regulatory approval efforts and significantly increase our costs to recover or reproduce the data. If our security measures, disaster recovery and business continuity plans are not adequate in the event of such a breach, serious disaster or similar event, we could incur substantial expenses and the further development and commercialization of our product candidates could be delayed, which could have a material adverse effect on our business.

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### ***Interruptions in the supply of product or inventory loss may adversely affect our operating results and financial condition.***

Our product candidates are manufactured using technically complex processes requiring specialized facilities, highly specific raw materials and other production constraints. The complexity of these processes, as well as strict company and government standards for the manufacture and storage of our products, subjects us to production risks. While product batches released for use in clinical trials or for commercialization undergo sample testing, some defects may only be identified following product release. In addition, process deviations or unanticipated effects of approved process changes may result in these intermediate products not complying with stability requirements or specifications. Most of our product candidates must be stored and transported at temperatures within a certain range. If these environmental conditions deviate, our product candidates' remaining shelf-lives could be impaired or their efficacy and safety could become adversely affected, making them no longer suitable for use. The occurrence or suspected occurrence of production and distribution difficulties can lead to lost inventories, and in some cases product recalls, with consequential reputational damage and the risk of product liability. The investigation and remediation of any identified problems can cause production delays, substantial expense, lost sales and delays of new product launches. Any interruption in the supply of finished products or the loss thereof could hinder our ability to timely distribute our products and satisfy customer demand. Any unforeseen failure in the storage of the product or loss in supply could delay our clinical trials and, if our product candidates are approved, result in a loss of our market share and negatively affect our revenues and operations.

### ***We may use our financial and human resources to pursue a particular research program or product candidate and fail to capitalize on programs or product candidates that may be more profitable or for which there is a greater likelihood of success.***

Because we have limited resources, we may forego or delay pursuit of opportunities with certain programs or product candidates or for indications that later prove to have greater commercial potential. Our resource allocation decisions may cause us to fail to capitalize on viable commercial products or profitable market opportunities. Our spending on current and future research and development programs for product candidates may not yield any commercially viable products. If we do not accurately evaluate the commercial potential or target market for a particular product candidate, we may relinquish valuable rights to that product candidate through strategic collaboration, licensing or other royalty arrangements in cases in which it would have been more advantageous for us to retain sole development and commercialization rights to such product candidate, or we may allocate internal resources to a product candidate in a therapeutic area in which it would have been more advantageous to enter into a partnering arrangement.

### ***Our ability to use our net operating loss carryforwards may be subject to limitation.***

Under Section 382 of the Internal Revenue Code of 1986, as amended, substantial changes in our ownership may limit the amount of net operating loss carryforwards that could be utilized annually in the future to offset our taxable income. Specifically, this limitation may arise in the event of a cumulative change in ownership of our company of more than 50% within a three-year period. Any such annual limitation may significantly reduce the utilization of our net operating loss carryforwards before they expire. The closing of this offering, alone or together with our initial public offering and other transactions in our stock that have occurred in the past and may occur in the future, may trigger an ownership change pursuant to Section 382, which could limit the amount of net operating loss carryforwards that could be utilized annually in the future to offset our taxable income, if any. Any such limitation, whether as the result of this offering, sales of common stock by our existing stockholders or additional sales of common stock by us after this offering, could potentially result in increased tax liability in future years. We have not completed a study to assess whether an ownership change has occurred, or whether there have been multiple ownership changes since our inception, due to the significant costs and complexities associated with such a study. However, we believe it is likely that transactions that have occurred in the past, alone or together with the closing of this offering and other transactions that may occur in the future, would trigger an ownership change pursuant to Section 382, which could limit the amount of net operating loss carryforwards that could be utilized annually in the future to offset our taxable income, if any.

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**Risks related to our intellectual property**

*If we are unable to obtain and maintain patent protection for our technology and products or if the scope of the patent protection obtained is not sufficiently broad, our competitors could develop and commercialize technology and products similar or identical to ours, and our ability to successfully commercialize our technology and products may be impaired.*

Our success depends in large part on our ability to obtain and maintain patent protection in the United States and other countries with respect to our proprietary technology and products. We seek to protect our proprietary position by filing patent applications in the United States and abroad related to our novel technologies and product candidates.

The patent prosecution process is expensive and time-consuming, and we may not be able to file and prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner. It is also possible that we will fail to identify patentable aspects of our research and development output before it is too late to obtain patent protection. Moreover, in some circumstances, we do not have the right to control the preparation, filing and prosecution of patent applications, or to maintain the patents, covering technology that we license from third parties. Therefore, these patents and applications may not be prosecuted and enforced in a manner consistent with the best interests of our business.

The patent position of biotechnology and pharmaceutical companies generally is highly uncertain, involves complex legal and factual questions and has in recent years been the subject of much litigation. In addition, the laws of foreign countries may not protect our rights to the same extent as the laws of the United States. For example, European patent law restricts the patentability of methods of treatment of the human body more than United States law does. Publications of discoveries in the scientific literature often lag behind the actual discoveries, and patent applications in the United States and other jurisdictions are typically not published until 18 months after filing, or in some cases not at all. Therefore, we cannot know with certainty whether we were the first to make the inventions claimed in our owned or licensed patents or pending patent applications, or that we were the first to file for patent protection of such inventions. As a result, the issuance, scope, validity, enforceability and commercial value of our patent rights are highly uncertain. Our pending and future patent applications may not result in issued patents that protect our technology or products, in whole or in part, or which effectively prevent others from commercializing competitive technologies and products. Changes in either the patent laws or interpretation of the patent laws in the United States and other countries may diminish the value of our patents or narrow the scope of our patent protection.

Moreover, we may be subject to a third-party preissuance submission of prior art to the United States Patent and Trademark Office, or become involved in opposition, derivation, reexamination, inter partes review, post-grant review or interference proceedings challenging our patent rights or the patent rights of others. An adverse determination in any such submission, proceeding or litigation could reduce the scope of, or invalidate, our patent rights, allow third parties to commercialize our technology or products and compete directly with us, without payment to us, or result in our inability to manufacture or commercialize products without infringing third-party patent rights. In addition, if the breadth or strength of protection provided by our patents and patent applications is threatened, it could dissuade companies from collaborating with us to license, develop or commercialize current or future product candidates.

Even if our owned and licensed patent applications issue as patents, they may not issue in a form that will provide us with any meaningful protection, prevent competitors from competing with us or otherwise provide us with any competitive advantage. Our competitors may be able to circumvent our owned or licensed patents by developing similar or alternative technologies or products in a non-infringing manner.

In addition, the issuance of a patent is not conclusive as to its inventorship, scope, validity or enforceability, and our owned and licensed patents may be challenged in the courts or patent offices in the United States and



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abroad. Such challenges may result in loss of exclusivity or freedom to operate or in patent claims being narrowed, invalidated or held unenforceable, in whole or in part, which could limit our ability to stop others from using or commercializing similar or identical technology and products, or limit the duration of the patent protection of our technology and products. Given the amount of time required for the development, testing and regulatory review of new product candidates, patents protecting such candidates might expire before or shortly after such candidates are commercialized. As a result, our owned and licensed patent portfolio may not provide us with sufficient rights to exclude others from commercializing products similar or identical to ours.

***Third parties may initiate legal proceedings alleging claims of intellectual property infringement, the outcome of which would be uncertain and could have a material adverse effect on the success of our business.***

Our commercial success depends in part on our avoiding infringement of the patents and proprietary rights of third parties. There is a substantial amount of litigation, both within and outside the United States, involving patent and other intellectual property rights in the biotechnology and pharmaceutical industries, including patent infringement lawsuits, interferences, oppositions and *inter partes* reexamination proceedings before the United States Patent and Trademark Office and corresponding foreign patent offices. Numerous United States and foreign issued patents and pending patent applications, which are owned by third parties, exist in the fields in which we are pursuing development candidates. As the biotechnology and pharmaceutical industries expand and more patents are issued, the risk increases that our product candidates may be subject to claims of infringement of the patent rights of third parties.

Third parties may assert that we are employing their proprietary technology without authorization. There may be third-party patents or patent applications with claims to materials, formulations, methods of manufacture or methods for treatment related to the use or manufacture of our product candidates. Because patent applications can take many years to issue, there may be currently pending patent applications that may later result in issued patents that our product candidates may infringe. In addition, third parties may obtain patents in the future and claim that use of our technologies infringes upon these patents. If any third-party patents were held by a court of competent jurisdiction to cover the manufacturing process of any of our product candidates, any molecules formed during the manufacturing process or any final product itself, the holders of any such patents may be able to block our ability to commercialize such product candidate unless we obtained a license under the applicable patents, or until such patents expire.

Similarly, if any third-party patents were held by a court of competent jurisdiction to cover aspects of our formulations, methods for manufacture or methods of use, including combination therapy, the holders of any such patents may be able to block our ability to develop and commercialize the applicable product candidate unless we obtained a license or until such patent expires. In either case, such a license may not be available on commercially reasonable terms or at all. Even if we were able to obtain a license, it could be non-exclusive, thereby giving our competitors access to the same technologies licensed to us.

Parties making claims against us may obtain injunctive or other equitable relief, which could effectively block our ability to further develop and commercialize one or more of our product candidates. Defense of these claims, regardless of their merit, would involve substantial litigation expense and would be a substantial diversion of employee resources from our business. In the event of a successful claim of infringement against us, we may have to pay substantial damages, including treble damages and attorneys' fees for willful infringement, pay royalties, redesign our infringing products or obtain one or more licenses from third parties, which may be impossible or require substantial time and monetary expenditure.

***We may not be successful in obtaining or maintaining necessary rights to gene therapy product components and processes for our development pipeline through acquisitions and in-licenses.***

Presently we have rights to the intellectual property to develop our gene therapy product candidates. Because a key element of our business strategy is to pursue in-licensing and intellectual property acquisitions for additional product candidates that may require the use of proprietary rights held by third parties, the growth of

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our business will likely depend in part on our ability to acquire, in-license or use these proprietary rights. In addition, our product candidates may require specific formulations to work effectively and efficiently and these rights may be held by others. We may be unable to acquire or in-license any compositions, methods of use, processes or other third-party intellectual property rights from third parties that we identify on terms that we find acceptable, or at all. The licensing and acquisition of third-party intellectual property rights is a competitive area, and a number of more established companies are also pursuing strategies to license or acquire third-party intellectual property rights that we may consider attractive. These established companies may have a competitive advantage over us due to their size, cash resources and greater clinical development and commercialization capabilities.

For example, we sometimes collaborate with United States and foreign academic institutions to accelerate our preclinical research or development under written agreements with these institutions. Typically, these institutions provide us with an option to negotiate a license to any of the institution's rights in technology resulting from the collaboration. Regardless of such right of first negotiation for intellectual property, we may be unable to negotiate a license within the specified time frame or under terms that are acceptable to us. If we are unable to do so, the institution may offer the intellectual property rights to other parties, potentially blocking our ability to pursue our program.

In addition, companies that perceive us to be a competitor may be unwilling to assign or license rights to us. We also may be unable to license or acquire third-party intellectual property rights on terms that would allow us to make an appropriate return on our investment. If we are unable to successfully obtain rights to required third-party intellectual property rights, our business, financial condition and prospects for growth could suffer.

***If we fail to comply with our obligations in the agreements under which we license intellectual property rights from third parties or otherwise experience disruptions to our business relationships with our licensors, we could lose license rights that are important to our business.***

Licensing of intellectual property is of critical importance to our business and involves complex legal, business and scientific issues and is complicated by the rapid pace of scientific discovery in our industry. We are a party to intellectual property license agreements with the University of Florida Research Foundation, an affiliate of the University of Florida, Johns Hopkins University, the UAB Research Foundation, an affiliate of The University of Alabama at Birmingham and the Trustees of the University of Pennsylvania, each of which is important to our business, and we expect to enter into additional license agreements in the future. Our existing license agreements impose, and we expect that future license agreements will impose, various diligence, milestone payment, royalty and other obligations on us. If we fail to comply with our obligations under these agreements, or we are subject to a bankruptcy, the licensor may have the right to terminate the license, in which event we would not be able to market products covered by the license.

We may need to obtain licenses from third parties to advance our research or allow commercialization of our product candidates, and we have done so from time to time. It is possible that we may fail to obtain any of these licenses at a reasonable cost or on reasonable terms, if at all. In that event, we may be required to expend significant time and resources to develop or license replacement technology. If we are unable to do so, we may be unable to develop or commercialize the affected product candidates, which could harm our business significantly. We cannot provide any assurances that third-party patents do not exist which might be enforced against our current product candidates or future products, resulting in either an injunction prohibiting our sales, or, with respect to our sales, an obligation on our part to pay royalties and/or other forms of compensation to third parties.

In many cases, patent prosecution of our licensed technology is controlled solely by the licensor. If our licensors fail to obtain and maintain patent or other protection for the proprietary intellectual property we license from them, we could lose our rights to the intellectual property or our exclusivity with respect to those rights, and our competitors could market competing products using the intellectual property. In certain cases, we control the

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prosecution of patents resulting from licensed technology. In the event we breach any of our obligations related to such prosecution, we may incur significant liability to our licensing partners. Disputes may arise regarding intellectual property subject to a licensing agreement, including:

the scope of rights granted under the license agreement and other interpretation-related issues;

the extent to which our technology and processes infringe on intellectual property of the licensor that is not subject to the licensing agreement;

the sublicensing of patent and other rights under our collaborative development relationships;

our diligence obligations under the license agreement and what activities satisfy those diligence obligations;

the ownership of inventions and know-how resulting from the joint creation or use of intellectual property by our licensors and us and our partners; and

the priority of invention of patented technology.

If disputes over intellectual property that we have licensed prevent or impair our ability to maintain our current licensing arrangements on acceptable terms, we may be unable to successfully develop and commercialize the affected product candidates.

***We may become involved in lawsuits to protect or enforce our patents or other intellectual property or the patents or other intellectual property of our licensors, which could be expensive, time-consuming and ultimately unsuccessful.***

Competitors may infringe our patents or other intellectual property or the patents or other intellectual property of our licensors. In response, we may be required to file infringement claims, which can be expensive and time-consuming. Any claims we assert against perceived infringers could provoke these parties to assert counterclaims against us, alleging that we infringe their patents. In addition, in a patent infringement proceeding, a court may decide that a patent of ours or our licensors is invalid or unenforceable, in whole or in part, construe the patent's claims narrowly or refuse to stop the other party from using the technology at issue on the grounds that our patents do not cover the technology in question. An adverse result in any litigation or defense proceeding could put one or more of our patents at risk of being invalidated or interpreted narrowly and could put our patent applications at risk of not issuing.

Interference proceedings provoked by third parties or brought by us may be necessary to determine the priority of inventions with respect to our patents or patent applications or those of our licensors. An unfavorable outcome could require us to cease using the related technology or to attempt to license rights to it from the prevailing party. Our business could be harmed if the prevailing party does not offer us a license on commercially reasonable terms. Our defense of litigation or interference proceedings may fail and, even if successful, may result in substantial costs and distract our management and other employees. We may not be able to prevent, alone or with our licensors, misappropriation of our intellectual property rights, particularly in countries where the laws may not protect those rights as fully as in the United States.

Furthermore, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential information could be compromised by disclosure during this type of litigation. There could also be public announcements of the results of hearings, motions or other interim proceedings or developments. If securities analysts or investors perceive these results to be negative, it could have a material adverse effect on the price of our common stock.

***Issued patents covering our product candidates could be found invalid or unenforceable if challenged in court.***

If we or one of our licensing partners initiate legal proceedings against a third party to enforce a patent covering one of our product candidates, the defendant could counterclaim that the patent covering our product



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candidate is invalid or unenforceable. In patent litigation in the United States, defendant counterclaims alleging invalidity or unenforceability are commonplace. Grounds for a validity challenge could be an alleged failure to meet any of several statutory requirements, including lack of novelty, obviousness or non-enablement. Grounds for an unenforceability assertion could be an allegation that someone connected with prosecution of the patent withheld relevant information from the United States Patent and Trademark Office, or made a misleading statement, during prosecution. Third parties may also raise similar claims before administrative bodies in the United States or abroad, even outside the context of litigation. Such mechanisms include re-examination, post grant review, and equivalent proceedings in foreign jurisdictions. Such proceedings could result in the revocation of or amendment to our patents in such a way that they no longer cover our product candidates. The outcome following legal assertions of invalidity and unenforceability is unpredictable. With respect to the validity question, for example, we cannot be certain that there is no invalidating prior art, of which we and the patent examiner were unaware during prosecution. If a defendant were to prevail on a legal assertion of invalidity or unenforceability, we could lose at least part, and perhaps all, of the patent protection on one or more of our product candidates. Such a loss of patent protection could have a material adverse impact on our business.

***We may be subject to claims that our employees, consultants or independent contractors have wrongfully used or disclosed confidential information of third parties or that our employees have wrongfully used or disclosed alleged trade secrets of their former employers.***

We employ individuals who were previously employed at universities or other biotechnology or pharmaceutical companies, including our competitors or potential competitors. Although we try to ensure that our employees, consultants and independent contractors do not use the proprietary information or know-how of others in their work for us, we may be subject to claims that we or our employees, consultants or independent contractors have inadvertently or otherwise used or disclosed intellectual property, including trade secrets or other proprietary information, of any of our employee's former employer or other third parties. Litigation may be necessary to defend against these claims. If we fail in defending any such claims, in addition to paying monetary damages, we may lose valuable intellectual property rights or personnel, which could adversely impact our business. Even if we are successful in defending against such claims, litigation could result in substantial costs and be a distraction to management and other employees.

***We may be subject to claims challenging the inventorship or ownership of our patents and other intellectual property.***

We may be subject to claims that former employees, collaborators or other third parties have an ownership interest in our patents or other intellectual property. While it is our policy to require our employees and contractors who may be involved in the development of intellectual property to execute agreements assigning such intellectual property to us, we may be unsuccessful in executing such an agreement with each party who in fact develops intellectual property that we regard as our own. We could be subject to ownership disputes arising, for example, from conflicting obligations of consultants or others who are involved in developing our product candidates. Litigation may be necessary to defend against these and other claims challenging inventorship or ownership. If we fail in defending any such claims, in addition to paying monetary damages, we may lose valuable intellectual property rights, such as exclusive ownership of, or right to use, valuable intellectual property. Such an outcome could have a material adverse effect on our business. Even if we are successful in defending against such claims, litigation could result in substantial costs and be a distraction to management and other employees.

***Intellectual property litigation could cause us to spend substantial resources and distract our personnel from their normal responsibilities.***

Even if resolved in our favor, litigation or other legal proceedings relating to intellectual property claims may cause us to incur significant expenses, and could distract our technical and management personnel from their normal responsibilities. In addition, there could be public announcements of the results of hearings, motions or other interim proceedings or developments, and if securities analysts or investors perceive these results to be

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negative it could have a substantial adverse effect on the price of our common stock. Such litigation or proceedings could substantially increase our operating losses and reduce the resources available for development activities or any future sales, marketing or distribution activities. We may not have sufficient financial or other resources to conduct such litigation or proceedings adequately. Some of our competitors may be able to sustain the costs of such litigation or proceedings more effectively than we can because of their greater financial resources. Uncertainties resulting from the initiation and continuation of patent litigation or other proceedings could compromise our ability to compete in the marketplace.

***Obtaining and maintaining our patent protection depends on compliance with various procedural, document submission, fee payment and other requirements imposed by governmental patent agencies, and our patent protection could be reduced or eliminated for non-compliance with these requirements.***

Periodic maintenance fees, renewal fees, annuity fees and various other governmental fees on patents and/or applications will be due to be paid to the United States Patent and Trademark Office and various governmental patent agencies outside of the United States in several stages over the lifetime of the patents and/or applications. We rely on our outside counsel to pay these fees due to non-U.S. patent agencies. The United States Patent and Trademark Office and various non-U.S. governmental patent agencies require compliance with a number of procedural, documentary, fee payment and other similar provisions during the patent application process. We employ reputable law firms and other professionals to help us comply, and in many cases, an inadvertent lapse can be cured by payment of a late fee or by other means in accordance with the applicable rules. However, there are situations in which non-compliance can result in abandonment or lapse of the patent or patent application, resulting in partial or complete loss of patent rights in the relevant jurisdiction. In such an event, potential competitors might be able to enter the market and this circumstance could have a material adverse effect on our business.

