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**2008 Annual Report**



April 29, 2009

Dear Bidz.com Stockholder:

We are pleased to report that in 2008 we continued to profitably grow Bidz.com. In spite of the challenging environment and extremely weak holiday season, we reported our 20th consecutive quarter of profitability in the fourth quarter and achieved record annual sales of \$207 million, up 10.8% from 2007. We believe our ability to deliver these results in this environment is a reflection of the strength of our business model combined with our growing reputation for offering superior value on quality jewelry. We are confident we are taking the necessary steps to make ourselves a stronger company that will benefit from the current disruption in the marketplace and allow us to further deliver long-term value to our shareholders.

During the year, we made significant progress on a number of important fronts. We appointed Leon Kuperman to the position of President. This has allowed me to focus more of my energies on my primary areas of expertise - strategic planning, purchasing and merchandising. Leon has successfully taken on many of my former responsibilities such as sales, marketing, and investor and public relations. Leon has further demonstrated his capabilities by overseeing and implementing the upgrade of our auction platform as well as the rollout of Buyz.com and three foreign language translations, Spanish, Arabic and German. We are also fortunate to have other very strong members of the senior management team, including Lawrence Kong, our Chief Financial Officer, and Claudia Liu, our Chief Operating Officer. These three officers continue to work together as a team and help me to execute our strategic plan and deliver strong financial results.

During 2008, we launched several new marketing initiatives including a campaign that encourages traditional Bidz customers to try Buyz.com, our new online Jewelry Superstore. With Buyz.com, we are committed to providing online shoppers with the largest selection of jewelry, anywhere. We continue to focus our marketing efforts online with campaigns primarily consisting of search advertising, affiliate marketing, display ad marketing and email marketing. In the future we also plan to strategically invest in our brands to build awareness, and enhance our identity and image to broaden our reach and appeal. As always, we will do this in a cost efficient manner with the customer experience at the forefront of our strategy.

In February 2009, our Board of Directors authorized a significant increase in our share buyback program leaving \$20 million of authorized capacity available for repurchases at that time. As of March 31, 2009, we had repurchased 2.2 million shares and there was approximately \$19.0 million remaining available for repurchases under our share repurchase plan. We will continue to make additional share repurchases in 2009.



We believe our company and our sites are unique and our entrepreneurial culture makes Bidz the destination of choice for consumers and the best place to buy jewelry online in a fun, entertaining environment at great prices. This is an exciting time for Bidz as we are increasingly becoming a highly recognizable brand. We remain committed to achieving strong performance in 2009 and beyond.

On behalf of our Board of Directors and the rest of the executive team, I would like to thank our stockholders, employees, and customers for their continuing confidence, loyalty, and support.

Sincerely,

David Zinberg  
CEO

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

OMB APPROVAL

OMB Number: 3235-0063

Expires: April 30, 2009

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response: 2,196.00

SEC  
Mail Processing  
Section

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

MAY 07 2009

For the fiscal year ended December 31, 2008

or

Washington, DC  
122

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file Number 000-51257

**BIDZ.com, Inc.**

(Exact name of registrant as specified in its charter)

Delaware  
State or other jurisdiction of  
incorporation or organization

3562 Eastham Drive, Culver City, California  
(Address of principal executive offices)

95-4728109  
(I.R.S. Employer  
Identification No.)

90232  
(Zip Code)

Registrant's telephone number, including area code (310) 280-7373

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

Title of each class  
Common Stock, \$.001 par value

Name of each exchange on which registered  
NASDAQ Capital Market

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

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

☐ YES ☒ NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

☐ YES ☒ NO

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

☒ YES ☐ NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer ☐  
Non-accelerated filer ☐  
(Do not check if a smaller reporting company)

Accelerated filer ☒  
Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

☐ YES ☒ NO

The aggregate market value of the voting stock held by non-affiliates of the registrant based upon the price of the common stock as of June 30, 2008 was approximately \$110.3 million. For purposes hereof, directors, executive officers and 10% or greater shareholders have been deemed affiliates. This determination of affiliate status is not necessarily a conclusive determination for others purposes.

The number of shares outstanding of the registrant's common stock was 22,917,918 as of February 23, 2009.

DOCUMENTS INCORPORATED BY REFERENCE

Information required by Part III (Items 10, 11, 12, 13 and 14) is incorporated by reference to portions of our definitive proxy statement for our 2009 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days of December 31, 2008.

**BIDZ.COM, INC.**

**ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED DECEMBER 31, 2008**

Table of Contents

|                                                                                                                             | <u>Page</u> |
|-----------------------------------------------------------------------------------------------------------------------------|-------------|
| <u>PART I</u>                                                                                                               |             |
| <u>Item 1. Business</u>                                                                                                     | 1           |
| <u>Item 1A. Risk Factors</u>                                                                                                | 1           |
| <u>Item 1B. Unresolved Staff Comments</u>                                                                                   | 11          |
| <u>Item 2. Properties</u>                                                                                                   | 21          |
| <u>Item 3. Legal Proceedings</u>                                                                                            | 21          |
| <u>Item 4. Submission of Matter to a Vote of Securities Holders</u>                                                         | 21          |
|                                                                                                                             | 22          |
| <u>PART II</u>                                                                                                              |             |
| <u>Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 22          |
| <u>Item 6. Selected Financial data</u>                                                                                      | 22          |
| <u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | 24          |
| <u>Item 7A. Quantitative and Qualitative Disclosures about Market Risk</u>                                                  | 25          |
| <u>Item 8. Financial Statements and Supplementary Data</u>                                                                  | 33          |
| <u>Item 9. Changes in and Disagreements With Accounting on Accounting and Financial Disclosure</u>                          | 33          |
| <u>Item 9A. Controls and Procedures</u>                                                                                     | 33          |
| <u>Item 9B. Other Information</u>                                                                                           | 33          |
|                                                                                                                             | 34          |
| <u>PART III</u>                                                                                                             |             |
| <u>Item 10. Directors and Executive Officers of the Registrant</u>                                                          | 34          |
| <u>Item 11. Executive Compensation</u>                                                                                      | 34          |
| <u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>              | 34          |
| <u>Item 13. Certain Relationships and Related Transactions</u>                                                              | 34          |
| <u>Item 14. Principal Accounting Fees and Services</u>                                                                      | 34          |
|                                                                                                                             | 35          |
| <u>PART IV</u>                                                                                                              |             |
| <u>Item 15. Exhibits and Financial Statement Schedules</u>                                                                  | 35          |
|                                                                                                                             | 35          |

## Part I

### Item 1. Business

#### Overview

We are a leading online retailer of jewelry, featuring a live auction format. We have established our retail brand in the online marketplace by offering high-quality merchandise, a unique user-friendly shopping experience, and the opportunity for buyers to achieve significant cost savings versus traditional retail channels. A key to our success has been our ability to efficiently and cost effectively source closeout and regular jewelry merchandise, and rapidly respond to changing consumer demands for certain jewelry. We offer our products through a continuous live format, featuring a \$1 minimum opening bid, and a unique 15-second auction extension period that allows our auctions to continue until all bids are received. On select auctions we maintain a reserve price that must be met before a sale will be consummated. In 2009, we plan to offer auctions with a minimum opening bid that is higher than \$1. The majority of our auctions are short-term, often lasting less than one hour, providing immediate gratification to our customers and encouraging frequent visits and active viewing of our website.

In addition to our auction site we have a fixed pricing format that offers similar items of merchandise as those listed for auction. This online store provides us access to different types of consumers, and we plan to offer customers the ability to design their own jewelry including diamond earrings and rings in the near future.

Our product inventory includes gold, platinum, and silver jewelry set with diamonds, rubies, emeralds, sapphires, and other precious and semi-precious stones; watches and accessories. We believe we are the second largest online retailer of jewelry based on revenue and the largest online jewelry auction site based on web traffic.

In line with our growth plans, we completed a major upgrade of our auction platform at the end of 2007. The new auction LiveBid system supports a broad range of leading browser software including Microsoft Internet Explorer, FireFox and Safari. The new system touts high availability, faster end-user response time and greater scalability among the key features delivered in this release. We have leveraged this new software solution to launch additional site features and our new online retail store. We launched the Spanish version of our website in May 2008, the Arabic version in October 2008 and the German version in December 2008.

The following aspects of our innovative auction model differentiate us from other auction websites:

- \$1 minimum bid format,
- interactive auctions with 15-second time extensions for all auctions each time a bid is received within 15 seconds of termination of the auction, and
- short term auctions, often lasting less than one hour, providing our customers immediate gratification to encourage frequent visits and active viewing of our website.

There is no charge to a potential buyer for registering on our website or placing bids. Buyers have access to a broad selection of items without expensive additional markups or commissions to intermediaries. Our website offers detailed product information, including photographs of our merchandise. Our website also provides a dynamic display of auto-refreshing screens, enabling our customers to follow our in-progress auctions in real-time. Successful bidders are automatically notified when an auction is completed. To assist users further, we offer customer support via phone, live-help and e-mail seven days a week. We provide a mechanism for our customers to provide comments and feedback on their bidding and purchasing experience.

We purchase jewelry inventory directly from manufacturers and liquidators. We also closely monitor our sales trends to assess consumer demand for certain jewelry styles and categories and purchase such non-closeout inventory directly from manufacturers. We have eliminated various inefficiencies and mark-ups associated with traditional intermediaries in the jewelry market. Our sourcing model provides a critical alternative liquidation channel for manufacturers, for which disposal of closeout inventory represents a significant challenge. We have the flexibility to purchase a variety of lot sizes, and our centralized warehouse and fulfillment center enables our suppliers to ship their products to a single location, easing the burden on their infrastructures. We have developed a database of product descriptions and pictures that enables us to rapidly post inventory for sale. In addition, we closely monitor sales and gross margin trends of our products on a daily basis, allowing us to select carefully additional products for purchase and adjust supplier pricing as necessary.

## History

We commenced operations in early 1998 by offering a limited selection of merchandise for sale on eBay's website through our predecessor, Asset Lenders of America, a group of 11 collateral lending stores. In the fall of 1998, we formed Bidz.com, Inc. as a California corporation, acquired Asset Lenders of America, and purchased the domain name *www.bidz.com*. In February 1999, we launched the *www.bidz.com* website and began offering closeout jewelry through our auction format. In November 1999, we merged Asset Lenders of America into our Company. In June 2006, the Company reincorporated in the state of Delaware.

## Industry Overview

### Growth of Online Commerce and the Online Auction Market

The Internet's development into a significant global medium for communication, content, and commerce has led to substantial growth in online shopping and has provided online retailers with new opportunities to eliminate intermediaries from the traditional retail supply chain. Internet usage and online commerce continue to grow worldwide. The growth can be attributed to factors such as an increased awareness of the convenience of online shopping, an expanded range of products available online, improvements in security and electronic payment technology, and increased access to broadband Internet connections facilitating online shopping.

Online auction sites have created a robust global marketplace, which overcomes the inefficiencies associated with traditional auction purchasing while offering the benefits of online commerce. Companies such as eBay spearheaded the creation of a centralized online auction market, offering buyers a significantly broader selection of goods to purchase. Today, online auction sites offer significant convenience, allowing trading at all hours and providing continually updated product offerings. By leveraging the interactive nature of the Internet, our website also enables customers to experience the excitement of live auctions, including the competitive bidding process.

### The Jewelry Market

Jewelry is designed and manufactured by a large number of manufacturers, generally with small operations. Jewelry manufacturers sell to a variety of wholesalers, distributors, and retailers. Jewelry in turn is sold to consumers through a variety of jewelry stores. The U.S. jewelry retail market consists primarily of small, independent stores, regional operators, and a limited number of national retail chains, such as Tiffany & Co., Zales, and Kay Jewelers. Multi-line department and discount stores and others also sell jewelry, such as Wal-Mart, Target, J. C. Penney, and Costco, as well as enterprises such as QVC and Home Shopping Network. Despite the presence of major jewelry retail chains, a majority of the jewelry retail business remains fragmented.

Manufacturers traditionally hold inventory to buffer against uncertain demand within their normal, offline sales channels. Manufacturers' primary distribution channels consist of regular sales to major established retailers at wholesale prices and sales to wholesalers that service smaller retail chains. In recent years, several dynamics have shifted inventory risk from retailers to manufacturers, including the following:

- dominant retailers insisting on just-in-time deliveries from manufacturers,
- dominant retailers often demanding to cancel orders mid-production and returning unsold merchandise,
- rapid changes in style, color, or models, turning inventory into closeout merchandise,
- incorrect estimates of consumer demand leading to overproduction, and
- changes in a retailer's financial situation or strategy resulting in cancelled orders.

Disposal of closeout jewelry represents a significant challenge for many manufacturers and liquidators. Manufacturers often use multiple channels, such as catalogs, resellers, liquidators, and small retailers, to sell their closeout jewelry inventory as a result of the wide variety in lot size of their products. Multiple channels create additional logistical burdens and reduce the control of manufacturers over distribution.

Manufacturers are often required to adhere to delivery and quantity specifications. If a manufacturer does not meet required delivery schedules or specifications, or products are unsold, the products may be returned to the manufacturer. In both cases, manufacturers rarely meet their costs on their closeout products. Manufacturers often opt to melt down the jewelry into its component parts and reconstruct jewelry pieces with current season styles. The melt-down process is difficult, requires skilled labor, and results in a very low return on manufacturing costs.

## Our Value Proposition

### *Value to Buyers*

Through online auctions and the fixed price online store on our website, we believe that we offer value to a broad range of customers by providing the following:

***Bargain prices.*** The price of all our products is dictated by the buyer alone based on that buyer's valuation of the product. Therefore, many items offered on our website are sold at a substantial discount to the prices in traditional retail channels, such as at jewelry stores located in shopping malls. Our \$1 minimum bid policy allows the savvy or lucky consumer the potential to purchase any product being auctioned for only \$1, offering even greater value to the consumer. Regardless of the closing price, once an auction is closed for those auctions without a reserve price, the final bidder will receive the product.

***Entertaining auction format.*** We offer our customers the excitement of winning an item that may not be available in the future. We offer short-term, live auctions, many lasting less than one hour, providing our customers an alternative to the traditional, longer auction format. We believe the shorter time frame of our auctions encourages repeat visits and active viewing of our website.

***Broad product selection.*** We offer a broad selection of jewelry, including rings, necklaces, earrings, bracelets, jewelry sets, and watches. Our selection includes gold and silver jewelry, as well as jewelry with precious and semi-precious stones.

***Product quality assurance.*** We provide detailed and accurate descriptions of each product. Our trained product specialists inspect our jewelry, utilizing the Gemological Institute of America Diamond and Colored Stone Grading System prior to posting on our website for auction. We guarantee the quality of our products through our 15-day return policy on all of our merchandise with a money-back guarantee if the product is not as described on our website. Items that are returned that are identical to their description are subject to a restocking fee, which is 15% of the original purchase price and shipping fees are non-refundable. Our commitment to quality and product description accuracy is demonstrated by consistently low return rates on our items, which were approximately 3% of all items sold in 2008.

***Prompt fulfillment and responsive customer service.*** We maintain in inventory all the products we offer on our website, enabling us to ensure prompt order fulfillment and delivery to our customers. Our customer service representatives are available seven days a week, via telephone, live-help and e-mail, and are trained to provide assistance and answer a broad range of questions regarding payment, delivery, and other matters.

***Positive shopping experience.*** Our easy-to-navigate website provides our customers with clear and detailed information about our products, including multiple photographs of many items. Customers can bid on our products 24 hours a day, seven days a week. Buyers are provided a five-day payment grace period on all products purchased.

### *Value to Suppliers*

Jewelry manufacturers continually look for a cost-effective, efficient way to sell their regular and closeout inventory. Our ability to purchase jewelry in various quantities provides a critical one-stop inventory clearance alternative for manufacturers and an efficient sales channel for liquidators that purchase closeout inventory from manufacturers.

***Single source for product disposition.*** Unlike many multi-store retail chains that often require large lot purchases to stock appropriate levels of inventory at their multiple locations, we have the flexibility to buy and sell both small and large jewelry lots in a highly efficient manner. As a single source for the sale of regular and closeout jewelry products, we provide suppliers with greater control of distribution by reducing the need to spread products across multiple channels. In addition, manufacturers and liquidators are often required to adhere to stringent product quantity and delivery schedule requirements. Products not delivered on time or in exact amounts are returned. We have the flexibility to tailor our purchasing to a supplier's needs with regard to quantity, variety, and timing.

***Resolution of channel conflict.*** Manufacturers seek to avoid liquidating their products through traditional retail channels in which their discounted products may be sold alongside their full-price products. Such side-by-side selling can result in weaker pricing and decreased brand strength, which is known as channel conflict or sales channel pollution. As a result, many manufacturers turn to liquidation wholesalers and discount retailers. These liquidation channels, however, provide manufacturers limited control over distribution and are unreliable and expensive to manage. Because we offer an alternate online distribution channel that focuses on the auction sale of jewelry, our suppliers are able to sell their discounted jewelry

independently of their full-priced products. We believe this enables our suppliers to avoid customer confusion and potential loss of sales of their full-priced jewelry products.

***Profitable alternative for suppliers.*** We eliminate the various inefficiencies and mark-ups associated with traditional intermediaries, and our high volume of sales from a single location provides us with favorable inventory turnover and lower inventory carrying and handling costs versus traditional jewelry retailers. Manufacturers can also sell excess products to us rather than expend the labor and cost of melting and reworking their gold, platinum or silver products.

## Growth Strategy

Our objective is to become the leading online jewelry retailer. We intend to achieve this objective through the following strategies:

***Expanding our customer base*** by maintaining and expanding our relationships with third-party search engines, Internet portals, and websites and by increasing our online advertising expenditures within these channels;

***Enhancing sourcing relationships*** by expanding the number of suppliers from which we opportunistically purchase regular and closeout inventory, thereby assuring consistent availability of a wide variety of designs and styles of jewelry, and purchasing for cash from suppliers that do not extend credit terms and to obtain better supplier pricing;

***Increasing the breadth and depth of our product offerings*** by increasing available inventory within specific jewelry categories, allowing us to make more jewelry categories available and enabling us to list more auction items on a daily basis;

***Continuing to build market share for our online jewelry retail store Buyz.com*** by allowing fixed price items to be sold that will complement our core auction format; and

***Focusing on new international markets*** by expanding into and creating a strong presence in a number of English-speaking countries, including the United Kingdom, Canada, Australia, Ireland, and New Zealand, along with the newly introduced foreign language versions of our website: Spanish, Arabic and German.

## Marketing

Our marketing strategy is designed to generate consumer traffic by increasing awareness of our website and recognition of our brand, building a loyal buyer base, and maximizing repeat purchases. Our website has experienced substantial growth in users and buyers, as evidenced through data compiled by us through the measurement tools on our website.

Our marketing and advertising efforts consist primarily of the following initiatives:

***Search marketing:*** We purchase search engine advertising primarily at an auction based price, which is paid each time a potential customer clicks on one of our advertisements. We currently maintain advertising relationships with, among others, Google (US, Australia, Canada, European Union, South East Asia, Mid East and South America), Yahoo (US, and Australia), MSN for search engine advertising.

***Online banner marketing:*** We utilize banner advertisements from the largest banner advertising channels. We focus on contextual and behavioral advertisements that appear on websites related to jewelry, fashion, shopping and women's lifestyle. The Company maintains portal advertising relationships with Yahoo, MSN, Casale Media, Advertising.com, ValueClick Media, AOL and others. The fee structure for our purchase of banner advertisements is based on a set price for an action (such as clicks or new buyers), or on a cost per thousand basis, for which we pay a set fee per thousand banner advertisements that appear on the selected websites.

***E-mail campaigns:*** We utilize an electronic direct marketing program to encourage prospect activation, customer referrals, customer retention, repeat purchases and customer acquisition. This program includes permission-based e-mail marketing to visitors who indicate a desire to continue to receive product recommendations and promotional discounts. We purchase e-mail direct marketing for a set fee per thousand e-mails sent or for each new lead from websites and marketing agencies that meet our policies against spamming. We also purchase on a cost per action basis such as clicks, new registration users and new buyers.

***Affiliate programs:*** We attract customers by participating in affiliate programs. Our affiliate programs offer other website operators an opportunity to earn commissions by providing their visitors access to our website. We use Link Share for our U.S. and U.K. programs and Commission Junction for our European affiliate programs. We also work with several other Affiliate Networks including Azoogle, Hydra Media and Neverblue Media. In so doing, we intend to extend the reach of our website and draw customers from a variety of other websites. By participating in our affiliate programs, website publishers earn volume-based commissions by directing customers to our website.

## **Sourcing Strategy**

We purchase closeout inventory directly from manufacturers, site-holders and liquidators. We also closely monitor our sales trends to assess consumer demand for certain jewelry styles and categories and purchase regular jewelry inventory directly from manufacturers. We have eliminated various inefficiencies and mark-ups associated with traditional intermediaries in the jewelry market. Our sourcing model provides a critical alternative liquidation channel for manufacturers, for which disposal of closeout inventory represents a significant challenge. We have the flexibility to purchase a variety of lot sizes, and our centralized warehouse and fulfillment center enables our suppliers to ship their products to a single location, easing the burden on their infrastructure. We have developed a database of product descriptions and pictures that enables us rapidly to post inventory for sale. In addition, we closely monitor sales and gross margin trends of our products on a daily basis, allowing us to select carefully additional products for purchase and adjust supplier pricing as necessary.

We identify manufacturers and liquidators with high-value products by capitalizing on our extensive experience in the jewelry industry. Our jewelry sourcing model capitalizes on our close industry relationships to avoid several layers of supply chain intermediaries and the mark-ups associated with additional intermediaries. We closely monitor the historical sales trends of our products on a daily basis.

We do not have any formal or binding supply agreements with any of our suppliers, manufacturers, distributors, or other suppliers. We purchase and carry inventory in the majority of the products we offer for sale to ensure availability and expedited delivery. In an effort to achieve a more diverse supplier base, we have started to acquire substantially more high-end brand name products. Currently, we acquire inventories from our suppliers on a cash and revolving credit basis with payment typically due within 60 to 90 days. This strategy will allow for more flexibility to increase our product selection, reduce our product costs, and enlarge our supply relationships by allowing us to purchase from vendors that do not extend credit to their customers.

We also purchase, from time to time, loose diamonds and semi-precious stones and deliver them to manufacturers to produce into finished jewelry inventory. This source of inventory allows us to reduce our product costs.

On a selective and limited basis, we take consignment inventory from our vendors to sell on our website. Since we only make payment for the inventory when payment is made by our customers this arrangement is beneficial to our cash flow. Sales of such merchandise remain small as our main focus is on closeout inventory.

## **Merchandising Strategy**

We seek to maintain profitability while providing variety and value to our customers by carefully selecting the types of products we post on our website at any given time, the duration of the auction for each item, and the frequency with which we re-post comparable items after sales. We actively monitor our auctions and sales so that we are able to adjust continually the makeup and quantity of goods on our website at any given time. Since bids on all merchandise start at \$1, losses are incurred on approximately 15% to 25% of the items sold on an annual basis. The risks associated with a \$1 minimum bid auction are mitigated by profits generated from items sold at a gain, which resulted in an overall 28.3% gross profit margin in 2008.

We post more expensive items with longer auction durations, typically running for two to three days, allowing customers to peruse the piece and make thoughtful decisions. Less expensive items are selected for shorter auctions, typically running for an hour or less, creating more excitement for the product and providing the customer with more immediate gratification. Items purchased in bulk are slotted for posting sequentially so that all items simultaneously posted on our website are unique.

## **Technology Operations**

Both our website user interface and back-office transaction processing systems are internally developed. This proprietary system maintains records for our registered users, sales invoicing and cash receipts, auction transactions, inventory control, and historical transaction data. Our system handles all aspects of the auction process, including notifying users via e-mail of auction status.

Our system architecture is built on industry-standard platforms that are designed to provide continuous service 24 hours a day, 365 days per year. Our website and back-office servers are located at a third-party co-location facility operated by Savvis Inc. in El Segundo, CA. Savvis provides redundant internet connectivity, physical security, climate control, redundant power delivered through a 100% uptime guarantee. The back-office processing system is housed in our headquarters in Culver City, and communicates with Savvis over four independent T1 lines. Our systems include both Oracle and Microsoft SQL database engines operating in a multi-processing Microsoft Windows environment designed to accommodate large volumes of online traffic and are configured for high fault tolerance with redundancy and load balancing. Our Internet servers utilize VeriSign Inc. digital certificates to provide secure website communications for sales and payment transactions.

In the third quarter we implemented a major system upgrade that has moved our primary back-office processing systems to Savvis Inc. This move followed the migration of our primary auction platform to Savvis in the fourth quarter of 2007.