***Changes in United States patent law could diminish the value of patents in general, thereby impairing our ability to protect our products.***

As is the case with other biotechnology companies, our success is heavily dependent on intellectual property, particularly patents. Obtaining and enforcing patents in the biotechnology industry involve both technological and legal complexity, and therefore obtaining and enforcing biotechnology patents is costly, time-consuming and inherently uncertain.

Recent patent reform legislation could increase the uncertainties and costs surrounding the prosecution of our patent applications and the enforcement or defense of our issued patents. On September 16, 2011, the Leahy-Smith America Invents Act, or the Leahy-Smith Act, was signed into law. The Leahy-Smith Act includes a number of significant changes to U.S. patent law. These include provisions that affect the way patent applications are prosecuted and may also affect patent litigation. The United States Patent and Trademark Office recently developed new regulations and procedures to govern administration of the Leahy-Smith Act, and many of the substantive changes to patent law associated with the Leahy-Smith Act, and in particular, the first to file provisions, only became effective on March 16, 2013. Accordingly, it is not clear what, if any, impact the Leahy-Smith Act will have on the operation of our business. However, the Leahy-Smith Act and its implementation could increase the uncertainties and costs surrounding the prosecution of our patent applications and the enforcement or defense of our issued patents, all of which could have a material adverse effect on our business and financial condition.

Moreover, recent United States Supreme Court rulings have narrowed the scope of patent protection available in certain circumstances and weakened the rights of patent owners in certain situations. In addition to increasing uncertainty with regard to our ability to obtain patents in the future, this combination of events has created uncertainty with respect to the value of patents, once obtained. Depending on decisions by the United States Congress, the federal courts, and the United States Patent and Trademark Office, the laws and regulations governing patents could change in unpredictable ways that would weaken our ability to obtain new patents or to enforce our existing patents and patents that we might obtain in the future.

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***We have not yet sought FDA approval of names for any of our product candidates and failure to secure such approvals could adversely affect our business.***

Any name we propose to use with our product candidates in the United States must be approved by the FDA, regardless of whether we have registered it, or applied to register it, as a trademark. The FDA typically conducts a review of proposed product names, including an evaluation of potential for confusion with other product names. If the FDA objects to any of our proposed proprietary product names, we may be required to expend significant additional resources in an effort to identify a suitable substitute name that would qualify under applicable trademark laws, not infringe the existing rights of third parties and be acceptable to the FDA.

***We may not be able to protect our intellectual property rights throughout the world.***

Filing, prosecuting and defending patents on product candidates in all countries throughout the world would be prohibitively expensive, and our intellectual property rights in some countries outside the United States can be less extensive than those in the United States. In addition, the laws of some foreign countries do not protect intellectual property rights to the same extent as federal and state laws in the United States. Consequently, we may not be able to prevent third parties from practicing our inventions in all countries outside the United States, or from selling or importing products made using our inventions in and into the United States or other jurisdictions. Competitors may use our technologies in jurisdictions where we have not obtained patent protection to develop their own products and further, may export otherwise infringing products to territories where we have patent protection, but enforcement is not as strong as that in the United States. These products may compete with our products and our patents or other intellectual property rights may not be effective or sufficient to prevent them from competing.

Many companies have encountered significant problems in protecting and defending intellectual property rights in foreign jurisdictions. The legal systems of certain countries, particularly certain developing countries, do not favor the enforcement of patents, trade secrets and other intellectual property protection, particularly those relating to biotechnology products, which could make it difficult for us to stop the infringement of our patents or marketing of competing products in violation of our proprietary rights generally. Proceedings to enforce our patent rights in foreign jurisdictions could result in substantial costs and divert our efforts and attention from other aspects of our business, could put our patents at risk of being invalidated or interpreted narrowly and our patent applications at risk of not issuing and could provoke third parties to assert claims against us. We may not prevail in any lawsuits that we initiate and the damages or other remedies awarded, if any, may not be commercially meaningful. Accordingly, our efforts to enforce our intellectual property rights around the world may be inadequate to obtain a significant commercial advantage from the intellectual property that we develop or license.

### **Risks related to this offering and ownership of our common stock**

***An active trading market for our common stock may not be sustained.***

Although we have listed our common stock on The NASDAQ Global Market, an active trading market for our common stock may not be sustained. In the absence of an active trading market for our common stock, you may not be able to sell your common stock at or above the public offering price or at the time that you would like to sell. An inactive trading market may also impair our ability to raise capital to continue to fund operations by selling shares and may impair our ability to acquire other companies or technologies by using our shares as consideration.

***The market price for our common stock may be volatile, which could contribute to the loss of your investment.***

Fluctuations in the price of our common stock could contribute to the loss of all or part of your investment. The public offering price for the shares of our common stock may not be indicative of the price that will prevail in the trading market following this offering. Since our initial public offering in March 2014, the trading price of our common stock has been, and following this offering is likely to continue to be, highly volatile and could be

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subject to wide fluctuations in response to various factors, some of which are beyond our control. Any of the factors listed below could have a material adverse effect on your investment in our common stock and our common stock may trade at prices significantly below the public offering price in this offering. In such circumstances the trading price of our common stock may not recover and may experience a further decline.

Factors affecting the trading price of our common stock may include:

our failure to develop and commercialize our product candidates;

actual or anticipated fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us;

changes in the market's expectations about our operating results;

adverse results or delays in preclinical studies or clinical trials;

our decision to initiate a clinical trial, not to initiate a clinical trial or to terminate an existing clinical trial;

adverse regulatory decisions, including failure to receive regulatory approval for any of our product candidates;

success of competitive products;

adverse developments concerning our collaborations and our manufacturers;

inability to obtain adequate product supply for any product candidate for clinical trials or commercial sale or inability to do so at acceptable prices;

the termination of a collaboration or the inability to establish additional collaborations;

unanticipated serious safety concerns related to the use of any of our product candidates;

our ability to effectively manage our growth;

the size and growth, if any, of the orphan ophthalmology and other targeted markets;

our operating results failing to meet the expectation of securities analysts or investors in a particular period or failure of securities analysts to publish reports about us or our business;



changes in financial estimates and recommendations by securities analysts concerning our company, the gene therapy market, or the biotechnology and pharmaceutical industries in general;

operating and stock price performance of other companies that investors deem comparable to us;

overall performance of the equity markets;

announcements by us or our competitors of acquisitions, new product candidates or programs, significant contracts, commercial relationships or capital commitments;

our ability to successfully market our product candidates;

changes in laws and regulations affecting our business, including but not limited to clinical trial requirements for approvals;

disputes or other developments relating to proprietary rights, including patents, litigation matters and our ability to obtain patent protection for our product candidates and gene therapy platform;

commencement of, or involvement in, litigation involving our company, our general industry, or both;

changes in our capital structure, such as future issuances of securities or the incurrence of additional debt;

the volume of shares of our common stock available for public sale;

additions or departures of key scientific or management personnel;

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any major change in our board or management;

changes in accounting practices;

ineffectiveness of our internal control over financial reporting;

sales of substantial amounts of common stock by our directors, executive officers or significant stockholders or the perception that such sales could occur; and

general economic and political conditions such as recessions, interest rates, fuel prices, international currency fluctuations and acts of war or terrorism.

Broad market and industry factors may materially harm the market price of our common stock irrespective of our operating performance. The stock market in general, and The NASDAQ Global Market and the market for biotechnology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of the particular companies affected. The trading prices and valuations of these stocks, and of ours, may not be predictable. A loss of investor confidence in the market for technology or software stocks or the stocks of other companies which investors perceive to be similar to us, the opportunities in the digital simulation market or the stock market in general, could depress our stock price regardless of our business, prospects, financial conditions or results of operations.

***If securities analysts do not publish research or reports about our business or if they downgrade our stock, the price of our common stock could decline.***

The trading market for our common stock relies in part on the research and reports that industry or financial analysts publish about us, our business, our markets and our competitors. We do not control these analysts. As a newly public company, we have only limited coverage by securities analysts. If securities analysts do not continue to cover our common stock, the lack of research coverage may adversely affect the market price of our common stock. Furthermore, if one or more of the analysts who do cover us downgrade our stock or if those analysts issue other unfavorable commentary about us or our business, our stock price would likely decline. If one or more of these analysts cease coverage of us or fails to regularly publish reports on us, we could lose visibility in the market and interest in our stock could decrease, which in turn could cause our stock price or trading volume to decline and may also impair our ability to expand our business with existing customers and attract new customers.

***The concentration of our capital stock ownership with insiders upon the closing of this offering will limit your ability to influence corporate matters.***

We anticipate that our executive officers, employees, directors, current 5% or greater stockholders, and their respective affiliates will together beneficially own or control, in aggregate, approximately 63.2% of the shares of our outstanding common stock, assuming no exercise of outstanding options or warrants following the closing of this offering (and assuming no exercise of the underwriters' over-allotment option). As a result, these executive officers, directors and principal stockholders, acting together, will have substantial influence over most matters that require approval by our stockholders, including the election of directors, any merger, consolidation or sale of all or substantially all or of our assets or any other significant corporate transaction. Corporate action might be taken even if other stockholders, including those who purchase shares in this offering, oppose such action. These stockholders may delay or prevent a change of control or otherwise discourage a potential acquirer from attempting to obtain control of our company, even if such change of control would benefit our other stockholders. This concentration of stock ownership may adversely affect investors' perception of our corporate governance or delay, prevent or cause a change in control of our company, any of which could adversely affect the market price of our common stock.

***We are an emerging growth company, and the reduced reporting requirements applicable to emerging growth companies may make our common stock less attractive to investors.***

We are an emerging growth company, as defined in the JOBS Act. For as long as we continue to be an emerging growth company, we may take advantage of exemptions from various reporting requirements that are



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applicable to other public companies that are not emerging growth companies, including not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in this prospectus and our periodic reports and proxy statements and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. We could be an emerging growth company for up to five years from the date of our initial public offering on March 26, 2014, although circumstances could cause us to lose that status earlier, including if the market value of our common stock held by non-affiliates exceeds \$700.0 million as of any December 31 before that time or if we have total annual gross revenue of \$1.0 billion or more during any fiscal year before that time, in which cases we would no longer be an emerging growth company as of the following June 30 or, if we issue more than \$1.0 billion in non-convertible debt during any three-year period before that time, we would cease to be an emerging growth company immediately. Even after we no longer qualify as an emerging growth company, we may still qualify as a smaller reporting company which would allow us to take advantage of many of the same exemptions from disclosure requirements, including not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act and reduced disclosure obligations regarding executive compensation in this prospectus and our periodic reports and proxy statements. We cannot predict if investors will find our common stock less attractive because we may rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.

Under the JOBS Act, emerging growth companies can also delay adopting new or revised accounting standards until such time as those standards apply to private companies. We have irrevocably elected not to avail ourselves of this exemption from new or revised accounting standards and, therefore, will be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies. As a result, changes in rules of U.S. generally accepted accounting principles or their interpretation, the adoption of new guidance or the application of existing guidance to changes in our business could significantly affect our financial position and results of operations.

***A significant portion of our total outstanding shares is restricted from immediate resale but may be sold into the market in the near future, which could cause the market price of our common stock to decline significantly, even if our business is doing well.***

Sales of a substantial number of shares of our common stock in the public market could occur at any time. These sales, or the perception in the market that the holders of a large number of shares of common stock intend to sell shares, could reduce the market price of our common stock. After this offering, we will have 16,077,942 shares of common stock outstanding based on the 14,077,942 shares outstanding immediately following the closing of the underwriters' over-allotment in our initial public offering on April 3, 2014 and the issuance of the 2,000,000 shares offered hereby (assuming no exercise of the underwriters' over-allotment option). Other than the 4,791,667 shares sold by us in our initial public offering, substantially all of the outstanding shares of our common stock are subject to a 180-day contractual lock-up with the underwriters for our initial public offering, which period began on March 26, 2014, and approximately 9.1 million shares are subject to a 90-day contractual lock-up with the underwriters for this offering, which period will begin on the date of effectiveness of the registration statement of which this prospectus forms a part. These shares can be sold, subject to any applicable volume limitations under federal securities laws, after the earlier of the expiration of, or release from, the applicable lock-up period. The balance of our outstanding shares of common stock may be freely sold in the public market at any time to the extent permitted by Rules 144 and 701 under the Securities Act of 1933, as amended, which we refer to as the Securities Act. Moreover, holders of a substantial portion of our common stock have rights, subject to conditions, to require us to file registration statements covering their shares or to include their shares in registration statements that we may file for ourselves or other stockholders.

In addition, as of June 30, 2014, there were 1,043,748 shares subject to outstanding options under our equity incentive plans, all of which shares we plan to register under the Securities Act on a registration statement on Form S-8. These shares, once vested and issued upon exercise, will be able to be freely sold in the public market,

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subject to volume limits applicable to affiliates and the lock-up agreements described above, to the extent applicable. Furthermore, as of June 30, 2014, there were 49,811 shares subject to outstanding warrants. These shares will become eligible for sale in the public market to the extent such warrants are exercised and to the extent permitted by the lock-up agreements and Rule 144 under the Securities Act.

***Future sales and issuances of our common stock or rights to purchase common stock, including pursuant to our equity incentive plans, could result in additional dilution of the percentage ownership of our stockholders and could cause our stock price to fall.***

We expect that significant additional capital may be needed in the future to continue our planned operations, including conducting clinical trials, commercialization efforts, expanded research and development activities, potential acquisitions, in-licenses, or collaborations and costs associated with operating a public company. To raise capital, we may sell common stock, convertible securities or other equity securities in one or more transactions at prices and in a manner we determine from time to time. If we sell common stock, convertible securities or other equity securities in more than one transaction, investors may be materially diluted by subsequent sales. Such sales may also result in material dilution to our existing stockholders, and new investors could gain rights, preferences and privileges senior to the holders of our common stock, including shares of common stock sold in this offering.

***You will experience immediate and substantial dilution in the net tangible book value of the shares you purchase in this offering.***

If you purchase shares of our common stock in this offering, you will experience immediate and substantial dilution, as the public offering price of our common stock will be substantially greater than the net tangible book value per share of our common stock. Based on an assumed offering price of \$18.52 per share, which was the last reported price of our common stock on The NASDAQ Global Market on July 18, 2014, if you purchase our common stock in this offering, you will suffer immediate and substantial dilution of approximately \$11.57 per share. If the underwriters exercise their over-allotment option, or if outstanding options and warrants to purchase our common stock are exercised, you will experience additional dilution. For a further description of the dilution that you will experience immediately after this offering, see the section entitled Dilution.

***Our board of directors and management will have broad discretion over the use of the proceeds we receive in this offering and might not apply the proceeds in ways that increase the value of your investment.***

Our board of directors and management will have broad discretion to use the net proceeds from this offering, including for any of the purposes described in the section entitled Use of Proceeds, and you will be relying on the judgment of our board of directors and management regarding the application of these proceeds. You will not have the opportunity to influence our decisions on how to use the proceeds, and we may not apply the net proceeds of this offering in ways that increase the value of your investment. Because of the number and variability of factors that will determine our use of the net proceeds from this offering, their ultimate use may vary substantially from their currently intended use. While we have not allocated these estimated net proceeds for any specific purposes, we expect to use the net proceeds from this offering to develop our product candidates and for general corporate purposes, including working capital. We may also use a portion of the proceeds in acquisitions or in-licenses of products and technologies that are complementary to our business. Although we have from time to time evaluated possible acquisitions and in-licenses, we currently have no commitments or agreements to make any material acquisition or in-license, and we may not make any acquisitions in the future. The failure by our management to apply these funds effectively could harm our business. Pending their use, we may invest the net proceeds from this offering in short-term, investment-grade, interest-bearing securities. These investments may not yield a favorable return to our stockholders. If we do not invest or apply the net proceeds from this offering in ways that enhance stockholder value, we may fail to achieve expected financial results, which could cause our stock price to decline.

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***We do not currently intend to pay dividends on our common stock and, consequently, your ability to achieve a return on your investment will depend on the appreciation in the price of our common stock.***

We have never declared or paid any cash dividends on our common stock. We currently intend to retain any future earnings to fund our future growth and do not expect to declare or pay any dividend on shares of our common stock in the foreseeable future. As a result, you may only receive a return on your investment in our common stock if the market price of our common stock appreciates and you sell your shares at a price above your cost. The price of our common stock may not appreciate in value or ever exceed the price that you paid for shares of our common stock in this offering.

***We could be subject to securities class action litigation.***

In the past, securities class action litigation has often been brought against a company following a decline in the market price of its securities. This risk is especially relevant for us because biotechnology companies have experienced significant stock price volatility in recent years. If we face such litigation, it could result in substantial costs and a diversion of management's attention and resources, which could harm our business.

***Anti-takeover provisions in our amended and restated certificate of incorporation and amended and restated bylaws, as well as provisions in Delaware law, might discourage, delay or prevent a change of control of our company or changes in our management and, therefore, depress the trading price of our common stock.***

Our certificate of incorporation, bylaws and Delaware law contain provisions that could have the effect of rendering more difficult or discouraging an acquisition deemed undesirable by our board of directors, even if doing so would benefit our stockholders or remove our current management. Our corporate governance documents include provisions:

providing for three classes of directors with the term of office of one class expiring each year, commonly referred to as a staggered board;

authorizing blank check preferred stock, which could be issued with voting, liquidation, dividend and other rights superior to our common stock;

limiting the liability of, and providing indemnification to, our directors and officers;

eliminating the ability of our stockholders to call and bring business before special meetings and to take action by written consent in lieu of a meeting;

requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors;

controlling the procedures for the conduct and scheduling of board and stockholder meetings;

limiting the determination of the number of directors on our board and the filling of vacancies or newly created seats on the board to our board of directors then in office; and

providing that directors may be removed by stockholders only for cause.

These provisions, alone or together, could delay hostile takeovers and changes in control or changes in our management.

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As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation Law, which prohibits a publicly-held Delaware corporation from engaging in a business combination with an interested stockholder, generally a person which together with its affiliates owns, or within the last three years has owned, 15% of our voting stock, for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner.

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The existence of the foregoing provisions and anti-takeover measures could limit the price that investors might be willing to pay in the future for shares of our common stock. They could also deter potential acquirers of our company, thereby reducing the likelihood that you could receive a premium for your common stock in an acquisition.



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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This prospectus contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. In some cases, you can identify these statements by forward-looking words such as may, could, should, would, intend, will, expect, anticipate, believe, estimate, continue, plan, potential predict, project or the negative of those words. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements. You should read these statements carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial condition or state other forward-looking information. These forward-looking statements include, among other things, statements about:

the anticipated timing, costs and conduct of our planned clinical trials for our ACHM and XLRS product candidates;

the anticipated timing, costs and conduct of our planned preclinical studies of our XLRP product candidate;

our plans to explore potential applications of our gene therapy platform in other indications, including wet AMD;

our plans to conduct additional preclinical studies of our product candidate for treatment of AAT;

our plans to pursue in-licensing, co-development, intellectual property acquisition or manufacturing agreements;

our plans to expand our manufacturing capabilities and create a pilot manufacturing group;

our expectations regarding the clinical effectiveness of our product candidates;

our beliefs regarding the scalability and commercial viability of our HAVE manufacturing method;

our commercialization, marketing and manufacturing capabilities and strategy;

our intellectual property position;

our competitive position;

our expectations related to the use of proceeds from this offering; and

our estimates regarding expenses, future revenue, capital requirements and needs for additional financing.

These forward-looking statements reflect our management's beliefs and views with respect to future events and are based on estimates and assumptions as of the date of this prospectus and are subject to risks and uncertainties. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements, and you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements we make. We

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have included important factors in the cautionary statements included in this prospectus, particularly in the Risk Factors section, that could cause actual results or events to differ materially from the forward-looking statements that we make. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments that we may make.

You should read this prospectus, the documents that we reference in this prospectus and the documents that we have filed as exhibits to the registration statement of which this prospectus is a part completely and with the understanding that our actual future results may be materially different from what we expect. We do not assume any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

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**USE OF PROCEEDS**

We estimate that the net proceeds from our issuance and sale of 2,000,000 shares of our common stock in this offering will be approximately \$34.4 million, based on an assumed public offering price of \$18.52 per share, which was the last reported sale price of our common stock on The NASDAQ Global Market on July 18, 2014, after deducting underwriting discounts and commissions and estimated offering expenses payable by us. If the underwriters exercise their over-allotment option in full, we estimate that the net proceeds from this offering will be approximately \$39.6 million, after deducting underwriting discounts and commissions and estimated offering expenses payable by us.

We plan to use the net proceeds from this offering as follows:

approximately \$8 million to \$12 million to fund our preclinical investigation and Phase 1/2 trials of potential product candidates for the treatment of wet AMD;

approximately \$3 million to \$5 million to expand our manufacturing capabilities and, in particular, to develop a pilot program for in-house process development and non-cGMP manufacturing at up to 100L scale, including expenditures for capital equipment of approximately \$2.5 million; and

the balance to in-license, acquire or invest in complementary gene therapy technologies, products or assets and for working capital and other general corporate purposes.

While we have and will continue to monitor the market for opportunities to in-license, acquire or invest in complementary gene therapy technologies, products and assets, at this time, we have no agreement or commitment for any specific in-license, acquisition or investment and we have not allocated any portion of the estimated net proceeds of this offering for these activities.

Our expected use of net proceeds from this offering represents our current intentions based upon our present plans and business condition. As of the date of this prospectus, we cannot predict with certainty all of the particular uses for the net proceeds to be received upon the closing of this offering or the amounts that we will actually spend on the uses set forth above. Due to the many variables inherent in the development of gene therapy products at this time, such as the timing of patient enrollment, the timing and results of preclinical animal studies and clinical trials and the timing of regulatory

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\$  
—

Total liabilities  
\$  
93

\$  
93

\$  
—

\$  
—

Fair Value Measurements at December 31, 2017:

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	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	\$ 25,455	\$ 25,455	\$ —	\$ —
Trading securities held in a "rabbi trust" (1)	74	74	—	—
Total assets	\$ 25,529	\$ 25,529	\$ —	\$ —
Liabilities:				
Deferred compensation accrual "rabbi trust" (2)	\$ 92	\$ 92	\$ —	\$ —
Total liabilities	\$ 92	\$ 92	\$ —	\$ —

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

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

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### Accounts receivable, net

Accounts receivable consist primarily of trade amounts due from customers in the United States, uncleared credit card transactions at period end, and carrier rebates. Accounts receivable are recorded at invoiced amounts and do not bear interest. From time to time, we grant credit to some of our business customers on normal credit terms (typically 30 days). We maintain an allowance for doubtful accounts receivable based upon our business customers' financial condition and payment history, and our historical collection experience and expected collectability of accounts receivable. The allowance for doubtful accounts receivable was \$1.9 million and \$1.3 million at September 30, 2018 and December 31, 2017, respectively.

### Concentration of credit risk

Three banks held the majority of our cash and cash equivalents at September 30, 2018. Two banks held the majority of our cash and cash equivalents at December 31, 2017. Our cash equivalents primarily consist of money market securities which are uninsured. We do not believe that, as a result of this concentration, we are subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships.

### Inventories, net

Inventories, net include merchandise purchased for resale, which are accounted for using a standard costing system which approximates the first-in-first-out ("FIFO") method of accounting, and are valued at the lower of cost and net realizable value. Inventory valuation requires us to make judgments, based on currently available information, about the likely method of disposition, such as through sales to individual customers, returns to product vendors, or liquidations, and expected recoverable values of each disposition category.

### Prepays and other current assets

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

### Cryptocurrencies

Cryptocurrency holdings are included in Prepays and other current assets in our consolidated balance sheets and totaled \$3.1 million and \$1.5 million at September 30, 2018 and December 31, 2017, respectively. Cryptocurrency holdings are recorded at cost less impairment.

We recognize impairment on these assets caused by decreases in market value based upon Level 1 inputs. See Fair value of financial instruments above. Such impairment in the value of our cryptocurrencies is recorded in General and administrative expense in our consolidated statements of operations. Impairments on cryptocurrencies were \$150,000 and \$9.6 million for the three and nine months ended September 30, 2018. There was no impairment on cryptocurrencies during the three and nine months ended September 30, 2017.

Gains and losses realized upon sale of cryptocurrencies are also recorded in General and administrative expense in our consolidated statements of operations. We occasionally use our cryptocurrencies to purchase other cryptocurrencies. Gains and losses realized with these non-cash transactions are also recorded in General and administrative expense in our consolidated statements of operations. These non-cash transactions as well as gains (losses) from cryptocurrencies received through our tZERO security token offering are also presented as an adjustment to reconcile Consolidated net loss to Net cash used in operating activities in our consolidated statements of cash flows. Realized gains on sale of

cryptocurrencies were \$64,000 and \$8.4 million for the three and nine months ended September 30, 2018. There were \$3.6 million realized gains or losses on sale of cryptocurrencies during the three and nine months ended September 30, 2017.

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## Fixed assets, net

Fixed assets are recorded at cost and stated net of depreciation and amortization. Fixed assets are depreciated using the straight-line method over the estimated useful lives of the related assets or the term of the related capital lease, whichever is shorter, as follows:

	Life (years)
Building	40
Land improvements	20
Building machinery and equipment	15-20
Furniture and equipment	5-7
Computer hardware	3-4
Computer software, including internal-use software and website development	2-4

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

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

During the three months ended September 30, 2018 and 2017, we capitalized \$4.0 million and \$2.2 million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally. Amortization of costs for the same periods associated with internal-use software and website development was \$3.4 million and \$3.9 million, respectively. During the nine months ended September 30, 2018 and 2017, we capitalized \$14.7 million and \$8.0 million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally. Amortization of costs associated with internal-use software and website development was \$10.0 million and \$12.2 million, respectively.

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Cost of goods sold - direct	\$85	\$72	\$252	\$230
Technology	5,330	5,940	16,103	18,802
General and administrative	1,038	974	3,082	2,863
Total depreciation, including internal-use software and website development	\$6,453	\$6,986	\$19,437	\$21,895

Total accumulated depreciation of fixed assets was \$202.3 million and \$186.4 million at September 30, 2018 and December 31, 2017, respectively.

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

Fixed assets included assets under capital leases of \$1.8 million at September 30, 2018 and December 31, 2017. Accumulated depreciation related to assets under capital leases was \$842,000 and \$458,000 at September 30, 2018 and December 31, 2017, respectively.

Depreciation expense of assets recorded under capital leases was \$120,000 and \$1.1 million for the three months ended September 30, 2018 and 2017, respectively, and \$384,000 and \$3.5 million for the nine months ended September 30, 2018 and 2017, respectively.



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## Equity investments under ASC 321

At September 30, 2018, we held minority interests (less than 20%) in thirteen privately held entities accounted for under ASC Topic 321, Investments - Equity Securities ("ASC 321"), which are included in Equity investments in our consolidated balance sheets. One of these equity investments, which had a carrying value of \$4.3 million at September 30, 2018, is carried at fair value based on Level 1 inputs. See Fair value of financial instruments above. The remaining equity investments lack readily determinable fair values and therefore the investments are measured at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar equity securities of the same issuer. Dividends received are reported in current earnings. We review our investments individually for impairment by evaluating if events or circumstances have occurred that may indicate the fair value of the investment is less than its carrying value. If such events or circumstances have occurred, we estimate the fair value of the investment and recognize an impairment loss equal to the difference between the fair value of the investment and its carrying value. In such cases, the estimated fair value of the investment is determined using unobservable inputs including assumptions by the investee's management including quantitative information such as lower valuations in recently completed or proposed financings. These inputs are classified as Level 3. Because several of our investees are in the early startup or development stages, these entities are subject to potential changes in cash flows, valuation, and inability to attract new investors which may be necessary for the liquidity needed to support their operations.

The carrying amount of our investments under ASC 321 was approximately \$18.5 million and \$6.5 million at September 30, 2018 and December 31, 2017, respectively. We recognized unrealized losses of \$73,000 and unrealized gains of \$1.8 million on investments carried at fair value during the three and nine months ended September 30, 2018, respectively. We recognized a \$511,000 impairment loss during the three and nine months ended September 30, 2018. We recognized a \$4.5 million impairment loss during the nine months ended September 30, 2017. Impairment loss and any unrealized gains or losses on our investments are recorded in Other income (expense), net on our consolidated statements of operations.

## Equity method investments under ASC 323

At September 30, 2018, we held minority interests in nine privately held entities accounted for as equity method investments under ASC Topic 323, Investments - Equity Method and Joint Ventures ("ASC 323"), which are included in Equity investments in our consolidated balance sheets. We can exercise significant influence, but not control, over the investees through either holding more than a 20% voting interest in the entity or through our representation on the entity's board of directors. Based on the nature of our ownership interests, we have variable interests in certain of these entities. However, because we do not have power to direct the investee's activities and we are not the investee's primary beneficiary, we therefore do not consolidate the investee in our financial statements.

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

The carrying amount of our equity method investments was approximately \$39.0 million and \$6.5 million at September 30, 2018 and December 31, 2017, respectively, and the difference between the carrying value and the amount of underlying equity in net assets of each investee was not significant. Our proportionate share of the net income or loss of our equity method investees was approximately \$1.2 million in losses and \$74,000 in losses for the three months ended September 30, 2018 and 2017, respectively, and approximately \$2.5 million in losses and \$74,000

in losses for the nine months ended September 30, 2018 and 2017, respectively.

#### Noncontrolling interests

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

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On December 18, 2017, tZERO launched an offering (the "security token offering") of the right to acquire tZERO Preferred Equity Tokens (the "tZERO Security Token") through a Simple Agreement for Future Equity ("SAFE"). The security token offering closed on August 6, 2018. At September 30, 2018, the SAFEs were classified as equity by tZERO. At September 30, 2018, cumulative proceeds, net of withdrawals, from the security token offering totaling \$104.8 million, have been classified as a component of noncontrolling interest within our consolidated financial statements. As of September 30, 2018, tZERO has incurred \$21.3 million of offering costs associated with the security token offering that are classified as a reduction in proceeds within noncontrolling interest of our consolidated financial statements. On October 12, 2018, tZERO issued the tZERO Security Tokens in settlement of the SAFEs. The tZERO Security Tokens are subject to a 90 day trading lock-up period.

During the first quarter of 2018, tZERO purchased 65.8% of ES Capital Advisors, LLC ("ES Capital"), a registered investment advisor under the Investment Advisers Act of 1940, which was accounted for as an asset acquisition. tZERO operates the ES Capital business under the name tZERO Advisors and offers automated investment advisory services under the FinanceHub tab on our Website. tZERO also purchased 81.0% of Verify Investor, LLC, an accredited investor verification company. This transaction is described further in Note 3—Acquisitions, Goodwill, and Acquired Intangible Assets. These entities are included in our consolidated financial statements.

Medici Land Governance Inc., a Delaware public benefit corporation ("MLG"), was recently formed by Medici Ventures with our President and Chief Executive Officer, Dr. Patrick M. Byrne ("Dr. Byrne"). Pursuant to the Subscription Agreements dated September 21, 2018, Medici Ventures contributed certain of its assets, including intellectual property relating to technologies regarding land governance and property rights, to MLG in exchange for 510,000 shares of MLG common stock and at the same time Dr. Byrne personally contributed \$6.7 million in cash to MLG in exchange for 390,000 shares of MLG common stock. As a result of the transactions described above, Medici Ventures holds approximately 57% of the outstanding capital stock of MLG, and Dr. Byrne, holds approximately 43% of the outstanding capital stock of MLG.

## Leases

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

## Treasury stock

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

## Goodwill

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

the goodwill to its carrying amount. In calculating the implied fair value of goodwill, the fair value of the reporting unit is allocated to the other assets and liabilities within the reporting unit based on estimated fair value. The excess of the fair value of a reporting unit over the amount allocated to its other assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized when the carrying amount of goodwill exceeds its implied fair value.

We test for impairment of goodwill annually or when we deem that a triggering event has occurred. There were no impairments to goodwill recorded during the nine months ended September 30, 2018 and 2017.

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For nine months ended September 30, 2018, we recognized \$7.4 million in goodwill related to a business acquisition as described in Note 3—Acquisitions, Goodwill, and Acquired Intangible Assets. The change in goodwill relates to a non-reportable segment, included in Other as described in Note 10—Business Segments.

## Intangible assets other than goodwill

We capitalize and amortize intangible assets other than goodwill over their estimated useful lives unless such lives are indefinite. Intangible assets other than goodwill acquired separately from third-parties are capitalized at cost while such assets acquired as part of a business combination are capitalized at their acquisition-date fair value. Indefinite lived intangible assets include intellectual property and investment advisor licenses purchased in connection with our tZERO Advisors and Medici Ventures' portfolio company in the blockchain property titling businesses. Certain licenses are subject to annual renewal terms with immaterial fees which are expensed as incurred. Indefinite-lived intangible assets are tested for impairment annually or more frequently when events or circumstances indicate that the carrying value more likely than not exceeds its fair value. In addition, we routinely evaluate the remaining useful life of intangible assets not being amortized to determine whether events or circumstances continue to support an indefinite useful life, including any legal, regulatory, contractual, competitive, economic, or other factors that may limit their useful lives. Definite lived intangible assets are amortized using the straight-line method of amortization over their useful lives, with the exception of certain intangibles (such as acquired technology, customer relationships, and trade names) which are amortized using an accelerated method of amortization based on cash flows. Definite lived intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable as described below under Impairment of long-lived assets.

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

	September 30, 2018	December 31, 2017
Intangible assets subject to amortization, gross (1)	\$ 28,347	\$ 17,779
Less: accumulated amortization of intangible assets subject to amortization	(14,040)	(10,442)
Intangible assets subject to amortization, net	14,307	7,337
Intangible assets not subject to amortization	10,833	—
Total intangible assets, net	\$ 25,140	\$ 7,337

(1) — At September 30, 2018, the weighted average remaining useful life for intangible assets subject to amortization, excluding fully amortized intangible assets, was 5.69 years.

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Technology	\$885	\$905	\$2,534	\$2,715
Sales and marketing	119	22	442	62
General and administrative	542	21	620	62
Total amortization	\$1,546	\$948	\$3,596	\$2,839

Estimated amortization expense for the next five years is: \$1.3 million for the remainder of 2018, \$4.7 million in 2019, \$2.2 million in 2020, \$1.8 million in 2021, \$892,000 in 2022, and \$3.5 million thereafter.

### Impairment of long-lived assets

We review property and equipment and other long-lived assets, including amortizable intangible assets other than goodwill, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability is measured by comparison of the assets' carrying amount to future undiscounted net cash flows the asset group is expected to generate. Cash flow forecasts are based on trends of historical performance and management's estimate of future performance, giving consideration to existing and anticipated competitive and economic

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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 nine months ended September 30, 2018 and 2017.

Other long-term assets, net

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

Revenue recognition

We derive our revenue primarily from retail merchandise sales on our Website. We also earn revenue from advertising on our Website and from other sources. We have organized our operations into two principal reporting segments based on the primary source of revenue: (i) direct revenue and (ii) partner and other revenue. Net revenue from contracts with customers is further disaggregated by Retail and Other net revenue as disclosed in Note 10—Business Segments.

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

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

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

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

During the nine months ended September 30, 2018, we recognized \$37.8 million of net revenue included in Deferred revenue at December 31, 2017.

The allowance for returns was \$12.4 million and \$17.4 million at September 30, 2018 and December 31, 2017, respectively.

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



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### Direct revenue

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

### Partner and other revenue

Partner and other revenue is derived primarily from merchandise sales of inventory sourced through our partners which are generally shipped directly to our consumers and businesses. Through contractual terms with our partners, we have the ability to control the promised goods or services and as a result record the majority of our partner revenue on a gross basis. Partner and other revenue comes from merchandise sales that occur primarily through our Website, but may also occur through offline and other channels, including through our broker dealer subsidiaries in our Other segment.

### Club O loyalty program

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

Earned Club O Reward dollars may be redeemed on future purchases made through our Website. We recognize revenue for Club O Reward dollars when customers redeem such rewards as part of a purchase on our Website. We account for these transactions as multiple element arrangements and allocate the transaction price to separated performance obligations using their relative fair values. We include the fair value of reward dollars earned in deferred revenue at the time the reward dollars are earned. Club O Reward dollars expire 90 days after the customer's Club O Gold membership expires. We recognize estimated reward dollar breakage, to which we expected to be entitled, over the expected redemption period in proportion to actual redemptions by customers. Upon adoption of Topic 606, Revenue Contracts with Customers, on January 1, 2018, we began classifying the breakage income related to Club O Reward dollars and gift cards as a component of revenue in our consolidated statements of operations rather than as a component of Other income (expense), net. Breakage included in revenue was \$1.3 million and \$4.2 million for the three and nine months ended September 30, 2018. We also recognized a cumulative adjustment that reduced Accumulated deficit by approximately \$5.0 million upon adoption related to the unredeemed portion of our gift cards and loyalty program rewards.

Our total deferred revenue related to the outstanding Club O Reward dollars was \$6.6 million and \$8.7 million at September 30, 2018 and December 31, 2017, respectively. The timing of revenue recognition of these reward dollars is driven by actual customer activities, such as redemptions and expirations.

### Advertising Revenue

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

### Cost of goods sold

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

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

	Three months ended				Nine months ended			
	September 30,		September 30,		September 30,		September 30,	
	2018	2017	2018	2017	2018	2017	2018	2017
Total revenue, net	\$440,580	100 %	\$424,007	100 %	\$1,369,044	100 %	\$1,288,466	100 %
Cost of goods sold								
Product costs and other cost of goods sold	334,156	76 %	321,678	76 %	1,039,518	76 %	977,827	76 %
Fulfillment and related costs	19,708	4 %	18,654	4 %	57,198	4 %	55,886	4 %
Total cost of goods sold	353,864	80 %	340,332	80 %	1,096,716	80 %	1,033,713	80 %
Gross profit	\$86,716	20 %	\$83,675	20 %	\$272,328	20 %	\$254,753	20 %

## Advertising expense

We expense the costs of producing advertisements the first time the advertising takes place and expense the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized as incurred based on the terms of the individual agreements, which are generally: 1) a commission for traffic driven to our Website that generates a sale or 2) a referral fee based on the number of clicks on keywords or links to our Website generated during a given period. Advertising expense is included in Sales and marketing expenses and totaled \$49.7 million and \$41.2 million during the three months ended September 30, 2018 and 2017, respectively. For the nine months ended September 30, 2018 and 2017, advertising expenses totaled \$207.5 million and \$114.6 million, respectively. Prepaid advertising (included in Prepaids and other current assets in the accompanying consolidated balance sheets) was \$1.2 million and \$987,000 at September 30, 2018 and December 31, 2017, respectively.

## Stock-based compensation

We measure compensation expense for all outstanding unvested share-based awards at fair value on the date of grant and recognize compensation expense over the service period for awards at the greater of a straight-line basis or on an accelerated schedule when vesting of the share-based awards exceeds a straight-line basis. When an award is forfeited prior to the vesting date, we recognize an adjustment for the previously recognized expense in the period of the forfeiture. See Note 9—Stock-Based Awards.

## Self-funded health insurance

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

We are responsible for estimating our liability for unpaid costs of insured events that have occurred, which includes known cases on a case-by-case basis, and also for events that have occurred, but have not yet been reported. The accrued liability related to the self-funded health insurance plan was \$1.5 million and \$1.0 million at September 30, 2018 and December 31, 2017, respectively, and is included in Accrued liabilities in the accompanying consolidated balance sheets. Actual claims may differ from the amount accrued and any difference could be significant.

## Loss contingencies

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

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### Income taxes

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

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

Each quarter we assess the recoverability of our deferred tax assets under ASC Topic 740. We assess the available positive and negative evidence to estimate whether we will generate sufficient future taxable income to use our existing deferred tax assets. We have limited carryback ability and do not have significant taxable temporary differences to recover our existing deferred tax assets, therefore we must rely on future taxable income, including tax planning strategies, to support their realizability. We have established a valuation allowance for our deferred tax assets not supported by carryback ability or taxable temporary differences, primarily due to uncertainty regarding our future taxable income. We have considered, among other things, the cumulative loss incurred over the three-year period ended September 30, 2018 as a significant piece of objective negative evidence. We intend to continue maintaining a valuation allowance on our net deferred tax assets until there is sufficient evidence to support the reversal of all or some portion of these allowances. The amount of the deferred tax asset considered realizable could be adjusted if objective negative evidence in the form of cumulative losses is no longer present and additional weight may be given to subjective evidence such as long-term projections for growth. We will continue to monitor the need for a valuation allowance against our remaining deferred tax assets on a quarterly basis.