We are continuing to plan and are currently implementing a standard ERP solution, Microsoft Dynamics AX that will integrate financial functions along with company operations including: Inventory and Warehouse Management (WHMS), Order Processing (OMS), and Customer Relationship Management (CRM) along with reporting and analytics functions.

We are currently planning to develop a second co-location in a different geographic region to provide greater load balancing and disaster recovery. We utilize the firewall protection and the services of TrustWave, which provides regular scanning of our systems for security vulnerabilities and PCI compliance.

At December 31, 2008, we had a technology and development staff of 20. We have structured the technology and development functions into two distinct departments: software development and production support. We anticipate that we will continue to devote significant resources to product development and product management in the future as we add new features and functionality.

### **Customer Service and Fulfillment Operations**

An important element of our sales strategy is to provide a high level of customer service support in order to establish long-term relationships with our customers and encourage repeat visits and purchases. Our customer service support staff provides detailed payment, billing, and delivery guidance and is trained to answer a broad array of questions regarding auctions and payments conducted on our website. Our informed and helpful staff together with the informative and educational aspects of our website, promote customer confidence in purchase decisions.

At December 31, 2008, we had a customer service and billing staff of 24. We utilize automated online live-help, e-mail and phone systems to route traffic to our customer service and billing support representatives to provide personalized assistance. The customer service center operates between the hours of 8:00 a.m. and 5:00 p.m., Pacific time, seven days a week for telephone support and 24 hours a day for online live-help and e-mail support. We outsource substantially all of our online live-help and e-mail support.

Customers may utilize the following payment methods: credit card, money orders, and checks. We also offer our customers the opportunity to make payments using PayPal and Bill-Me-Later services. We require payment to be received by us prior to shipping the merchandise.

We maintain a fraud prevention department to detect suspect payments. Our internal system flags suspect payments when the billing address or other pertinent information does not match cardholder information. Our fraud prevention department then requests that the customer provide additional information to verify identity before shipment is released.

We provide our customers with a five-day grace period to pay for products won through auctions. If payment is not received by the fifth day, the purchase order lapses and the product is cycled back into inventory. If a customer purchases additional items during the five-day period, we offer the customer the opportunity to save on shipping by aggregating all purchased items into one shipment. If payment is not made within the five-day period, the product is offered for auction again and thus the same item may be auctioned more than once.

Our goal is to fulfill purchase orders on a timely, secure, and accurate basis. We inspect and track each product at all stages of the receiving and order fulfillment process. Following payment, the merchandise is processed for shipment. Customer orders are typically delivered within seven business days, depending on the shipping method. Most purchases are delivered with signature or delivery confirmation. We ship all products via nationally recognized carriers, such as Federal Express and the U. S. Postal Service.

We have a 15-day return policy on all of our merchandise with a money-back guarantee if the product is not as described on our website. Items that are returned that are as described are subject to a 15% restocking fee. Our facility has security controls with restricted access and has been designed for the prompt receipt, storage, and shipment of our products. In addition, we have security guards on duty 24 hours a day, seven days a week to patrol the premises. Security is complemented by video and alarm surveillance.

### **Seasonality**

Historically, sales in the jewelry industry are seasonal and have been higher in the fourth quarter as a result of higher consumer spending during the December holiday shopping season. Approximately 28.5%, 33.8% and 16.9% of our net revenue was generated during the fourth quarter of 2006, 2007 and 2008, respectively. The fourth quarter of 2008 was an exception as we encountered a significant slowdown in sales resulting from the 2008 financial and economic crisis. As we continue to grow, we expect to experience more pronounced seasonal fluctuations in our net revenue and anticipate a disproportionate amount of our revenue will be in the fourth quarter.

## **Competition**

The online jewelry auction market is new, rapidly evolving, and intensely competitive with relatively low barriers to entry, as new competitors can launch websites at relatively low cost. We believe that competition in the online jewelry market is based predominantly on the following:

- price,
- product quality and selection,
- vendor reliability,
- shopping convenience,
- customer service, and
- brand recognition.

We currently compete with a variety of online auction jewelry sellers, such as eBay and uBid; online liquidation companies, such as Overstock; and online jewelry retailers, such as Blue Nile. We also compete with traditional offline jewelry retail chains, such as Zales, Finlay Fine Jewelry, and Reed's Jewelers, as well as with department and discount and other stores that sell jewelry at wholesale prices, such as Wal-Mart, Target, J. C. Penney, and Costco, as well as with QVC and Home Shopping Network. We compete primarily on the basis of our prices, the selection of merchandise, and our website functionality and ease-of-use. The negative factors relating to our competitive position relate primarily to the relative size and name recognition of our competitors.

As the online regular jewelry and liquidation market grows, we believe that companies involved in online retail, as well as traditional retailers and liquidation brokers, will increase their efforts to develop services that compete with our online services. We also face potential competition from online companies not yet focused on the liquidation market and from retail companies not yet operating online.

Many of our competitors have greater brand recognition, longer operating histories, larger customer bases, and significantly greater financial, marketing, and other resources than we do. Smaller competitors may enter into strategic or commercial relationships with larger, more established and well-financed companies. Some of our competitors could enter into exclusive distribution arrangements with our suppliers and deny us access to their products, devote greater resources to marketing and promotional campaigns, and devote substantially more resources to their website and systems development than we do. New technologies and the continued enhancement of existing technologies also may increase competitive pressures on us.

## **Intellectual Property**

We regard our domain names and similar intellectual property as critical to our success. As of January 2009, we hold registered trademarks for "Bidz.com" and the Bidz.com Logo. We currently do not hold any patents pertaining to intellectual property surrounding the technology and business processes utilized by Bidz.com. We have however filed patent applications with the US patent office for 5 inventions. We also rely on a combination of laws and contractual restrictions with our employees, customers, suppliers, affiliates, and others to establish and protect our proprietary rights. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our intellectual property without authorization. In addition, others may independently develop substantially similar intellectual property. Although we are pursuing the registration of our additional trademarks and patents in the United States, some of our trade names are not eligible to receive trademark protection. In addition, effective trademark and patent protection may not be available or may not be sought by us in every country in which our products are made available online.

From time to time, we may be subject to legal proceedings and claims in the ordinary course of our business, including claims of alleged infringement of the trademarks and other intellectual property rights of third parties. In addition, litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets, or to determine the validity and scope of our intellectual proprietary rights and those of others. Any such litigation, regardless of outcome or merit, could result in substantial costs and diversion of management and technical resources, any of which could materially harm our business.

## **Government Regulation**

We are subject to federal and state consumer protection laws, including laws protecting the privacy of consumer non-public 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, must provide advance notice of any changes to our policies and, with limited exceptions, must give consumers the right to prevent sharing of their non-public personal information with unaffiliated third parties. Furthermore, the growth and demand for online commerce could result in more stringent consumer protection laws that impose additional compliance burdens on online retailers. These consumer protection laws could result in substantial compliance costs and could interfere with the conduct of our business.

Moreover, there is currently great uncertainty in many states whether or how existing laws governing issues such as property ownership, sales and other taxes, and libel and personal privacy apply to the Internet and commercial online retailers. These issues may take years to resolve. For example, tax authorities in a number of states, as well as a Congressional advisory commission, are currently reviewing the appropriate tax treatment of companies engaged in online commerce, and new state tax regulations may subject us to additional state sales and income taxes. New legislation or regulation, 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 could have an adverse effect on our results of operations. Furthermore, there is a possibility that we may be subject to significant fines or other payments for any past failures to comply with these requirements.

Numerous states and foreign jurisdictions, including California, where our headquarters is located, have regulations regarding how auctions may be conducted and the liability of auctioneers in conducting such auctions. No final legal determination has been made whether the California regulations apply to businesses such as the business we conduct, and little precedent exists in this area. Several states and some foreign jurisdictions have attempted, and may attempt in the future, to impose such regulations upon companies similar to us and their customers, which could harm our business. Regulatory and licensure claims could result in costly litigation or could require us to change our manner of doing business in ways that increase our costs or reduce our revenue or force us to prohibit listings of certain items for some locations. We could also be subject to fines or other penalties. Any of these outcomes could harm our business.

California applies the burden of security risks to those owning and operating computer systems and networks, under a mandatory disclosure law (SB 1386). Companies holding computerized personal information of California residents are required to take steps either to encrypt this personal information or adopt, as part of an information security policy, notice and disclosure procedures for any computer security breaches, whether or not the breach occurs in California. If we were found to be noncompliant we would be subject to civil suits, including class actions, for damages and injunctive remedies in California courts.

### **Employees**

At December 31, 2008, we had 164 full-time and 1 part-time employee. We may utilize part-time employees, temporary employees, and independent contractors to respond to fluctuations in our business. None of our employees are covered by a collective bargaining agreement with us, and we consider our relations with our employees to be good.

We have an agreement with Administaff, a professional employer organization, to manage all payroll processing, workers' compensation, health insurance, and other employment-related benefits for our employees. Although Administaff processes our payroll and pays our workers' compensation, health insurance and other employment-related benefits, we are responsible for such payments and for complying with state and federal employment regulations, as well as all personnel management policies and procedures that are maintained by Administaff. We pay Administaff a fee based on the aggregate salaries paid to our employees for these services.

### **Delaware Reincorporation**

On June 22, 2006 the Company reincorporated in the state of Delaware. In connection with our reincorporation in Delaware, we are authorized to issue 100,000,000 shares of common stock, \$0.001 par value, and 4,000,000 shares of undesignated preferred stock, \$0.001 par value.

The following discussion describes the Delaware Certificate of Incorporation and the Bylaws that were adopted and is intended to be a summary and does not describe all provisions of our certificate of incorporation or bylaws or Delaware law that may be applicable to us. For a more thorough understanding of the terms of our capital stock, you should refer to our certificate of incorporation and bylaws, which have been filed as exhibits to this report.

### **Common Stock**

The holders of common stock are entitled to one vote per share on all matters to be voted upon by stockholders. There will be no cumulative voting. Subject to preferences that may be applicable to any outstanding preferred stock, holders of common stock are entitled to receive ratably such dividends as may be declared by our Board of Directors out of funds legally available for that purpose. In the event of the liquidation, dissolution, or winding up of our company, the holders of common stock are entitled to share ratably in all assets remaining after payment of liabilities and the liquidation preferences of any outstanding preferred stock. The common stock has no preemptive or conversion rights, other subscription rights, or redemption or sinking fund provisions.

### **Preferred Stock**

Our certificate of incorporation authorizes our Board of Directors, without any vote or action by the holders of our common stock, to issue preferred stock from time to time in one or more series. Our Board of Directors is authorized to determine the number of shares and to fix the designations, powers, preferences, and the relative, participating, optional, or other rights of any series of preferred

stock. Issuances of preferred stock would be subject to the applicable rules of Nasdaq or other organizations on which our securities are then quoted or listed. Depending upon the terms of preferred stock established by our Board of Directors, any or all series of preferred stock could have preference over the common stock with respect to dividends and other distributions and upon our liquidation. If any shares of preferred stock are issued with voting powers, the voting power of the outstanding common stock would be diluted. No shares of preferred stock are presently outstanding, and we have no present intention to issue any shares of preferred stock.

## **Anti-Takeover Effects of Provisions of the Certificate of Incorporation and Bylaws**

### *General*

Our Delaware certificate of incorporation, our bylaws, and the DGCL contain certain provisions that could delay or make more difficult an acquisition of control of our company not approved by our Board of Directors, whether by means of a tender offer, open market purchases, a proxy contest, or otherwise. These provisions have been implemented to enable us, particularly but not exclusively in the initial years of our existence as a publicly owned company, to develop our business in a manner that will foster our long-term growth without disruption caused by the threat of a takeover not deemed by our Board of Directors to be in the best interests of our company and our stockholders. These provisions could have the effect of discouraging third parties from making proposals involving an acquisition or change of control of our company even if such a proposal, if made, might be considered desirable by a majority of our stockholders. These provisions may also have the effect of making it more difficult for third parties to cause the replacement of our Board of Directors or our current management without the concurrence of our Board of Directors.

There is set forth below a description of the provisions contained in our Delaware certificate of incorporation and bylaws and the DGCL that could impede or delay an acquisition of control of our company that our Board of Directors has not approved. This description is intended as a summary only and is qualified in its entirety by reference to our certificate of incorporation and bylaws, which are included as exhibits to this report, as well as the DGCL.

### *Authorized but Unissued Preferred Stock*

Our certificate of incorporation authorizes our Board of Directors to issue one or more series of preferred stock and to determine, with respect to any series of preferred stock, the terms and rights of such series without any further vote or action by our stockholders. The existence of authorized but unissued shares of preferred stock may enable our Board of Directors to render more difficult or discourage an attempt to obtain control of our company by means of a proxy contest, tender offer, or other extraordinary transaction. Any issuance of preferred stock with voting and conversion rights may adversely affect the voting power of the holders of common stock, including the loss of voting control to others. The existence of authorized but unissued shares of preferred stock will also enable our Board of Directors, without stockholder approval, to adopt a “poison pill” takeover defense mechanism. We have no present plans to issue any shares of preferred stock.

### *Number of Directors; Removal; Filling Vacancies*

Our certificate of incorporation and bylaws provides that the number of directors shall be fixed only by resolution of our Board of Directors from time to time. Our certificate of incorporation provides that directors may be removed by stockholders for cause by the affirmative vote of a majority of the shares entitled to vote. Delaware law provides that vacancies on the Board of Directors may be filled only by a majority vote of the remaining directors or by the sole remaining director.

### *Classified Board*

Our certificate of incorporation provides for our board to be divided into three classes, as nearly equal in number as possible, serving staggered terms. Approximately one-third of our board will be elected each year. The provision for a classified board could prevent a party who acquires control of a majority of our outstanding common stock from obtaining control of the board until our second annual stockholders meeting following the date the acquirer obtains the controlling share interest. The classified board provision could have the effect of discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of us and could increase the likelihood that incumbent directors will retain their positions.

### *Stockholder Action*

Our certificate of incorporation provides that stockholder action may be taken only at an annual or special meeting of stockholders. This provision prohibits stockholder action by written consent in lieu of a meeting. Our certificate of incorporation and bylaws further provide that special meetings of stockholders may be called only by our Chairman of the Board of Directors, Chief Executive Officer, President, or Secretary, and shall be called by any such person at the request in writing of a majority of the Board of Directors. Stockholders are not permitted to call a special meeting or to require our Board of Directors to call a special meeting of stockholders.

The provisions of our certificate of incorporation and bylaws prohibiting stockholder action by written consent may have the effect of delaying consideration of a stockholder proposal until the next annual meeting unless a special meeting is called as provided above.

These provisions would also prevent the holders of a majority of the voting power of our stock from unilaterally using the written consent procedure to take stockholder action. Moreover, a stockholder could not force stockholder consideration of a proposal over the opposition of the Board of Directors by calling a special meeting of stockholders prior to the time our chairman or a majority of the whole board believes such consideration to be appropriate.

#### *Advance Notice for Stockholder Proposals and Director Nominations*

Our bylaws establish an advance notice procedure for stockholder proposals to be brought before any annual or special meeting of stockholders and for nominations by stockholders of candidates for election as directors at an annual meeting or a special meeting at which directors are to be elected. Subject to any other applicable requirements, including, without limitation, Rule 14a-8 under the Exchange Act, only such business may be conducted at a meeting of stockholders as has been brought before the meeting by, or at the direction of, our Board of Directors, or by a stockholder who has given our Secretary timely written notice, in proper form, of the stockholder's intention to bring that business before the meeting. The presiding officer at such meeting has the authority to make such determinations. Only persons who are nominated by, or at the direction of, our Board of Directors, or who are nominated by a stockholder that has given timely written notice, in proper form, to our Secretary prior to a meeting at which directors are to be elected, are eligible for election as directors.

#### *Amendments to Bylaws*

Our certificate of incorporation provides that only our Board of Directors or the holders of a majority of the shares entitled to vote at an annual or special meeting of stockholders have the power to amend or repeal our bylaws.

#### *Amendments to Certificate of Incorporation*

Any proposal to amend, alter, change, or repeal any provision of our certificate of incorporation requires approval by the affirmative vote of a majority of the voting power of all of the shares of our capital stock entitled to vote on such matters.

#### *Delaware Statutory Provisions*

**Anti-Takeover Provision of Delaware Law.** Under Section 203 of the DGCL, no Delaware corporation shall engage in a "business combination" with an "interested stockholder" for a period of three years following the date that the stockholder became an interested stockholder. "Business combination" includes a merger, consolidation, asset sale, or other transaction resulting in financial benefit to the interested stockholder. "Interested stockholder" is a person who, together with affiliates and associates, owns, or within three years, did own 15% or more of the corporation's voting stock. This prohibition does not apply if:

- prior to the time that the stockholder became an interested stockholder, the board of directors of the corporation approved either the business combination or the transaction resulting in the stockholder's becoming an interested stockholder,
- upon consummation of the transaction resulting in the stockholder's becoming an interested stockholder, the stockholder owns at least 85% of the outstanding voting stock of the corporation, excluding voting stock owned by directors who are also officers and certain employee stock plans, or
- at or subsequent to the time that the stockholder became an interested stockholder, the business combination is approved by the board and authorized at an annual or special meeting of stockholders, and not by written consent, by the affirmative vote of at least two-thirds of the outstanding voting stock that the interested stockholder does not own.

A Delaware corporation may elect not to be governed by these restrictions. We have not made such election. Although David Zinberg and Marina Zinberg each own more than 15% of our stock, they are not subject to the restrictions of Section 203.

#### **Limitation of Liability and Indemnification of Officers and Directors**

Our certificate of incorporation limits the liability of our directors to the fullest extent permitted by the DGCL. In addition, our certificate of incorporation and bylaws provide that we will indemnify our directors and officers to the fullest extent permitted by law.

#### **Indemnification for Securities Act Liabilities**

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted for directors, officers, or controlling persons pursuant to the provisions described in the preceding paragraph, we have been informed that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

## **Transfer Agent and Registrar**

The transfer agent and registrar for our common stock is American Stock Transfer & Trust Company. The transfer agent's address is 6201 15<sup>th</sup> Avenue, Brooklyn, New York 11219 and its telephone number is (718) 921-8124.

## **ITEM 1A. Risk Factors**

*We believe the risks and uncertainties described below are the most significant we face. The occurrence of any of the following risks could harm our business. In that case, the value of our common stock could decline, and you may lose part or all of your investment. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our operations.*

***The trading price in our common stock may be volatile and you may lose all or part of your investment.***

The market price of our common stock has been subject to significant fluctuations and these fluctuations could continue. Some factors that could affect the market price of our common stock are as follows:

- actual or anticipated changes in our operating results,
- our stock is subject to short selling and may cause trading in our common stock to be volatile,
- changes in research analysts recommendations or estimates of financial performance,
- changes in market valuation of similar companies, economic and general market conditions,
- announcements of significant contracts, company developments, commercial relationships, banking credit facilities, capital commitments, acquisitions or joint ventures,
- issuance of additional shares of common stock or other securities, and
- intellectual property or litigation developments.

Trading in our common stock may experience significant price and volume fluctuations and adversely affect the trading price of our common stock. Following periods of volatility in the market price of a public company's securities, securities class action litigation has often been instituted against that company. Such litigation could result in substantial cost and a diversion of management's attention and resources.

***The adverse domestic and global economic conditions or the perception of said conditions may have adverse effects on our growth and operating results.***

The continued success of our business depends on the willingness of our customers to spend in a discretionary manner. While we do offer lower priced merchandise and may consequently fare better than those who exclusively offer more expensive merchandise, jewelry is essentially perceived as a luxury good. If the economy continues to decline it will cause people to feel less comfortable purchasing discretionary goods and would cause a negative effect on our operating results. Our annual and quarterly operating results may vary significantly in the future based on economic factors over which we have little or no control. Because we have little or no control over these factors and/or their magnitude, our operating results are difficult to predict. Any substantial adverse change in the economic factors could negatively affect our business and results of operations.

***Our business has been and may continue to be significantly impacted by the decline in worldwide economic conditions, and the current uncertainty in the outlook for the global economy makes it more likely that our actual results will differ materially from expectations.***

Global financial markets have been experiencing extreme disruptions in recent months, including severely diminished liquidity and credit availability, declines in consumer confidence, declines in economic growth, increases in unemployment rates, and uncertainty about economic stability. There can be no assurance that there will not be further deterioration in financial markets and confidence in economic conditions. These economic uncertainties affect businesses such as ours in a number of ways, making it difficult to accurately forecast and plan our future business activities. The current tightening of credit in financial markets may lead consumers to postpone spending, which may cause our customers to reduce purchases of jewelry. Demand for jewelry is a function of the health of the economies in the United States and around the world. Since the US economy and other economies around the world are in a recession, the demand for jewelry has been and may continue to be adversely affected and therefore, demand for our jewelry products and our operating results have been and may continue to be adversely affected as well. We cannot predict the timing, strength or duration of any economic disruption or subsequent economic recovery, worldwide, in the United States, in our industry, or in the jewelry market. These and other economic factors have had and may continue to have a material adverse effect on demand for our jewelry products and on our financial condition and operating results.

***Our future operating results are highly dependent upon how well we manage our business to respond to the economic recession.***

Our annual and quarterly operating results may fluctuate based on how well we manage our business to respond to the economic recession. Some of these factors include the following:

- our ability to manage our sales and marketing efforts;
- our ability to structure our organization to achieve our operating objectives and to meet the needs of our customers; and
- our ability to manage expenses and inventory levels.

If we fail to manage our business effectively, our results of operations could be adversely affected.

***We will devote necessary resources to respond promptly and thoroughly to the SEC investigation.***

On February 10, 2009, the Securities and Exchange Commission (“SEC”) issued a subpoena to us to produce documents relating to the Company’s inventory reserve policies, as well as other matters. We intend to cooperate fully with the SEC’s formal investigation, and our management will devote the resources required to respond promptly and thoroughly to any request by the SEC for any additional information or documents. Although the investigation is in its preliminary stages, and it is therefore difficult to predict the time required by senior management to respond to it, we do not presently anticipate that the investigation will adversely affect management, our results of operations or our financial position. Until the investigation is concluded, however, it is difficult to assess its impact on us.

***We must continue to generate a high volume of visitor traffic to our website and convert those visitors into buyers.***

Our net revenue depends to a significant extent on the number of customers who visit our website to purchase merchandise and the dollar amount of their purchases. Generating increased traffic to our website and converting that traffic into buyers requires us to achieve effective results from our marketing campaigns; offer a wide variety of products that our customers can purchase at favorable prices; maintain a user-friendly shopping experience; ensure the satisfactory availability, performance, and reliability of our website, network infrastructure, and transaction processing systems; and provide high-quality customer service. Our business will be harmed if we are unable to increase our customer base and the dollar volume of the orders customers place with us.

***We are subject to “prank” bidding by persons who are not required to provide their identification.***

Presently, we do not require new users to our site to provide their identification upon registration. Consequently, from time to time we are subject to “prank” bidders who may win auctions but do not intend to purchase our merchandise. Although the Company rescues merchandise not purchased by such bidders, a large number of failed auctions in which winning bidders do not complete their purchases could adversely affect our results of operations.

***We may face increasing costs to acquire new customers.***

The acquisition of new customers is a key factor in increasing demand for our jewelry products and increasing our revenue. We currently attract new customers by driving traffic to our website using a marketing and advertising strategy that includes targeted keyword searches, online banner advertising, targeted e-mail advertising, and participation in affiliate programs. We do not maintain long-term contracts or arrangements with any companies, including any search engines, Internet portals, or other websites, and we may not successfully enter into additional relationships or maintain existing ones. In addition, traffic to our website could decline if our online marketing programs become less effective or the traffic decreases to the search engines, Internet portals, and websites with which we advertise. Our business could be materially and adversely affected if any substantial number of companies on which we advertise experience financial or operational difficulties or experience other corporate developments that adversely affect their performance. A failure to maintain or expand existing online advertising relationships or to establish additional online advertising relationships that generate a significant amount of traffic from other websites could result in decreased sales or limit the growth of our business.

***Our growth will depend on our ability to increase the popularity of our website, and we may not be able to do so effectively.***

We believe that continuing to increase the popularity of our website will be critical to expanding our business. Promoting and positioning our website will depend largely on the success of our marketing efforts and our ability to provide a variety and sufficient quantity of high-quality products at attractive prices in a convenient manner. Promoting our website will require us to increase our marketing budget and otherwise increase our financial commitment to creating and maintaining brand loyalty among users. Brand promotion activities may not yield increased revenue, and even if they do, any increased revenue may not offset the expenses we incur

in building our website popularity and our brand. If we do attract new users to our website, they may not conduct transactions on a frequent basis or in sufficient dollar amounts. If we fail to promote and maintain our website or incur substantial expenses in an unsuccessful attempt to promote and maintain our brand, our business would be harmed.