Tax laws and regulations themselves are subject to change as a result of changes in fiscal policy, changes in legislation, the evolution of regulations, and court rulings. On December 22, 2017, the President signed into law Public Law No. 115-97, commonly referred to as the Tax Cuts and Jobs Act ("TCJA"), following its passage by the United States Congress. The TCJA made significant changes to U.S. federal income tax laws, mostly effective for tax years beginning after December 31, 2017. Among many other changes, the new law lowers the corporate tax rate from 35% to 21% for tax years beginning in 2018, transitions U.S. international taxation from a worldwide tax system to a territorial system, and includes a one-time transition tax on the mandatory deemed repatriation of cumulative foreign earnings as of December 31, 2017. Staff Accounting Bulletin No. 118 ("SAB 118") was issued to address the application of US GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the TCJA. As noted at year-end, however, we were able to reasonably estimate certain effects and, therefore, recorded adjustments associated with the remeasurement of certain deferred tax assets and liabilities and the mandatory deemed repatriation of cumulative foreign earnings.

Our accounting for the following elements of the TCJA is complete. The expense related to the remeasurement of certain deferred tax assets and liabilities, based on the rates at which they are expected to reverse in the future, was \$25.2 million. The expense related to the one-time transition tax on the mandatory deemed repatriation of cumulative foreign earnings was \$47,000. We did not make any measurement-period adjustments related to these items during the quarter because there were no significant changes to our provisional amounts, and therefore, there is no impact to our effective tax rate due to measurement-period adjustments.

The TCJA includes a provision to tax global intangible low-taxed income ("GILTI") of foreign subsidiaries beginning in 2018. Under GAAP, we can make an accounting policy election to either treat taxes due on the GILTI inclusion as a current period expense, or factor such amounts into our measurement of deferred taxes. We will elect to treat any potential GILTI inclusions as a period cost as we are not projecting any material impact from GILTI inclusions and any deferred taxes related to any inclusion would be immaterial.

The TCJA included a mandatory deemed repatriation of cumulative foreign earnings for the year ended December 31, 2017, for which we accrued U.S. tax expense. However, we would still need to accrue and pay various other taxes on this amount if repatriated, which we have not provided for because we intend to indefinitely reinvest these earnings outside the U.S. We have begun expansion of operations outside of the U.S. and have plans for additional expansion for which we have incurred

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and will continue to incur capital requirements. We have considered ongoing capital requirements of the parent company in the U.S.

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

## Net loss per share

In 2016, we issued shares of our Blockchain Voting Series A Preferred Stock and our Voting Series B Preferred Stock (collectively the "preferred shares"). These shares are considered participating securities, and as a result, net loss per share is calculated using the two-class method. Under this method, we give effect to preferred dividends and then allocate remaining net loss attributable to our stockholders to both common shares and participating securities (based on the percentages outstanding) in determining net loss per common share.

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

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

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net loss attributable to stockholders of Overstock.com, Inc.	\$(47,923)	\$(786 )	\$(163,743)	\$(14,188)
Less: Preferred stock dividends - declared and accumulated	27	27	80	80
Undistributed loss	(47,950 )	(813 )	(163,823 )	(14,268 )
Less: Undistributed loss allocated to participating securities	(1,055 )	(22 )	(3,728 )	(386 )
Net loss attributable to common shares	\$(46,895)	\$(791 )	\$(160,095)	\$(13,882)
Net loss per common share—basic:				
Net loss attributable to common shares—basic	\$(1.55 )	\$(0.03)	\$(5.47 )	\$(0.55 )
Weighted average common shares outstanding—basic	30,279	25,003	29,256	25,024
Effect of dilutive securities:				
Stock options and restricted stock awards	—	—	—	—
Weighted average common shares outstanding—diluted	30,279	25,003	29,256	25,024
Net loss attributable to common shares—diluted	\$(1.55 )	\$(0.03)	\$(5.47 )	\$(0.55 )





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

	Three months ended September 30, 2018		Nine months ended September 30, 2017	
Stock options and restricted stock units	498	192	578	165
Common shares issuable under stock warrant	—	—	28	—

## Warrants

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

## Recently adopted accounting standards

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

The implementation did not impact our gross and net recognition for our revenue transactions. In addition, we continue to recognize revenue related to merchandise sales upon delivery to our customers. However, we now present breakage on our Club O Rewards and gift cards in Partner and other revenue in our consolidated statement of operations rather as a component of Other expense, net.

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

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

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, which provides guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. We adopted the changes under the new standard on January 1, 2018 on a prospective basis. The implementation of ASU 2017-01 did not have a material impact on our consolidated financial statements and related disclosures.

#### Recently issued accounting standards

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which, among other things, requires lessees to recognize most leases on their balance sheets related to the rights and obligations created by those leases. The new standard also requires new disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows

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arising from leases. The new standard becomes effective for us on January 1, 2019, with early adoption permitted. We plan to adopt this ASU beginning on January 1, 2019. The amendments in this update should be applied under a modified retrospective approach. We are evaluating the effect that ASU 2016-02 will have on our consolidated financial statements and related disclosures.

In June 2018, the FASB issued ASU 2018- 07, Compensation-Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting; which aligns the measurement and classification guidance for share-based payments to nonemployees with the guidance for share-based payments to employees, with certain exceptions. Under the guidance, the measurement of equity-classified nonemployee awards will be fixed at the grant date. The new standard becomes effective for us on January 1, 2019, with early adoption permitted. We plan to adopt this ASU beginning on January 1, 2019. We do not expect the adoption to have a material impact on our consolidated financial statements and related disclosures.

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

#### Verify Investor, LLC

On February 12, 2018, tZERO acquired 81% of the total equity interests of Verify Investor, LLC, an accredited investor verification company, for a total purchase price of \$12.0 million in cash. With the acquisition of the majority interest in Verify Investor, LLC, tZERO plans to integrate the software and technology of Verify Investor, LLC with the Token Trading System that tZERO plans to develop and deploy. We estimated the fair value of the acquired assets based on Level 3 inputs, which were unobservable (see Note 2—Accounting Policies, Fair value of financial instruments). These inputs included our estimate of future revenues, operating margins, discount rates, royalty rates and assumptions about the relative competitive environment.

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

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

The following table details the identifiable intangible assets acquired at their fair value and estimated useful lives as of September 30, 2018 (amounts in thousands):

Intangible Assets	Fair Value	Estimated Useful Life (in years)
Technology and developed software	\$6,300	10
Trade name	700	10
Customer relationships	400	0.5
Total acquired intangible assets at the acquisition date	7,400	
Less: accumulated amortization of acquired intangible assets	904	
Total acquired intangible assets, net	\$8,304	

The expense for amortizing intangible assets acquired in connection with this acquisition was \$302,000 and \$904,000 for the three and nine months ended September 30, 2018, respectively.

Acquired intangible assets primarily include technology, trade name, and customer relationships. As described above, we determined the fair value of these assets using an income approach method to determine the present value of expected future

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cash flows for each identifiable intangible asset. This method was based on discount rates which incorporate a risk premium to take into account the risks inherent in those expected cash flows. The expected cash flows were estimated based on the company's historical operating results.

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

## Mac Warehouse, LLC

On June 25, 2018, we acquired 100% of the total equity interests of Mac Warehouse, LLC, an electronics retailer of refurbished Apple products, for a total purchase price of \$1.2 million in cash. With the acquisition of Mac Warehouse, LLC, we plan to integrate the inventory and business processes of Mac Warehouse, LLC in our direct retail business. We estimated the fair value of the acquired assets based on Level 3 inputs, which were unobservable (see Note 2—Accounting Policies, Fair value of financial instruments). These inputs included our estimate of future revenues, operating margins, discount rates, royalty rates and assumptions about the relative competitive environment.

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

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

Purchase Price	Fair Value
Cash paid, net of cash acquired	\$1,143
Allocation	
Accounts receivable, net	\$399
Inventories, net	1,772
Prepays and other current assets	29
Fixed assets	154
Intangible assets	2,763
Accounts payable	(682 )
Accrued liabilities	(223 )
Long-term debt, net	(3,069 )
Total net assets, net of cash acquired	\$1,143

Acquired intangible assets primarily include trade name and customer relationships which have an estimated useful life of 18 months.

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

The following unaudited pro forma financial information presents our results as if the current year acquisitions of Mac Warehouse, LLC had occurred at the beginning of 2017 (amounts in thousands):

Three months ended		Nine months ended	
September 30,		September 30,	
2018	2017	2018	2017

Total revenue	\$440,580	\$428,309	\$1,373,228	\$1,300,365
Consolidated net loss	\$(49,257)	\$(778)	\$(171,673)	\$(14,472)

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The unaudited pro forma financial information is not intended to represent or be indicative of our consolidated results of operations that would have been reported had the acquisition been completed during the periods indicated, nor should it be taken as indicative of our future consolidated results of operations.

## 4. ACCRUED LIABILITIES

Accrued liabilities consist of the following (in thousands):

	September 30, 2018	December 31, 2017
Sales and other taxes payable	\$ 20,254	\$ 2,363
Accounts payable accruals	16,393	16,614
Accrued compensation and other related costs	16,200	10,716
Accrued marketing expenses	13,446	25,959
Allowance for returns	12,448	17,391
Accrued loss contingencies	10,304	608
Accrued freight	6,754	5,040
Other accrued expenses	4,954	3,920
Total accrued liabilities	\$ 100,753	\$ 82,611

## 5. BORROWINGS

## High Bench Senior Credit Agreement

On June 25, 2018, we became party to a senior credit agreement, as amended, with High Bench-Mac Warehouse-Senior Debt, LLC ("High Bench Loan"), in connection with our acquisition of Mac Warehouse, LLC. Under the amended agreement, the loan carries an annual interest rate of 11.0% and a default rate of 18.0%. The High Bench Loan is subject to monthly interest only payments with the remaining principal amount and any then unpaid interest due and payable on April 18, 2020. The High Bench Loan is subject to mandatory prepayment under certain circumstances, and is prepayable at our election at any time without penalty or premium. There are no financial covenants associated the High Bench Loan. At September 30, 2018, our outstanding balance on the High Bench Loan was \$3.1 million.

## Letters of credit

At September 30, 2018 and December 31, 2017, letters of credit totaling \$280,000 and \$355,000, respectively, were issued on our behalf collateralized by compensating cash balances held at a bank, which are included in Restricted cash in our consolidated balance sheets.

## Commercial purchasing card agreement

We have a commercial purchasing card (the "Purchasing Card") agreement. We use the Purchasing Card for business purpose purchasing and must pay it in full each month. At September 30, 2018, \$107,000 was outstanding and \$893,000 was available under the Purchasing Card. At December 31, 2017, \$822,000 was outstanding and \$4.2 million was available under the Purchasing Card.

## Capital lease

During the year ended December 31, 2017, we entered into a capital lease arrangement of computer equipment for \$1.4 million. The arrangement will expire in 2020. At September 30, 2018, the outstanding balance under the capital lease was \$1.0 million and is included in Other current liabilities, net and Other long-term liabilities on our consolidated balance sheets. Future payment obligations, including interest, under the capital lease are \$124,000, \$496,000 and \$413,000 for the rest of 2018, 2019 and 2020, respectively.



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## 6. COMMITMENTS AND CONTINGENCIES

Summary of future minimum lease payments for all operating leases

Minimum future payments under all operating leases as of September 30, 2018, are as follows (in thousands):

Payments due by period

2018 (Remainder)	\$ 1,757
2019	7,446
2020	5,648
2021	6,038
2022	6,156
Thereafter	17,515
	\$44,560

Rental expense for operating leases totaled \$1.9 million and \$2.1 million for the three months ended September 30, 2018 and 2017, respectively, and \$5.3 million and \$7.0 million for the nine months ended September 30, 2018 and 2017, respectively.

Legal proceedings and contingencies

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

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

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

On September 20, 2018, a jury returned a verdict against us in our Delaware unclaimed property case, which is expected to result in a judgment against us in the amount of approximately \$7.3 million (for certain unredeemed gift card balances, treble damages, and penalties) plus attorneys' fees and costs. Our estimated liability for these amounts has been included in Accrued liabilities as of September 30, 2018 and the expense associate with these litigation charges are included in general and administrative expense in our consolidated statement of operations for the three and nine months ended September 30, 2018. William French ("French") and the State of Delaware ("Delaware") sued us, along with numerous other defendants, in the Superior Court of the State of Delaware for alleged violations of Delaware's unclaimed property laws. French and Delaware alleged that we knowingly refused to fulfill obligations under Delaware's Abandoned Property Law by failing to report and deliver unclaimed gift card funds to the State of Delaware, and knowingly made, used or caused to be made or used, false

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statements and records to conceal, avoid or decrease an obligation to pay or transmit money to Delaware in violation of the Delaware False Claims and Reporting Act. We intend to file an appeal once the judgment has been entered by the court.

On June 21, 2018, the U.S. Supreme Court issued an opinion in our South Dakota sales tax case and ruled against us. The State of South Dakota sued us along with three other defendants in the Sixth Judicial Circuit Court of South Dakota alleging that U.S. constitutional law should be revised to permit South Dakota to require out-of-state e-commerce websites to collect and remit sales tax in South Dakota in accordance with South Dakota's sales tax statute. Under the U.S. Supreme Court's ruling, the longstanding *Quill Corp v. North Dakota* sales tax case was overruled, and states may now require remote sellers to collect sales tax under certain circumstances. We began collecting sales tax in all 45 states that have sales tax. Pursuant to South Dakota's statute, we are not required to pay sales tax retroactively. The U.S. Supreme Court's opinion vacated and remanded the case back to the South Dakota Supreme Court for further proceedings.

On July 7, 2017, the State of Wyoming sued us along with five other defendants in the Second Judicial District Court of Wyoming. Wyoming alleged that U.S. constitutional law should be revised to permit Wyoming to require out-of-state e-commerce retailers to collect and remit sales tax in Wyoming in accordance with Wyoming's sales tax statute. After the U.S. Supreme Court's ruling in our South Dakota case listed above, we began collecting sales tax in Wyoming. Wyoming's statute does not require us to pay sales tax retroactively. The Wyoming case has not yet been dismissed.

On August 28, 2017, the State of Indiana sued us along with one other defendant in the Superior Court of Indiana, Marion County. Indiana alleged that U.S. constitutional law should be revised to permit Indiana to require out-of-state e-commerce retailers to collect and remit sales tax in Indiana in accordance with Indiana's sales tax statute. After the U.S. Supreme Court's ruling in our South Dakota case listed above, we began collecting sales tax in Indiana. Indiana's statute does not require us to pay sales tax retroactively. The Indiana case was dismissed August 16, 2018.

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

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

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

broker-dealer subsidiaries to satisfy their regulatory authorities that they are in compliance with all applicable rules and regulations could have a material adverse effect on tZERO and on us.

In addition, in December 2017, SpeedRoute received a letter from FINRA stating that the Department of Enforcement at FINRA has received a referral from the staff of FINRA's Department of Market Regulation relating to rules applicable to supervision and required supervisory procedures for review of certain potential trading activity, such as pre-arranged trades or wash trades. In addition, SpeedRoute continues to have discussions with FINRA about several matters, including a matter related to potential violations of FINRA rules relating to Order Audit Trail System reporting and trading practice matters, and has received document requests from FINRA in connection with certain ongoing matters. SpeedRoute has received and responded to inquiries from FINRA and the SEC. In an unrelated matter, SpeedRoute and PRO Securities have been named in a FINRA investigatory matter in which FINRA has conducted on the record interviews of certain senior officers of SpeedRoute and PRO Securities, who are also senior officers of tZERO.

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On March 29, 2018, a purported securities class action lawsuit was filed against us and two of our executives in the United States District Court in the Central District of Utah, alleging violations of the Securities Exchange Act of 1934 ("Exchange Act"). On April 6, 2018, a substantially similar lawsuit was filed in the same court also naming the Company, and two of our executives as defendants, bringing the same claims under the Exchange Act, and seeking substantially similar relief. On June 20, 2018, the Court consolidated the two cases and appointed a lead plaintiff in the case. On August 7, 2018, the plaintiffs voluntarily dismissed the lawsuit without prejudice.

We have recognized liabilities for contingencies deemed probable and estimable totaling \$10.3 million and \$608,000 at September 30, 2018 and December 31, 2017, which are included in Accrued liabilities in our consolidated balance sheets. It is reasonably possible that the actual losses may exceed our accrued liabilities.

### 7. INDEMNIFICATIONS AND GUARANTEES

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

### 8. STOCKHOLDERS' EQUITY

#### Common Stock

Each share of common stock has the right to one vote. The holders of common stock are also entitled to receive dividends declared by the Board of Directors out of funds legally available, subject to prior rights of holders of all classes of stock outstanding having priority rights as to dividends. No dividends have ever been declared or paid on our common stock.

#### Preferred Stock

Each share of Series A Preferred and each share of Series B Preferred (collectively the "preferred shares") is intended to have voting and dividend rights similar to those of one share of common stock. Preferred shares rank senior to common stock with respect to dividends. Holders of the preferred shares will be entitled to an annual cash dividend of \$0.16 per share, in preference to any dividend payment to the holders of the common stock, out of funds of the Company legally available for payment of dividends and subject to declaration by our Board of Directors. Holders of the preferred shares 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 potentially different treatment if we effect a stock dividend, stock split or combination of the common stock. There are no arrearages in cumulative preferred dividends. We declared and paid a cash dividend of \$0.16 per share on our preferred stock during 2017.

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.

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### JonesTrading Sales Agreement

In August 2018, we entered into a sales agreement with JonesTrading Institutional Services LLC ("JonesTrading"), under which we conducted "at the market" public offerings of our common stock during the quarter ended September 30, 2018 and may conduct additional "at the market" public offerings of our common stock from time to time. Under the sales agreement, JonesTrading, acting as our agent, may offer our common stock in the market on a daily basis or otherwise as we request from time to time. We have no obligation to sell additional shares under the sales agreement, but expect to do so from time to time. We will pay JonesTrading up to a 2.0% sales commission on all sales. The sales agreement contemplates sales of up to \$150 million of our common stock over a period of up to three years. As of September 30, 2018, we had sold 2,883,344 shares of our common stock pursuant to the sales agreement and have received \$94.6 million in proceeds, net of \$2.6 million of offering costs, including commissions paid to JonesTrading. The average price per share of stock sold pursuant to the sales agreement during the quarter ended September 30, 2018, excluding offering costs, was \$33.71.

### JonesTrading Standby Equity Agreement

In August 2018 we also entered into a standby equity underwriting agreement with JonesTrading. We did not sell any shares under the standby equity underwriting agreement, and the agreement terminated in accordance with its terms during the quarter ended September 30, 2018. Under the standby underwriting agreement, we had the right, but no obligation, to sell up to \$50 million of our common stock to JonesTrading, as underwriter, for sale to the public in a firm commitment public offering. We paid a 1% commitment fee to JonesTrading for entering into the underwriting agreement.

### GSR Agreements

As previously announced, in August 2018, Overstock signed a Token Purchase Agreement with GSR Capital Ltd., a Cayman Islands exempted company ("GSR"), and a term sheet contemplating a sale of Overstock common stock to GSR. Concurrently, tZERO signed a term sheet contemplating a sale of tZERO common stock to GSR.

The Token Purchase Agreement sets forth the terms on which GSR agreed to purchase, for \$30 million, on May 6, 2019 or such other date as may be agreed by the parties, security tokens at a price of \$6.67 per security token. These security tokens were issued by tZERO to Overstock in satisfaction of \$30 million of tZERO's indebtedness to Overstock. We may be required to obtain additional tokens in order to fulfill our obligations under the agreement. The agreement states that the obligations of GSR to complete the transaction described will be subject to conditions, some of which are unidentified.

Overstock, tZERO and GSR are currently negotiating definitive agreements for GSR's purchase of Overstock common stock and tZERO common stock. Although we continue to negotiate the terms, GSR has proposed purchasing fewer shares and at a lower price per share than those described in the Overstock term sheet. We believe that if a definitive agreement is reached regarding the purchase of tZERO shares, the terms, including the post money valuation of tZERO, may be less favorable than those described in the tZERO term sheet. Both the Overstock and tZERO term sheets constitute binding agreements for the parties to negotiate in good faith the terms of the transaction documents; however, the obligation to negotiate in good faith terminates on December 15, 2018, if any of the closing conditions, one of which is the negotiation, execution and delivery of mutually acceptable transaction documents, have not been satisfied. While we expect to complete these transactions, there can be no assurance that Overstock, tZERO or GSR will enter into definitive agreements regarding either of the proposed transactions.

## 9. STOCK-BASED AWARDS

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Overstock restricted stock awards	\$1,779	\$1,015	\$6,863	\$3,000
Medici Ventures stock options	138	9	273	9
tZERO equity awards	329	—	4,518	—
Total stock-based compensation expense	\$2,246	\$1,024	\$11,654	\$3,009



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## Overstock restricted stock awards

The Overstock.com, Inc. Amended and Restated 2005 Equity Incentive Plan provides for the grant of restricted stock units and other types of equity awards of the Company. The restricted stock awards generally vest over three years at 33.3% at the end of the first year, 33.3% at the end of the second year and 33.3% at the end of the third year; subject to the recipient's continuing service to us.

The following table summarizes restricted stock award activity during the nine months ended September 30, 2018 (in thousands):

	Nine months ended September 30, 2018	Weighted Average Grant Date Fair Value
Outstanding—beginning of year	540	\$ 17.05
Granted at fair value	360	68.85
Vested	(226)	17.29
Forfeited	(109)	43.63
Outstanding—end of period	565	\$ 44.82

## Medici Ventures stock options

The Medici Ventures, Inc. 2017 Stock Option Plan provides for the grant of options to employees and directors of and consultants to Medici Ventures to acquire up to 10% of the authorized shares of Medici Ventures' common stock. During the nine months ended September 30, 2018, Medici Ventures granted 19,700 stock options with a cumulative grant date fair value of \$1.7 million which vest over a three year period. During the year ended December 31, 2017, Medici Ventures granted 74,750 stock options to certain Medici Ventures and Overstock employees with a cumulative grant date fair value of \$91,000 which will be expensed on a straight-line basis over the vesting period of three years.

## tZERO equity awards

The tZERO.com 2017 Equity Incentive Plan provides for grant of options to employees and directors of and consultants to tZERO to acquire up to 5% of the authorized shares of tZERO's common stock. In January 2018, tZERO granted stock awards under the equity incentive plan for an aggregate of approximately 1.0% of tZERO's common stock all of which vested on January 23, 2018. In January 2018, tZERO recognized \$4.0 million in compensation expense associated with these awards, which was the entire estimated fair value at the grant date. Accordingly, there is no expense to be recognized in future periods related to these awards. As a result of these vested awards, our indirect ownership interest in tZERO was reduced from 81% to approximately 80%. During the nine months ended September 30, 2018, tZERO granted awards to acquire 382 shares of its stock with a cumulative grant date fair value of \$3.1 million which will be expensed on a straight-line basis over the vesting period of two to three years. No awards were issued during the year ended December 31, 2017.

## 10. BUSINESS SEGMENTS

Segment information has been prepared in accordance with ASC Topic 280 Segment Reporting. We determined our segments based on how we manage our business, which, in our view, consists primarily of our Retail and Medici businesses. Our Retail business consists of our Direct and Partner reportable segments. We use gross profit as the measure to determine our reportable segments because there is not discrete financial information available below gross profit for our Direct and Partner segments. As a result, our Medici business is not significant as compared to our Direct and Partner segments and is included in Other. Our Other segment consists of Medici Ventures and its subsidiaries, including tZERO. Although our Direct and Partner segments both relate to our Retail business, we do not combine these segments because they have dissimilar economic characteristics, such as gross profit margins. We do not allocate assets between our segments for our internal management purposes, and as such, they are not presented here. There were no significant inter-segment sales or transfers during the three and nine months ended September 30, 2018 and 2017.

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The following table summarizes information about reportable segments for three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three months ended September 30,				
	Direct	Partner	Retail Total	Other	Total
2018					
Revenue, net	\$ 15,424	\$ 420,351	\$ 435,775	\$ 4,805	\$ 440,580
Cost of goods sold	16,205	334,446	350,651	3,213	353,864
Gross profit	\$(781 )	\$ 85,905	\$ 85,124	\$ 1,592	\$ 86,716
Operating expenses			124,571	9,977	134,548
Interest and other expense, net (1)			(515 )	(1,051 )	(1,566 )
Pre-tax loss			(39,962 )	(9,436 )	(49,398 )
Provision for (benefit from) income taxes			(155 )	14	(141 )
Net loss (2)			\$(39,807 )	\$(9,450)	\$(49,257 )
2017					
Revenue, net	\$ 19,645	\$ 400,419	\$ 420,064	\$ 3,943	\$ 424,007
Cost of goods sold	19,577	318,121	337,698	2,634	340,332
Gross profit	\$ 68	\$ 82,298	\$ 82,366	\$ 1,309	\$ 83,675
Operating expenses			90,592	4,958	95,550
Interest and other income (expense), net (1)			5,375	(17 )	5,358
Pre-tax loss			(2,851 )	(3,666 )	(6,517 )
Benefit from income taxes			(3,993 )	(1,419 )	(5,412 )
Net income (loss) (2)			\$ 1,142	\$(2,247)	\$(1,105 )
	Nine months ended September 30,				
	Direct	Partner	Retail Total	Other	Total
2018					
Revenue, net	\$ 46,409	\$ 1,307,045	\$ 1,353,454	\$ 15,590	\$ 1,369,044
Cost of goods sold	45,649	1,039,834	1,085,483	11,233	1,096,716
Gross profit	\$ 760	\$ 267,211	\$ 267,971	\$ 4,357	\$ 272,328
Operating expenses			399,540	41,550	441,090
Interest and other income (expense), net (1)			654	(1,966 )	(1,312 )
Pre-tax loss			(130,915 )	(39,159 )	(170,074 )
Benefit from income taxes			(283 )	(162 )	(445 )
Net loss (2)			\$(130,632 )	\$(38,997)	\$(169,629 )
2017					
Revenue, net	\$ 64,572	\$ 1,211,536	\$ 1,276,108	\$ 12,358	\$ 1,288,466
Cost of goods sold	61,687	963,310	1,024,997	8,716	1,033,713
Gross profit	\$ 2,885	\$ 248,226	\$ 251,111	\$ 3,642	\$ 254,753
Operating expenses			264,455	14,217	278,672
Interest and other income (expense), net (1)			5,490	(4,428 )	1,062
Pre-tax loss			(7,854 )	(15,003 )	(22,857 )
Benefit from income taxes			(3,280 )	(4,447 )	(7,727 )
Net loss (2)			\$(4,574 )	\$(10,556)	\$(15,130 )

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(1) — Excludes intercompany transactions eliminated in consolidation, which consist primarily of service fees and interest. The net amounts of these intercompany transactions were \$539,000 and \$403,000 for the three months

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ended September 30, 2018 and 2017, respectively, and \$3.0 million and \$1.1 million for the nine months ended September 30, 2018 and 2017, respectively.

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

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

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

For the three and nine months ended September 30, 2018 and 2017, substantially all of our sales revenues were attributable to customers in the United States. At September 30, 2018 and December 31, 2017, substantially all our fixed assets were located in the United States.

## 11. BROKER DEALERS

As part of our Medici blockchain and fintech technology initiatives, we hold a controlling interest in each of two broker dealers, SpeedRoute LLC ("SpeedRoute") and Pro Securities LLC ("Pro Securities"), which we acquired in January 2016.

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

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

SpeedRoute and Pro Securities are subject to the SEC's Uniform Net Capital Rule (SEC Rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1 and that equity capital may not be withdrawn or cash dividends paid if the resulting net capital ratio would exceed 10 to 1. At September 30, 2018, SpeedRoute had net capital of \$873,707, which was \$746,775 in excess of its required net capital of \$126,932 and SpeedRoute's net capital ratio was 2.18 to 1. At September 30, 2018, Pro Securities had net capital of \$55,572 which was \$50,572 in excess of its required net capital of \$5,000 and Pro Securities net capital ratio was 0.34 to 1. At December 31, 2017, SpeedRoute had net capital of \$334,848, which was \$233,485 in excess of its required net capital of \$101,363 and SpeedRoute's net capital ratio was 4.5 to 1. At December 31, 2017, PRO Securities had net capital of \$24,175, which was \$19,175 in excess of its required net capital of \$5,000 and PRO Securities net capital ratio was 1.3 to 1.

SpeedRoute and Pro Securities did not have any securities owned or securities sold, not yet purchased at September 30, 2018 and December 31, 2017, respectively.

## 12. RELATED PARTY TRANSACTIONS

PCL L.L.C. term loan repayment

On November 6, 2017, we entered into a loan agreement with PCL L.L.C., an entity directly or indirectly wholly-owned by the mother and brother of our President and Chief Executive Officer, Dr. Patrick M. Byrne ("Dr. Byrne"). The agreement provides for a \$40.0 million term loan (the "PCL Loan") which carries an annual interest rate of 8.0%. On May 8, 2018, our Board of Directors approved a prepayment of the PCL Loan and we repaid the entire outstanding balance under the loan plus accrued interest.

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### SiteHelix

On June 28, 2018, we entered into and concurrently closed a Stock Purchase Agreement with the stockholders of SiteHelix, Inc., a Delaware corporation ("SiteHelix") pursuant to which we purchased all of the common stock of SiteHelix for \$500,000 plus 100,000 shares of Overstock common stock with a transaction date fair value of \$2.9 million for an aggregate purchase price of \$3.4 million. The transaction was accounted for as an asset purchase. Saum Noursalehi, who owned approximately 62% of the SiteHelix common stock, is a member of our Board of Directors and served as President, Retail, of Overstock until May 8, 2018, when he became Chief Executive Officer of tZERO.

### Bitsy Agreement

In July 2018, Medici Ventures entered into a stock purchase agreement with Bitsy, Inc. ("Bitsy") to acquire an additional 25% equity interest in Bitsy for \$3.0 million and \$1.5 million worth of Overstock.com common stock (47,378 shares). Subsequent to the purchase, Medici Ventures holds a 33% interest in Bitsy. Bitsy is a U.S.-based startup company founded and 25% owned by Medici Ventures' chief operating officer and general counsel, Steve Hopkins. Bitsy plans to build a regulatory-compliant bridge between the U.S. Dollar and cryptocurrencies and offer our customers the ability to purchase cryptocurrencies on or through the Bitsy app and our Website.

### Chainstone Labs

In September 2018, Medici Ventures entered into a stock purchase agreement with Chainstone Labs, Inc. ("Chainstone") to acquire a 29% equity interest in Chainstone for \$3.6 million. Chainstone is a U.S.-based startup company founded and 71% owned by a Board member of Medici Ventures, Bruce Fenton. Chainstone is focused on blockchain, tokenization of securities, and decentralized asset management.

### Medici Land Governance

Medici Land Governance Inc., a Delaware public benefit corporation ("MLG"), was recently formed by Medici Ventures with Dr. Byrne. Pursuant to the Subscription Agreements dated September 21, 2018, Medici Ventures contributed certain of its assets, including intellectual property relating to technologies regarding land governance and property rights, to MLG in exchange for 510,000 shares of MLG common stock and at the same time Dr. Byrne personally contributed \$6.7 million in cash to MLG in exchange for 390,000 shares of MLG common stock. At the same time MLG, Medici Ventures and Dr. Byrne entered into a Stockholders Agreement dated September 21, 2018 regarding MLG (the "MLG Stockholder Agreement"). The MLG Stockholder Agreement restricts the transfer of the shares held by Medici Ventures and Dr. Byrne, creates rights of first refusal in favor of MLG, Medici Ventures and Dr. Byrne to acquire shares to be sold by Medici Ventures or Dr. Byrne, creates purchase rights in favor of MLG and Medici Ventures in the event of the death or incapacity of Dr. Byrne, creates preemptive rights in favor of MLG and Medici Ventures if MLG proposes to sell capital stock to any other person (subject to certain exceptions), provides for voting for board members, and requires a supermajority consent of the stockholders for any sale of MLG or substantially all of its assets, merger, consolidation, or other transaction having substantially the same effect.

As a result of the transactions described above, Medici Ventures holds approximately 57% of the outstanding capital stock of MLG, and Dr. Byrne, our President and Chief Executive Officer, a member of our board of directors and our largest stockholder, holds approximately 43% of the outstanding capital stock of MLG. Dr. Byrne is also a member of the board of directors of MVI and is a member of the board of directors of MLG.

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

Special Note Regarding Forward-Looking Statements

This Report on Form 10-Q and the documents incorporated herein by reference, as well as our other public documents and statements our officers and representatives may make from time to time, contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements relate to our financial condition, liquidity, results of operations, earnings outlook and prospects. You can find many of these statements by looking for words such as "may," "would," "could," "should," "will," "expect,"



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"anticipate," "predict," "project," "potential," "continue," "contemplate," "seek," "assume," "believe," "intend," "plan," "forecast," "goal," "estimate," or other similar expressions which identify these forward-looking statements. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry and business, and on management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, you are cautioned that any such forward-looking statements are not guarantees of future performance and are subject to assumptions, risks and uncertainties that are difficult to predict, and that actual results may be materially different from the results expressed or implied by any of our forward-looking statements. We claim the protection of the safe harbor provided by the Private Securities Litigation Reform Act of 1995, as amended, for all such forward-looking statements.

Unless otherwise required by law, we also disclaim any obligation to update our view of any such risks or uncertainties or to announce publicly any revisions to any forward-looking statements made or incorporated by reference in this report. A number of important factors could cause actual results to differ materially from those indicated by the forward-looking statements, including the risks set forth in the "Risk Factors" section of this report, and the risks described in our Annual Report on Form 10-K for the year ended December 31, 2017 and the risks described in our Quarterly Report on Form 10-Q for the quarters ended March 31, 2018 and June 30, 2018. Our forward-looking statements include all statements other than statements of historical fact including, without limitation, all statements regarding:

- our strategies and plans for our e-commerce business and our Medici businesses, including our tZERO initiatives; the possibility that we will pursue or attempt to pursue a strategic alternative that could change our business dramatically, including the possibility and potential effects of a sale of our e-commerce business, as well as the possibility that we will determine not to pursue any strategic alternative at all in the foreseeable future;
- our expectation that if we sell our e-commerce business for cash and retain the after-tax proceeds of the sale, we would return a portion of the after-tax proceeds to our stockholders within 12 months after any such sale, by means of a stock repurchase program, dividend, one or more issuer tender offers or other means;
- all statements of our expectations regarding the "Capital on Demand" Sales Agreement we have entered into with JonesTrading Institutional Services LLC, including any statement about our ability to raise additional capital pursuant to such agreement;
- all statements of our expectations regarding the term sheets we and tZERO signed with GSR Capital in August 2018 and the Token Purchase Agreement we signed with GSR Capital in August 2018;
- our expectations regarding the effects on us of the recent Tax Cuts and Jobs Act;
- our expectations regarding the costs, benefits and risks of Medici Ventures' efforts to develop blockchain applications and tZERO's efforts to develop financial technology ("fintech") applications, including applications using blockchain technology and how effectively that technology will be adopted, and including our expectations regarding the costs, benefits and risks of the operations of tZERO;
- all statements regarding the plans of tZERO or Medici Ventures;
- our expectations regarding the costs, benefits and risks of tZERO's ownership of SpeedRoute and PRO Securities, each of which is a registered broker dealer;
- our expectations regarding the costs, benefits and risks of having less than wholly-owned subsidiaries, including our indirect approximately 80% owned subsidiary tZERO and our currently wholly-owned subsidiary Medici Ventures, which has issued stock options to employees and consequently may not be wholly-owned in the future;
- all statements regarding the tZERO security token offering, including the possibility that the proceeds of the security token offering might be treated as income to us for federal income tax purposes, and might be treated as a liability rather than equity for accounting purposes;
- our expectations regarding the costs, benefits and risks of our efforts and plans to advertise or offer financial product and services offerings on our website, including discount stock brokerage trading services, automated investment advisory services, accredited investor verification services, and other financial service offerings and other businesses, innovations and projects that we or our subsidiaries may engage in, offer or advertise in the future;
- our expectations regarding Medici Ventures' funding of efforts to create a system to help areas of the world that lack reliable widely-recognized land-titling and record-keeping processes implement blockchain-based systems for doing

so;

• our plans to modify our branding and marketing strategy;

• our beliefs regarding our ability to attract and retain customers in a cost-efficient manner;

- the anticipated effectiveness of or potential improvements in our marketing;

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our future operating and financial results, including any projections of revenue, profits or losses, contribution, technology expense, general and administrative expense, cash flow, capital expenditures or other financial measures or amounts or non-GAAP financial measures or amounts or anticipated changes in any of them;

our beliefs and expectations regarding the adequacy of our facilities, including leased and any third-party operated warehouse facilities, as well as the possibility that we may add distribution centers or other distribution facilities to our distribution system and our expectations regarding the results of any such additions;

our future capital requirements and our ability to satisfy our capital needs;

the adequacy of our liquidity and our ability, if any, to increase our liquidity or capital resources through traditional capital raising or otherwise;

tZERO's plans, including without limitation its plans to develop its Token Trading System and all statements about tZERO's plans and expectations regarding tZERO's joint venture with Box Digital;

whether the tZERO Token Trading System will be able to comply with SEC rules and regulations;

our plans and expectations regarding the costs, benefits, and risks of attempting to develop technology applications including applications using or relating to blockchain technology and our plans to commercialize any of these potential applications;

the competition we currently face and anticipate;

the effects of current and future government regulation;

our expectations for our international sales efforts;

our efforts to provide multi-channel fulfillment services;

our plans for further changes to our business;

our expectations and beliefs regarding our ability to effectively change business strategies, including by increasing or decreasing our e-commerce branding and marketing expenditures;

our beliefs regarding current or future litigation or regulatory actions or fines, including our expectations regarding the investigation the Division of Enforcement of the Securities and Exchange Commission is conducting and its request for information and documents related to tZERO and the tZERO security token offering;

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

our beliefs regarding the adequacy of our insurance coverage;

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

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

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

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

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

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

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

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

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

any changes we may make to our business as a result of our current ongoing review of potential strategic alternatives, which could involve a sale of our e-commerce business, additional equity or debt financings, or other significant changes to our business;

the possibility that we may sell our e-commerce business for cash and retain some or all of the after-tax proceeds of the sale for use in our blockchain initiatives, which could result in our stockholders owning equity interests in a

publicly-held corporation seeking to develop entirely new businesses and revenue streams, without the benefits of our current e-commerce business and the approximately \$1.7 billion it generates in annual net revenues but with most if not all of the expenses of operating a publicly-held corporation;  
the potentially substantial corporate level income tax expense we could incur if we were to sell our e-commerce business in a taxable transaction;

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

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

the possibility that we will be unable to raise the amount of capital we may need to continue funding both our e-commerce business losses and our blockchain initiatives as contemplated by the GSR term sheets or otherwise;

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

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

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

the effects of changes we have recently made and of additional changes we may make in the future to the amount of our sales and marketing expenditures, which could continue to have an adverse effect on our near-term financial results as they did in the first nine months of 2018;

the costs of, and difficulties we have encountered and may continue to encounter with, the implementation of our strategies for our e-commerce business;

the possibility that we may be unable to fund our plans for sales and marketing activities, additional new distribution facilities, our technology platforms, our Club O rewards program, our private label strategy, and other e-commerce initiatives, and also continue to fund our blockchain initiatives at the level we think appropriate;

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

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

difficulties we have encountered and continue to encounter with our natural search results;

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

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

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

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

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

the fact that tZERO necessarily allocates its limited resources among the projects it is pursuing, and at present has re-allocated developers from working on its DLR Software to working on other projects, and at present does not have an agreement with a retail broker-dealer that will be necessary for the operation of the DLRs;

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

the substantial technical, operational, financial, regulatory, legal, marketing and other obstacles to tZERO's plans to create and launch a U.S. national exchange with regulatory approval to trade security tokens, including any

difficulties tZERO may have with its joint venture with Box Digital;  
the difficulties tZERO will face in attempting to generate revenues from blockchain-based applications of any nature;  
Medici Ventures' current business model of providing the services of its developers at Medici Ventures' cost to companies in which Medici Ventures owns an interest;

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any difficulties we may have with the interests in other companies that we or Medici Ventures or tZERO may own or acquire in the future, including any additional impairment charges we may recognize with respect to any of them; the substantial obstacles Medici Ventures faces in connection with its efforts to fund the creation of a system to help areas of the world that lack reliable widely-recognized land-titling and record-keeping processes implement blockchain-based systems for doing so, including the substantial difficulties it may encounter with persons who benefit from existing locally-recognized systems currently in use in many places;

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

the current downturn in portions of the U.S. housing market, which at least one article published in late July 2018 by a nationally-recognized online news service said "appears to be headed for the broadest slowdown in years," and any broader or deeper downturn in the U.S. housing market or other changes in U.S. and global economic conditions or U.S. consumer spending;

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

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

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

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

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

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

any claims we may face regarding cyber security issues or data breaches or difficulties we encounter regarding Internet or other infrastructure or communications impairment problems or the costs of preventing or responding to any such problems, including cyber security issues or data breaches that could result from cyber security issues or data breaches at companies with which we do business or at companies with which our customers do business;

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

any future substantial decrease in our liquidity, whether as a result of our e-commerce business operations, our blockchain or fintech initiatives, or as a result of the expenses or results of governmental inquiries or investigations or litigation or other claims against us, and the possibility that we will be unable to obtain financing or any other source of liquidity adequate to enable us to continue our operations;

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

any liabilities that may be asserted against us for not having collected sales tax in jurisdictions in which we did not do so;

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

difficulties we may have in responding to technological changes;

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

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

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

- any failure of any of our product or service offerings outside of our main shopping Website offerings to provide the benefits we expect from them;
- any difficulties we may encounter as a result of our reliance on numerous third parties that we do not control for the performance of critical functions material to our business;

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

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

additional difficulties we may have with our efforts to increase our revenues at an acceptable cost in accordance with our plans and to return to profitability;

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

fluctuations in our operating results;

difficulties we may encounter in connection with our efforts to expand internationally, including claims we may face and liabilities we may incur in connection with those efforts;

adverse results in legal proceedings, investigations or other claims, and costs we may incur in connection with any of them, including the costs of responding to the investigation the Division of Enforcement of the Securities and Exchange Commission is conducting;

any difficulties we may have optimizing our warehouse operations;

the risks of inventory management and seasonality, particularly with inventory subject to rapid price declines;

any decrease in the rate of growth of e-commerce, particularly in home goods, and the occurrence of any event that would adversely affect e-commerce or discourage or prevent consumers from shopping online or via mobile apps;

the possibility that we will suffer adverse consequences as a result of one or more of the related party transactions we have entered into or other related party transactions that we may enter into in the future; and

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 or elsewhere in this report and the risks described in our Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on March 15, 2018 and those described in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2018 filed with the SEC on May 8, 2018, and in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2018 filed with the SEC on August 9, 2018, especially under the headings "Risk Factors," "Legal Proceedings," and "Management's Discussion and Analysis of Financial Condition and Results of Operations." These factors may cause our actual results to differ materially from those contemplated by any forward-looking statement in this report. 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.