***We anticipate expanding our international sales activities, causing our business to become increasingly susceptible to numerous risks that could affect our profitability.***

In 2007 and 2008, 22.3% and 23.9%, respectively, of our net revenue was generated by shipments to customers outside of the United States. We plan, over time, to expand our reach into international markets. We do not, however, currently have any overseas fulfillment, distribution, or server facilities. We cannot be certain that we will be able to expand our global presence. In addition, there are certain risks associated with doing business on an international basis, including regulatory requirements, legal uncertainty regarding liability, tariffs, and other trade barriers, longer payment cycles, and potentially adverse tax consequences, any of which could adversely affect our business. Although our foreign sales historically have been denominated in U.S. dollars, we also may be subject to increased risks relating to foreign currency exchange rate fluctuations to the extent we decide to denominate our sales in foreign currencies.

***Customer complaints or negative publicity about our customer service could adversely affect our reputation and, as a result, our business could suffer.***

Customer complaints or negative publicity about our customer service could severely diminish consumer confidence and the use of our website. Effective customer service requires significant personnel expense, and this expense, if not managed properly, could significantly impact our profitability. The failure to manage or train our customer service representatives properly could compromise our ability to handle customer inquiries and complaints effectively. If we do not handle customer inquiries and complaints effectively, we may lose customer confidence. As a result, our revenue could suffer and our operating margin may decrease.

***Our limited operating history makes it difficult for us to forecast accurately net revenue and appropriately plan our expenses.***

We have a limited operating history. As a result, it is difficult to forecast accurately our sales or operating expenses. We base our estimated expense levels on our operating forecasts and estimates of future sales. Sales and results of operations are difficult to forecast because they generally depend on the number, dollar volume, and timing of the orders we receive, which are uncertain. Some of our expenses are fixed, making it difficult to adjust our spending in a timely manner to take into account any unexpected shortfall in sales. We may also be unable to adjust spending in a timely manner to compensate for any unexpected sales shortfall, which could cause our net income in a given quarter to be lower than expected.

***Quarterly financial results may not be consistent and impact our stock price.***

There are numerous influences on our quarterly financial results that extend beyond the normal seasonal trends. Fluctuations that are under our control include: our ability to influence the timing and quantity of items we place for auction; our decision to acquire merchandise at favorable prices; our expenditures on marketing and our ability to attract customer visits to our website. Fluctuations that are not under our control that may directly impact our quarterly financial results include: changes in market price for precious metals and gems; changes in consumers' discretionary income and demand for our products; and changes in fashion trends.

***We may be at risk to accurately report financial results or detect fraud if we fail to maintain an effective system of internal controls.***

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the Securities and Exchange Commission adopted rules requiring public companies to include a report that contains an assessment by management on the company's internal control over financial reporting in their annual reports on Form 10-K. In addition, the independent registered public accounting firm auditing the company's financial statements must attest to and report on our assessment of the effectiveness of the internal controls over financial reporting. While we are consistently working on improvements and conducting rigorous reviews of our internal controls over financial reporting, our independent auditors may interpret Section 404 requirements and apply related rules and regulations differently. If our independent auditors are not satisfied with our internal control over financial reporting or with the level at which it is documented, operated or reviewed, they may decline to attest to management's assessment or issue a qualified report. Additionally, if we are not able to meet all the requirements of Section 404 in a timely manner or with adequate compliance, we might be subject to sanctions or investigation by regulatory authorities, such as the Securities and Exchange Commission.

Future changes in our accounting, financial reporting, and regulatory environment may create new areas of risk exposure. Failure to modify our existing control environment accordingly may impair our controls over financial reporting and cause our investors to lose confidence in the reliability of our financial reporting, which may adversely affect our stock price.

***We do not have a guaranteed supply of jewelry products, and we have a concentration of inventory purchases from our top two suppliers.***

The success of our business depends, in part, on our ability to offer our customers a wide variety of jewelry that they can purchase at prices that are substantially below those of traditional jewelry retailers. We do not have any formal or binding supply agreements with any of our manufacturers, distributors, or other suppliers for our supply of jewelry products. As a result, we do not have a guaranteed supply of jewelry products at favorable prices. Our inability to maintain and expand our jewelry supply relationships or the inability of our suppliers to continue to supply us with jewelry products at favorable prices would substantially harm our business and results of operations.

In addition, we have a concentration of inventory purchases from a small number of suppliers. Our top two suppliers accounted for approximately 31.1%, 24.0% and 14.6% of our total purchases in 2006, 2007, and 2008, respectively.

***We may give substantial deposits of inventory to our manufacturing vendors to produce finished jewelry products.***

We may be at risk of loss for the diamonds, precious and semi-precious gems that we have given to our manufacturing vendors to produce into finished jewelry products. If the businesses of the vendors fail, the diamond inventory is lost or stolen, the vendors do not have adequate insurance coverage or if the vendors fail to produce and deliver finished jewelry products, we would incur substantial losses that would have a material impact on our net income and financial position.

***Competition from online auctioneers and other online companies with greater brand recognition may adversely affect our sales.***

The market for online auctions is rapidly evolving and intensely competitive. We expect competition to intensify further in the future. Barriers to entry are relatively low, and current and new competitors can launch new websites at relatively low cost using commercially available software.

We currently compete with a number of other companies, and other competitors may appear in the future. Our competitors currently include various online auction services and retailers that offer jewelry, including eBay, Blue Nile, Overstock, and uBid. We also encounter competition from national jewelry retail chains, such as Zales, Kay Jewelers, and Finlay Fine Jewelry, and mass retailers and other enterprises that sell jewelry, such as Wal-Mart, Target, J. C. Penney, Costco, QVC, and Home Shopping Network. Many of our competitors have greater brand recognition, longer operating histories, larger customer bases, and significantly greater financial, marketing, and other resources than we do. Smaller competitors may enter into strategic or commercial relationships with larger, more established, and well-financed companies. Other competitors may enter into exclusive distribution agreements with our suppliers that deny us access to suppliers' products. Competitors may also devote greater resources to marketing and promotional campaigns and to website and systems technology than we do. We may not be able to compete successfully against current and future competitors or address increased competitive pressures. Furthermore, attempts have been made in the past to develop and market synthetic stones and gems to compete in the market for gemstones and gemstone jewelry. We expect such efforts to continue in the future. If any such efforts are successful in creating widespread demand for synthetic or alternative gemstone products, demand and price levels for our products could decline and our business and results of operations would be substantially harmed.

***We rely heavily on the sale of jewelry for our net revenue, and demand for these products could decline.***

Luxury products, such as jewelry, are discretionary purchases for consumers. The volume and dollar amount of such purchases may be affected by adverse trends in the general economy and consumer perceptions of those trends, and purchases may significantly decrease during economic downturns. The success of our business depends in part on macroeconomic factors, such as employment levels, salary levels, tax rates, and credit availability, all of which affect disposable income and consumer spending. Any reduction in disposable income or consumer spending may affect us more significantly than companies in other industries.

Our net revenue and results of operations depend in part on the demand for jewelry. Consumers' tastes are subject to frequent, significant, and sometimes unpredictable changes. Should prevailing consumer tastes for jewelry change or the demand for jewelry decrease, the sale of our products could decline and our business and results of operations would suffer.

Furthermore, our ability to increase our net revenue and enhance our profitability may depend on our ability to expand our product offerings beyond our current offerings. If we offer new products that are not accepted by customers, our brand and reputation could be adversely affected, our sales may fall short of expectations, and we may incur substantial expenses that are not offset by increased sales.

***Because we carry all of our jewelry products in inventory, our net revenue and gross margin may decrease if we are unable to predict and plan for changes in consumer demand.***

If our sales increase, we will be required to increase our inventory proportionately. Consumer tastes and preferences for jewelry products can change rapidly, thereby exposing us to significant inventory risks. Currently, because the products we sell also consist of closeout merchandise from manufacturers, distributors, and other suppliers, we have less control over the specific items that we offer for sale than we would if we primarily ordered goods manufactured for us. In addition, it is important that we are able to purchase jewelry that we perceive to be in demand. The demand for specific products can change between the time we order items and when we sell them. As a result, we may be required to take significant inventory markdowns, which could reduce our gross margin, if we do not accurately predict these trends or if we overstock unpopular merchandise.

***We may be subject to a tax liability for past sales and our future sales may decrease if we are required to collect sales and use taxes on the products we sell.***

In accordance with current industry practice and our interpretation of current law, we do not currently collect sales or other taxes with respect to shipments of goods into states other than California and New York. However, additional states or foreign countries may seek to impose sales or other tax obligations on us in the future. A successful assertion by one or more states or foreign countries that we should be collecting sales or other taxes on the sale of our products could result in substantial tax liabilities for past and future sales, discourage customers from purchasing products from us, decrease our ability to compete with traditional retailers, and otherwise substantially harm our business, financial condition, and results of operations.

***We rely on suppliers and third-party carriers as part of our fulfillment process, and these third parties may fail to meet shipping schedules or requirements.***

We rely on suppliers to deliver our orders promptly, which we then carry in inventory to ensure availability and expedited delivery to our customers. We also rely on third-party carriers to ship our products to our customers. As a result, we are subject to various risks, including employee strikes and inclement weather, associated with the ability of third-party carriers to provide delivery services to meet our shipping needs and those of our suppliers. The failure of our suppliers and third-party carriers to deliver products to us or our customers in a timely manner or otherwise to serve us or our customers adequately would damage our reputation and brand and substantially harm our business and results of operations.

***Increases in the cost of precious metals and precious and semi-precious stones would increase the cost of our jewelry products.***

The jewelry industry is affected by fluctuations in the prices of precious metals and precious and semi-precious stones. The availability and prices of gold, silver, platinum, and other precious metals and precious and semi-precious stones may be influenced by such factors as cartels, political instability in exporting countries, changes in global demand, and inflation. Shortages of these materials or an increase in their prices could reduce the quantity of products we have available for sale and our ability to sell our products for more than our cost, causing reduced sales or lower margins compared to our historical and expected sales and margins.

***The satisfactory availability, performance, and reliability of our website, network infrastructure, and transaction processing systems are critical to our ability to attract, retain, and service customers.***

Any problems with the availability, performance, or reliability of our website, network infrastructure, or transaction processing systems could result in decreased customer traffic, reduced orders, reduced order fulfillment performance, and lower net revenue as well as negative publicity and damage to our reputation. In order to remain competitive, we must continually seek to improve and expand the functionality and features of our website, network infrastructure, transaction processing systems, and delivery and shipping functions to accommodate any substantial increase in the volume of traffic to and orders from our website. We may not be successful in these efforts, and we may not be able to project accurately the rate or timing of increases, if any, in the use of or sales from our website, or timely expand or upgrade our website, infrastructure, or systems to accommodate any such increases. Additionally, we may not be able to remedy any such availability, performance, or reliability problems in a timely manner, or at all, because we depend in part on third parties for such availability, performance, and reliability.

***Our business and results of operations would be harmed in the event of any failure of our auction and bidding systems hardware, which is located at a single third-party co-location facility, or any failure of our fulfillment and administrative hardware.***

Our business depends in part on the efficient and uninterrupted operation of our computer and communications hardware. The servers and other hardware necessary to operate our website, including our auction and bidding systems, are located at a single third-party co-location facility in El Segundo, CA. We rely on that facility to provide Internet access with the speed, capacity, and reliability we require. Our servers and other hardware that run our transaction processing, order fulfillment, and office administration tasks are located at our headquarters. Our servers and other hardware are vulnerable to damage or interruption from human error, fire, flood, power loss, telecommunications failure, terrorist attacks, acts of war, break-ins, earthquakes, and similar events. We do not currently

have redundant systems in multiple locations or a formal disaster recovery plan, and our business interruption insurance may be insufficient to compensate us for any losses that may occur. In addition, our servers are vulnerable to computer viruses, physical or electronic break-ins, and similar disruptions, which could lead to interruptions, delays, loss of critical data, the inability to accept and fulfill customer orders, or the unauthorized disclosure of confidential customer data. System disruptions or failures would also create a large number of customer questions and complaints that need to be addressed by our customer service support personnel. The occurrence of any of the foregoing risks could substantially harm our business and results of operations. Our systems are vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunication failures, terrorist attacks, computer viruses, computer denial-of-service attacks, and similar events.

***Our failure to protect confidential information of our customers and our network against security breaches could damage our reputation and substantially harm our business and results of operations.***

A significant barrier to online commerce and communications is the secure transmission of confidential information over public networks. Third parties may have the technology or expertise to breach the security of customer transaction data. Our security measures may not prevent security breaches that could result in substantial harm to our business and results of operations and damage to our reputation. Currently, a majority of our sales are billed to our customers' credit card accounts directly. Under current credit card practices, we are liable for fraudulent credit card transactions because we do not obtain cardholder signatures. We rely on encryption and authentication technology licensed from third parties to effect secure transmission of confidential information, including credit card numbers. We do not currently carry insurance against this risk. Advances in computer capabilities, new discoveries in the field of cryptography, or other developments may result in a compromise or breach of the technology we use to protect customer transaction data. In addition, anyone who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. Any such compromise of our security could damage our reputation and brand and expose us to a risk of loss or litigation and possible liability, which would substantially harm our business and results of operations.

***We are vulnerable to fraudulent activities on our website, including unauthorized use of customer information and identity theft by third parties.***

Our network security measures to prevent third parties from penetrating our network and improperly accessing our customers' personal information or credit card information may not be successful. Although we have not experienced any theft of our customers' credit card information to date, as new discoveries in the field of cryptography and advances in computer capabilities occur, our security measures may not effectively prevent others from obtaining improper access to our customer information. In addition, third parties may target our customers directly with fraudulent identity theft schemes designed to appear as legitimate e-mails from us. In March 2006, one such third party attempted to solicit customer information through a tactic, commonly known as "phishing," whereby an e-mail purporting to be from us solicited customer information from recipients of the e-mail. Any such security breach or fraud perpetrated on our customers could expose us to increased costs and could harm our business and results of operations.

***Our ability to grow our business will be impaired by delays, interruptions, or failures of the Internet.***

Our success depends on the continued growth and maintenance of the Internet. The Internet has experienced, and is likely to continue to experience, significant growth in the numbers of users and amount of traffic. If Internet usage continues to grow as anticipated, the infrastructure may not be able to support the level of usage and its performance and reliability may decline. If outages or delays on the Internet increase, overall Internet usage could grow more slowly or decline. In addition, the performance of the Internet may be harmed by increased number of users or bandwidth requirements or by viruses, worms, and similar issues. The Internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure, and it could face outages and delays in the future. These outages and delays could reduce the level of Internet usage.

***We depend on the continued growth and acceptance of online commerce, and our business will be substantially impaired if the growth of online commerce slows or does not grow as expected.***

Our success depends on the widespread acceptance and use of the Internet as an effective medium for commerce by consumers. The acceptance and use of the Internet may not continue to expand as expected, and a sufficient broad base of consumers necessary for its continued growth may not adopt the Internet as a medium for commerce. Consumers who historically have used traditional means of commerce may have concerns about privacy, the inability to physically inspect merchandise before buying, delivery time, product damage during shipment, and the costs and inconvenience involved in returning purchased items, which may inhibit their crossover to e-commerce. In order to expand our user base, we must appeal to and acquire consumers who historically have used traditional means of commerce to purchase goods. If these new customers execute fewer or lower dollar amounts of orders than our historical users, and we are unable to gain efficiencies in our operating costs, including the cost of acquiring new customers, our business and profits could be adversely affected.

***Increased product returns and the failure to predict product returns could substantially harm our business and results of operations.***

As we expand our business and product offerings, rates of product return may increase. Any significant increase in product returns above our return assumptions and allowances could substantially harm our business and results of operations.

***Our inventory is vulnerable to damage or loss caused by fire, flood, earthquakes, and similar events, and we face the risk of theft of our products from inventory or during shipment.***

Our inventory is stored at our warehouse/office facility in Culver City, California. Consequently, our merchandise supply is vulnerable to fire, flood, earthquakes, and similar events that may impact our facility. Any damage to or loss of all or a significant portion of our inventory could cause significant delays in shipment of goods to our customers, resulting in negative publicity about and diminished customer confidence in our website. In addition, we may experience theft of our products while they are being held in inventory or during the course of their shipment to our customers by third-party carriers. We have implemented security measures to prevent such theft and maintain insurance to cover losses resulting from theft. Nevertheless, we could incur significant losses from theft, which would substantially harm our business and results of operations, if our security measures fail, losses exceed our insurance coverage, or we are not able to maintain insurance at a reasonable cost.

***Increases in credit card processing fees could increase our costs.***

Visa, MasterCard, American Express, and Discover Card could increase the interchange fees that they charge for transactions using their cards. Increases in interchange fees may result in increased operating costs and reduced profit margin.

***We may default on our obligations, if we are unable to generate sufficient cash through sales in a timely manner.***

Since our formation, we have funded our operations through the sale of equity securities and cash generated from operations. The working capital characteristics of our business have allowed us to collect cash from sales to customers within several business days of the related sale, while we typically have extended payment terms with our suppliers. We do not, however, have any formal or binding supply agreements with any of our suppliers, manufacturers, distributors, or other suppliers or any other formal agreements with them on payment terms. Accordingly, there is a risk that we may default on our obligations if we are unable to generate sufficient cash through sales in a timely manner or through our credit facility.

***Seasonal fluctuations in our net revenue could cause our quarterly results to fluctuate and cause our results of operations to be below expectations.***

Historically, sales in the jewelry industry are seasonal and have been higher in the fourth quarter of the calendar year as a result of higher consumer spending during the December holiday season. Approximately 28.5%, 33.8% and 16.9% of our net revenue was generated during the fourth quarter of 2006, 2007 and 2008, respectively. The fourth quarter of 2008 was an exception as we encountered a significant slowdown in sales resulting from the 2008 financial and economic crisis. As we continue to grow, we expect to experience more pronounced seasonal fluctuations in our net revenue and anticipate a disproportionate amount of our revenue will occur in the fourth quarter. In anticipation of any increased sales activity during the fourth quarter, we may incur significant additional expenses, including higher sales and marketing costs and additional staffing in our fulfillment and customer support operations. If we were to experience lower than expected sales during any future fourth quarter, it would have a disproportionately large impact on our results of operations for that year. In the future, our seasonal sales patterns may become more pronounced, may strain our personnel and fulfillment activities, and may cause a shortfall in sales compared with expenses in a given period, which would substantially harm our business and results of operations.

***Sales growth in prior periods may not be indicative of our future growth.***

Our sales have fluctuated significantly in the past, in part, as a result of varying amounts of funds we have spent on advertising and inventory levels and may fluctuate significantly in the future because of increasing advertising and inventory costs. These factors may prevent the meaningful use of period-to-period comparisons of financial results. For these and other reasons, investors should not rely on past sales growth rates as a prediction of our future sales growth.

***We had grown quickly, and our business will suffer if we fail to manage our future growth.***

We had expanded our operations at a rapid pace prior to the 2008 financial and economic crisis. This expansion had placed a significant strain on our management, operations, and financial resources. When the economy recovers, we anticipate adding personnel in the future, including managerial, technical, and operations personnel. In order to manage the future growth of our operations, we also will be required to improve existing and implement new transaction-processing, operational and financial systems, procedures, and controls. If we are unable to manage growth effectively, our business and results of operations will be harmed.

In conjunction with the expiration of our property lease in Culver City, California in October, 2009, we have begun seeking alternative real estate options that may require us to relocate our operations. In managing this transition, our operations could be interrupted and

we could experience increased employee turnover, or both.

***Descriptions of our jewelry items are not guarantees and may confuse, mislead, or disappoint our customers.***

In an effort to provide accurate descriptions of jewelry posted on our website, we provide appraisal summaries from third-party gemological laboratories for some of our jewelry items. All other jewelry and watch descriptions are provided by our full-time Gemological Institute of America, or GIA, trained gemologists and several experienced product specialists. Nevertheless, there is a subjective component involved with respect to assessing the clarity, color, and carat characteristics of diamonds and other gemstones. In addition, mistakes or omissions of important information in our descriptions may occur. Even if our descriptions are accurate, buying a product online may lead to disappointment resulting in returned merchandise. For example, a customer may determine that a piece does not have the expected look, feel, and overall appearance of the merchandise that the buyer envisioned from the website photograph.

Additionally, in response to customer requests and as a courtesy to resellers, we provide “Compare,” and/or “Retail” prices for jewelry items listed on our website. Compare prices are not meant to reflect fair market values or manufacturer suggested retail prices, and in fact, may be higher than prices found in local retail stores. As a consequence, perceived misrepresentations in item descriptions by disappointed buyers may occur, resulting in negative publicity about and diminished customer confidence in our website.

***We may unknowingly be involved in “conflict” diamond purchases that result in a negative public relationship impact.***

There has been an increase in attention to “conflict” diamonds originating out of war-torn regions of Africa. The proceeds from the sale of “conflict” diamonds have been used to fund ongoing aggression and terrorist activities throughout the world. We make every effort to evaluate our vendor sources to ensure they are not a dealer in “conflict” diamonds. In addition we have implemented an anti-money laundering program to guard against both illicit purchase and sales activities. If these risks were to occur, we may face a negative public reaction to our brand name resulting in loss of sales.

***We may not be able to maintain our domain name uniqueness.***

Our Internet domain name is critical to our success. Under current domain name registration practices, no other entity can obtain an identical domain name, but can obtain a similar name or the identical name with a different suffix, such as “.net” or “.org,” or with a different country designation, such as “.jp” for Japan. We have not registered our domain name with different suffixes nor have we registered our name in any other jurisdiction. As a result, third parties may use domain names that are similar to our domain name, which may result in confusion to potential customers and lost sales. We are aware that other businesses have registered the name “.biz” with other suffixes and in other countries.

***We may be subject to assertions by third parties for infringement on their intellectual property rights.***

Third parties may in the future assert that we have infringed on their intellectual property rights as we self-develop our auction platform, sales transaction system, and inventory control system. We have a larger exposure to being accused of intellectual property rights infringements than if we had purchased our technology off the shelf. We also may be at risk for selling items that infringe on other third party trade dress rights, copyright, or patent rights that may cause the offended party to bring an action against us. In either event of alleged infringement, we would face substantial litigation cost to defend ourselves and utilization of our management and personnel resources.

***We may be unable to protect or enforce our own intellectual property rights adequately, and we may become subject to intellectual property litigation.***

We regard the protection of our trademarks, copyrights, domain name, trade dress, and trade secrets as critical to our success. We rely on a combination of common law as well as trademark, copyright, trade dress, and trade secret laws to protect our intellectual property rights. We also have entered into confidentiality and invention assignment agreements with our employees and relevant contractors and nondisclosure agreements with relevant parties with whom we conduct business in order to limit access to and disclosure of our proprietary information. These contractual arrangements and other steps we have taken to protect our intellectual property may not prevent misappropriation of our intellectual property or deter independent development of similar intellectual property by others. We also are pursuing the registration of our domain name, trademarks, and service marks in the United States and internationally. Effective trademark, copyright, patent, trade dress, trade secret, and domain name protection is very expensive to maintain and may require litigation. We must protect our trademarks, copyrights, patents, and domain names in an increasing number of jurisdictions, a process that is expensive and may not be successful in every location.

Third parties may from time to time claim that we have infringed their intellectual property relating to our business model or auction systems. We expect that participants in our market increasingly will be subject to infringement claims as the number of services and competitors in our industry segment grows. Any claim like this, whether meritorious or not, could be time-consuming, result in costly litigation, cause service upgrade delays, or require us to enter into royalty or license agreements. These royalty or license agreements may not be available on acceptable terms or at all. As a result, any such claim could harm our business.

***We may be unable to enforce protection of our intellectual property rights under the laws of other countries.***

We anticipate that we will become increasingly subject to international intellectual property risks, including differing intellectual property laws, which may be insufficient to protect our intellectual property, unique local laws, and lack of applicable law or clear precedent.

***Various legal rules and regulations related to privacy and the collection, dissemination, and security of personal information may adversely affect our marketing efforts.***

We are subject to increasing regulation at the federal, state, and international levels relating to privacy and the use of personal user information designed to protect the privacy of personally identifiable information as well as to protect against its misuse. These laws include the Federal Trade Commission Act, the CAN-SPAM Act of 2003, the Children's Online Privacy Protection Act, the Fair Credit Reporting Act, the Homeland Security Act, and related regulations. Several states have proposed legislation that would limit the use of personal information gathered online or require online services to establish privacy policies. Moreover, proposed legislation in the United States and existing laws in foreign countries require companies to establish procedures to notify users of privacy and security policies, obtain consent from users for collection and use of personal information, and/or provide users with the ability to access, correct, and delete personal information stored by companies. These regulations and other laws, rules, and regulations enacted in the future may adversely affect our ability to collect, disseminate, or share demographic and personal information about users and our ability to e-mail or telephone users, which could be costly and adversely affect our marketing efforts.