### Available Information

Our Annual Reports 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 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 website and the information contained therein or connected thereto are not a part of or incorporated into this Quarterly Report on Form 10-Q.

### Overview

We are an online retailer and advancer of blockchain technology. Through our online retail business, we offer a broad range of price-competitive products, including furniture, home decor, bedding and bath, housewares, jewelry and watches, among other products. We sell our 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. As part of our Medici initiatives, we have formed a wholly-owned subsidiary Medici Ventures, Inc. ("Medici Ventures") and acquired a majority interest in a financial technology company and two related registered broker dealers which are owned by our majority-owned subsidiary tZERO Group, Inc. ("tZERO"), formerly tØ.com, Inc. In 2015, we were the first public company to issue a private security using blockchain technology and in December 2016, as a demonstration of our technology, we issued publicly traded blockchain preferred shares of Overstock.com, Inc. Medici Ventures

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also holds minority interests in several blockchain technology companies. Medici Ventures has assembled a core blockchain development group of software engineers, developers, and other technologists that provide services to the blockchain community on a contract basis as requested, including the companies in which we hold a minority interest. In 2018, tZERO acquired majority-ownership interests in a registered investment adviser entity and an accredited investor verification entity and further purchased minority interests in multiple financial services companies, including an equity interest in a joint venture with BOX Digital Markets LLC to pursue the development of the first U.S. security token exchange.

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," "the Company", "we," "our" and similar terms include Overstock.com, Inc. and our majority-owned subsidiaries, unless the context indicates otherwise.

### Our Business

#### Retail 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. 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.

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. Our retail direct business includes sales made to individual consumers and businesses from our owned inventory and that are fulfilled primarily from our warehouses in Salt Lake City, Utah, Carlisle, Pennsylvania, and Kansas City, Kansas.

For our retail partner business, we sell merchandise from manufacturers, distributors and other suppliers ("partners") primarily through our Website. We are considered to be the principal and control the specific good or service before it is transferred to the customer 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. 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.

## Medici business

Our Medici business initiatives seek to leverage the security, transparency and immutability of cryptographically protected, distributed ledgers, such as blockchains, and are focused on solving important problems, including financial transaction issues, particularly in the areas of securities settlement, commercial blockchain applications, capital markets applications, digital currency, money and banking applications, compliance, personal identity, voting, supply chain, social media, and property and land applications. Our wholly-owned subsidiary, Medici Ventures, conducts its primary business through its majority-owned subsidiary tZERO, which includes a financial technology company, two related registered broker dealers, a registered investment advisor, and an accredited investor verification company. tZERO also holds minority interests

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in multiple financial services companies, including an equity interest in a joint venture with BOX Digital Markets LLC to pursue the development of the first U.S. security token exchange.

As described further in Item 1 of Part I, "Financial Statements (Unaudited)"—Note 10. Business Segments, 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 risk is not significant as compared to our Direct and Partner segments and is included in Other. Our Other segment consists of Medici Ventures and its subsidiaries, including tZERO.

### Recent tZERO Business Developments

An important part of tZERO's strategy is to buy, build, or partner with other entities in order to aggregate all the necessary components to have end-to-end ownership of the first fully regulated security token trading, clearing and settlement platform. As previously announced in early 2018, tZERO purchased a 24% equity interest in StockCross Financial Services, Inc. ("StockCross"), which is an affiliate of Siebert Financial Corp. ("Siebert"), and an interest in Siebert, for \$12 million. tZERO also purchased a 1% interest in Kennedy Cabot Acquisition, the majority stockholder of Siebert, and an interest in Siebert, for \$1 million. Our equity interest in StockCross was a step toward achieving our strategy by adding a partner with the custodial and clearing functionality of a U.S. DTCC member firm. We also intended to enter into definitive agreements with StockCross to act as an Introducing Broker and Clearing Broker for security token trading. tZERO has decided not to enter into a definitive agreement with StockCross for security token trading. tZERO anticipates that StockCross may license tZERO's Digital Locate Receipt software upon agreement of mutually acceptable terms. tZERO expects that the stock loan agreement currently in place between StockCross and tZERO's subsidiary SpeedRoute will remain in place.

In addition, as previously announced in early 2018, tZERO entered into a letter of intent contemplating that tZERO would acquire 81% of the outstanding membership interests of Weeden Prime Services, LLC ("WPS"), a U.S. registered broker-dealer, for \$18 million through a series of transactions beginning in the third quarter of 2018. tZERO has also decided not to enter into a definitive agreement with WPS. Accordingly, in October 2018, tZERO notified these parties that it no longer intends to pursue such agreements.

During the third quarter of 2018, tZERO began evaluating alternative strategic relationships that may replace one or more roles tZERO expected StockCross to fulfill. tZERO believes it has identified suitable candidates to perform these roles but has not yet entered into definitive agreements with those parties. Management of tZERO will continue to devote time and resources to identify the necessary components for tZERO's trading ecosystem and enter into appropriate licensing and/or other contractual arrangements with one or more entities. Doing so will likely require capital and may cause delays to the development and launch of tZERO's planned trading platform.

tZERO and StockCross, including their affiliates, have a number of business relationships, and the resolution of some of those relationships are undetermined at this time but could include tZERO's sale of its equity interest in StockCross and its affiliates, and/or the possibility of entering into new business relationships with StockCross under terms not previously considered. At present, tZERO expects that the stock loan agreement currently in place between StockCross and tZERO's subsidiary SpeedRoute will remain in place through its expiration date of March 31, 2019. tZERO does not currently expect the foregoing matters to affect the December 31, 2017 agreement among tZERO, SpeedRoute and Muriel Siebert & Co. Inc. ("Muriel Siebert") pursuant to which Muriel Siebert is currently advertising discounted online trading of U.S. equity securities on Overstock's website; however, revenues associated with such services are currently immaterial to Overstock.

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."

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Revenue in Q3 2018 increased 4% compared to Q3 2017. The growth in revenue was primarily driven by increased marketing expenses as we continued our strategy to more aggressively pursue revenue growth and new customers early in the quarter. However, we shifted our marketing strategy in early August as we sought to minimize losses, which tapered our revenue growth throughout the quarter. We also saw a 6% increase in average order size (excluding promotional activities) primarily due to a continued sales mix shift into home and garden products. 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, and an increase in marketplace sales (for which we record only our commission as revenue). While our marketing spend efficiency has improved significantly during Q3 2018, we continue to face challenges in our natural search marketing.

Gross profit in Q3 2018 increased 4% compared to Q3 2017 primarily as a result of revenue growth. Gross margin was 19.7% in Q3 2018, unchanged from Q3 2017. Gross margin was negatively impacted by increased promotional activities, but this was offset by a continued shift in sales mix into higher margin home and garden products and an increase in marketplace sales (for which we record only our commission as revenue).

Sales and marketing expenses as a percentage of revenue increased from 10.6% to 12.6% in Q3 2018 as compared to Q3 2017, primarily due to our effort to aggressively pursue increased revenue and new customers early in the quarter. This included significantly increased spending in the display ads on social media, sponsored search, and direct mail marketing channels, as well as increased staff-related costs.

Technology expenses in Q3 2018 increased \$5.1 million compared to Q3 2017, primarily due to an increase in staff-related costs of \$3.4 million and an increase in technology licenses and maintenance of \$1.6 million.

General and administrative expenses in Q3 2018 increased \$23.7 million compared to Q3 2017 primarily due to \$10.8 million in special legal costs in Q3 2018 largely related to our gift card escheatment case in Delaware and capital raising efforts, a \$5.1 million increase in staff-related costs, and a \$3.2 million increase in consulting and outside services.

## Liquidity

In Q3 2018, our consolidated cash and cash equivalents balance increased \$29.8 million, from \$152.2 million to \$182.0 million, primarily as the result of cash inflows of \$94.6 million, net of offering costs, from the sale of common stock under our "at the market" sales agreement with JonesTrading and a \$6.7 million cash inflow from the capital contributions received by a consolidated subsidiary, Medici Land Governance, which was partially offset by cash outflows from operating activities of \$50.2 million for the quarter and \$14.1 million in cash outflows related to acquisitions of equity interests in other entities and \$7.9 million in expenditures for fixed assets.

We continue to seek opportunities for growth in our retail business, through our Medici blockchain and financial technology initiatives, and through other means. As a result of these initiatives, we will continue to incur additional expenses and may purchase interests in, or make acquisitions of, other technologies or businesses. We anticipate that our initiatives may cause us to continue to incur losses in the foreseeable future. These losses, additional expenses, acquisitions or purchases may be material, and, coupled with existing marketing expense trends, and potential strategic changes in our retail business, may lead to increased consolidated losses in some periods, and to reduced liquidity. Additionally, we may recognize additional impairment charges from our ownership interests in other entities.

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.





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## Results of Operations

The following table sets forth our results of operations expressed as a percentage of total net revenue:

	Three months ended September 30, 2018		2017		Nine months ended September 30, 2018		2017	
	(as a percentage of total net revenue)		(as a percentage of total net revenue)		(as a percentage of total net revenue)		(as a percentage of total net revenue)	
Revenue, net								
Direct	3.5	%	4.6	%	3.4	%	5.0	%
Partner and other	96.5		95.4		96.6		95.0	
Total net revenue	100.0		100.0		100.0		100.0	
Cost of goods sold								
Direct	3.7		4.6		3.3		4.8	
Partner and other	76.6		75.6		76.8		75.4	
Total cost of goods sold	80.3		80.3		80.1		80.2	
Gross profit	19.7		19.7		19.9		19.8	
Operating expenses:								
Sales and marketing	12.6		10.6		16.6		9.8	
Technology	7.7		6.8		7.1		6.7	
General and administrative	10.3		5.1		8.5		5.2	
Total operating expenses	30.5		22.5		32.2		21.6	
Operating loss	(10.9 )		(2.8 )		(12.3 )		(1.9 )	
Other income (expense), net	(0.4 )		1.3 )		(0.1 )		0.1 )	
Loss before income taxes	(11.2 )		(1.5 )		(12.4 )		(1.8 )	
Benefit from income taxes	—		(1.3 )		—		(0.6 )	
Consolidated net loss	(11.2 )%		(0.3 )%		(12.4 )%		(1.2 )%	

Comparisons of Three Months Ended September 30, 2018 to Three Months Ended September 30, 2017, and Nine Months Ended September 30, 2018 to Nine Months Ended September 30, 2017

## Revenue

The following table reflects our net revenues for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three months ended September 30,				Nine months ended September 30,			
	2018	2017	\$ Change	% Change	2018	2017	\$ Change	% Change
Revenue, net								
Direct	\$15,424	\$19,645	\$(4,221)	(21.5)%	\$46,409	\$64,572	\$(18,163)	(28.1)%
Partner and other	425,156	404,362	20,794	5.1	1,322,635	1,223,894	98,741	8.1
Total revenue, net	\$440,580	\$424,007	\$16,573	3.9%	\$1,369,044	\$1,288,466	\$80,578	6.3%

The increased total net revenue for the three months ended September 30, 2018, as compared to the same period in 2017, was primarily driven by increased marketing expenses as we continued our strategy to more aggressively pursue revenue growth and new customers early in the quarter. However, we shifted our marketing strategy in early August as we sought to minimize losses, which tapered our revenue growth throughout the quarter. We also saw a 6% increase in average order size (excluding promotional activities) primarily due to a continued sales mix shift into

home and garden products. 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, and an increase in marketplace sales (for which we record only our commission as revenue). While our marketing spend efficiency has improved significantly during Q3, we continue to face challenges in our natural search marketing.

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The increased total net revenue for the nine months ended September 30, 2018, as compared to the same period in 2017, was primarily driven by increased marketing expenses as we more aggressively pursued revenue growth and new customers. Our increased marketing expenses resulted in a 5% increase in orders, and we also saw a 6% increase in average order size (excluding promotional activities) primarily due to a continued sales mix shift into home and garden products. 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, and an increase in marketplace sales (for which we record only our commission as revenue).

The decreased direct revenue for the three months ended September 30, 2018, as compared to the same period in 2017, was primarily due to a decrease in direct sales of home and garden products.

The decreased direct revenue for the nine months ended September 30, 2018, as compared to the same period in 2017, was primarily due to a decrease in direct sales of home and garden and clothing products, and increased promotional activities.

The increase in partner revenue for the three months ended September 30, 2018, as compared to the same period in 2017, was primarily driven by increased marketing expenses and an increase in partner sales of home and garden products. This increase was partially offset by increased promotional activities, including coupons and site sales due to our driving a higher proportion of our sales using such promotions and an increase in marketplace sales (for which we record only our commission as revenue).

The increase in partner revenue for the nine months ended September 30, 2018, as compared to the same period in 2017, was primarily driven by increased marketing expenses and an increase in partner sales of home and garden products. This increase was partially offset by increased promotional activities, including coupons and site sales due to our driving a higher proportion of our sales using such promotions and an increase in marketplace sales (for which we record only our commission as revenue).

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 1 of Part I, "Financial Statements (Unaudited)"—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 and we do not currently foresee 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, are generally an economic result of the factors described above, which may change from time to time.

International net revenues were less than 3% of total net revenues for the three and nine months ended September 30, 2018 and 2017.

Change in estimate of average transit times (days)

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. 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.

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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 pre-tax income for the three months ended September 30, 2018 (in thousands):

Change in the Estimate of Average Transit Times (Days)	Three Months Ended September 30, 2018	
	Increase (Decrease) Revenue	Increase (Decrease) Pre-Tax Income
2	\$(14,450)	\$(1,532 )
1	\$(5,967 )	\$(624 )
As reported	As reported	As reported
-1	\$5,048	\$ 483
-2	\$9,361	\$ 905

## 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; 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 three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three months ended September 30,				Nine months ended September 30,			
	2018	2017	\$ Change	% Change	2018	2017	\$ Change	% Change
Revenue, net								
Direct	\$15,424	\$19,645	\$(4,221 )	(21.5 )%	\$46,409	\$64,572	\$(18,163)	(28.1 )%
Partner and other	425,156	404,362	20,794	5.1	1,322,635	1,223,894	98,741	8.1
Total net revenue	\$440,580	\$424,007	\$16,573	3.9 %	\$1,369,044	\$1,288,466	\$80,578	6.3 %
Cost of goods sold								
Direct	\$16,205	\$19,577	\$(3,372 )	(17.2 )%	\$45,649	\$61,687	\$(16,038)	(26.0 )%
Partner and other	337,659	320,755	16,904	5.3	1,051,067	972,026	79,041	8.1
Total cost of goods sold	\$353,864	\$340,332	\$13,532	4.0 %	\$1,096,716	\$1,033,713	\$63,003	6.1 %
Gross Profit								
Direct	\$(781 )	\$68	\$(849 )	(1,249 )%	\$760	\$2,885	\$(2,125 )	(73.7 )%
Partner and other	87,497	83,607	3,890	4.7	271,568	251,868	19,700	7.8
Total gross profit	\$86,716	\$83,675	\$3,041	3.6 %	\$272,328	\$254,753	\$17,575	6.9 %

Gross margins for the past seven quarterly periods and fiscal year ending 2017 were:

	Q1 2017	Q2 2017	Q3 2017	Q4 2017	FY 2017	Q1 2018	Q2 2018	Q3 2018
Direct	8.2 %	4.3 %	0.3 %	(2.3 )%	3.0 %	9.2 %	0.3 %	(5.1 )%
Partner and other	20.8 %	20.3 %	20.7 %	19.7 %	20.3 %	21.5 %	19.6 %	20.6 %
Combined	20.1 %	19.5 %	19.7 %	18.8 %	19.5 %	21.1 %	19.0 %	19.7 %

Gross profit for the three months ended September 30, 2018 increased 4% compared to the same period in 2017 primarily as a result of increased revenue. Gross margin was 19.7% for the three months ended September 30, 2018,

unchanged from the same period in 2017. Gross margin was negatively impacted by increased promotional activities, but this was offset by a continued shift in sales mix into higher margin home and garden products and an increase in marketplace sales (for which we record only our commission as revenue).

Gross profit for the nine months ended September 30, 2018 increased 7% compared to the same period in 2017 as a result of increased revenue and increased gross margin. Gross margin increased to 19.9% for the nine months ended September

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30, 2018 compared to 19.8% for the same period in 2017. This increase in gross margin was primarily due to a continued shift in sales mix into higher margin home and garden products and an increase in marketplace sales (for which we record only our commission as revenue), partially offset by increased promotional activities.

The 541 basis point decrease in direct gross margin for the three months ended September 30, 2018, as compared to the same period in 2017, was primarily due to increased promotional activities.

The 283 basis point decrease in direct gross margin for the nine months ended September 30, 2018, as compared to the same period in 2017, was primarily due to increased promotional activities, partially offset by a shift in sales mix into higher margin home and garden products.

The 10 basis point decrease in partner gross margin for the three months ended September 30, 2018, as compared to the same period in 2017, was primarily due to increased promotional activities, partially offset by a continued shift in sales mix into higher margin home and garden products and an increase in marketplace sales (which we recognize on a net basis).

The 5 basis point decrease in partner gross margin for the nine months ended September 30, 2018, as compared to the same period in 2017 was primarily due to increased promotional activities, partially offset by a continued shift in sales mix into higher margin home and garden products and an increase in marketplace sales (which we recognize on a net basis).

Cost of goods sold includes stock-based compensation expense of \$41,000 and \$46,000 for the three months ended September 30, 2018 and 2017, respectively, and \$152,000 and \$134,000 for the nine months ended September 30, 2018 and 2017, respectively.

## Fulfillment costs

Fulfillment costs include all warehousing costs, including fixed overhead and variable handling costs (excluding packaging costs), as well as credit card fees and customer service costs, all of which we include as costs in calculating gross margin. We believe that some companies in our industry, including some of our competitors, account for fulfillment costs within operating expenses, and therefore exclude fulfillment costs from gross margin. As a result, our gross margin may not be directly comparable to others in our industry.