***We may be subject to regulations governing the conduct and liability of auctioneers, which could affect the way in which we conduct our business or otherwise increase our cost of doing business.***

Numerous states and foreign jurisdictions, including California, where our headquarters are located, have regulations regarding how auctions may be conducted and the liability of auctioneers in conducting such auctions. No final legal determination has been made whether the California regulations apply to our business, and little precedent exists in this area. Several states and some foreign jurisdictions have attempted, and may attempt in the future, to impose regulations that could affect us or our users, which could harm our business.

***We are subject to regulations relating to consumer privacy, which could increase the cost of our doing business, expose us to litigation costs, increase our service or delivery costs, and otherwise harm our business.***

Several states have proposed, and California, Minnesota, Utah, and Vermont have recently passed, legislation that would limit the uses of personal user information gathered online or offline. Many states already have such laws and continually consider strengthening them, especially against online services. However, the Fair Credit Reporting Act, or FCRA, a federal statute enacted in 1970 to protect consumer privacy, includes a provision preempting conflicting state laws on the sharing of information between corporate affiliates. The preemptive provisions of FCRA were permanently extended in 2002, thereby ensuring that we are not subject to the laws of each individual state with respect to matters within the scope of FCRA, but remain subject to the other provisions of FCRA.

The Federal Trade Commission also has settled several proceedings against companies regarding the manner in which personal information is collected from users and provided to third parties. Specific statutes intended to protect user privacy have been passed in many foreign jurisdictions. Compliance with these laws, given the tight integration of our systems across different countries and the need to move data to facilitate transactions among our users, such as payment companies and shipping companies, is both necessary and difficult. Failure to comply could subject us to lawsuits, fines, criminal penalties, statutory damages, adverse publicity, and other losses that could harm our business. Changes to existing laws or the passage of new laws intended to address these issues could directly affect the way we do business or could create uncertainty on the use of the Internet. This could reduce demand for our products, increase the cost of our doing business, expose us to litigation costs, increase our service or delivery costs, or otherwise harm our business.

***New and existing regulations could harm our business.***

We are subject to the same foreign and domestic laws as other companies conducting both online and offline business. There are still relatively few laws specifically directed towards online business. However, due to the increasing popularity and use of the Internet and online services, many laws relating to the Internet are being debated at all levels of government around the world, and it is possible that such laws and regulations will be adopted. These laws and regulations could cover issues such as user privacy, freedom of expression, pricing, fraud, content and quality of products and services, taxation, advertising, intellectual property rights, and information security. Applicability to the Internet of existing laws governing issues, such as property ownership, copyrights and other intellectual property issues, taxation, libel and defamation, obscenity, and personal privacy is uncertain. The vast majority of these laws were adopted prior to the advent of the Internet and related technologies and, as a result, do not contemplate or address the unique issues of the Internet and related technologies. Those laws that do reference the Internet, such as the U.S. Digital Millennium Copyright Act and the European Union's Directive on Distance Selling and Electronic Commerce, have only recently begun to be interpreted by the courts and implemented by the European Union member states, so their applicability and scope remain uncertain. As our activities and the types of goods listed on our website expand, regulatory agencies may claim that we or our users are subject to licensure in their jurisdiction, either with respect to our business in general, or in order to allow the sale of certain items, such as real estate, event tickets, boats, and automobiles.

In addition, because our products are available over the Internet in multiple states and because we sell merchandise to consumers residing in multiple states, we could be required to qualify to do business as a foreign corporation in each state in which our products are available. Our failure to qualify as a foreign corporation in a jurisdiction in which we are required to do so could subject us to penalties. Any new legislation or regulation, or the application of laws or regulations from jurisdictions whose laws do not currently apply to our business could have a material adverse affect on our business.

***We depend to a very significant extent on David Zinberg, our Chairman of the Board and Chief Executive Officer.***

Our performance depends substantially upon David Zinberg, our Chairman of the Board and Chief Executive Officer, who has extensive experience with the purchase and sale of jewelry. We rely on Mr. Zinberg to make critical operational decisions on a daily basis, such as product offerings and purchases, and to make key strategic plans. We have an employment agreement with Mr. Zinberg extending through 2009. The loss of the services of Mr. Zinberg would adversely affect our business and operations.

***Holders of common stock issued by us in prior offerings may be entitled to rescind their purchases.***

From our inception until mid-2003, we raised over \$20.5 million in gross equity capital by selling shares of our common stock to approximately 830 investors at prices ranging from \$4.00 to \$6.00 per share with a weighted average share price of \$4.50. We also issued shares of common stock to about 30 persons in exchange for services and other non-cash consideration valued in excess of \$5.5 million and issued approximately 250 stock option grants to purchase common stock at a weighted average exercise price of \$4.45. After conducting these sales of our securities, we determined that these sales were not exempt from the registration requirements under the Securities Act of 1933 and similar provisions of laws of the states in which our stockholders reside, because certain of our employees who solicited investors engaged in a "general solicitation" of securities. In addition, these employees received compensation for selling our common stock and were required to be licensed as broker-dealers with the Securities and Exchange Commission, or SEC, and various state authorities, but they were not so licensed. In such situations, a number of remedies may be available to regulatory authorities and the investors who purchased common stock in those offerings, including a right of rescission, civil penalties, a restraining order or injunction, and a court order to pay restitution and costs. We believe, however, that as to any options by investors at this time or in the future, applicable statutes of limitations will mitigate our exposure to any civil remedies.

***We do not intend to pay dividends on our common stock, and, consequently, your only opportunity to achieve a return on your investment is if the price of our common stock appreciates.***

We have never declared or paid any cash dividends on our common stock and do not intend to pay dividends on our common stock for the foreseeable future. We intend to invest any future earnings to fund our business. Therefore, stockholders likely will not receive any dividends on our common stock for the foreseeable future. Investors cannot be certain that they will receive a positive return on their investment when they sell their shares or that they will not lose the entire amount of their investment.

***The concentration of our capital stock ownership with our founder and executive officers and directors and their affiliates will limit your ability to influence corporate matters.***

Our founder, executive officers, and directors together own approximately 34.9% of our common stock as of December 31, 2008. Marina Zinberg, our Vice President, who is the sister of David Zinberg, our Chairman and Chief Executive Officer, owns an additional 32.0% of our common stock. As a result, these individuals will have significant influence over our management and affairs and over all matters requiring stockholder approval, including the election of directors and the approval of significant corporate transactions, such as a merger or a sale of our company or its assets, for the foreseeable future. This concentrated control will limit the ability of other stockholders to influence corporate matters. Because of this, we may take actions that some of our stockholders do not view as beneficial. As a result, the market price of our common stock could be adversely affected because stockholders may not view favorably the concentration of control in the hands of management.

***Our charter documents and Delaware law could make it more difficult for a third party to acquire us, and discourage a takeover.***

On June 22, 2006, we reincorporated in Delaware, and the Delaware certificate of incorporation and the Delaware General Corporation Law, or DGCL, contain provisions that may have the effect of making more difficult or delaying attempts by others to obtain control of our company, even when these attempts may be in the best interests of our stockholders. The Delaware certificate of incorporation also authorizes our Board of Directors, without stockholder approval, to issue one or more series of preferred stock, which could have voting and conversion rights that adversely affect or dilute the voting power of the holders of common stock. Delaware law also imposes conditions on certain business combination transactions with “interested stockholders.” The Delaware certificate of incorporation divides our Board of Directors into three classes, with one class to stand for election each year for a three-year term after the initial election. The classification of directors tends to discourage a third party from initiating a proxy solicitation or otherwise attempting to obtain control of our company and may maintain the incumbency of our Board of Directors, as this structure generally increases the difficulty of, or may delay, replacing a majority of directors. The Delaware bylaws authorize our Board of Directors to fill vacancies or newly created directorships. A majority of the directors then in office may elect a successor to fill any vacancies or newly created directorships.

#### **ITEM 1B. Unresolved Staff Comments**

Not applicable.

#### **Item 2. Properties.**

We lease a 50,000 square foot facility in Culver City, California, which serves as our corporate headquarters and houses our sales, marketing, research and development, customer service, fulfillment, and warehouse operations. Our lease expires in October 2009 and we will either extend the lease or relocate to another suitable location. In August 2007, we leased a separate 12,000 square-foot warehouse in Culver City, California and this lease expires in August 2012.

#### **Item 3. Legal Proceedings**

On February 10, 2009, the Securities and Exchange Commission (“SEC”) issued a subpoena to produce documents relating to the Company’s inventory reserve policies, as well as other matters. We intend to fully cooperate with the SEC regarding this matter.

On or about January 15, 2009, Landmark Technology, LLC (“Landmark”) filed a First Amended Complaint in the civil action titled Landmark Technology, LLC v. Zale Corp, et al. in the U.S. District Court for the Eastern District of Texas. The First Amended Complaint added the Company as a defendant and alleged that the Company infringed and is infringing certain patents of Landmark directly, contributorily and by inducement. The First Amended Complaint seeks a temporary, preliminary and permanent injunction against infringement of the Landmark patents, damages (including a reasonable royalty and lost profits), enhanced or exemplary damages, a finding that the alleged infringement is “willful,” attorneys fees, costs and other relief.

On or about September 29, 2008, we were served with a lawsuit filed in the U.S. District Court for the Central District of California by Marla Tidenberg against Bidz.com, Mr. Zinberg and Marina Zinberg. The lawsuit purports to represent a class and alleges, among other things, that we engaged in unfair business practices by misrepresenting the value of our merchandise and by “false” bidding. The complaint purports to represent a class of persons who purchased any merchandise from us. We believe that the lawsuit is meritless and intend to defend the case vigorously.

On or about April 12, 2006, a lawsuit was filed in the U.S. District Court for the Southern District of New York by Cartier, a division of Richemont North America, and Cartier International B.V. against Bidz.com, Inc., David Zinberg and others. The lawsuit alleges that Cartier has proprietary rights, including trade dress, patents, trademarks, copyrights and others, in watch designs known as a

Tank, Tank Francaise, Tank Americaine, Panthere and Pasha De Cartier Grille, and Tank Devan, and further alleges that we have infringed upon those rights by selling watches bearing copies of one or more of the watch designs. The Company and Mr. Zinberg entered into a settlement agreement with Cartier in August 2008. A Consent Judgment was entered in the civil action.

We are, from time to time, a party to disputes arising from normal business activities, including various employee-related matters. In the opinion of our management, resolution of these matters, individually or collectively, will not have a material adverse effect upon our financial condition or future operating results.

#### Item 4. Submission of Matters to a Vote of Security Holders

In June 25, 2008, we held our Annual Meeting of Shareholders. We solicited proxies for the Annual Meeting pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended. There was no solicitation in opposition to the two nominees of the Board of Directors listed in our Proxy Statement, dated June 5, 2008, and both nominees were elected.

The following matters were acted upon by our shareholders at the Annual Meeting, at which approximately 12,715,726 shares of common stock, or 53.1% of the shares of common stock outstanding and entitled to vote at the Annual Meeting, were present in person or by proxies:

1. Election of Directors. The Board of Directors nominated two persons for election as Class II directors, each to hold office for three-year terms. Each nominee was an incumbent director, no other person was nominated, and each nominee was elected. The votes cast for, or withheld or abstained with respect to, each nominee were as follows: Man Jit Singh—12,590,783 for, 124,943 withheld, and Lawrence Y. Kong—12,567,580 for, 148,146 withheld.
2. Proposal to Approve Amendment to 2006 Stock Award Plan. The Board of Directors submitted a resolution that the shareholders approve an amendment to our 2006 Stock Award Plan to increase by 500,000 shares of common stock, from 1,000,000 to 1,500,000 shares, the total number of shares of common stock reserved and available in connection with awards under the 2006 Plan. There were 12,142,763 shares voting in favor of, 540,564 shares voting against, the resolution. The holders of 32,399 shares abstained, and there were no “broker non-votes.” The resolution, having received the affirmative vote of the holders of a majority of the shares of common stock outstanding and entitled to vote at the Annual Meeting, was adopted.
3. Ratification of Appointment of Independent Auditor. The Board of Directors submitted a resolution that the shareholders ratify the action of the Audit Committee in selecting and appointing the firm of Stonefield Josephson, Inc. as the Company’s independent registered public accounting firm for the year ending December 31, 2008. There were 12,677,921 shares voting in favor of, 13,180 shares voting against the resolution. The holders of 24,625 shares abstained, and there were no “broker non-votes.” The resolution, having received the affirmative vote of the holders of a majority of the shares of common stock outstanding and entitled to vote at the Annual Meeting, was adopted.

## Part II

#### Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is quoted on The NASDAQ Stock Market LLC under the symbol “BIDZ.” The following table sets forth the high, low and closing market prices of our common stock during each of the four calendar quarters for 2008:

| For the quarter ended: | High     | Low     | Close   |
|------------------------|----------|---------|---------|
| March 31, 2008         | \$ 11.55 | \$ 7.09 | \$ 8.40 |
| June 30, 2008          | \$ 13.95 | \$ 7.91 | \$ 8.71 |
| September 30, 2008     | \$ 11.98 | \$ 7.50 | \$ 8.66 |
| December 31, 2008      | \$ 9.00  | \$ 2.00 | \$ 4.60 |

As of December 31, 2008, there were 22,917,918 shares of common stock outstanding.

We have established a public market for our common stock on the NASDAQ Capital Market since June 2007. We have registered for offer and sale the shares of common stock that are reserved for issuance pursuant to stock options covered by our stock option plans. Shares covered by such registration statements upon the exercise of stock options or warrants generally will be eligible for sale in the public market, except that affiliates will continue to be subject to volume limitations and other requirements of Rule 144. As of December 31, 2008, the number of shares of our common stock that is subject to outstanding options to purchase common stock is 6,864,500.

Shares held by management and affiliates of our company are subject to the resale limitations of Rule 144. In general, under Rule 144 as currently in effect, any person, or persons whose shares are aggregated for purposes of Rule 144, who beneficially owns restricted securities with respect to which at least six months has elapsed since the later of the date the shares were acquired from us, or from an affiliate of ours, is entitled to sell within any three-month period a number of shares that does not exceed the greater of 1% of the then outstanding shares of our common stock and the average weekly trading volume in common stock during the four calendar weeks preceding such sale. Sales under Rule 144 also are subject to certain manner-of-sale provisions and notice requirements and to the availability of current public information about us.

## Dividends

We have never declared or paid any dividends on our common stock and do not anticipate that we will pay any dividends to holders of our common stock in the foreseeable future. Instead, we currently plan to retain any earnings to finance the growth of our business. Payments of any cash dividends in the future will be within the discretion of our Board of Directors and will depend on our financial condition, results of operations, and capital requirements as well as other factors deemed relevant by our Board of Directors.

## Equity Compensation Plan Information

| Plan category                                                     | Number of securities to be issued upon exercise of outstanding options, warrants and rights (1) | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|-------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Equity compensation plans approved by security holders</b>     |                                                                                                 |                                                                             |                                                                                                                                             |
| 2006 Stock award plan                                             | 290,500                                                                                         | \$ 7.89                                                                     | 1,302,990                                                                                                                                   |
| 2002 Special stock option plan                                    | —                                                                                               | \$ —                                                                        | —                                                                                                                                           |
| <b>Equity compensation plans not approved by security holders</b> |                                                                                                 |                                                                             |                                                                                                                                             |
| 2001 Stock option plan                                            | 549,000                                                                                         | \$ 6.00                                                                     | —                                                                                                                                           |
| Non-statutory stock option (2)                                    | 6,025,000                                                                                       | \$ 6.00                                                                     | —                                                                                                                                           |
| <b>Total</b>                                                      | <b>6,864,500</b>                                                                                | <b>\$ 6.20</b>                                                              | <b>—</b>                                                                                                                                    |

- (1) The total number of shares of common stock to be issued upon exercise of all outstanding stock options is 6,864,500 as of December 31, 2008.
- (2) Includes a non-statutory stock option to purchase 6,000,000 shares at an exercise price of \$6.00 per share granted to David Zinberg, our Chief Executive Officer.

## Recent Sales of Unregistered Securities

During the past three years we have sold the following securities that were not registered under the Securities Act of 1933. The share issuances were undertaken in reliance on the exemption from registration under the Securities Act of 1933 (the "Act") set forth in Section 4(2) of the Act or Rule 701 under the Act.

In 2008, we issued 24,800 restricted share awards of our common stock, with 25% vesting at the end of each year over a four year period, under the 2006 Award Plan to 13 employees for services rendered to our company. No stock options were granted in 2008.

In 2007, we issued 10,000 and 8,750 shares of our common stock to each of our outside directors, Peter Hanelt and Man Jit Singh, respectively, as payment of independent director fees. We also issued 40,000, 35,000 and 35,000 restricted share awards of our common stock, with 25% vesting at the end of each year over a four year period, under the 2006 Award Plan to each of our outside directors, Peter Hanelt, Man Jit Singh and Garry Itkin, respectively, as payment of independent director fees. We issued stock options to purchase an aggregate of 1,000,000 shares in our common stock at an exercise price of \$8.23 per share to 4 of our employees under our 2006 Award Plan for services rendered to the our company. We also issued 16,000 restricted share awards of our common stock, with 25% vesting at the end of each year over a four year period, under the 2006 Award Plan to 5 employees for services rendered to our company.

In 2006, we issued 10,000 shares of our common stock to each of our outside directors, Peter Hanelt and Man Jit Singh, as payment of independent director fees. We also issued 15,000 and 1,404 shares of common to an employee and independent consultant,

respectively, for services rendered. The shares of common stock were issued at a price of \$6.00 per share. We issued stock options to purchase an aggregate of 235,000 shares of our common stock at an exercise price of \$6.00 per share to three of our employees under our 2006 Award Plan for services rendered to our company.

### Issuer Purchases of Equity Securities

The following table contains information about repurchases of our common stock during the fourth quarter of 2008:

| 2008                     | Total<br>number<br>of<br>shares<br>purchased | Average<br>price<br>paid<br>per<br>share | Total number of<br>shares<br>purchased as<br>part of a<br>publicly<br>announced<br>program | Maximum<br>dollar value<br>of shares that<br>may<br>yet be purchased<br>under the<br>program (1) |
|--------------------------|----------------------------------------------|------------------------------------------|--------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|
| October 1 — October 31   | —                                            | —                                        | 1,377,534                                                                                  | \$ 7,963,000                                                                                     |
| November 1 — November 30 | 450,386                                      | \$ 2.82                                  | 1,827,915                                                                                  | \$ 6,691,000                                                                                     |
| December 1 — December 31 | 25,953                                       | \$ 3.93                                  | 1,853,868                                                                                  | \$ 6,590,000                                                                                     |
| Total                    | 476,339                                      | \$ 7.23                                  | 1,853,868                                                                                  | \$ 6,590,000                                                                                     |

(1) In June 2007, we authorized the stock buyback program for up to \$5 million of our outstanding common stock to be repurchased through the open market at prices deemed appropriate by management. In February 2008, we authorized an increase in the stock buyback program to \$20 million from \$5 million. In February 2009, we authorized an increase in the stock buyback program to \$33.5 million from \$20.0 million. As of February 23, 2009 we have repurchased a total of approximately 1.9 million shares for a total of approximately \$13.5 million. About \$20.0 million remain available under the buyback program to repurchase shares in the open market. The stock buyback will be at prices deemed appropriate by management over a 24 month period.

### Item 6. Selected Financial Data

The selected financial data presented below has been derived from our financial statements. The statement of operations data for each of the fiscal years ended December 31, 2006, 2007, and 2008 and the balance sheet data at December 31, 2007 and 2008 are derived from our audited financial statements that are included in this report. The statement of operations data for the years ended December 31, 2004 and 2005 and the balance sheet data at December 31, 2004, 2005 and 2006 are derived from audited financial statements that are not included in this report. The historical results presented below are not necessarily indicative of the results to be expected in any future period. You should read this information together with “Management’s discussion and analysis of financial condition and results of operations” and our financial statements and the related notes included elsewhere in this report.

| (in thousands, except per share data) | Years ended December 31, |           |            |            |            |
|---------------------------------------|--------------------------|-----------|------------|------------|------------|
|                                       | 2004                     | 2005      | 2006       | 2007       | 2008       |
| <b>Statement of income data:</b>      |                          |           |            |            |            |
| Net revenue                           | \$ 65,324                | \$ 90,579 | \$ 131,823 | \$ 187,131 | \$ 207,410 |
| Cost of revenue                       | 53,072                   | 71,257    | 100,633    | 132,683    | 148,688    |
| Gross profit                          | 12,252                   | 19,322    | 31,190     | 54,448     | 58,722     |
| Operating expenses:                   |                          |           |            |            |            |
| General & administrative              | 8,800                    | 10,938    | 13,853     | 20,458     | 21,209     |
| Sales & marketing                     | 2,542                    | 5,078     | 10,300     | 12,578     | 12,681     |
| Public offering costs                 | —                        | 442       | 1,287      | —          | —          |
| Depreciation & amortization           | 139                      | 157       | 273        | 498        | 690        |
| Total operating expenses              | 11,481                   | 16,615    | 25,713     | 33,534     | 34,580     |
| Income from operations                | 771                      | 2,707     | 5,477      | 20,914     | 24,142     |
| Interest income (expense), net        | —                        | 22        | 32         | (250)      | (142)      |
| Income taxes                          | —                        | (82)      | (120)      | (2,538)    | (9,597)    |
| Net income                            | \$ 771                   | \$ 2,647  | \$ 5,389   | \$ 18,126  | \$ 14,403  |
| Net income common share:              |                          |           |            |            |            |
| Basic                                 | \$ 0.03                  | \$ 0.11   | \$ 0.23    | \$ 0.77    | \$ 0.61    |
| Diluted                               | \$ 0.03                  | \$ 0.11   | \$ 0.23    | \$ 0.69    | \$ 0.57    |

**Balance sheet data:**

|                                      |            |          |          |           |           |
|--------------------------------------|------------|----------|----------|-----------|-----------|
| Cash & cash equivalents              | \$ 5       | \$ 7     | \$ 359   | \$ 4,808  | \$ 4,456  |
| Working capital (deficit)            | (2,164)    | 1,009    | 5,974    | 29,865    | 32,785    |
| Total assets                         | 12,490     | 17,746   | 38,542   | 70,965    | 48,405    |
| Revolving credit line                | —          | —        | 3,941    | 5,924     | —         |
| Total liabilities                    | 13,570     | 15,963   | 31,815   | 39,383    | 13,599    |
| Total stockholders' equity (deficit) | \$ (1,080) | \$ 1,783 | \$ 6,727 | \$ 31,582 | \$ 34,806 |

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion should be read in conjunction with the financial statements and related notes which appear elsewhere in this form. This discussion contains forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including various risks and uncertainties discussed below and throughout this report.*

**Overview**

We are a leading online retailer of jewelry, featuring a live auction format. We have established our retail brand in the online marketplace by offering high-quality merchandise, a unique user-friendly shopping experience, and the opportunity for buyers to achieve significant cost savings versus traditional retail channels. A key to our success has been our ability to efficiently and cost effectively source closeout and regular jewelry merchandise, and rapidly respond to changing consumer demands for certain jewelry. We offer our products through a continuous live format, featuring a \$1 minimum opening bid, and a unique 15-second auction extension period that allows our auctions to continue until all bids are received. On select auctions we maintain a reserve price that must be met before a sale will be consummated. In 2009, we will offer auctions with a minimum opening bid that is higher than \$1. The majority of our auctions are short-term, often lasting less than one hour, providing immediate gratification to our customers and encouraging frequent visits and active viewing of our website.

In addition to our auction site we have a fixed pricing format that offers similar items of merchandise as those listed for auction. This online store provides us access to different types of consumers and we plan to offer customers the ability to design their own jewelry including diamond earrings and rings in the near future.

Our product inventory includes gold, platinum, and silver jewelry set with diamonds, rubies, emeralds, sapphires, and other precious and semi-precious stones; watches and accessories. We believe we are the second largest online retailer of jewelry based on revenue and the largest online jewelry auction site based on web traffic.

We sell to consumers looking for reliable bargains on jewelry. Because we purchase and retain all of our jewelry inventory onsite, we can provide our customers with timely service and delivery of their purchases. In addition, each item is inspected by one of our trained product specialists prior to its placement on our website, which assures our customers of the quality of their purchases of our products.