The following table has been included to provide investors additional information regarding our classification of fulfillment costs, gross profit and margin, thus enabling investors to better compare our gross margin with others in our industry (in thousands):

	Three months ended				Nine months ended			
	September 30,		September 30,		September 30,		September 30,	
	2018	2017	2018	2017	2018	2017	2018	2017
Total revenue, net	\$440,580	100%	\$424,007	100%	\$1,369,044	100%	\$1,288,466	100%
Cost of goods sold								
Product costs and other cost of goods sold	334,156	76%	321,678	76%	1,039,518	76%	977,827	76%
Fulfillment and related costs	19,708	4%	18,654	4%	57,198	4%	55,886	4%
Total cost of goods sold	353,864	80%	340,332	80%	1,096,716	80%	1,033,713	80%
Gross profit	\$86,716	20%	\$83,675	20%	\$272,328	20%	\$254,753	20%

Fulfillment costs as a percentage of sales may vary due to several factors, such as our ability to manage costs at our warehouses, significant changes in the number of units received and fulfilled, the extent to which we use third-party fulfillment services and warehouses, and our ability to effectively manage customer service costs and credit card fees.

Fulfillment and related costs remained flat during the three and nine months ended September 30, 2018 as compared to the same periods in 2017.

See "Gross profit" above for additional discussion.

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## Operating expenses

## Sales and marketing expenses

We use a variety of methods to target our 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.

Costs associated with our discounted shipping and other promotions, such as coupons, are not included in sales and marketing expense. Rather, they are accounted for as a reduction in revenue as they reduce the amount of consideration we expect to receive in exchange for goods or services and therefore affect net revenues and gross margin. We consider discounted shipping and other promotions, such as our policy of free shipping on orders over \$45, as an effective marketing tool, and intend to continue to offer them as we deem appropriate as part of our overall marketing plan.

The following table reflects our sales and marketing expenses for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three months ended				Nine months ended			
	September 30,		\$ Change	% Change	September 30,		\$ Change	% Change
	2018	2017			2018	2017		
Sales and marketing expenses	\$55,312	\$45,153	\$ 10,159	22.5 %	\$226,942	\$126,068	\$ 100,874	80.0 %
Sales and marketing expenses as a percent of net revenues	12.6	% 10.6	%		16.6	% 9.8	%	

The 191 basis point increase in sales and marketing expenses as a percentage of revenue for the three months ended September 30, 2018, as compared to the same period in 2017, was primarily due to our effort to aggressively pursue increased revenue and new customers early in the quarter through significantly increased spending in the display ads on social media, sponsored search, and direct mail marketing channels, as well as increased staff-related costs.

The 679 basis point increase in sales and marketing expenses as a percentage of revenue for the nine months ended September 30, 2018, as compared to the same period in 2017, was primarily due to our effort to aggressively pursue increased revenue and new customers. This effort consisted of significantly increased spending in the sponsored search, display ads on social media, and television marketing channels, and continued through early August when we shifted our retail strategy to reduce these expenses. We also had a \$7.9 million increase in staff-related costs, including \$2.9 million at tZERO for employee severance and a special restricted stock grant which fully vested during Q1 2018.

Sales and marketing expenses include stock-based compensation expense of \$277,000 and \$109,000 for the three months ended September 30, 2018 and 2017, respectively, and \$1.5 million and \$318,000 for the nine months ended September 30, 2018 and 2017, respectively. The increase during the nine months ended September 30, 2018 was primarily due to \$600,000 of expense related to the tZERO equity awards granted, vested, and fully expensed in January 2018.

## Technology expenses

We seek to invest efficiently in technology, including web services, customer support solutions, website search, expansion of new and existing product categories, and in investments in technology to enhance the customer experience, improve our process efficiency and support and expand our logistics infrastructure. We expect to continue to increase our technology expenses to support these initiatives and these increases may be material.

The frequency and variety of cyberattacks on our Website, our corporate systems, and on third parties that we use to support our technology continue to increase. The impact of such attacks, their costs, and the costs we incur to protect ourselves against future attacks have not been material. However, we consider the threat from cyberattacks to be serious and will continue to incur costs related to efforts to protect ourselves against them.

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The following table reflects our technology expenses for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three months ended				Nine months ended			
	September 30,		\$ Change	% Change	September 30,		\$ Change	% Change
	2018	2017			2018	2017		
Technology expenses	\$33,880	\$28,746	\$ 5,134	17.9 %	\$97,597	\$85,982	\$ 11,615	13.5 %
Technology expenses as a percent of net revenues	7.7	% 6.8	%		7.1	% 6.7	%	

The \$5.1 million increase in technology costs for the three months ended September 30, 2018, as compared to the same period in 2017, was primarily due to an increase in staff-related costs of \$3.4 million and an increase in technology licenses and maintenance of \$1.6 million.

The \$11.6 million increase in technology costs for the nine months ended September 30, 2018, as compared to the same period in 2017, was primarily due to an increase in staff-related costs of \$9.7 million, and an increase in technology licenses and maintenance costs of \$4.9 million, partially offset by a decrease in depreciation expense of \$2.8 million.

Technology expenses include stock-based compensation expense of \$583,000 and \$166,000 for the three months ended September 30, 2018 and 2017, respectively, and \$1.7 million and \$476,000 for the nine months ended September 30, 2018 and 2017, respectively.

## General and administrative expenses

The following table reflects our general and administrative expenses for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three months ended				Nine months ended			
	September 30,		\$ Change	% Change	September 30,		\$ Change	% Change
	2018	2017			2018	2017		
General and administrative expenses	\$45,356	\$21,651	\$ 23,705	109.5 %	\$ 116,551	\$66,622	\$ 49,929	74.9 %
General and administrative expenses as a percent of net revenues	10.3	% 5.1	%		8.5	% 5.2	%	

The \$23.7 million increase in general and administrative expenses for the three months ended September 30, 2018, as compared to the same period in 2017, was primarily due to \$10.8 million in special legal costs in Q3 2018, related to our gift card escheatment case in Delaware and capital raising efforts, a \$5.1 million increase in staff-related costs, and a \$3.2 million increase in consulting and outside services.

The \$49.9 million increase in general and administrative expenses for the nine months ended September 30, 2018, as compared to the same period in 2017, was primarily due to an \$18.7 million increase in legal costs largely related to our gift card escheatment case in Delaware and costs related to the tZERO SEC investigation and capital raising efforts, a \$15.3 million increase in staff-related costs, and a \$9.3 million increase in consulting and outside services. In addition, we had a \$2.5 million increase in travel expenses, a \$1.5 million increase in office and facilities expenses and a \$1.2 million increase in impairments on cryptocurrencies.

General and administrative expenses include stock-based compensation expense of approximately \$1.3 million and \$703,000 for the three months ended September 30, 2018 and 2017, respectively, and \$8.3 million and \$2.1 million

for the nine months ended September 30, 2018 and 2017, respectively. The increase was primarily due to \$3.4 million of expense related to the tZERO equity awards granted, vested, and fully expensed in January 2018.

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## Depreciation and amortization expense

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

	Three months ended		Nine months ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Cost of goods sold - direct	\$85	\$72	\$252	\$230
Technology	5,330	5,940	16,103	18,802
General and administrative	1,038	974	3,082	2,863
Total depreciation, including internal-use software and website development	\$6,453	\$6,986	\$19,437	\$21,895

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

	Three months ended		Nine months ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Technology	\$885	\$905	\$2,534	\$2,715
Sales and marketing	119	22	442	62
General and administrative	542	21	620	62
Total amortization of intangible assets other than goodwill	\$1,546	\$948	\$3,596	\$2,839

## Other income (expense), net

Other income (expense), net for the three months ended September 30, 2018 was (\$1.8 million) as compared to \$5.9 million in 2017. The decrease is primarily due to \$5.5 million from gains on the sale of cryptocurrencies and precious metals in Q3 2017 that was not repeated in Q3 2018, a \$1.0 million increase in equity method loss, a \$692,000 decrease in Club O and gift card breakage which we began recognizing as a component of revenue in 2018 following the adoption of ASC 606, and a \$584,000 increase in unrealized losses, including impairments, on equity securities that were recognized in Q3 2018.

Other income (expense), net for the nine months ended September 30, 2018 was (\$1.5 million) as compared to \$2.8 million for the same period in 2017. The decrease is primarily due to \$5.5 million from gains on the sale of cryptocurrencies and precious metals in Q3 2017 that was not repeated in Q3 2018, a \$1.9 million decrease in Club O and gift card breakage which we began recognizing as a component of revenue in 2018 following the adoption of ASC 606, and a \$2.4 million increase in losses on equity method investments. These were partially offset by a \$4.5 million decrease in impairment charges on equity securities, and a \$1.3 million increase in unrealized gains, net of impairments, on equity securities.

## Income taxes

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

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

Our benefit from income taxes for the nine months ended September 30, 2018 and 2017 was \$445,000 and \$7.7 million. The effective tax rate for the nine months ended September 30, 2018 and 2017 was 0.3% and 33.8%, respectively. The decrease in the effective tax rate is primarily attributable to the valuation allowance we are maintaining on our net deferred tax

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assets and a decrease in pre-tax income during the nine months ended September 30, 2018 as compared to the same period in 2017.

We have indefinitely reinvested foreign earnings of \$1.3 million at September 30, 2018. We would need to accrue and pay various taxes on this amount if repatriated. We do not intend to repatriate these earnings.

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

Each quarter we assess the recoverability of our deferred tax assets under ASC 740. We assess the available positive and negative evidence to estimate whether we will generate sufficient future taxable income to use our existing deferred tax assets. We have limited carryback ability and do not have significant taxable temporary differences to recover our existing deferred tax assets, therefore we must rely on future taxable income, including tax planning strategies, to support their realizability. We have established a valuation allowance for our deferred tax assets not supported by carryback ability or taxable temporary differences, primarily due to uncertainty regarding our future taxable income. We have considered, among other things, the cumulative loss incurred over the three-year period ended September 30, 2018 as a significant piece of objective negative evidence. We intend to continue maintaining a valuation allowance on our net deferred tax assets until there is sufficient evidence to support the reversal of all or some portion of these allowances. The amount of the deferred tax asset considered realizable could be adjusted if objective negative evidence in the form of cumulative losses is no longer present and additional weight may be given to subjective evidence such as long-term projections for growth. We will continue to monitor the need for a valuation allowance against our remaining deferred tax assets on a quarterly basis.

### Seasonality

Based upon our historical experience, revenue typically increases during the fourth quarter because of the holiday retail season and gross margin decreases due to increased sales of certain lower margin products, such as electronics. Revenue typically decreases in the following quarter(s), as shown in the table below. The actual quarterly results for each quarter could differ materially depending upon consumer preferences, availability of product and competition, among other risks and uncertainties. Accordingly, there can be no assurances that seasonal variations will not materially affect our results of operations in the future.

The following table reflects our total net revenues for each of the quarters in 2018, 2017 and 2016 (in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2018	\$445,331	\$483,134	\$440,580	\$N/A
2017	432,435	432,024	424,007	456,290
2016	413,677	418,540	441,564	526,182

### Liquidity and Capital Resources

#### Overview

Although we believe that our cash and cash equivalents currently on hand and expected cash flows from future operations will be sufficient to continue operations for at least the next twelve months, we also believe that we may need to raise additional capital and/or obtain significant additional debt financing to be able to fully pursue some or all of our plans discussed below, including plans for our retail business while also funding our Medici initiatives, beyond

the next twelve months.

We continue to seek opportunities for growth in our retail business, through our Medici blockchain and financial technology initiatives, and through other means. We also want to invest in additional distribution facilities to speed shipping and improve our customer service; in additional automation, technology and engineering resources because we believe they can improve our customers' shopping experience and increase our sales; in our Club O rewards program, primarily to increase member benefits and to develop additional personalization programs; and in expansion of our private label initiative because we believe that private label brands can generate significant brand equity and customer loyalty.

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Our Medici initiatives also require substantial funding. Medici Ventures and its majority-owned subsidiary, tZERO, continue to identify, evaluate and pursue various opportunities for strategic acquisitions or purchases of interests to expand the services and expertise they offer their customers. As a result of these initiatives, we will continue to incur additional expenses and expect to purchase interests in, or make acquisitions of, other technologies and businesses.

We anticipate that our initiatives will cause us to incur additional losses in the foreseeable future. These losses, additional expenses, acquisitions or purchases may be material, and, coupled with existing marketing expense trends, and potential strategic changes in our retail business, may lead to increased consolidated losses in some periods, and to reduced liquidity.

### Current sources of liquidity

We believe that our cash and cash equivalents currently on hand and expected cash flows from future operations will be sufficient to continue operations for at least the next twelve months. However, our failure to generate sufficient revenues or profits or to obtain additional financing or raise additional capital could have a material adverse effect on our operations and on our ability to achieve our business objectives, and could require us to decrease or cease funding initiatives we consider important in our retail business, our Medici business or both. Any projections of future cash needs and cash flows are subject to substantial uncertainty.

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

In December 2017, tZERO launched an offering (the "security token offering") of the right to acquire tZERO Preferred Equity Tokens (the "tZERO Security Token") through a Simple Agreement for Future Equity ("SAFE"). The security token offering closed on August 6, 2018. As of September 30, 2018, tZERO has received \$104.8 million in cumulative proceeds, net of withdrawals, and incurred \$21.3 million of offering costs. On October 12, 2018, tZERO issued the tZERO Security Tokens in settlement of the SAFEs. The tZERO Security Tokens are subject to a 90 day trading lock-up period.

In August 2018, we entered into a sales agreement with JonesTrading Institutional Services LLC ("JonesTrading"), under which we conducted "at the market" public offerings of our common stock during the quarter ended September 30, 2018 and may conduct additional "at the market" public offerings of our common stock from time to time. Under the sales agreement, JonesTrading, acting as our agent, may offer our common stock in the market on a daily basis or otherwise as we request from time to time. We have no obligation to sell additional shares under the sales agreement, but expect to do so from time to time. We will pay JonesTrading up to a 2.0% sales commission on all sales. The sales agreement contemplates sales of up to \$150 million of our common stock over a period of up to three years. As of September 30, 2018, we had sold 2,883,344 shares of our common stock pursuant to the sales agreement and have received \$94.6 million in proceeds, net of \$2.6 million of offering costs, including commissions paid to JonesTrading. The average price per share of stock sold pursuant to the sales agreement during the quarter ended September 30, 2018, excluding offering costs, was \$33.71.

In August 2018, we also entered into a standby equity underwriting agreement with JonesTrading. We did not sell any shares under the standby equity underwriting agreement, and the agreement terminated in accordance with its terms during the quarter ended September 30, 2018. Under the standby underwriting agreement, we had the right, but no obligation, to sell up to \$50 million of our common stock to JonesTrading, as underwriter, for sale to the public in a firm commitment public offering. We paid a 1% commitment fee to JonesTrading for entering into the underwriting

agreement.

At September 30, 2018, our principal sources of liquidity are cash flows generated from operations, our existing cash and cash equivalents, and proceeds from the warrants, shares sold under the at the market offering, and tZERO's security token offering. At September 30, 2018, we had cash and cash equivalents of \$182.0 million. The intramonthly balance of our cash and cash equivalents on hand fluctuates significantly, generally reaching the highest balance at the end of month and the lowest balances after the first and sixteenth of the month when we make our regular partner and supplier payments.

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## Contemplated Financing Transactions

As previously announced, in August 2018, Overstock signed a Token Purchase Agreement with GSR Capital Ltd., a Cayman Islands exempted company ("GSR"), and a term sheet contemplating a sale of Overstock common stock to GSR. Concurrently, tZERO signed a term sheet contemplating a sale of tZERO common stock to GSR.

The Token Purchase Agreement sets forth the terms on which GSR agreed to purchase, for \$30 million, on May 6, 2019 or such other date as may be agreed by the parties, security tokens at a price of \$6.67 per security token. These security tokens were issued by tZERO to Overstock in satisfaction of \$30 million of tZERO's indebtedness to Overstock. We may be required to obtain additional tokens in order to fulfill our obligations under the agreement. The agreement states that the obligations of GSR to complete the transaction described will be subject to conditions, some of which are unidentified.

Overstock, tZERO and GSR are currently negotiating definitive agreements for GSR's purchase of Overstock common stock and tZERO common stock. Although we continue to negotiate the terms, GSR has proposed purchasing fewer shares and at a lower price per share than those described in the Overstock term sheet. We believe that if a definitive agreement is reached regarding the purchase of tZERO shares, the terms, including the post money valuation of tZERO, may be less favorable than those described in the tZERO term sheet. Both the Overstock and tZERO term sheets constitute binding agreements for the parties to negotiate in good faith the terms of the transaction documents; however, the obligation to negotiate in good faith terminates on December 15, 2018, if any of the closing conditions, one of which is the negotiation, execution and delivery of mutually acceptable transaction documents, have not been satisfied. While we expect to complete these transactions, there can be no assurance that Overstock, tZERO or GSR will enter into definitive agreements regarding either of the proposed transactions.

Cash flow information is as follows (in thousands):

	Nine months ended September 30,		Twelve months ended September 30,	
	2018	2017	2018	2017
Cash provided by (used in):				
Operating activities	\$(120,300)	\$(62,448)	\$(93,073)	\$(7,445)
Investing activities	(89,508 )	(14,368 )	(93,100 )	(28,649 )
Financing activities	189,575	(13,884 )	276,782	4,021

## Cash flows from operating activities

Our operating cash flows result primarily from cash received from our customers, offset by cash payments we make for employee compensation (less amounts capitalized related to internal-use software that are reflected as cash used in investing activities), and changes in working capital and other related activities. Working capital at any specific point in time is subject to many variables, including seasonality, inventory management, expansion efforts, the timing of cash receipts and payments, and vendor payment terms. Cash received from customers generally corresponds to our net revenues as our customers primarily use credit cards to buy from us causing our receivables from these sales transactions to settle quickly. We have payment terms with our partners that generally extend beyond the amount of time necessary to collect proceeds from our customers. As a result, following our typically seasonally strong fourth quarter sales, at December 31 of each year, our cash, cash equivalents, accounts payable and accrued liability balances normally reach their highest level (other than as a result of cash flows provided by or used in investing and financing activities).

The \$120.3 million of net cash used in operating activities during the nine months ended September 30, 2018 was primarily due to consolidated net loss of \$169.6 million, partially offset by cash provided by operating assets and liabilities of \$12.3 million, and certain non-cash items including depreciation and amortization expense of \$23.0 million, stock-based compensation of \$11.7 million, and impairment losses, net of realized gains, recognized on cryptocurrency holdings of \$1.2 million.

The \$62.4 million of net cash used in operating activities during the nine months ended September 30, 2017 was primarily due to consolidated net loss of \$15.1 million, cash used in operating assets and liabilities of \$68.5 million, and certain non-cash items including deferred income taxes of \$8.7 million and other non-cash items of \$1.5 million, partially offset by certain non-cash items including depreciation and amortization expense of \$24.7 million, stock-based compensation of \$3.0

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million, impairments recognized on cost method investments of \$4.5 million, and net of realized gains recognized on cryptocurrency holdings of \$845,000.

Notwithstanding our current negative cash flows from operating activities, we believe that our cash and cash equivalents currently on hand and expected cash flows from future operations will be sufficient to continue operations for at least the next twelve months. However, we also believe that we may need to raise additional capital and/or obtain significant additional debt financing to be able to fully pursue some or all of our plans, including plans for our retail business while also funding our Medici initiatives, beyond the next twelve months.

## Cash flows from investing activities

For the nine months ended September 30, 2018, investing activities resulted in net cash outflows of \$89.5 million primarily due to \$43.7 million investment in equity securities, \$12.9 million acquisition of businesses, net of cash acquired, \$20.7 million of expenditures for fixed assets, and \$9.6 million purchase of intangible assets.

For the nine months ended September 30, 2017, investing activities resulted in net cash outflows of \$14.4 million primarily due to \$20.9 million of expenditures for fixed assets and \$4.2 million investment in equity securities, partially offset by \$11.6 million in proceeds from the sale of precious metals.

## Cash flows from financing activities

For the nine months ended September 30, 2018, financing activities resulted in net cash inflows of \$189.6 million primarily due to \$94.6 million of net proceeds from the sale of common stock under the at the market offering, \$82.6 million of net proceeds from the security token offering, \$50.6 million of proceeds from the sale and exercise of stock warrants, and \$6.7 million of proceeds from capital contributions received by a consolidated subsidiary, partially offset by a \$40.0 million repayment of long-term debt and \$4.6 million of taxes withheld upon vesting of restricted stock.