We operate in a highly competitive market with low barriers to entry. By selling our own merchandise, we provide a buying environment in which we minimize fraudulent activity and questionable product quality frequently associated with purchase transactions from third-party sellers. We also provide a 15-day return policy on all merchandise. We believe that many of our customers resell merchandise that they purchase from our auctions on eBay, at local auctions, and through other retail channels. Our auctions and fixed price sales are conducted 24 hours a day, seven days a week. We also offer daily telephone customer support, 24-hour online live-help and e-mail customer support.

In line with our growth plans, we completed a major upgrade of our auction platform at the end of 2007. The new auction LiveBid system supports a broad range of leading browser software including Microsoft Internet Explorer, FireFox and Safari. The new system touts high availability, faster end-user response time and greater scalability among the key features delivered in this release. We have leveraged this new software solution to launch additional site features and the new online retail store. We launched the Spanish version of our website in the second quarter of 2008, the Arabic version in October 2008 and the German version in December 2008.

### **Critical Accounting Policies**

The preparation of our financial statements requires us to make certain estimates and judgments that affect amounts reported and disclosed in our financial statements and related notes. We base our estimates on historical experience and on other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. The following are the critical accounting policies that we believe require significant estimation and judgment.

#### *Revenue Recognition*

We derive our revenue from four sources: merchandise sales, which include wholesale merchandise sales, shipping revenue, transaction fee revenue and other revenue. In accordance with SAB 104, we recognize revenue from all four sources when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) the product has been shipped or the service has been rendered and the customer takes ownership and assumes the risk of loss; (3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured.

For online sales through our website, we recognize merchandise sales upon shipments made to consumers that are fulfilled from our warehouse. We require payment before we ship and the payment is generally made online by credit card or other electronic payment methods. We record amounts received or billed prior to shipment of goods to customers as deferred revenue. We reduce gross sales by returns and chargebacks from customers. For wholesale merchandise sales, we recognize sales when the merchandise is delivered to the customer and credit terms may be offered to such customers.

We report shipping and handling fees and costs in accordance with Emerging Issues Task Force ("EITF") issue No. 00-10, "Accounting for Shipping and Handling Fees and Costs." As such, in the Statement of Operations all amounts billed to customers by us related to shipping and handling are included in "Net revenue" and our shipping costs are included in "Cost of revenue."

We include transaction fee revenue in net revenue. The 3% auction transaction fee is applied to all merchandise sales, including shipping and handling but not to wholesale merchandise sales.

We present sales tax liability on a net basis in accordance with Emerging Issues Task Force ("EITF") Issue No. 06-03. Sales are not grossed up with the attendant taxes and deducted as a separate line item. The EITF became effective for interim and annual reporting periods beginning after December 15, 2006.

Other revenue consists primarily of commissions we derive from hosting sales of Certified Merchant merchandise that is owned by third parties and we recognize only the commission portion of the price our customers pay for the purchased products because we are acting as an agent in such transactions.

#### *Cost of Revenue*

Cost of revenue includes product costs, inbound and outbound shipping charges, packaging and shipping supplies, insurance on shipments, product repair and service costs, and credit card and other electronic payment fees, and is recorded in the same period in which related revenue has been recorded. The cost of revenue is reduced by amortized co-op marketing contributions from our vendors.

### *Return and Allowance Reserve*

We estimate potential future product returns and chargebacks related to current period revenue. We analyze historical returns, and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales returns reserve and other allowances in any accounting period. If actual returns are greater than our estimates, we will record additional returns and allowances in addition to our estimates, which will result in lower net revenue recorded during that period. Reserves for returns and chargebacks are included in accrued expenses.

### *Inventories*

Inventories consist mainly of merchandise purchased for resale and are stated at the lower of first-in, first-out (FIFO) cost or market.

### *Inventory Reserve*

The unique nature of our business model where customers set the prices they are willing to pay may result in items selling below our cost, and we provide reserves against our inventory based on the difference between the average selling price and the cost of inventory if the average selling price is lower than the cost of inventory. We also provide reserves for obsolescence and slow moving inventory.

### *Inventory Co-op Marketing Contributions*

In the third quarter of 2007, we started to bill and collect from our inventory vendors co-op marketing contributions as an incentive for us to market and sell their merchandise on the Bidz website. In accordance with EITF 02-16: Accounting by a Customer (including a Reseller) for Certain Consideration Received from a Vendor, the co-op marketing contributions that cannot be identified specifically to benefit the vendors are a reduction in cost of sales and will result in an increase in gross profit. We cannot specifically identify the benefits to each vendor, consequently, co-op marketing contributions are charged against inventory as a reduction of costs and amortized as a reduction of cost of sales. For the years ended December 31, 2007 and 2008, we have earned \$4.8 million and \$11.1 million of co-op marketing contributions, respectively, with \$4.2 and \$4.3 million, respectively, remaining unamortized and is an offset to inventory at December 31, 2007 and 2008. Receivable from vendors for co-op marketing contributions, less allowance for doubtful accounts, is included in other current assets and amounted to \$2.9 million and \$934,000 at December 31, 2007 and 2008, respectively.

### *Deferred Tax Benefit*

We recognized total current and long term deferred tax benefits of \$2.3 million and \$2.0 million as of December 31, 2007 and 2008, respectively, (and more fully described in Note 11 in our audited financial statements).

### *Stock-Based Compensation*

On January 1, 2006, we adopted SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R") requiring that share-based payment transactions be recognized in the financial statements based on the fair value of the equity or liability instrument issued. We use the Black-Scholes option pricing model to estimate the value of our options in implementing SFAS 123R and the calculated method to determine expected volatility. Under SFAS 123R stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest. Accordingly, stock-based compensation expense recognized in the statements of income will be reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

## Description of Our Revenue, Costs, and Expenses

The following table presents our historical results of operations for the periods indicated as a percentage of net revenue.

|                                | Years ended December 31, |        |        |
|--------------------------------|--------------------------|--------|--------|
|                                | 2006                     | 2007   | 2008   |
| Net revenue                    | 100.0%                   | 100.0% | 100.0% |
| Gross profit                   | 23.7                     | 29.1   | 28.3   |
| Operating expenses:            |                          |        |        |
| General & administrative       | 10.5                     | 10.9   | 10.3   |
| Sales & marketing              | 7.8                      | 6.7    | 6.1    |
| Public offering costs          | 1.0                      | —      | —      |
| Depreciation & amortization    | 0.2                      | 0.3    | 0.3    |
| Total operating expenses       | 19.5                     | 17.9   | 16.7   |
| Income from operations         | 4.2                      | 11.2   | 11.6   |
| Interest income (expense), net | 0.0                      | (0.1)  | (0.1)  |
| Income taxes                   | (0.1)                    | (1.4)  | (4.6)  |
| Net income                     | 4.1%                     | 9.7%   | 6.9%   |

### Net Revenue

Substantially all of our net revenue consists of jewelry sold via the Internet, net of returns. We also generate net revenue from wholesale merchandise sales that is not online, shipping and handling, transaction fee revenue, and other revenue.

The following table presents our sources of revenue for the periods indicated as a percentage of net revenue.

|                             | Year Ended December 31, |        |        |
|-----------------------------|-------------------------|--------|--------|
|                             | 2006                    | 2007   | 2008   |
| Net Revenue                 |                         |        |        |
| Merchandise sales           | 85.3%                   | 84.6%  | 71.9%  |
| Wholesale merchandise sales | —                       | —      | 14.4   |
| Shipping & handling         | 11.5                    | 12.1   | 10.8   |
| Transaction fee             | 3.1                     | 3.1    | 2.7    |
| Other revenue               | 0.1                     | 0.2    | 0.2    |
| Total Net Revenue           | 100.0%                  | 100.0% | 100.0% |

As described in note 12 to our audited financial statements, net revenue by geographic area is presented based upon the country of destination. No foreign country accounted for 10% or more of net revenue for any of the fiscal years presented. Net revenue by geographic area for the periods indicated was as follows:

| (in thousands, except percentages) | Years ended December 31, |         |            |         |            |         |
|------------------------------------|--------------------------|---------|------------|---------|------------|---------|
|                                    | 2006                     |         | 2007       |         | 2008       |         |
|                                    | Amount                   | Percent | Amount     | Percent | Amount     | Percent |
| Geographic area                    |                          |         |            |         |            |         |
| United States                      | \$ 104,338               | 79.2%   | \$ 145,412 | 77.7%   | \$ 157,747 | 76.1%   |
| International                      | 27,485                   | 20.8    | 41,719     | 22.3    | 49,663     | 23.9    |
| Total                              | \$ 131,823               | 100.0%  | \$ 187,131 | 100.0%  | \$ 207,410 | 100.0%  |

### Gross Profit

Our gross profit consists of net revenue less the cost of revenue. Our cost of revenue consists of the cost of merchandise sold to customers, amortized co-op marketing contributions from vendors, inbound and outbound shipping costs, packaging and shipping supplies, insurance on shipments, product repair and service costs, and credit card and other transaction fees associated with payments.

### General and Administrative Expenses

Our general and administrative expenses consist primarily of payroll and related benefit costs for our employees. These expenses also include fulfillment, customer service, technology, professional fees, other general corporate expenses, and stock-based compensation, consisting substantially of stock option grants and restricted stock awards to employees and consultants.

### *Sales and Marketing Expenses*

Our marketing expenses consist primarily of costs associated with paid website search marketing, online banner marketing, e-mail campaigns, affiliate programs and optimization services. These marketing programs, which are designed to drive buyers to our website, are the most important factor in increasing demand for our jewelry products and increasing net revenue.

### *Public Offering Costs*

These costs consist primarily of regulatory filing fees, accountant fees, legal fees and printing expenses incurred in the planned initial public offering.

## **Results of Operations**

### **Comparison of Year Ended December 31, 2008 with Year Ended December 31, 2007**

#### *Net Revenue*

Net revenue increased 10.8% to \$207.4 million in 2008 from \$187.1 million in 2007. This increase in net revenue was due primarily to the growth in our wholesale sales of \$29.9 million offset by a decline in our online sales of \$9.6 million. In 2008, we started selling consignment inventory on a selective and limited basis and recorded revenue of \$635,000 from sales of inventory that were on consignment from vendors. Based on the terms of the consignment agreements, we record as revenue sales of the consignment inventory.

The financial and economic crisis of 2008 resulted in a major slowdown in our revenue from the fourth quarter of 2008. For the year ended December 31, 2008, there was an overall decrease in online demand for our jewelry as consumers reduced their discretionary spending. If the economy continues to decline it will cause a decline in demand and have a negative effect on our revenue.

#### *Gross Profit*

Gross profit increased 7.9% to \$58.7 million in 2008 from \$54.4 million in 2007. Gross profit as a percentage of net revenue decreased to 28.3% in 2008 from 29.1% in 2007. The decrease in gross profit percentage resulted primarily from lower gross margins from wholesale revenue offset by higher gross margins from online revenue. Co-op marketing contributions from vendors contributed more to gross margins in 2008 due to a full year of contribution compared to 2007 when it was only implemented in the third quarter of 2007. The total gross profit dollars increased despite the drop in the gross profit percentage due to the increase in revenue.

#### *General and Administrative Expenses*

General and administrative expenses increased 3.7% to \$21.2 million in 2008 from \$20.5 million in 2007. We managed to hold the general and administrative expenses relatively flat for the year after making significant cost reductions in the fourth quarter of 2008. We reduced our personnel from 240 at year end 2007 to 165 at year end 2008 with most of the reduction occurring in the fourth quarter of 2008. General and administrative expenses as a percentage of net revenue declined to 10.3% in 2008 compared to 10.9% in 2007.

An impairment charge of \$256,000 was recorded in 2008 on advances made to employees to purchase shares of our common stock when the value of our common stock held as collateral for the advances fell below the amount of the advances. The 154,000 shares of the common stock held as collateral were valued based on the closing price at the end of the year ended December 31, 2008.

### *Sales and Marketing Expenses*

Sales and marketing expenses increased 0.8% to \$12.7 million in 2008 from \$12.6 million in 2007. We reduced significantly the sales and marketing expenses in the fourth quarter of 2008 in line with the significantly slowing online revenue. Sales and marketing expenses as a percentage of net revenue decreased to 6.1% in 2008 from 6.7% in 2007.

### **Comparison of Year Ended December 31, 2007 with Year Ended December 31, 2006**

#### *Net Revenue*

Net revenue increased 42.0% to \$187.1 million in 2007 from \$131.8 million in 2006. This increase in net revenue was due primarily to the growth in demand for our jewelry products and the increase in average order value. The growth in demand was primarily the result of the number of new buyers we attracted during 2007. We have also implemented three initiatives in 2007 that generated more demand from our customers. In certain circumstances, including satisfaction of our gross profit criteria and availability of multiple quantities of items, we allow customers who did not have the winning bid to purchase items at their last bid price, we allow customers to purchase multiple quantities of items and we allow customers viewing the item to purchase the item at the winning bid price.

### *Gross Profit*

Gross profit increased 74.6% to \$54.4 million in 2007 from \$31.2 million in 2006. Gross profit as a percentage of net revenue increased to 29.1% in 2007 from 23.7% in 2006. The increase in gross profit as a percentage of net revenue resulted primarily from more effective purchases, increased margin on shipping and handling charges, and co-op marketing contributions from vendors commencing in July 2007. Gross profit margins benefited from the amortized co-op marketing contributions that reduced our cost of sales by \$4.8 million or 2.6% of net revenue.

### *General and Administrative Expenses*

General and administrative expenses increased 47.7% to \$20.5 million in 2007 from \$13.9 million in 2006. The increase in general and administrative expenses was due mainly to increases in payroll and payroll related expenses, SOX compliance costs, outsourcing and other administrative expenses. We increased our personnel from 198 at year end, 2006 to 240 at year end, 2007. General and administrative expenses as a percentage of net revenue was 10.9% in 2007 compared to 10.5% in 2006.

### *Sales and Marketing Expenses*

Sales and marketing expenses increased 22.1% to \$12.6 million in 2007 from \$10.3 million in 2006. This increase resulted primarily from increased marketing campaigns to attract new buyers. Our efforts to control the sales and marketing expenses and improve the effectiveness of our marketing campaigns have been successful in lowering the costs relative to the higher growth in net revenue. Consequently, sales and marketing expenses as a percentage of net revenue decreased to 6.7% in 2007 from 7.8% in 2006. We expect our sales and marketing expenses to continue to increase in absolute dollars, as we intend to continue increasing our online marketing campaigns in order to attract new customers.

### *Public Offering Costs*

These costs consist primarily of regulatory filing fees, accountant fees, legal fees and printing expenses incurred in the planned initial public offering, which amounted to \$0 and \$1.3 million for the years ended December 31, 2007 and 2006, respectively. Costs incurred in 2006 relate to the registration statement of the planned initial public offering. The capitalized costs of the planned initial public offering were expensed when the Company determined it was unable to complete the offering and subsequently requested withdrawal of the registration statement.

### **Quarterly Operations Data**

The following tables set forth quarterly statements of operations data for the eight quarters ended December 31, 2008, including amounts expressed as a percentage of net revenue. This quarterly information is unaudited, but has been prepared on the same basis as the annual financial statements and, in our opinion, reflects all adjustments necessary for a fair representation of the information for the periods presented. This quarterly statement of operations data should be read in conjunction with our audited financial statements and the related notes included elsewhere in this prospectus. Results of operations for any quarter are not necessarily indicative of results for any future period.

Historically, sales in the jewelry industry are seasonal and have been higher in the fourth quarter as a result of higher consumer spending during the December holiday season. Approximately 28.5%, 33.8%, and 16.9% of our net revenue in 2006, 2007, and 2008, respectively, was generated during the fourth quarter. The fourth quarter of 2008 was an exception as we encountered a significant slowdown in sales resulting from the 2008 financial and economic crisis. As we continue to grow, we expect to experience more pronounced seasonal fluctuations in our net revenue and anticipate a disproportionate amount of our revenue in the fourth quarter in the future.

| (in thousands,<br>except per share data)                              | Quarters ended    |                  |                   |                  |                   |                  |                   |                  |
|-----------------------------------------------------------------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|
|                                                                       | March 31,<br>2007 | June 30,<br>2007 | Sept. 30,<br>2007 | Dec. 31,<br>2007 | March 31,<br>2008 | June 30,<br>2008 | Sept. 30,<br>2008 | Dec. 31,<br>2008 |
|                                                                       | (unaudited)       |                  |                   |                  |                   |                  |                   |                  |
| Net revenue                                                           | \$ 44,724         | \$ 39,123        | \$ 40,051         | \$ 63,233        | \$ 61,929         | \$ 54,986        | \$ 55,356         | \$ 35,139        |
| Gross profit                                                          | 11,128            | 10,874           | 12,695            | 19,751           | 18,036            | 15,318           | 13,294            | 12,075           |
| General and administrative                                            | 4,843             | 4,985            | 4,945             | 5,684            | 5,907             | 5,680            | 5,267             | 4,355            |
| Sales and marketing                                                   | 2,600             | 2,019            | 2,406             | 5,552            | 4,199             | 3,131            | 2,314             | 3,037            |
| Depreciation and amortization                                         | 74                | 113              | 160               | 152              | 162               | 172              | 172               | 185              |
| Income from operations                                                | 3,611             | 3,757            | 5,184             | 8,363            | 7,768             | 6,335            | 5,541             | 4,498            |
| Net income                                                            | \$ 3,435          | \$ 2,915         | \$ 3,563          | \$ 8,213         | \$ 4,605          | \$ 3,615         | \$ 3,259          | \$ 2,924         |
| Net income per share available<br>to common stockholders —<br>Basic   | \$ 0.15           | \$ 0.13          | \$ 0.15           | \$ 0.34          | \$ 0.19           | \$ 0.15          | \$ 0.14           | \$ 0.13          |
| Net income per share available<br>to common stockholders —<br>Diluted | \$ 0.14           | \$ 0.12          | \$ 0.14           | \$ 0.29          | \$ 0.18           | \$ 0.14          | \$ 0.13           | \$ 0.13          |
| Weighted average number of<br>shares outstanding — Basic              | 23,246            | 23,272           | 23,593            | 24,150           | 24,538            | 23,828           | 23,523            | 23,312           |
| Weighted average number of<br>shares outstanding —<br>Diluted         | 23,725            | 24,147           | 26,324            | 28,507           | 25,829            | 25,739           | 25,213            | 23,313           |
|                                                                       | March 31,<br>2007 | June 30,<br>2007 | Sept. 30,<br>2007 | Dec. 31,<br>2007 | March 31,<br>2008 | June 30,<br>2008 | Sept. 30,<br>2008 | Dec. 31,<br>2008 |
|                                                                       | (unaudited)       |                  |                   |                  |                   |                  |                   |                  |
| Net revenue                                                           | 100.0%            | 100.0%           | 100.0%            | 100.0%           | 100.0%            | 100.0%           | 100.0%            | 100.0            |
| Gross profit                                                          | 24.9              | 27.8             | 31.7              | 31.2             | 29.1              | 27.9             | 24.0              | 34.4             |
| General and administrative                                            | 10.8              | 12.7             | 12.3              | 9.0              | 9.5               | 10.3             | 9.5               | 12.4             |
| Sales and marketing                                                   | 5.8               | 5.2              | 6.0               | 8.8              | 6.8               | 5.7              | 4.2               | 8.7              |
| Depreciation and amortization                                         | 0.2               | 0.3              | 0.4               | 0.2              | 0.3               | 0.3              | 0.3               | 0.5              |
| Operating income                                                      | 8.1               | 9.6              | 12.9              | 13.2             | 12.5              | 11.6             | 10.0              | 12.8             |
| Net income                                                            | 7.7%              | 7.5%             | 8.9%              | 13.0%            | 7.4%              | 6.6%             | 5.8%              | 8.3%             |

Additional operating metrics:

|                                            | March 31,<br>2007 | June 30,<br>2007 | Sept. 30,<br>2007 | Dec. 31,<br>2007 | March 31,<br>2008 | June 30,<br>2008 | Sept. 30,<br>2008 | Dec. 31,<br>2008 |
|--------------------------------------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|
|                                            | (unaudited)       |                  |                   |                  |                   |                  |                   |                  |
| Average selling price per<br>order (gross) | \$ 154            | \$ 171           | \$ 173            | \$ 169           | \$ 182            | \$ 183           | \$ 175            | \$ 169           |
| Average orders per day                     | 3,317             | 2,678            | 2,699             | 4,443            | 3,734             | 3,023            | 2,453             | 2,462            |
| Average items sold per day                 | 9,482             | 8,678            | 8,814             | 12,709           | 12,186            | 10,082           | 8,431             | 8,287            |
| Acquisition cost per new<br>buyer          | \$ 45             | \$ 38            | \$ 43             | \$ 51            | \$ 50             | \$ 48            | \$ 43             | \$ 51            |
| Number of new buyers                       | 58,056            | 53,637           | 55,423            | 109,833          | 83,179            | 64,882           | 54,072            | 59,485           |

## Liquidity and Capital Resources

The significant components of our working capital are inventory and liquid assets such as cash and accounts receivable, reduced by revolving credit line, accounts payable, accrued expenses and deferred revenue. Our business model contains beneficial working capital characteristics: while we collect cash from sales to customers within several business days of the related online payment, we typically have extended payment terms with our suppliers.

As of December 31, 2008, we had a working capital surplus of \$32.8 million and have no long-term debt obligations. Net cash provided by operating activities was \$18.6 million in 2008 compared with net cash used for operating activities of \$2.0 million in 2007. Net cash is affected primarily by changes in net income, inventories, accounts receivable, other receivable, accounts payable, accrued expenses, and deferred revenue. We recorded net income of \$5.4 million in 2006, \$18.1 million in 2007 and \$14.4 million in 2008. Inventories, and accounts payable generally increase or decrease in line with sales trend and changes in our inventory strategy. Our inventory strategy is influenced by our ability to secure inventory that we believe will improve sales and our gross margins.

The increase in cash provided by operating activities in 2008 compared with cash used for operating activities in 2007 was \$20.6 million. Net income was \$14.4 million in 2008 compared with \$18.1 million in 2007. Inventories decreased by \$19.3 million in 2008 compared with an increase of \$23.0 million in 2007. Accounts receivable decreased by \$1.6 million in 2008 compared to an increase of \$216,000 in 2007. Other receivable decreased by \$2.0 million in 2008 compared to an increase of \$3.0 million in 2007. Accounts payable decreased by \$16.4 million in 2008 compared to an increase of \$4.4 million in 2007. The decrease in inventories and corresponding decrease in accounts payable in 2008 is attributable to the declining business and economic outlook. Accrued expenses decreased by \$1.4 million in 2008 compared to an increase of \$2.6 million in 2007. Deferred revenue decreased by \$2.0 million in 2008 compared to a decrease of \$1.0 million in 2007.

Net cash used for investing activities were 367,000, \$1.4 million, and \$1.0 million in 2006, 2007 and 2008, respectively, and was primarily related to capital expenditures for our office equipment and technology system infrastructure, including hardware and software.

Net cash used for financing activities was \$18.0 million in 2008; \$5.9 million was used to pay down the revolving credit facility, \$2.5 million was used to retire shares from the net exercise of stock options, and \$12.5 million was used to repurchase treasury shares net against proceeds of \$2.1 million from the exercise of stock options and \$716,000 from the tax benefit from exercise of stock options. Net cash provided by financing activities was \$7.8 million in 2007; financing was provided by proceeds from the revolving credit line of \$2.0 million, exercise of stock options of \$4.8 million, and tax benefit from exercise of stock options of \$3.2 million net against repurchase of treasury shares of \$886,000. Net cash used for financing activities was \$3.2 million in 2006, related to proceeds from the revolving line of credit of \$3.9 million net against \$690,000 for the retirement of common stock from net vesting of restricted stocks and \$90,000 for the purchase of treasury stock.

In July 2006, we entered into a revolving credit line agreement with LaSalle Bank (Bank of America) to provide working capital financing secured by inventories and tangible assets. As of December 31, 2008, we have a limit of \$25 million under the loan agreement. All cash receipts from our revenues are restricted to being deposited into a Bank of America account, to be applied to current reported cash disbursements requirements, under a positive pay system, and then to the credit line outstanding balance. The revolving credit line agreement expires in July of 2010. As of December 31, 2008, there was no outstanding balance under the revolving credit line. The interest rate is at prime and there is an unused fee of 0.15% on the unused portion of the revolving credit line.

We believe that cash and cash equivalents currently on hand, cash flows from operations and the availability of a \$25 million revolving line of credit will be sufficient to continue our operations and to pursue our growth strategy for the foreseeable future. Our future capital requirements will depend on many factors, including the rate of our revenue growth; the timing and extent of spending to enhance our website, network infrastructure, and transaction processing systems; the extent of our advertising and marketing programs; the levels of the inventory we carry; acquisition and relocation to a new corporate office; and other factors relating to our business. Enhancement of our website, network infrastructure, and transaction processing systems will require us to spend significantly more than we have in the past. Moreover, to date our spending in these areas has been lower than industry averages. We anticipate increasing our system expenditures to accommodate these needs in the future. We may require additional financing in the future in order to execute our operating plan and we may not be able to obtain such financing. We cannot predict whether this additional financing will be in the form of equity, debt, or a combination of debt and equity.

## Lease Obligations

The following table presents our contractual obligations at December 31, 2008, over the next five years and thereafter (in thousands):

| Payments by period | Total amount    | Less than 1 year | 1 to 3 years  | 3 to 5 years  | After 5 years |
|--------------------|-----------------|------------------|---------------|---------------|---------------|
| Property lease     | \$ 1,448        | \$ 987           | \$ 346        | \$ 115        | \$ —          |
| Equipment lease    | 207             | 56               | 104           | 47            | —             |
|                    | <u>\$ 1,655</u> | <u>\$ 1,043</u>  | <u>\$ 450</u> | <u>\$ 162</u> | <u>\$ —</u>   |

As more fully described in Note 8 to the audited financial statements, we are obligated for the lease of our office and warehouse space, and operating leases for copy machines.

## Impact of Inflation

The effect of inflation and changing prices on our operations was not significant during the periods presented.

## Item 7A. Quantitative and Qualitative Disclosure about Market Risk

Market risk represents the risk of loss arising from adverse changes in market rates and foreign exchange rates. We do not believe that a change in market interest rates would have a material effect on our results of operations or financial condition. Although we derive a portion of our sales outside of the United States, all of our sales are denominated in U.S. dollars. We have limited exposure to financial market risks, including changes in interest rates and foreign currency exchange rates.

## Item 8. Financial Statements and Supplementary Data

See Item 15(a)

## Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

## Item 9A. Controls and Procedures

### *Evaluation of Disclosure Controls and Procedures*

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Disclosure controls and procedures are the controls and other procedures that we designed to ensure that we record, process, summarize and report in a timely manner the information we must disclose in reports that we file with or submit to the Securities and Exchange Commission. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of the date of their evaluation, our disclosure controls and procedures were effective. There were no significant changes made in our internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation.

### *Report of Management on Internal Control over Financial Reporting*

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) of the 1934 Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting include those policies and procedures that (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our transactions and dispositions of our assets; (2) provide reasonable assurance that our transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with appropriate authorizations; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

We assessed the effectiveness of our internal control over financial reporting as of December 31, 2008, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control — Integrated Framework. Based on this assessment, management has concluded that our internal control over financial reporting was effective as of December 31, 2008.

Stonefield Josephson, Inc., an independent registered public accounting firm, has issued an attestation report on management's assessment of internal control over financial reporting, a copy of which is included in this annual report on Form 10-K.

### ***Changes in Internal Control over Financial Reporting***

There has been no change in our internal controls over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) that occurred during the fourth quarter of our fiscal year ended December 31, 2008 that our certifying officers concluded materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### ***Limitations on Controls***

Management does not expect that our disclosure controls and procedures or our internal control over financial reporting 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. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### **Item 9B. Other Information**

None.

### **Part III**

We have omitted the information required in Part III of this annual report because we intend to include that information in our definitive proxy statement for our 2009 annual meeting of shareholders, which we expect to file before 120 days after December 31, 2008. We incorporate that information in this annual report by reference to our 2009 proxy statement.

### **Item 10. Directors, Executive Officers and Corporate Governance.**

Information required by this item is incorporated by reference from the definitive proxy statement required to be filed pursuant to Regulation 14A for the 2009 Annual Meeting of our stockholders.

We have adopted a code of conduct that applies to our Chief Executive Officer, Chief Financial Officer, and to all of our other officers, directors, employees and agents. The code of conduct is available at the Corporate Governance section of the Investor Relations link on our website at [www.bidz.com](http://www.bidz.com). We intend to disclose future amendments to, or waivers from, certain provisions of our code of ethics on the above website.

### **Item 11. Executive Compensation.**

Information required by this item is incorporated by reference from the definitive proxy statement required to be filed pursuant to Regulation 14A for the 2009 Annual Meeting of our stockholders.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

Information required by this item is incorporated by reference from the definitive proxy statement required to be filed pursuant to Regulation 14A for the 2009 Annual Meeting of our stockholders.

### **Item 13. Certain Relationships and Related Transactions, and Director Independence.**

Information required by this item is incorporated by reference from the definitive proxy statement required to be filed pursuant to Regulation 14A for the 2009 Annual Meeting of our stockholders.

**Item 14. Principal Accountant Fees and Services.**

Information required by this item is incorporated by reference from the definitive proxy statement required to be filed pursuant to Regulation 14A for the 2009 Annual Meeting of our stockholders.

**Part IV**

**Item 15. Exhibits and Financial Statement Schedules**

The following documents are filed as part of this report:

**(a) Financial Statements**

Report of Independent Registered Public Accounting Firm  
Balance Sheets as of December 31, 2007 and 2008  
Statements of Income for the Years ended December 31, 2006, 2007, and 2008  
Statements of Changes in Stockholders' Equity for the Years ended December 31, 2006, 2007, and 2008  
Statements of Cash Flows for the Years ended December 31, 2006, 2007, and 2008  
Notes to Financial Statements

**(b) Financial Statement Schedule**

## **Report of Independent Registered Public Accounting Firm**

To The Board of Directors and Stockholders of Bidz.com, Inc.:

We have audited the accompanying balance sheets of Bidz.com, Inc. (the "Company") as of December 31, 2007 and 2008, and the related statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2008. Our audits also included the financial statement schedule listed in the index at Item 15. These financial statements and the schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Bidz.com, Inc. as of December 31, 2007 and 2008, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 23, 2009 expressed an unqualified opinion.

/s/ Stonefield Josephson, Inc.

Los Angeles, California  
February 23, 2009

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Bidz.com, Inc.

We have audited Bidz.com, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Bidz.com, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying "Report of Management on Internal Control over Financial Reporting." Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Bidz.com, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets as of December 31, 2007 and 2008 and the related statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2008, of Bidz.com, Inc., and our report dated February 23, 2009 expressed an unqualified opinion.

/s/ Stonefield Josephson, Inc.  
Los Angeles, California  
February 23, 2009

**Bidz.com, Inc.**

**Balance Sheets**

*(in thousands, except share and per share data)*

|                                                                                                                                                                           | December 31, |           |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|-----------|
|                                                                                                                                                                           | 2007         | 2008      |
| <b>Assets</b>                                                                                                                                                             |              |           |
| Current assets:                                                                                                                                                           |              |           |
| Cash                                                                                                                                                                      | \$ 4,808     | \$ 4,456  |
| Accounts receivable                                                                                                                                                       | 2,146        | 591       |
| Inventories, net of reserves of \$1,075 and \$820 at December 31, 2007 and December 31, 2008, respectively                                                                | 56,686       | 37,657    |
| Other receivable (includes related party amounts of \$673 and \$102 at December 31, 2007 and December 31, 2008, respectively)                                             | 3,002        | 1,041     |
| Current deferred tax assets                                                                                                                                               | 2,121        | 1,950     |
| Other current assets                                                                                                                                                      | 485          | 689       |
| Total current assets                                                                                                                                                      | 69,248       | 46,384    |
| Long term deferred tax asset                                                                                                                                              | 129          | 84        |
| Property and equipment, net                                                                                                                                               | 1,323        | 1,672     |
| Intangible asset                                                                                                                                                          | 161          | 161       |
| Deposits                                                                                                                                                                  | 104          | 104       |
| Total assets                                                                                                                                                              | \$ 70,965    | \$ 48,405 |
| <b>Liabilities and Stockholders' Equity</b>                                                                                                                               |              |           |
| Current liabilities:                                                                                                                                                      |              |           |
| Revolving credit line                                                                                                                                                     | \$ 5,924     | \$ —      |
| Accounts payable (includes related party amounts of \$5,050 and \$1,364 at December 31, 2007 and December 31, 2008, respectively)                                         | 26,050       | 9,636     |
| Accrued expenses                                                                                                                                                          | 4,509        | 3,091     |
| Deferred revenue                                                                                                                                                          | 2,900        | 872       |
| Total current liabilities                                                                                                                                                 | 39,383       | 13,599    |
| Commitments and contingencies (Note 14)                                                                                                                                   |              |           |
| Stockholders' equity:                                                                                                                                                     |              |           |
| Preferred stock: par value \$0.001; authorized 4,000,000 shares; none issued and outstanding at December 31, 2007 and December 31, 2008, respectively                     | —            | —         |
| Common stock: par value \$0.001; authorized 100,000,000 shares; issued and outstanding 24,556,354 and 22,917,918 at December 31, 2007 and December 31, 2008, respectively | 25           | 23        |
| Additional paid in capital                                                                                                                                                | 36,961       | 24,520    |
| Shares held in treasury, at cost; 100,000 and 0 shares at December 31, 2007 and December 31, 2008, respectively                                                           | (886)        | —         |
| Employees share purchase receivable                                                                                                                                       | (1,086)      | (708)     |
| Accumulated earnings (deficit)                                                                                                                                            | (3,432)      | 10,971    |
| Total stockholders' equity                                                                                                                                                | 31,582       | 34,806    |
|                                                                                                                                                                           | \$ 70,965    | \$ 48,405 |

**Bidz.com, Inc.**

**Statements of Income**

*(in thousands, except share and per share data)*

|                                                                 | Years Ended December 31, |                   |                   |
|-----------------------------------------------------------------|--------------------------|-------------------|-------------------|
|                                                                 | 2006                     | 2007              | 2008              |
| <b>Net revenue:</b>                                             |                          |                   |                   |
| Merchandise sales                                               | \$ 131,687               | \$ 186,830        | \$ 177,089        |
| Wholesale merchandise sales                                     | —                        | —                 | 29,886            |
| Other revenue                                                   | 136                      | 301               | 435               |
|                                                                 | <u>131,823</u>           | <u>187,131</u>    | <u>207,410</u>    |
| Cost of revenue                                                 | 100,633                  | 132,683           | 148,688           |
| Gross Profit                                                    | <u>31,190</u>            | <u>54,448</u>     | <u>58,722</u>     |
| <b>Operating expenses:</b>                                      |                          |                   |                   |
| General and administrative                                      | 13,853                   | 20,458            | 21,209            |
| Sales and marketing                                             | 10,300                   | 12,578            | 12,681            |
| Public offering costs                                           | 1,287                    | —                 | —                 |
| Depreciation and amortization                                   | 273                      | 498               | 690               |
| Total operating expenses                                        | <u>25,713</u>            | <u>33,534</u>     | <u>34,580</u>     |
| Income from operations                                          | 5,477                    | 20,914            | 24,142            |
| Other income - interest income                                  | 80                       | 41                | 40                |
| Other expense - interest (expense)                              | (48)                     | (291)             | (182)             |
| Income before income tax expense                                | 5,509                    | 20,664            | 24,000            |
| Income tax expense                                              | 120                      | 2,538             | 9,597             |
| Net income                                                      | <u>\$ 5,389</u>          | <u>\$ 18,126</u>  | <u>\$ 14,403</u>  |
| Net income per share available to common shareholders - basic   | <u>\$ 0.23</u>           | <u>\$ 0.77</u>    | <u>\$ 0.61</u>    |
| Net income per share available to common shareholders - diluted | <u>\$ 0.23</u>           | <u>\$ 0.69</u>    | <u>\$ 0.57</u>    |
| Weighted average number of shares outstanding - basic           | <u>23,302,026</u>        | <u>23,567,995</u> | <u>23,798,338</u> |
| Weighted average number of shares outstanding - diluted         | <u>23,791,368</u>        | <u>26,266,008</u> | <u>25,069,509</u> |

Bidz.com, Inc.

Statements of Changes in Stockholders' Equity

(in thousands)

|                                                                                | Common stock |           | Additional | Treasury | Employees  | Deferred     | Accumulated | Total         |
|--------------------------------------------------------------------------------|--------------|-----------|------------|----------|------------|--------------|-------------|---------------|
|                                                                                | Shares       | Amount    | paid in    | shares   | share      | stock-based  | earnings    | stockholders' |
|                                                                                |              |           | capital    |          | purchase   | compensation | (deficit)   | equity        |
| Balance at December 31, 2005                                                   | 23,312       | \$ 28,830 | \$ —       | \$ —     | \$ —       | \$ (100)     | \$ (26,947) | \$ 1,783      |
| Reincorporation from California (no par value) to Delaware (\$0.001 par value) | —            | (28,807)  | 28,807     | —        | —          | —            | —           | —             |
| Issuance of common stock for service                                           | 37           | —         | 219        | —        | —          | —            | —           | 219           |
| Fair value of options granted to employees                                     | —            | —         | 16         | —        | —          | —            | —           | 16            |
| Retirements of common stock from net vesting of restricted stocks              | (115)        | —         | (690)      | —        | —          | —            | —           | (690)         |
| Purchase of treasury stock                                                     | —            | —         | —          | (90)     | —          | —            | —           | (90)          |
| Amortization of deferred stock-based compensation                              | —            | —         | —          | —        | —          | 100          | —           | 100           |
| Net income                                                                     | —            | —         | —          | —        | —          | —            | 5,389       | 5,389         |
| Balance at December 31, 2006                                                   | 23,234       | \$ 23     | \$ 28,352  | \$ (90)  | \$ —       | \$ —         | \$ (21,558) | \$ 6,727      |
| Issuance of common stock to directors                                          | 19           | —         | 113        | —        | —          | —            | —           | 113           |
| Employees share purchase receivable                                            | —            | —         | —          | —        | (1,086)    | —            | —           | (1,086)       |
| Issuance of common stock from exercise of stock options                        | 1,192        | 2         | 4,770      | —        | —          | —            | —           | 4,772         |
| Tax benefit from exercise of options                                           | —            | —         | 3,155      | —        | —          | —            | —           | 3,155         |
| Fair value of options granted to employees                                     | —            | —         | 488        | —        | —          | —            | —           | 488           |
| Grant of restricted stock awards to employees and directors                    | 126          | —         | 173        | —        | —          | —            | —           | 173           |
| Retirements of common stock                                                    | (15)         | —         | (90)       | 90       | —          | —            | —           | —             |
| Purchase of treasury stock                                                     | —            | —         | —          | (886)    | —          | —            | —           | (886)         |
| Net income                                                                     | —            | —         | —          | —        | —          | —            | 18,126      | 18,126        |
| Balance at December 31, 2007                                                   | 24,556       | \$ 25     | \$ 36,961  | \$ (886) | \$ (1,086) | \$ —         | \$ (3,432)  | \$ 31,582     |
| Issuance of common stock for service                                           | 1            | —         | 5          | —        | —          | —            | —           | 5             |
| Employees share purchase receivable                                            | —            | —         | —          | —        | 122        | —            | —           | 122           |
| Impairment in employees share purchase receivable                              | —            | —         | —          | —        | 256        | —            | —           | 256           |
| Retirements of common stock from net vesting of restricted stocks              | —            | —         | (10)       | —        | —          | —            | —           | (10)          |
| Issuance of common stock from exercise of stock options                        | 442          | —         | 2,095      | —        | —          | —            | —           | 2,095         |
| Retirement of common stock from net exercise of stock options                  | (250)        | —         | (2,480)    | —        | —          | —            | —           | (2,480)       |
| Tax benefit from exercise of options                                           | —            | —         | 716        | —        | —          | —            | —           | 716           |
| Fair value of stock options granted to employees                               | —            | —         | 283        | —        | —          | —            | —           | 283           |
| Grant of restricted stock awards to employees and directors                    | 25           | —         | 358        | —        | —          | —            | —           | 358           |
| Cancellation of restricted stock awards to employee                            | (2)          | —         | —          | —        | —          | —            | —           | —             |
| Retirements of common stock                                                    | (1,854)      | (2)       | (13,408)   | 13,410   | —          | —            | —           | —             |
| Purchase of treasury stock                                                     | —            | —         | —          | (12,524) | —          | —            | —           | (12,524)      |
| Net income                                                                     | —            | —         | —          | —        | —          | —            | 14,403      | 14,403        |
| Balance at December 31, 2008                                                   | 22,918       | \$ 23     | \$ 24,520  | \$ —     | \$ (708)   | \$ —         | \$ 10,971   | \$ 34,806     |

Bidz.com, Inc.

Statements of Cash Flows

(in thousands)

|                                                                                          | Years Ended December 31, |                 |                 |
|------------------------------------------------------------------------------------------|--------------------------|-----------------|-----------------|
|                                                                                          | 2006                     | 2007            | 2008            |
| <b>Cash flows provided by (used for) operating activities:</b>                           |                          |                 |                 |
| Net income                                                                               | \$ 5,389                 | \$ 18,126       | \$ 14,403       |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                          |                 |                 |
| Depreciation and amortization                                                            | 273                      | 498             | 686             |
| Loss on disposal of fixed asset                                                          | —                        | —               | 4               |
| Change in inventory reserve                                                              | 130                      | 614             | (255)           |
| Impairment in employees share purchase receivable                                        | —                        | —               | 256             |
| Amortization of deferred stock-based compensation                                        | 100                      | —               | —               |
| Stock-based compensation                                                                 | 235                      | 774             | 641             |
| <b>Changes in assets and liabilities:</b>                                                |                          |                 |                 |
| <b>(Increase) decrease in assets:</b>                                                    |                          |                 |                 |
| Accounts receivable                                                                      | (1,044)                  | (216)           | 1,555           |
| Inventories                                                                              | (18,517)                 | (22,992)        | 19,284          |
| Other receivable                                                                         | —                        | (3,002)         | 1,961           |
| Current deferred tax assets                                                              | —                        | (2,121)         | 171             |
| Other current assets                                                                     | (1,034)                  | 357             | (204)           |
| Deposits                                                                                 | 115                      | 21              | —               |
| <b>Increase (decrease) in liabilities:</b>                                               |                          |                 |                 |
| Post-dated check financing                                                               | (5,315)                  | —               | —               |
| Accounts payable                                                                         | 14,690                   | 4,413           | (16,414)        |
| Accrued expenses                                                                         | 178                      | 2,557           | (1,418)         |
| Deferred revenue                                                                         | 2,358                    | (1,035)         | (2,028)         |
| Net cash provided by (used for) operating activities                                     | (2,442)                  | (2,006)         | 18,642          |
| <b>Cash flows provided by (used for) investing activities:</b>                           |                          |                 |                 |
| Capital expenditures                                                                     | (367)                    | (1,354)         | (1,058)         |
| Proceeds from sale of fixed asset                                                        | —                        | —               | 19              |
| Net cash used for investing activities                                                   | (367)                    | (1,354)         | (1,039)         |
| <b>Cash flows provided by (used for) financing activities:</b>                           |                          |                 |                 |
| Revolving credit line                                                                    | 3,941                    | 1,983           | (5,924)         |
| Long term deferred tax assets                                                            | —                        | (129)           | 45              |
| Issuance of common stock                                                                 | —                        | —               | 5               |
| Employees share purchase receivable                                                      | —                        | (1,086)         | 122             |
| Retirements of common stock from net vesting of restricted stocks                        | (690)                    | —               | (10)            |
| Proceeds from exercise of stock options                                                  | —                        | 4,772           | 2,095           |
| Retirements of common stock from net exercise of stock options                           | —                        | —               | (2,480)         |
| Tax benefit from exercise of stock options                                               | —                        | 3,155           | 716             |
| Purchase of treasury stock                                                               | (90)                     | (886)           | (12,524)        |
| Net cash provided by (used for) financing activities                                     | 3,161                    | 7,809           | (17,955)        |
| <b>Net increase (decrease) in cash</b>                                                   | <b>352</b>               | <b>4,449</b>    | <b>(352)</b>    |
| <b>Cash, beginning of period</b>                                                         | <b>7</b>                 | <b>359</b>      | <b>4,808</b>    |
| <b>Cash, end of period</b>                                                               | <b>\$ 359</b>            | <b>\$ 4,808</b> | <b>\$ 4,456</b> |
| <b>Supplemental disclosure of cash flow information:</b>                                 |                          |                 |                 |
| Interest paid                                                                            | \$ 48                    | \$ 291          | \$ 182          |
| Income taxes paid                                                                        | \$ 323                   | \$ 502          | \$ 9,874        |
| <b>Supplemental disclosure of non-cash investing and financing activities:</b>           |                          |                 |                 |
| Retirement of property and equipment                                                     | \$ 17                    | \$ 293          | \$ 9            |
| Retirement of treasury shares                                                            | \$ —                     | \$ 90           | \$ 13,410       |

**Bidz.com, Inc.**

**Notes to financial statements**

**(in thousands, except share and per share amounts)**

**(1) Summary of Significant Accounting Policies:**

*Business and Organization:*

We were formed in November 1998 as a California corporation and in June 2006, we were re-incorporated as a Delaware corporation with our principal location of business in Los Angeles, California. We operate a website located at [www.bidz.com](http://www.bidz.com) for the purpose of selling merchandise, utilizing our unique online sales auction platform and a fixed price online store at [www.buyz.com](http://www.buyz.com).

We sell our products throughout the United States and in international markets, concentrated mainly in English speaking countries such as Canada, Australia and the United Kingdom. Revenue generated from the United States accounted for approximately 79.2%, 77.7%, and 76.1% of net revenue for the years ended December 31, 2006, 2007, and 2008, respectively.

*Reclassification*

Certain amounts from prior years have been reclassified to conform to the current year's presentation.

*Recent Developments:*

On February 10, 2009, the Securities and Exchange Commission ("SEC") issued a subpoena to produce documents relating to the Company's inventory reserve policies, as well as other matters. We intend to fully cooperate with the SEC regarding this matter.

In February 2009, we authorized an increase in the stock buyback program to \$33.5 million from \$20.0 million. As of February 23, 2009 we have repurchased a total of approximately 1.9 million shares for a total of approximately \$13.5 million. About \$20.0 million remain available under the buyback program to repurchase shares in the open market.

*Use of Estimates:*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. We have made estimates for return and allowance reserve, inventory reserve, vendor co-op marketing contributions, deferred tax assets, accrued expenses, stock price volatility, stock option forfeiture rate, and expected stock option term.

*Fair Value of Financial Instruments:*

The carrying amount of our cash, accounts receivable, other current assets, accounts payable, deferred revenue and accrued expenses approximates their estimated fair values as a result of the short-term maturities of those financial instruments.

*Cash and Cash Equivalents:*

For purposes of the statements of cash flows, cash equivalents include all highly liquid debt instruments with original maturities of three months or less that do not secure any corporate obligation. We had no cash equivalents at December 31, 2007 or 2008.

Our credit card processor maintains a security interest in substantially all our bank accounts.

*Accounts Receivable:*

Accounts receivable consist mainly of amounts due from customer credit card and other electronic payments billed but not yet received at period end. We had no allowance for doubtful accounts at December 31, 2007 or 2008.

#### *Return and Allowance Reserve:*

We estimate potential future product returns and chargebacks related to current period revenue. We analyze historical returns and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales returns reserve and other allowances in any accounting period. If actual returns and chargebacks are greater than our estimates, we will record additional returns and allowances in addition to our estimates, which will result in lower net revenue recorded during that period. Reserves for returns and charge backs are included in accrued expenses.

#### *Concentration of Credit Risk:*

Financial instruments that potentially subject us to significant concentrations of credit risk consist primarily of cash and receivables. The current banking crisis may put cash deposits with our banks at risk and the FDIC deposit insurance will not be sufficient to cover any potential loss arising from a bank failure. We derive our accounts receivable primarily from revenue earned from customers located in the United States. We maintain an allowance for doubtful accounts based upon the expected collectability of accounts receivable. We record an allowance if one is necessary. No customer accounted for more than 10% of revenue or receivables during 2006, 2007, or 2008.

We had a concentration on two merchandise suppliers during 2006, 2007, and 2008, as more fully described in Note 13.

#### *Inventories:*

Inventories consist mainly of merchandise purchased for resale and are stated at the lower of first-in, first-out cost (FIFO) or market. We record in inventories loose diamonds and semi-precious stones that we purchased and delivered to manufacturers to produce into finished jewelry inventory to resell.

We record payments made to our suppliers for purchases we have yet to receive as prepaid inventory until they are in our possession and satisfactorily examined. Prepaid inventory included in inventories is \$94,000 and \$36,000 at December 31, 2007 and 2008, respectively.

#### *Inventory Reserve*

The unique nature of our business model where customers set the prices they are willing to pay may result in items selling below our cost, and we provide reserves against our inventory based on the difference between the average selling price and the cost of inventory if the average selling price is lower than the cost of inventory. We also provide reserves for obsolescence and slow moving inventory.