For the nine months ended September 30, 2017, financing activities resulted in net cash outflows of \$13.9 million primarily due to the purchase of treasury stock for \$10.0 million, \$2.4 million of payments on finance obligations, and \$1.1 million of taxes withheld upon vesting of restricted stock.

## Free cash flow

"Free Cash Flow" (a non-GAAP measure) for the nine months ended September 30, 2018 and 2017, was \$(141.0) million and \$(83.3) million, respectively, and \$(116.5) million and \$(41.2) million for the twelve months ended September 30, 2018 and 2017, respectively. See Non-GAAP Financial Measures below for a reconciliation of Free Cash Flow to net cash provided by (used in) operating activities.

## Contractual Obligations and Commitments

The following table summarizes our contractual obligations as of September 30, 2018 and the effect such obligations and commitments are expected to have on our liquidity and cash flow in future periods (in thousands):

Contractual Obligations	Payments Due by Period						Total
	Remainder of 2018	2019	2020	2021	2022	Thereafter	
Operating leases	1,757	7,446	5,648	6,038	6,156	17,515	44,560
Purchase obligations	2,927	—	—	—	—	—	2,927

Technology services	508	2,031	1,693	—	—	—	4,232
High Bench Senior Credit Agreement	—	—	3,069	—	—	—	3,069
Total contractual cash obligations	\$5,192	\$9,477	\$10,410	\$6,038	\$6,156	\$17,515	\$54,788

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### Operating leases

From time to time we enter into operating leases for facilities and equipment for use in our operations. In August 2018, we entered into a new agreement to lease a warehouse located in Kansas City, Kansas. The term of the lease is for a period of 61 months, beginning August 2018 and ending August 2023.

### Purchase obligations

The amount of purchase obligations shown above is based on assumptions regarding the legal enforceability against us of inventory purchase orders we had outstanding at September 30, 2018. Under different assumptions regarding our rights to cancel our purchase orders or different assumptions regarding the enforceability of the purchase orders under applicable law, the amount of purchase obligations shown in the table above would be less.

### Technology services

From time to time we enter into long-term contractual agreements for technology services and capital leases for equipment included in such service agreements.

### High Bench Senior Credit Agreement

We are party to a financing agreement acquired in connection with our acquisition of Mac Warehouse, LLC (see Borrowings below). The amounts presented reflect our related principal payments.

### Tax contingencies

We are involved in various tax matters, the outcomes of which are uncertain. As of September 30, 2018, accrued tax contingencies were \$1.4 million. Changes in state, federal, and foreign tax laws may increase our tax contingencies. The timing of the resolution of income tax contingencies is highly uncertain, and the amounts ultimately paid, if any, upon resolution of issues raised by the taxing authorities may differ from the amounts accrued. It is reasonably possible that within the next 12 months we will receive additional assessments by various tax authorities. These assessments may or may not result in changes to our contingencies related to positions on prior years' tax filings.

### Borrowings

#### High Bench Senior Credit Agreement

On June 25, 2018, we became party to a senior credit agreement, as amended, with High Bench-Mac Warehouse-Senior Debt, LLC ("High Bench Loan"), in connection with our acquisition of Mac Warehouse, LLC. Under the amended agreement, the loan carries an annual interest rate of 11.0% and a default rate of 18.0%. The High Bench Loan is subject to monthly interest only payments with the remaining principal amount and any then unpaid interest due and payable on April 18, 2020. The High Bench Loan is subject to mandatory prepayment under certain circumstances, and is prepayable at our election at any time without penalty or premium. There are no financial covenants associated the High Bench Loan. At September 30, 2018, our outstanding balance on the High Bench Loan was \$3.1 million.

#### Letters of credit

At September 30, 2018 and December 31, 2017, letters of credit totaling \$280,000 and \$355,000, were issued on our behalf collateralized by compensating cash balances held at a bank, which are included in Restricted cash in the

accompanying consolidated balance sheets.

#### Commercial purchasing card agreement

We have a commercial purchasing card (the "Purchasing Card") agreement. We use the Purchasing Card for business purpose purchasing and must pay it in full each month. At September 30, 2018, \$107,000 was outstanding and \$893,000 was available under the Purchasing Card. At December 31, 2017, \$822,000 was outstanding and \$4.2 million was available under the Purchasing Card.



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### Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that would be material to investors.

### Transactions with Related Parties

Our related party Transactions are discussed in Item 1 of Part I, "Financial Statements (Unaudited)"—Note 12. Related Party Transactions, contained in the "Notes to Unaudited Consolidated Financial Statements" of this Quarterly Report on Form 10-Q.

### Critical Accounting Policies and Estimates

The preparation of our financial statements requires that we make estimates and judgments. We base these on historical experience and on other assumptions that we believe to be reasonable. Our critical accounting policies are discussed in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of our Annual Report on Form 10-K for the year ended December 31, 2017, and our accounting policies and use of estimates are further discussed in Item 1 of Part I, "Financial Statements (Unaudited)"—Note 2. Accounting Policies, contained in the "Notes to Unaudited Consolidated Financial Statements" of this Quarterly Report on Form 10-Q and elsewhere in this Management's Discussion and Analysis of Financial Condition and Results of Operations.

During Q1 2018, we implemented ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) on a modified retrospective basis and recognized \$5.0 million of additional breakage income related to the unredeemed portion of our gift cards and loyalty program rewards through a cumulative effect adjustment in retained earnings as of January 1, 2018. In addition, we now recognize estimated breakage on our gift cards and loyalty program rewards in Partner and other revenue in our consolidated statement of operations rather as a component of Other expense, net. The adoption of these new accounting standards is discussed further in Item 1 of Part I, "Financial Statements (Unaudited)"—Note 2. Accounting Policies, contained in the "Notes to Unaudited Consolidated Financial Statements" of this Quarterly Report on Form 10-Q. There have been no other material changes to the critical accounting policies previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017.

For information about recently issued accounting standards not yet adopted, see Recently issued accounting standards not yet adopted, included in Item 1 of Part I, "Financial Statements (Unaudited)"—Note 2. Accounting Policies, contained in the "Notes to Unaudited Consolidated Financial Statements" of this Quarterly Report on Form 10-Q.

### Non-GAAP Financial Measures

Regulation G, Conditions for Use of Non-GAAP Financial Measures, and other SEC regulations regulate the disclosure of certain non-GAAP financial information.

### Retail and Medici pre-tax income or loss

Retail and Medici pre-tax income or loss (non-GAAP financial measures - which we reconcile to Consolidated pre-tax income or loss) consists of income or loss before taxes of our Retail (which consists of Direct and Partner) and Medici (which is included in Other) businesses, excluding intercompany transactions eliminated in consolidation. We believe these measures provide management and users of the financial statements useful information because they provide financial results for our separate businesses which are distinct in nature. The material limitation associated with these measures is that they are an incomplete measure of our consolidated operations. These measures should be used in addition to and in conjunction with results presented in accordance with GAAP and should not be relied upon to the

exclusion of GAAP financial measures. You should review our financial statements and publicly-filed reports in their entirety and not rely on any single financial measure. For additional information regarding our segment reporting, and a reconciliation of Retail and Medici pre-tax income or loss, please see Item 1 of Part I, "Financial Statements (Unaudited)"—Note 10. Business Segments, contained in the "Notes to Unaudited Consolidated Financial Statements" of this Quarterly Report on Form 10-Q.

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## Free cash flow

Free cash flow (a non-GAAP financial measure) reflects an additional way of viewing our cash flows and liquidity that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our cash flows and liquidity. Free cash flow, which we reconcile below to "Net cash used in operating activities," the nearest GAAP financial measure, is net cash provided by operating activities reduced by "Expenditures for fixed assets, including internal-use software and website development." We believe that net cash provided by operating activities is an important measure, since it includes both the cash impact of the continuing operations of the business and changes in the balance sheet that impact cash. We believe free cash flow is a useful measure to evaluate our business since purchases of fixed assets are a necessary component of ongoing operations and free cash flow measures the amount of cash we have available for mandatory debt service and financing obligations, changes in our capital structure, and future investments after purchases of fixed assets. Free cash flow measures have limitations as they omit certain components of the overall consolidated statement of cash flows and do not represent the residual cash flow available for discretionary expenditures. Free cash flow should not be considered a substitute for net income (loss) or cash flow data prepared in accordance with GAAP and may not be comparable to similarly titled measures used by other companies. Therefore, we believe it is important to view free cash flow as a complement to our entire consolidated statements of cash flows as reconciled below (in thousands):

	Nine months ended September 30,		Twelve months ended September 30,	
	2018	2017	2018	2017
Net cash used in operating activities	\$(120,300)	\$(62,448)	\$(93,073 )	\$(7,445 )
Expenditures for fixed assets, including internal-use software and website development	(20,677 )	(20,873 )	(23,390 )	(33,772 )
Free cash flow	\$(140,977)	\$(83,321)	\$(116,463)	\$(41,217)

## Government Regulation

Our e-commerce 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 impede our growth. These regulations and laws cover taxation, privacy, data protection, pricing, content, copyrights, distribution, 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. On June 21, 2018, the U.S. Supreme Court issued an opinion in our South Dakota sales tax case and overruled the 1992 Quill Corp v. North Dakota case, and states may now require remote sellers to withhold sales tax under certain circumstances. In June 2018, we began withholding sales tax in all 45 states that have sales tax. If any state were to assert that we have any liability for sales tax for prior periods, it could have an adverse effect on us. 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, our broker dealers 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 our Annual Report on Form 10-K for the year ended December 31, 2017, Part I - Item 1A - "Risk Factors - PRO Securities and SpeedRoute, two subsidiaries of tZERO that currently generate substantially all of tZERO's revenues, are registered broker-dealers and are subject to extensive regulation."

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Further, some of the business opportunities that the companies in which Medici Ventures holds an interest are pursuing may be subject to approvals by the SEC and/or other governmental authorities, and we have no ability to ensure that they can obtain any such approvals on a timely basis or at all.

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, 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. Our ownership interests in Bitt Inc. and Bitsy, Inc. also may expose us to additional laws and regulations relating to money transmitters and money services businesses. See our Annual Report on Form 10-K for the year ended December 31, 2017, Part I - Item 1A - "Risk Factors - Our ownership interest in Bitt Inc. may expose us to additional risks."

### Other Factors that May Affect Future Results

We believe that our cash and cash equivalents currently on hand and expected cash flows from future operations will be sufficient to continue operations for at least the next twelve months. Any projections of future cash needs and cash flows are subject to substantial uncertainty, including those set forth under Item 1A of Part II, "Risk Factors" of this report and in our Annual Report on Form 10-K for the year ended December 31, 2017, Part I - Item 1A - "Risk Factors."

We periodically evaluate opportunities to repurchase our equity securities, obtain credit facilities, or issue additional debt or equity securities. In addition, we may, from time to time, consider purchases of equity interests in, or acquisition of, complementary businesses, products, services, or technologies, whether related to our retail business, our Medici initiatives or otherwise, any of which might affect our liquidity requirements or cause us to issue additional debt or equity securities. There can be no assurance that financing arrangements will be available in amounts or on terms acceptable to us, or at all.

Any investment in our securities involves a high degree of risk. Investors should consider carefully the risks and uncertainties described in this Form 10-Q, including the risks described in Item 1A of Part II, "Risk Factors" of this report and in our Annual Report on Form 10-K for the year ended December 31, 2017, Part I - Item 1A - "Risk Factors," and all other information in this Form 10-Q and in our other filings with the SEC including those we file after we file this Form 10-Q, 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 under "Risk Factors" in this report or in our Annual Report on Form 10-K for the year ended December 31, 2017 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.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our financial instruments consist of cash and cash equivalents, trade accounts and contracts receivable, accounts payable and long-term obligations. We consider highly-liquid instruments with a remaining maturity of 90 days or less at the date of purchase to be cash equivalents. We currently do not hold any derivative financial instruments or foreign exchange contracts.

Our exposure to market risk for changes in interest rates relates primarily to our short-term investments and short-term obligations; thus, fluctuations in interest rates would not have a material impact on the fair value of these securities.

However, the fair values of our investments may be subject to fluctuations due to volatility of the stock market in general, investment-specific circumstances, and changes in general economic conditions.

At September 30, 2018, we had \$182.0 million in cash and cash equivalents. Hypothetically, an increase or decrease in interest rates of one hundred basis points would have an estimated impact of \$1.8 million on our earnings or loss, or the cash flows of these instruments.

At September 30, 2018, letters of credit totaling \$280,000 were outstanding under our credit facilities. Hypothetically, an increase or decrease in interest rates of one hundred basis points would have an estimated impact of \$2,800 on our earnings or loss if the letters of credit were fully drawn.

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At September 30, 2018, we had cryptocurrency-denominated assets totaling \$3.1 million. Hypothetically, a decrease in the market value of one hundred basis points would have an estimated impact of \$31,000 on our earnings or loss, and the recorded value of these instruments. Reported earnings resulting from increases in the market value of cryptocurrency would be limited to realized gains.

ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The term disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation required by the Exchange Act under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) of the Exchange Act, as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Beginning January 1, 2018, we implemented ASU 2014-09, Revenue from Contracts with Customers (Topic 606). In connection with its adoption, we implemented changes to our processes and internal control activities over financial reporting to ensure compliance with the new accounting and disclosure rules.

Except for the preceding changes, there has not occurred any change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives as specified above. Management does not expect, however, that our disclosure controls and procedures will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth under Item 1 of Part I, "Financial Statements"—Note 6—"Commitments and Contingencies," subheading "Legal Proceedings and Contingencies," contained in the "Notes to Unaudited Consolidated Financial Statements" of this Quarterly Report on Form 10-Q is incorporated by reference in answer to this Item.

ITEM 1A. RISK FACTORS

Any investment in our securities involves a high degree of risk. 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. Many of the risks we face involve more than one type of risk. Consequently, you should read all of the risk factors below carefully, as well as the risk factors described in our Form 10-K for the year ended December 31, 2017, the risk factors described in our Form 10-Q for the quarters ended March 31, 2018 and June 30, 2018, and in any reports we file with the SEC after we file this Form 10-Q, before deciding whether to purchase or hold our securities. The occurrence of any of these risks could harm our business, the trading price of our securities could decline, and investors could lose part or all of their investment.

Other than the risk factors set forth below, there are no material changes from the risk factors previously disclosed in Part I - Item 1A - "Risk Factors," of our Annual Report on Form 10-K for the year ended December 31, 2017, and disclosed in Part II - Other Information - Item 1A - "Risk Factors," of our Quarterly Report on Form 10-Q for the quarters ended March 31, 2018 and June 30, 2018.

Our ownership interest in Bitsy Inc. may expose us to additional risks.

In the third quarter of 2018, Medici Ventures increased its ownership interest in Bitsy, Inc., a U.S.-based company founded and partially owned by Medici Ventures' chief operating officer and general counsel, to approximately 33%. In September 2018, Bitsy announced that it had begun a limited beta launch of a digital wallet service intended to create a bridge between traditional fiat currencies and cryptocurrencies. Various aspects of the business that Bitsy is engaging in are heavily regulated. 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. 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. Bitsy has registered with FinCEN and has confirmed to us that it intends to obtain all licenses it is required to obtain. 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. Further, under U.S. federal law, anyone who owns all or part of an unlicensed money transmitting business may be subject to civil and criminal penalties.

Our discussions with potential bidders for our e-commerce business could result in the compromise of our intellectual property.



Although we enter into confidentiality agreements with potential bidders for our e-commerce business prior to disclosing confidential information to them, it may be possible for potential bidders to misappropriate intellectual property and other confidential information from us.

We may have additional exposure to claims under Delaware's Abandoned Property Law.

In September 2018 we lost a jury trial in Delaware brought on Delaware's behalf alleging that we had violated Delaware's unclaimed property laws by failing to report and turn over to Delaware certain unused gift card balances. The time period covered by the lawsuit was 2004 through 2007. The jury returned a verdict, which we expect to result in a judgment

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against us of approximately \$7.3 million plus attorneys' fees and costs. We may have additional exposure for the time period 2008 through 2014.

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

At September 30, 2018, Overstock and its subsidiaries held minority interests totaling approximately \$57.4 million in several companies that are in the startup or development stages and may acquire additional minority interests in other entities in the future. These interests 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 these interests are in companies that 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 companies we have funded would be successful, even if they were brought to market. We have written off amounts related to these interests in the past and may in the future write off additional amounts related to these interests. Any such write-offs could be material, and could have a material adverse effect on our financial results and business.

tZERO's recent decision not to use StockCross as the introducing broker for the trading of its security tokens may result in additional expense and may delay the trading of tZERO's security tokens.

Management of tZERO will need to devote significant time and resources to identify a suitable broker dealer and to enter into an appropriate licensing and/or other contractual arrangements with one or more options, which may divert management's time and attention from other matters. If tZERO is unable to enter into the necessary contractual arrangements with an appropriate broker dealer promptly or at a reasonable cost, it could have a material adverse effect on tZERO's plans to begin the trading of its security tokens in January 2019. Although tZERO believes it has identified suitable candidates to perform these roles and intends to identify additional candidates, tZERO does not have a licensing or other contractual arrangement with any other broker dealer to perform the roles of introducing broker.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

### Unregistered issuance of equity securities

On June 28, 2018, we issued 100,000 shares of our common stock in a private placement to the stockholders of SiteHelix, Inc., including Saum Noursalehi, who owned approximately 62% of the SiteHelix common stock, as part of the acquisition price for our acquisition of all of the common stock of SiteHelix. Mr. Noursalehi is a member of our Board of Directors and served as President, Retail, of Overstock until May 8, 2018, when he became Chief Executive Officer of tZERO. The issuance was exempt from the registration requirements of the Securities Act of 1933, as amended, as a private placement under Rule 506(b) of Regulation D.

On September 20, 2018, we issued 47,378 shares of our common stock in a private placement to Bitsy, Inc. ("Bitsy"), as part of the acquisition price for our equity interest in Bitsy. Subsequent to the purchase, we hold, through our wholly-owned subsidiary, Medici Ventures, a 33% interest in Bitsy. Bitsy is a U.S.-based startup company founded and 25% owned by Medici Ventures' chief operating officer and general counsel. The issuance was exempt from the registration requirements of the Securities Act of 1933, as amended, as a private placement under section 4(a)(1) thereof.

### Issuer purchases of equity securities

None.

### Limitations upon the payment of 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.

In December 2016, we issued a total of 695,898 shares of our preferred stock (the "Preferred Stock"), of which 681,259 shares remained outstanding at September 30, 2018. The Preferred Stock ranks senior to our common stock with respect to dividends. Holders of the Preferred Stock are entitled to an annual cash dividend of \$0.16 per share, in preference to any dividend payment to the holders of the common stock, out of funds legally available for payment of dividends and subject

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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 potentially different treatment if we effect a stock dividend, stock split or combination of the common stock. There are no arrearages in cumulative preferred dividends. We declared and paid a cash dividend of \$0.16 per share on our preferred stock during 2017.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits

- 10.1 Capital on Demand<sup>TM</sup> Sales Agreement with JonesTrading Institutional Services LLC, as agent, dated August 9, 2018 (incorporated by reference to exhibit 1.1 to our Form S-3 filed on August 9, 2018, File No. 333-226729)
- 10.2 Standby Equity Underwriting Agreement with JonesTrading Institutional Services LLC, as underwriter, dated August 9, 2018 (incorporated by reference to exhibit 1.2 to our Form S-3 filed on August 9, 2018, File No. 333-226729)
- 10.3 Stockholders Agreement dated September 21, 2018 by and among Medici Land Governance, Inc., Medici Ventures, Inc. and Patrick M. Byrne (incorporated by reference to exhibit 10.1 to our Form 8-K filed on September 26, 2018, File No. 000-49799)
- \*31.1 Exhibit 31.1 Certification of Chief Executive Officer
- \*31.2 Exhibit 31.2 Certification of Chief Financial Officer
- \*32.1 Exhibit 32.1 Section 1350 Certification of Chief Executive Officer
- \*32.2 Exhibit 32.2 Section 1350 Certification of Chief Financial Officer
- 101 Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income (Loss), (iv) Consolidated Statements of Cash Flows, (v) Consolidated Statements of Stockholders' Equity, and (vi) Notes to Consolidated Financial Statements.

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\* Filed herewith.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 9, 2018 OVERSTOCK.COM, INC.

/s/ GREGORY J. IVERSON

Gregory J. Iverson

Chief Financial Officer

(Principal Financial Officer and Principal Accounting Officer)

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