#### *Inventory Co-op Marketing Contributions*

In the third quarter of 2007, we started to bill and collect from our inventory vendors co-op marketing contributions as an incentive for us to market and sell their merchandise on the Bidz website. In accordance with EITF 02-16: Accounting by a Customer (including a Reseller) for Certain Consideration Received from a Vendor, the co-op marketing contributions that cannot be identified specifically to benefit the vendors are a reduction in cost of sales and will result in an increase in gross profit. We cannot specifically identify the benefits to each vendor; consequently, co-op marketing contributions are charged against inventory as a reduction of costs and amortized as a reduction of cost of sales. For the years ended December 31, 2007 and 2008, we have earned \$4.8 million and \$11.1 million of co-op marketing contributions, respectively, with \$4.2 and \$4.3 million, respectively, remaining unamortized and is an offset to inventory at December 31, 2007 and 2008. Receivable from vendors for co-op marketing contributions, less allowance for doubtful accounts, is included in other current assets and amounted to \$2.9 million and \$934,000 at December 31, 2007 and 2008, respectively.

#### *Property and Equipment:*

Property and equipment are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the related assets as follows:

|                         | Years |
|-------------------------|-------|
| Computer software       | 3     |
| Computer hardware       | 3     |
| Automobile              | 5     |
| Furniture and equipment | 5     |

#### *Intangible Asset:*

Our intangible asset consists of the cost to acquire our domain names, which was \$161,000 as of December 31, 2007 and 2008. Our domain names have indefinite lives and therefore are not subject to amortization. We perform an annual evaluation for impairment on the intangible asset. No impairment existed at December 31, 2007 or 2008 and no loss or impairment was recognized during 2006, 2007 and 2008.

#### *Long-Lived Assets:*

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," long-lived assets to be held and used are analyzed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. SFAS No. 144 applies to assets subject to amortization. We review property, equipment, and other long-lived assets subject to amortization for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. We measure recoverability by comparing the assets' carrying amount with future undiscounted net cash flows the assets are expected to generate.

If such assets are considered to be impaired, we measure the impairment to be recognized by the amount by which the carrying amount of the assets exceeds the projected discounted future cash flows arising from the assets or their fair values, whichever is more determinable.

#### *Revenue Recognition:*

We derive our revenue from four sources: merchandise sales, which include wholesale merchandise sales, shipping revenue, transaction fee revenue, and other revenue. In accordance with SAB 104, we recognize revenue from all four sources when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) the product has been shipped or the service has been rendered and the customer assumes the risk of loss; (3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured.

For online sales through our website, we recognize merchandise sales upon shipments made to individual consumers and businesses that are fulfilled from our warehouse. We require payment before we ship and the payment is generally made online by credit card or other electronic payment methods. We record amounts received or billed prior to shipment of goods to customers as deferred revenue. We reduce gross sales by returns, charge backs from customers, and other discounts redeemed to obtain such sales. For wholesale merchandise sales, we recognize sales when the merchandise is delivered to the customer and credit terms may be offered to such customers.

We report shipping and handling fees and costs in accordance with Emerging Issues Task Force ("EITF") issue No. 00-10, "Accounting for Shipping and Handling Fees and Costs." As such, in the Statement of Income all amounts billed to customers by us related to shipping and handling are included in "Net revenue" and our shipping costs are included in "Cost of revenue."

We include transaction fee revenue in net revenue. The 3% transaction fee is applied to all merchandise sales, including shipping and handling, but not to wholesale merchandise sales.

Other revenue includes primarily commissions and advertising revenue. We derive commission revenue from sales of Certified Merchant merchandise that is owned by third parties and recognize that revenue when services have been rendered. For commission revenue, we recognize as revenue only the commission portion of the price our customers pay for the purchased products because we are acting as an agent in such transactions. We recognize advertising revenue from allowing other companies to advertise on our web site when the services are rendered and the advertising revenue is known and collectible.

We present sales tax liability on a net basis in accordance with Emerging Issues Task Force ("EITF") Issue No. 06-03.

Outbound shipping revenue from customers are included in merchandise sales and amounted to \$15.1 million, \$22.6 million, and \$22.3 million in 2006, 2007, and 2008, respectively.

#### *Cost of Revenue:*

Cost of revenue includes product costs, inbound and outbound shipping charges, packaging and shipping supplies, insurance on shipments, product repair and service costs, and credit card and other electronic payment fees, and is recorded in the same period in which related revenue has been recorded. The cost of revenue is reduced by amortized co-op marketing contributions from our vendors.

Outbound shipping costs on merchandise sales totaled \$6.9 million, \$9.7 million, and \$10.0 million in 2006, 2007, and 2008, respectively.

*Deferred Revenue:*

Deferred revenue liability is recorded for sales transactions where the products had not yet been shipped.

*Income Tax Expense:*

We account for income taxes using an asset and liability approach, which requires the recognition of taxes payable or refundable for the current year and deferred tax assets and liabilities for the future tax consequences of events that have been recognized in our financial statements or tax returns. The measurement of current and deferred tax assets and liabilities is based on provisions of enacted tax laws; the effects of future changes in tax laws or rates are not anticipated. If necessary, the measurement of deferred tax assets is reduced by the amount of any tax benefits that are not expected to be realized based on available evidence.

*Stock-Based Compensation:*

Prior to January 1, 2006, we measured compensation expense to employees for our stock option incentive plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Utilizing the intrinsic value method prescribed by APB No. 25, we did not record compensation expense when stock options were granted to eligible participants as long as the exercise price was not less than the fair market value of the stock when the option was granted.

We recorded stock-based compensation representing the difference between the option exercise price and the deemed fair value of our common stock on the grant date for financial reporting purposes. We determined the deemed fair value of our common stock based upon the most recent third-party sale of our common stock known to us. Had different assumptions or criteria been used to determine the deemed fair value of our common stock, different amounts of stock-based compensation could have been reported.

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," and SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," which amended SFAS No. 123, we disclosed pro forma net income and net income per share as if the fair value based method had been applied in measuring compensation expense. The disclosure provisions of SFAS No. 148 were effective for financial statements for interim periods beginning after December 15, 2002. We adopted the disclosure requirements in the first quarter of 2003. The fair values of options and shares issued pursuant to our option plan at each grant date were estimated using the Black-Scholes option pricing model. Because there has been no public market for our common stock, we used the minimum value method in determining the expected volatility of our common stock was zero. The transition provisions did not have an impact on our financial position or results of operations as we did not elect to adopt the fair value-based method of accounting for stock-based employee compensation under SFAS No. 123.

On January 1, 2006, we adopted SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R") requiring that share-based payment transactions be recognized in the financial statements based on the fair value of the equity or liability instrument issued. For the years ended December 31, 2006 and 2007, we used the Black-Scholes option pricing model to estimate the value of our options in implementing SFAS 123R and the calculated method to determine expected volatility, rather than the minimum value method, which we previously used to determine expected volatility. No options were granted for the year ended December 31, 2008.

Under SFAS 123R stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest. Accordingly, stock-based compensation expense recognized in the statements of income will be reduced for estimated forfeitures, which is 0% for the years ended December 31, 2006 and 2007. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the pro forma information required under SFAS 148 for the period prior to 2006, we did not account for forfeitures, as all options granted were fully vested at the date of grant and were not subject to any service period conditions. We expensed stock-based compensation on the date of grant, as all options granted prior to January 1, 2006, vested immediately. Stock-based compensation subsequent to January 1, 2006 includes vesting provisions and therefore stock-based compensation expense is reduced for estimated forfeitures.

We adopted SFAS 123R using the modified prospective method which requires the application of the accounting standard as of January 1, 2006. Under this transition method, we are required to recognize compensation cost beginning January 1, 2006 for the portion of outstanding awards for which the requisite service has been rendered, based on the grant-date fair value of those awards calculated under SFAS 123 for our pro forma disclosures. In accordance with the modified prospective method, the financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123R.

#### *Internal Use Software:*

Pursuant to SOP 98-1, we expense all costs incurred for the development of internal use software that relate to the planning and post-implementation phases of the development and certain maintenance and enhancement costs. We capitalize and amortize direct costs incurred in the application development phase over the software's estimated useful life of three years. The capitalized software costs of \$250,000 was incurred from 2002 to 2004, and have been amortized since placed in use. At December 31, 2007 and 2008, the net unamortized balance included in Property and Equipment is \$0. The capitalized software costs of \$250,000 were retired in the year ended December 31, 2007 when it was determined that the software was no longer in use. We expense research and development costs and other computer software maintenance costs related to software development as incurred.

#### *Basic and Diluted Income per Share:*

In accordance with SFAS No. 128, "Earnings Per Share," we compute the basic income per common share by dividing net income available to common stockholders by the weighted average number of common shares outstanding. We compute diluted income per common share similarly to basic income per common share, except that we increase the denominator to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. At December 31, 2006, 2007, and 2008, we had 8,353,000 shares, 8,131,300 shares, and 6,864,500 shares, respectively, of common stock equivalents upon the exercise of the employee and non-employee stock options. These common stock equivalents consisted of 7,726,000 employee stock options and 627,000 non-employee stock options as of December 31, 2006; and 8,079,300 employee stock options and 52,000 non-employee stock options as of December 31, 2007; and 6,839,500 employee stock options and 25,000 non-employee stock options as of December 31, 2008. As of December 31, 2006, dilutive common stock equivalents totaled 489,342 consisting of 291,716 employee stock options and 197,626 non-employee stock options. As of December 31, 2007, dilutive common stock equivalents totaled 2,698,013 consisting of 2,682,069 employee stock options and 15,944 non-employee stock options. As of December 31, 2008, dilutive common stock equivalents totaled 1,271,171 consisting of 1,265,568 employee stock options and 5,602 consisting of non-employee stock options.

The dilutive effect of outstanding stock options is reflected in diluted earnings per share by application of the treasury stock method for the years ended December 31, 2006, 2007 and 2007. The following table sets forth the computation of basic and diluted net income per share (in thousands, except share and per share data):

|                                                     | 2006       | 2007       | 2008       |
|-----------------------------------------------------|------------|------------|------------|
| <b>Basic and diluted net income per share:</b>      |            |            |            |
| <b>Numerator:</b>                                   |            |            |            |
| Net income                                          | \$ 5,389   | \$ 18,126  | \$ 14,403  |
| <b>Denominator:</b>                                 |            |            |            |
| Weighted average shares of common stock outstanding | 23,302,026 | 23,567,995 | 23,798,338 |
| Effect of dilutive securities                       | 489,342    | 2,698,013  | 1,271,171  |
| Denominator for diluted calculation                 | 23,791,368 | 26,266,008 | 25,069,509 |
| Net income per share, basic                         | \$ 0.23    | \$ 0.77    | \$ 0.61    |
| Net income per share, diluted                       | \$ 0.23    | \$ 0.69    | \$ 0.57    |

#### *Advertising Expense:*

We recognize advertising expenses in accordance with SOP 93-7, "Reporting on Advertising Costs." As such, we expense the costs of producing advertisements at the time production occurs and we expense the cost of communicating advertisements in the period during which the advertising space or airtime is used. We recognize Internet advertising expenses based on the terms of the individual agreements, which are generally (1) during the period customers are acquired; (2) based on the number of clicks generated during a given period over the term of the contract; or (3) based on the number of e-mails sent during an e-mail distribution campaign. Advertising expenses totaled \$10.3 million, \$12.6 million, and \$12.7 million during the years ended December 31, 2006, 2007, and 2008, respectively.

#### *Public Offering Costs:*

These costs consist primarily of regulatory filing fees, accountant fees, legal fees and printing expenses incurred in the planned initial public offering, which amounted to \$1.3 million for the year ended December 31, 2006. The costs incurred in 2006 relate to the registration statement of the planned initial public offering. The capitalized costs of the rescission and initial public offering were expensed when the Company determined it was unable to complete the offering and subsequently requested withdrawal of the registration statement.

*New Accounting Pronouncements:*

In February 2007, the FASB issued Statement No. 159 ("FAS 159") which expanded FAS No. 157, "*Fair Value Measurements*," which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. FAS 159 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. FAS 159 is effective for fiscal years beginning after November 15, 2007. The adoption of FAS 157 and FAS 159 did not have a material impact on our financial statements.

In September 2006, the FASB issued Statement SFAS No. 157 ("FAS 157"), "*Fair Value Measurements*," which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. FAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007.

**(2) Inventories:**

Inventories consist of the following at December 31, 2007 and 2008 (in thousands):

|                                         | 2007             | 2008             |
|-----------------------------------------|------------------|------------------|
| Fine jewelry, watches and other         | \$ 53,054        | \$ 37,485        |
| Loose diamonds and semi-precious stones | 4,392            | 570              |
| Prepaid inventory                       | 94               | 36               |
| Inventory with manufacturing vendors    | 221              | 386              |
| Product inventories                     | 57,761           | 38,477           |
| Less: inventory reserve                 | (1,075)          | (820)            |
|                                         | <u>\$ 56,686</u> | <u>\$ 37,657</u> |

As of December 31, 2007 and 2008, all inventories have been pledged as collateral for our revolving credit line with LaSalle Bank (Bank of America).

**(3) Other Current Assets:**

Other current assets consist of the following at December 31, 2007 and 2008 (in thousands):

|                      | 2007          | 2008          |
|----------------------|---------------|---------------|
| Prepaid expense      | \$ 355        | \$ 328        |
| Prepaid income tax   | —             | 282           |
| Other current assets | 130           | 79            |
|                      | <u>\$ 485</u> | <u>\$ 689</u> |

**(4) Property and Equipment:**

Property and equipment consists of the following at December 31, 2007 and 2008 (in thousands):

|                                                 | 2007            | 2008            |
|-------------------------------------------------|-----------------|-----------------|
| Computer hardware and software                  | \$ 1,608        | \$ 2,626        |
| Furniture and equipment                         | 508             | 517             |
| Automobile                                      | 27              | 30              |
|                                                 | 2,143           | 3,173           |
| Less: accumulated depreciation and amortization | 820             | 1,501           |
|                                                 | <u>\$ 1,323</u> | <u>\$ 1,672</u> |

Depreciation and amortization expense of property and equipment totaled \$273,000, \$498,000 and \$690,000 for the years ended December 31, 2006, 2007, and 2008, respectively.

As of December 31, 2007 and 2008, all property and equipment have been pledged as collateral for our revolving credit line with LaSalle Bank (Bank of America).

**(5) Revolving Credit Line:**

In July 2006, we entered into a revolving credit line agreement with LaSalle Bank (Bank of America), to provide working capital financing secured by inventories and tangible assets. The agreement allowed for us to initially draw on a line of credit up to \$10.0 million, with a provision to increase the limit up to \$15.0 million with the future consent of the bank's loan committee. During the first quarter of 2007 we increased the limit to \$15.0 million and during the first quarter of 2008 we further increased the limit to \$25.0 million.

All cash receipts from our revenues are restricted to being deposited into a LaSalle Bank account, to be applied to current reported cash disbursements requirements, under a positive pay system, and then to the credit line outstanding balance. The revolving credit line agreement expires in July of 2010. As of December 31, 2008, there was no outstanding balance under the revolving credit line. There is an unused fee of 0.25% on the unused portion of the revolving credit line.

Day-to-day drawdown on the credit line is subject to the prevailing prime rate. The interest is calculated on the average outstanding balance and compound monthly. As of December 31, 2008 our effective interest rate was 3.25%. We have the option to extended term advances, for 30, 60, or 90 days that are subject to LIBOR rates. The rates will be a certain percentage above the LIBOR rates and will vary with the maturity term and amount borrowed. Interest is calculated over the stated term at an annual rate. As of December 31, 2008 we have no advances under LIBOR.

Under the terms and conditions of the revolving credit line agreement, the Company is subject to certain restrictive covenants including the following restrictive financial covenants:

**Minimum TTM EBITDA:** Actual Trailing Twelve Month (TTM) EBITDA compliance is measured on a monthly basis, and shall not vary negatively from the Dollar amount for planned LTM EBITDA, set forth in an agreed upon schedule, for the applicable period, and is subject to resetting in Lender's discretion based upon a business plan for subsequent periods acceptable to Lender.

**Capital Expenditures:** Borrower shall not make capital expenditures in excess of an agreed upon amount for each fiscal year covered by the loan agreement. All capital expenditure limits are subject to resetting on an annual basis at the Lender's discretion based upon a business plan for subsequent periods acceptable to the Lender.

**Minimum Excess Availability:** We are to maintain an Excess Availability of \$2.5 million with a Maximum Revolver Amount of \$25.0 million. This covenant is subject to resetting at the Lender's discretion based upon a business plan for subsequent periods acceptable to Lender.

**(6) Accounts Payable:**

During the years ending December 31, 2007 and 2008 we employ "positive pay" procedures with our financial institution by transmitting check disbursement information to the financial institution to allow for our review and approval of exception transaction prior to them being posted to our account.

**(7) Accrued Expenses:**

Accrued expenses consist of the following at December 31, 2007 and 2008 (in thousands):

|                                         | 2007            | 2008            |
|-----------------------------------------|-----------------|-----------------|
| Income tax payable                      | 921             | —               |
| Accrued payroll and other related costs | 1,451           | 878             |
| Accrued net sales returns               | 346             | 171             |
| Other accrued expenses                  | 1,446           | 1,309           |
| Accrued marketing expenses              | 345             | 733             |
|                                         | <u>\$ 4,509</u> | <u>\$ 3,091</u> |

## (8) Commitments:

The following table presents our contractual obligations at December 31, 2008, over the next five years and thereafter (in thousands):

| Payments by period | Total amount    | Less than 1 year | 1 to 3 years  | 3 to 5 years  | After 5 years |
|--------------------|-----------------|------------------|---------------|---------------|---------------|
| Property lease     | \$ 1,448        | \$ 987           | \$ 346        | \$ 115        | \$ —          |
| Equipment lease    | 207             | 56               | 104           | 47            | —             |
|                    | <u>\$ 1,655</u> | <u>\$ 1,043</u>  | <u>\$ 450</u> | <u>\$ 162</u> | <u>\$ —</u>   |

We lease a 50,000 square-foot office and warehouse and a separate 12,000 square-foot warehouse space in Culver City, California. The leases expire in October 2009 and August 2012, respectively. We are obligated to pay real estate taxes, insurance, and maintenance expenses. We expect that, in the normal course of business, the lease will be renewed or replaced by leases on other properties upon termination. Thus, we anticipate that future minimum lease commitments will likely be more than the amounts shown for 2007. Rental expenses for operating leases totaled \$908,000, \$995,000, and \$1.2 million for the years ended December 31, 2006, 2007, and 2008, respectively.

We have commitment for operating leases of copy machines used in our office.

## (9) Stockholders' Equity:

### *Delaware Reincorporation*

On June 22, 2006 the Company reincorporated in the state of Delaware. In connection with our reincorporation in Delaware, we are authorized to issue 100,000,000 shares of common stock, \$0.001 par value, and 4,000,000 shares of undesignated preferred stock, \$0.001 par value.

### *Preferred Stock*

Our certificate of incorporation authorizes our Board of Directors, without any vote or action by the holders of our common stock, to issue preferred stock from time to time in one or more series. Our Board of Directors will be authorized to determine the number of shares and to fix the designations, powers, preferences, and the relative, participating, optional, or other rights of any series of preferred stock. Depending upon the terms of preferred stock established by our Board of Directors, any or all series of preferred stock could have preference over the common stock with respect to dividends and other distributions and upon our liquidation. If any shares of preferred stock are issued with voting powers, the voting power of the outstanding common stock would be diluted. No shares of preferred stock are presently outstanding, and we have no present intention to issue any shares of preferred stock.

### *Common Stock*

The holders of common stock are entitled to one vote per share on all matters to be voted upon by stockholders. There will be no cumulative voting. Subject to preferences that may be applicable to any outstanding preferred stock, holders of common stock will be entitled to receive ratably such dividends as may be declared by our Board of Directors out of funds legally available for that purpose. In the event of the liquidation, dissolution, or winding up of our company, the holders of common stock will be entitled to share ratably in all assets remaining after payment of liabilities and the liquidation preferences of any outstanding preferred stock. The common stock has no preemptive or conversion rights, other subscription rights, or redemption or sinking fund provisions.

No dividends have been declared or paid on our common stock through December 31, 2008.

In 2008, common stock shares totaling 442,500 shares were issued from the exercise of stock options and 249,623 shares were retired in the net exercise of options to pay for the exercise price and payroll taxes. 1,853,873 shares held in treasury from our stock repurchase program were retired. 1,250 shares were issued as obligations for service. Restricted common stock awards totaling 24,800 shares were issued to employees. 2,000 shares of restricted common stock were retired on termination of employment of an employee and 1,490 shares were retired from net vesting of restricted common stock to pay for payroll taxes. Restricted common stock awards outstanding and yet to be vested totaled 117,800 shares as of December 31, 2008.

In 2007, common stock shares totaling 1,192,700 were issued from the exercise of stock options and 15,000 shares held in treasury were retired. Common stock shares totaling 18,750 were issued to independent board members. Restricted common stock awards totaling 110,000 shares were issued to independent board members, and 16,000 shares were issued to employees. Restricted common stock awards outstanding and yet to be vested totaled 126,000 shares as of December 31, 2007.

In 2006, common stock shares totaling 20,000 were issued to independent board members. 15,000 shares were issued to an employee, and 1,404 shares were issued to a non-employee for services rendered. We repurchased and retired 115,000 shares from the Chief Financial Officer and we repurchased 15,000 shares from an employee that is held in Treasury.

#### *Deferred Stock-Based Compensation*

In connection with certain stock grants to two employees during the year ended December 31, 2001, we recognized \$2.0 million in deferred stock-based compensation for the deemed fair value of common stock at the date of the grant. We include such amounts as a reduction of stockholders' equity (deficit). We amortize such amounts over the vesting period of five years in accordance with FASB Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans."

Amortization expenses totaled \$100,000, \$0, and \$0 during the years ended December 31, 2006, 2007, and 2008, respectively. As of December 31, 2008, all existing deferred stock-based compensation grants were fully vested and all associated costs had been fully amortized.

To meet the statutory obligation for the applicable income and other employment taxes, 115,000 common shares were surrendered back to us in 2006 and a net-share settlement was effected. Based on a fair market value of \$6.00 per share on the vesting date as determined based on a combination of factors that include recent share transactions between shareholders and an independent valuation of the Company, the employee's tax obligations to the taxing authorities were approximately \$690,000. The net-share settlement had the effect of share repurchases by us as it reduced and retired the number of shares outstanding and did not represent an expense to the Company. The employee received no cash proceeds and taxes were paid directly to the taxing authorities.

#### **(10) Stock Compensation Plans:**

We adopted our 2001 Stock Option Plan, our 2002 Special Stock Option Plan and our 2006 Award Plan (collectively, the "Plans"), in January 2001, January 2002, and March 2006, respectively. The Plans provide for the granting of awards in the form of incentive stock options, nonqualified stock options, stock appreciation rights, shares of restricted common stock, bonus stock in lieu of obligations, or other stock-based awards to employees, directors, and independent contractors who provide valuable services to our company. The vesting requirements, performance thresholds and other terms and conditions of options granted under the Plans will be determined by our Compensation Committee and Board of Directors. Outstanding options all vest immediately prior to 2006 and have 25% vesting at the end of each year over four years for options granted in 2006 and 2007. No options were granted in 2008. Options generally have an expiration period of five years and new common stock shares are issued upon the exercise of stock options. At December 31, 2008, 1,302,990 shares were available for future grants under the Plans.

The following is a summary of stock option activity for the year ended December 31, 2008:

| Options                          | Shares    | Weighted-average exercise price | Weighted average remaining life of contract (years) | Aggregate intrinsic value as of 12/31/08 |
|----------------------------------|-----------|---------------------------------|-----------------------------------------------------|------------------------------------------|
| Outstanding at January 1, 2008   | 8,131,300 | \$ 6.20                         |                                                     |                                          |
| Granted                          | —         | —                               |                                                     |                                          |
| Exercised                        | (442,500) | 4.74                            |                                                     |                                          |
| Cancelled                        | (807,500) | 8.07                            |                                                     |                                          |
| Expired                          | (16,800)  | 4.50                            |                                                     |                                          |
| Outstanding at December 31, 2008 | 6,864,500 | \$ 6.08                         | 2.36                                                | \$ —                                     |
| Exercisable at December 31, 2008 | 6,864,500 | \$ 6.08                         | 2.36                                                | \$ —                                     |

During the year ended December 31, 2007 and 2008, stock options to purchase shares in our common stock were issued. New shares in our common stock are issued when stock options are exercised. During 2007, 1,192,700 stock options were exercised and the recognized tax benefit related thereto is \$3.2 million. The total fair value of options exercised during 2007 was \$9.5 million. During 2008, 442,500 stock options were exercised and the recognized tax benefit related thereto is \$818,000. The total fair value of options exercised during 2008 was \$2.3 million. In 2008, 375,000 of the stock options exercised were "net exercised" and 249,623 shares were surrendered back to us and retired in payment for the exercise price and payroll taxes.

In 2008, employees voluntarily cancelled 807,500 unvested options to purchase shares as the options were substantially "out of the money" and 16,800 options expired "out of the money." As of December 31, 2008, all 6,864,500 stock options to purchase shares were fully vested.

The following is a summary of stock option activity for the years ended December 31, 2006, 2007, and 2008:

|                                  | 2006      |                                 | 2007      |                                 | 2008      |                                 |
|----------------------------------|-----------|---------------------------------|-----------|---------------------------------|-----------|---------------------------------|
|                                  | Shares    | Weighted average exercise price | Shares    | Weighted average exercise price | Shares    | Weighted average exercise price |
| Outstanding at beginning of year | 8,342,000 | \$ 5.63                         | 8,353,000 | \$ 5.64                         | 8,131,300 | \$ 6.20                         |
| Granted                          | 235,000   | 6.00                            | 1,000,000 | 8.23                            | —         | —                               |
| Exercised                        | —         | —                               | 1,192,700 | 4.00                            | (442,500) | 4.74                            |
| Canceled / forfeited             | (224,000) | 5.45                            | (29,000)  | 6.00                            | (824,300) | 8.00                            |
| Outstanding at year-end          | 8,353,000 | \$ 5.64                         | 8,131,300 | \$ 6.20                         | 6,864,500 | \$ 6.08                         |
| Options exercisable at year-end  | 8,238,000 | \$ 5.64                         | 7,045,050 | \$ 5.92                         | 6,864,500 | \$ 6.08                         |

The weighted-average grant date fair values of options granted during 2006, and 2007 were \$2.40, and \$2.59 per share, respectively, and no options were granted in 2008.

The following table summarizes information about stock options outstanding and exercisable at December 31, 2008:

| Options outstanding and exercisable<br>as of December 31, 2008 |          |                                     |                                                 |                                          |                                     |                                          |  |
|----------------------------------------------------------------|----------|-------------------------------------|-------------------------------------------------|------------------------------------------|-------------------------------------|------------------------------------------|--|
| Range of<br>exercise prices                                    |          | Number<br>outstanding<br>12/31/2008 | Options outstanding                             |                                          | Options exercisable                 |                                          |  |
|                                                                |          |                                     | Weighted<br>average<br>remaining<br>contractual | Weighted<br>average<br>exercise<br>price | Number<br>exercisable<br>12/31/2008 | Weighted<br>average<br>exercise<br>price |  |
| \$ 5.01                                                        | \$ 6.00  | 6,631,500                           | 2.33                                            | \$ 6.00                                  | 6,631,500                           | \$ 6.00                                  |  |
| \$ 6.01                                                        | \$ 7.00  | 105,500                             | 3.18                                            | \$ 6.50                                  | 105,500                             | \$ 6.50                                  |  |
| \$ 9.01                                                        | \$ 10.00 | 127,500                             | 3.45                                            | \$ 9.90                                  | 127,500                             | \$ 9.90                                  |  |
| \$ 5.01                                                        | \$ 10.00 | 6,864,500                           | 2.36                                            | \$ 6.08                                  | 6,864,500                           | \$ 6.08                                  |  |

#### Stock Option Compensation

During the years ended December 31, 2006, and 2007, and 2008, respectively, we recognized approximately \$16,000, \$488,000, and \$283,000 respectively, of employee stock-option compensation. We recognize compensation expense on a straight-line basis over the requisite service period for each stock option grant. The unamortized stock-option compensation expense as of December 31, 2007 and 2008 is \$2.4 million and \$0, respectively. The cancellation of all unvested options in 2008 resulted in no unamortized expense as of December 31, 2008.

Options granted in 2006 and 2007 were valued in accordance with SFAS 123R and no options were granted in 2008. The fair value of these options was calculated using a Black-Scholes option pricing model using the following assumptions: (1) risk-free interest rates of 4.3% to 5.0%, (2) an expected life of four to five years, (3) expected volatility of 31% to 37%, (4) expected forfeitures of 0%, and (5) a dividend yield of 0%. Because there was no public market for our common stock in 2006 and limited trading history at the time of grant in 2007, and in accordance with SFAS 123R, we used the calculated method to determine volatility. Prior to June 15, 2007, we had estimated the expected life to be equal to the option period and from June 15, 2007 we had estimated the expected life to be equal to the vesting period.

#### Restricted Stock Awards

We began issuing restricted stock awards in 2007, pursuant to the 2006 Award Plan. The restricted stock awards were issued as time-based awards, which vest typically with 25% vesting at the end of each year over four years or earlier if there is an acceleration event. The restricted stock awards are expensed pro rata over the vesting period based upon the market value of the awards at the time of grant. Stock-based compensation from the issuance of common stock and restricted stock awards totaled \$286,000 and \$358,000 for the years ended December 31, 2007 and 2008, respectively. The unamortized stock-based expense for restricted stock awards was \$1.1 million and \$967,000 as of December 31, 2007 and 2008, respectively.

The total fair value of 31,000 restricted shares that vested in 2008 was \$220,000, and no restricted shares were vested during 2007. Restricted common stock awards outstanding and yet to be vested totaled 126,000 shares and 117,800 as of December 31, 2007 and 2008, respectively.

A summary of all restricted stock activity during the years ended December 31, 2007 and 2008 follows:

|                                                  |          |
|--------------------------------------------------|----------|
| Restricted shares outstanding, January 1, 2007   | —        |
| Shares granted                                   | 126,000  |
| Shares vested                                    | —        |
| Shares forfeited                                 | —        |
| Restricted shares outstanding, December 31, 2007 | 126,000  |
| Shares granted                                   | 24,800   |
| Shares vested                                    | (31,000) |
| Shares forfeited                                 | (2,000)  |
| Restricted shares outstanding, December 31, 2008 | 117,800  |

The weighted-average grant date fair values of restricted stock awards during 2007, and 2008 were \$10.41, and \$8.61 per share, respectively.

**(11) Income Tax Expense:**

Income tax expense amounted to \$2.5 million and \$9.6 million for the years ended December 31, 2007 and 2008 (an effective rate of 12.3% for 2007 and 40.0% for 2008). A reconciliation of the provision (benefit) for income tax expense with amounts determined by applying the statutory U.S. federal income tax rate to income before income tax expense is as follows (in thousands):

|                                                                        | 2006     | 2007     | 2008     |
|------------------------------------------------------------------------|----------|----------|----------|
| Computed tax benefit at federal statutory rate of 35%                  | \$ 1,873 | \$ 7,026 | \$ 8,400 |
| State taxes, net federal tax benefits                                  | 364      | 347      | 1,380    |
| Meals and entertainment                                                | 26       | 15       | 5        |
| Limitation on executive compensation—section 162 (m)                   | 387      | —        | —        |
| Change in valuation allowance, net of adjustment of net operating loss | (2,535)  | (4,850)  | —        |
| Minimum tax credit                                                     | 108      | —        | —        |
| Excess benefit of vested stock                                         | (170)    | —        | —        |
| Other                                                                  | 67       | —        | (188)    |
| Total income tax provision                                             | \$ 120   | \$ 2,538 | \$ 9,597 |

The income tax expense for 2008 consists of the following (in thousands):

|          | Federal  | State    | Total    |
|----------|----------|----------|----------|
| Current  | \$ 7,758 | \$ 2,017 | \$ 9,775 |
| Deferred | (259)    | 81       | (178)    |
| Total    | \$ 7,499 | \$ 2,098 | \$ 9,597 |

The difference in annual effective tax rates arises from the net operating loss carryforwards available to offset the taxable income for the 2007 tax year. All net operating losses were utilized and are not available to offset the federal and California taxable income for the year ended December 31, 2008.

Deferred tax assets and liabilities are recognized for future tax consequences between the carrying amounts of assets and liabilities and their respective tax bases using enacted tax rates in effect for the year in which the differences are expected to reverse. Significant deferred tax assets and liabilities consist of the following (in thousands):

|                                          | 2007            | 2008            |
|------------------------------------------|-----------------|-----------------|
| <b>Deferred tax assets:</b>              |                 |                 |
| <b>Current deferred tax assets:</b>      |                 |                 |
| Inventory costs                          | \$ 1,309        | \$ 868          |
| Minimum tax credit carryforwards         | 28              | —               |
| Accrued expenses                         | 157             | 80              |
| Other reserves and allowances            | 258             | 159             |
| Deferred revenue                         | 351             | 240             |
| State taxes                              | 18              | 603             |
| Total current deferred tax assets        | 2,121           | 1,950           |
| <b>Current deferred tax liability:</b>   |                 |                 |
| <b>Net current deferred tax asset</b>    | <b>\$ 2,121</b> | <b>\$ 1,950</b> |
| <b>Long term deferred tax assets:</b>    |                 |                 |
| Employee stock options                   | \$ 304          | \$ 244          |
| Other (fixed assets)                     | 96              | 3               |
| Total long term deferred tax assets      | 400             | 247             |
| <b>Long term deferred tax liability:</b> |                 |                 |
| Inventory costs                          | (271)           | (163)           |
| <b>Net long term deferred tax asset</b>  | <b>\$ 129</b>   | <b>\$ 84</b>    |

The tax benefits from the expense in 2007 and 2008 for share based compensation awards that will result in future tax deduction are included in deferred tax assets. The actual tax deduction exceeds the compensation cost recognized by the company for financial reporting purposes. The excess tax benefits increased the company's additional paid in capital by \$3.2 million and \$716,000 for the years ended December 31, 2007 and 2008, respectively, as required by FAS 123R.

We adopted the provisions of FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. Previously, we had accounted for tax contingencies in accordance with Statement of Financial Accounting Standards 5, *Accounting for Contingencies*. As required by Interpretation 48, which clarifies Statement 109, *Accounting for Income Taxes*, we recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. At the adoption date, we applied Interpretation 48 to all tax positions for which the statute of limitations remained open. Our analysis of the implementation of Interpretation 48 reveals that there is no material effect on our financial statements.

There are no unrecognized tax benefits that, if recognized, would impact the effective tax rate. We do not anticipate any significant change in our positions in the next twelve months.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. During the year ended December 31, 2008, no interest or penalties were recognized in the income statement or balance sheet by the Company.

We are subject to income taxes in the U.S. federal jurisdiction and California. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and require significant judgment to apply. With few exceptions, we are no longer subject to U.S. federal and California examinations by tax authorities for the years before 2007.

We were under examination by the Internal Revenue Service for the 2004, 2005 and 2006 tax years. The examination was concluded as of December 31, 2007 and final settlement was accrued and made in the amount of \$35,000, including interest and penalties.

**(12) Segment Information:**

Net revenue by geographic area is presented based upon the country of destination. No foreign country accounted for 10% or more of net revenue for any of the fiscal years presented. Net revenue by geographic area was as follows for the years ended December 31, 2006, 2007 and 2008 (in thousands):

|               | 2006              | 2007              | 2008              |
|---------------|-------------------|-------------------|-------------------|
| United States | \$ 104,338        | \$ 145,412        | \$ 157,747        |
| International | 27,485            | 41,719            | 49,663            |
| Total         | <u>\$ 131,823</u> | <u>\$ 187,131</u> | <u>\$ 207,410</u> |

Long-lived assets include property and equipment and intangible assets that resided in the United States during the years ended December 31, 2006, 2007, and 2008.

**(13) Concentrations:**

Purchase of merchandise from one of our top two vendors which is a related party (see Note 15), constituted 26.4%, 11.9%, and 9.9% of total merchandise purchased by us in the years ending December 31, 2006, 2007, and 2008, respectively. Purchases of merchandise from our top two vendors amounted to \$34.4 million, \$40.4 million, and \$18.3 million representing 31.1%, 24.0%, and 14.6%, respectively, of the total purchases during the years ended December 31, 2006, 2007, and 2008, respectively.

Outstanding accounts payable to our top two vendors totaled \$6.2 million and \$1.3 million as of December 31, 2007 and 2008, respectively. Loss of either of these vendors will not have a negative impact on our operations.

**(14) Contingencies:**

We are subject to various legal proceedings and claims that arise in the ordinary course of business. Although the Company believes it has defenses to the allegations and intends to pursue them vigorously, currently, management does not currently have sufficient information to assess the validity of the claims or the amount of potential damages. Company management currently believes, however, that resolution of such legal matters will not have a material adverse impact on the Company's financial position, results of operations or cash flows.

In September 2008, we were served with an alleged class action lawsuit alleging, among other things, that the company engaged in unfair business practices by misrepresenting the value of its merchandise and by "false" bidding. The complaint purports to represent a class of persons who purchased any merchandise from the company. The company believes that the lawsuit is meritless and intends to file a motion to dismiss forthwith.

*Prior Sales of Securities*

From our inception until mid-2003, we raised over \$20.5 million in gross equity capital by selling shares of our common stock to approximately 830 investors at prices ranging from \$4.00 to \$6.00 per share with a weighted average share price of \$4.50. We also issued shares of common stock to about 30 persons in exchange for services and other non-cash consideration valued in excess of \$5.5 million and issued approximately 250 stock option grants to purchase common stock at a weighted average exercise price of \$4.45. After conducting these sales of our securities, we determined that these sales were not exempt from the registration requirements under the Securities Act of 1933 and similar provisions of laws of the states in which our stockholders reside, because certain of our employees who solicited investors engaged in a "general solicitation" of securities. In addition, these employees received compensation for selling our common stock and were required to be licensed as broker-dealers with the Securities and Exchange Commission, or SEC, and various state authorities, but they were not so licensed. In such situations, a number of remedies may be available to regulatory authorities and the investors who purchased common stock in those offerings, including a right of rescission, civil penalties, a restraining order or injunction, and a court order to pay restitution and costs. After voluntarily reporting these violations to the SEC, the SEC staff advised us that it would not undertake an investigation in the matter.

The probability that stockholders would assert a claim against us and the extent of the our liability, if any, are contingent on a number of factors, including a stockholder's desire to rescind, applicable legal precedent, and statutes of limitation. We believe, however, that as to any options by investors at this time or in the future, applicable statutes of limitations will mitigate our exposure to any civil remedies. Based on current facts known to management at this time, management does not believe that assertion of any such claims by the Company's shareholders in a material amount is probable. Accordingly, no accruals for either potential amounts payable or reserves have been made at this time.

**(15) Related Party Transactions:**

We purchased approximately 26.4%, 11.9%, and 9.9% of our merchandise in 2006, 2007, and 2008, respectively, from LA Jewelers, where one of its managers is a stockholder who beneficially owns approximately 5.1% of our outstanding common stock as of

December 31, 2008 (see Note 13). The accounts payable balances due to LA Jewelers were \$5.1 million and \$1.4 million as of December 31, 2007 and 2008, respectively. All business with LA Jewelers is conducted at arm's length and the purchase price, terms and conditions that have been negotiated are competitive with the market and other suppliers.

LA Jewelers participates in our inventory co-op marketing program. For the years ended December 31, 2007 and 2008, we earned \$522,000 and \$1.2 million, respectively, from LA Jewelers relating to co-op marketing contributions and \$361,000 was unamortized as of December 31, 2008. The amounts of co-op marketing contributions due from LA Jewelers were \$544,000 and \$22,000 as of December 31, 2007 and 2008, respectively.

In May, 2007 we entered into an understanding with LA Jewelers whereby they will guarantee that we will earn a certain minimum gross profit margin on their merchandise. This agreement provides that in the event of a gross profit margin shortfall we will be compensated for the difference between our actual gross profit margin and the guaranteed minimum gross profit margin. For the years ended December 31, 2007 and 2008, we recognized \$427,000 and \$588,000, respectively, under this agreement. As of December 31, 2007 and 2008, we have \$129,000 and \$80,000, respectively, outstanding under this gross profit margin guarantee.

Marina Zinberg, who is a Vice President and owns 32.0% of our outstanding shares, is the sister of and reports to David Zinberg, our Chief Executive Officer. During 2008 we paid Ms. Zinberg a salary of \$100,000. Ms. Zinberg was previously our corporate secretary and treasurer.

**(16) Subsequent Events:**

See Recent Developments in Note 1.

**(b) Financial Statement Schedules:**

**Schedule II — Valuation and Qualifying Accounts**

(in thousands)

| Description                                             | Balance at the<br>beginning of<br>the year | Charged to<br>revenue,<br>cost, or<br>expenses | Deductions | Balance at the<br>end of the<br>year |
|---------------------------------------------------------|--------------------------------------------|------------------------------------------------|------------|--------------------------------------|
| <b>Reserve deducted from asset to which it applies:</b> |                                            |                                                |            |                                      |
| <b>Year ended December 31, 2007</b>                     |                                            |                                                |            |                                      |
| Reserve for inventory                                   | \$ 461                                     | \$ 675                                         | \$ (61)    | \$ 1,075                             |
| Reserve for sales returns                               | 164                                        | 970                                            | (788)      | 346                                  |
| Reserve for charge-backs                                | 25                                         | 75                                             | —          | 100                                  |
| <b>Year ended December 31, 2008</b>                     |                                            |                                                |            |                                      |
| Reserve for inventory                                   | \$ 1,075                                   | \$ —                                           | \$ (255)   | \$ 820                               |
| Reserve for sales returns                               | 346                                        | (727)                                          | 552        | 171                                  |
| Reserve for charge-backs                                | 100                                        | —                                              | (46)       | 54                                   |

(c) Exhibits

The following exhibits are incorporated by reference or filed herewith

| Exhibit Number | Exhibits                                                                                                                                                          |
|----------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1            | Agreement and Plan of Merger, dated as of March 15, 2006, by and between Bidz.com, Inc., a Delaware corporation, and Bidz.com, Inc., a California corporation (1) |
| 3.1            | Certificate of Incorporation of the Registrant (2)                                                                                                                |
| 3.2            | Bylaws of the Registrant (3)                                                                                                                                      |
| 10.1           | 2001 Stock Option Plan(4)                                                                                                                                         |
| 10.2           | 2002 Stock Option Plan(5)                                                                                                                                         |
| 10.3           | 2006 Stock Award Plan (6)                                                                                                                                         |
| 10.4           | Employment Agreement, dated as of June 6, 2006, between Bidz.com, Inc. and David Zinberg (7)                                                                      |
| 10.4.1         | Employment Agreement, dated as of November 1, 2002, between Bidz.com, Inc. and David Zinberg (8)                                                                  |
| 10.5           | Employment Agreement, dated as of June 6, 2006, between Bidz.com, Inc. and Lawrence Y. Kong (9)                                                                   |
| 10.6           | Stock Vesting Agreement, dated as of June 30, 2001, between Bidz.com, Inc. and Lawrence Y. Kong (10)                                                              |
| 10.7           | Form of Indemnification Agreement between Bidz.com, Inc. and each officer and director (11)                                                                       |
| 10.7.1         | Indemnification Agreement, dated as of November 1, 2002, between Bidz.com, Inc. and David Zinberg (12)                                                            |
| 10.8           | Lease, between Bidz.com, Inc. and PAS Trust, dated as of April 15, 2003, and Addendum No. 2, dated as of March 3, 2004(13)                                        |
| 10.9           | Client Service Agreement dated January 2, 2006 between Bidz.com, Inc. and Administaff Companies II, L.P. (14)                                                     |
| 10.10          | Loan and Security Agreement by Bidz.com, Inc. and LaSalle Retail Finance, dated July 12, 2006 (15)                                                                |
| 10.11          | Employment Agreement, dated as of March 1, 2007 between Bidz.com, Inc. and Leon Kuperman (16)                                                                     |
| 10.12          | Employment Agreement, dated as of February 21, 2007 between Bidz.com, Inc. and Claudia Liu (17)                                                                   |
| 31.1           | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act.                                                                   |
| 31.2           | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act.                                                                   |
| 32             | Certification of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act                                        |

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- (1) Incorporated by reference to Exhibit 2.1 of Registrant's Form S-1 (File No. 333-132545).
  - (2) Incorporated by reference to Exhibit 3.1 of Registrant's Form S-1 (File No. 333-132545).
  - (3) Incorporated by reference to Exhibit 3.2 of Registrant's Form S-1 (File No. 333-132545).
  - (4) Incorporated by reference to Exhibit 10.1 of Registrant's Form 10 (File No. 000-51257).
  - (5) Incorporated by reference to Exhibit 10.2 of Registrant's Form 10 (File No. 000-51257).
  - (6) Incorporated by reference to Exhibit 10.3 of Registrant's Form S-1 (File No. 333-132545).
  - (7) Incorporated by reference to Exhibit 10.4 of Registrant's Form S-1 (File No. 333-132545).
  - (8) Incorporated by reference to Exhibit 10.3 of Registrant's Form 10 (File No. 000-51257).
  - (9) Incorporated by reference to Exhibit 10.5 of Registrant's Form S-1 (File No. 333-132545).
  - (10) Incorporated by reference to Exhibit 10.6 of Registrant's Form S-1 (File No. 333-132545).
  - (11) Incorporated by reference to Exhibit 10.7 of Registrant's Form S-1 (File No. 333-132545).
  - (12) Incorporated by reference to Exhibit 10.4 of Registrant's Form 10 (File No. 000-51257).
  - (13) Incorporated by reference to Exhibit 10.5 of Registrant's Form 10 (File No. 000-51257).
  - (14) Incorporated by reference to Exhibit 10.9 of Registrant's Form S-1 (File No. 333-132545).
  - (15) Incorporated by reference to Exhibit 10.10 of Registrant's Form 10 (File No. 000-51257)
  - (16) Incorporated by reference to Exhibit 10.11 of Registrant's Form 10 (File No. 000-51257)
  - (17) Incorporated by reference to Exhibit 10.12 of Registrant's Form 10 (File No. 000-51257)
  - (18) The certification attached as Exhibit 32 that accompanies this Annual Report on Form 10-K is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Bidz.com, Inc. under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date of this Annual Report on Form 10-K, irrespective of any general incorporation language contained in such filing.

## SIGNATURES

Pursuant to the requirements of Section 13 or Section 15(d) of the Securities Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BIDZ.COM, INC.

By: /s/ DAVID ZINBERG

**David Zinberg**  
**Chief Executive Officer**

Dated: February 23, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <u>Signature</u>                                | <u>Title</u>                                                                            | <u>Date</u>       |
|-------------------------------------------------|-----------------------------------------------------------------------------------------|-------------------|
| <u>/s/ DAVID ZINBERG</u><br>David Zinberg       | Chairman of the Board and<br>Chief Executive Officer (Principal<br>Executive Officer)   | February 23, 2009 |
| <u>/s/ LAWRENCE Y. KONG</u><br>Lawrence Y. Kong | Chief Financial Officer and<br>Director (Principal Financial and<br>Accounting Officer) | February 23, 2009 |
| <u>/s/ PETER G. HANELT</u><br>Peter G. Hanelt   | Director                                                                                | February 23, 2009 |
| <u>/s/ MAN JIT SINGH</u><br>Man Jit Singh       | Director                                                                                | February 23, 2009 |
| <u>/s/ GARRY ITKIN</u><br>Garry Itkin           | Director                                                                                | February 23, 2009 |

CERTIFICATION

I, David Zinberg, certify that:

1. I have reviewed this Annual Report on Form 10-K of Bidz.com, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant is made known to us by others, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal year that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 23, 2009

/s/ David Zinberg  
David Zinberg  
Chairman of the Board and  
Chief Executive Officer (Principal  
Executive Officer)

## CERTIFICATION

I, Lawrence Kong, certify that:

1. I have reviewed this Annual Report on Form 10-K of Bidz.com, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant is made known to us by others, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal year that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 23, 2009

/s/ Lawrence Kong  
Lawrence Kong  
Chief Financial Officer  
(Principal Financial and  
Accounting Officer)

**CERTIFICATION**

Each of the undersigned hereby certifies, for the purposes of section 1350 of chapter 63 of title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, in his capacity as an officer of Bidz.com, Inc. ("Bidz.com"), that, to his knowledge, the Annual Report of Bidz.com on Form 10-K for the period ended December 31, 2008 fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that the information contained in such report fairly presents, in all material respects, the financial condition and results of operation of Bidz.com.

Date: February 23, 2009

By /s/ David Zinberg  
David Zinberg  
Chief Executive Officer

Date: February 23, 2009

By /s/ Lawrence Kong  
Lawrence Kong  
Chief Financial Officer