

LIQUIDITY SERVICES INC
Form 10-K
December 07, 2007

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended September 30, 2007

OR

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

For the transition period from _____ to _____
Commission file number 0-51813

LIQUIDITY SERVICES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

52-2209244
(I.R.S. Employer
Identification No.)

1920 L Street, N.W., 6th Floor, Washington, D.C.
(Address of Principal Executive Offices)

20036
(Zip Code)

(202) 467-6868

(Registrant's Telephone Number, Including Area Code)

Securities Registered pursuant to Section 12(b) of the Act:
None

Securities Registered pursuant to Section 12(g) of the Act:
Common Stock, par value \$.001 per share

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 15(d) of the Act. Yes No

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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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant as of March 30, 2007 based upon the closing price of the common stock as reported by The NASDAQ Stock Market on such date, was approximately \$251,471,000.

The number of shares outstanding of the issuer's common stock, par value \$.001 per share, as of December 7, 2007 was 27,947,198.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement relating to its 2008 Annual Stockholders' Meeting, to be filed subsequently, are incorporated by reference into Part III of this Form 10-K.

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Unless the context requires otherwise, references in this report to "we," "us," the "Company" and "our" refer to Liquidity Services, Inc. and its subsidiaries.

PART I

Item 1. Business.

Overview

We are a leading online auction marketplace for wholesale, surplus and salvage assets. We enable buyers and sellers to transact in an efficient, automated online auction environment offering over 500 product categories. Our marketplaces provide professional buyers access to a global, organized supply of wholesale, surplus and salvage assets presented with digital images and other relevant product information. Additionally, we enable our corporate and government sellers to enhance their financial return on excess assets by providing a liquid marketplace and value-added services that integrate sales and marketing, logistics and transaction settlement into a single offering. We organize our products into categories across major industry verticals such as consumer electronics, general merchandise, apparel, scientific equipment, aerospace parts and equipment, technology hardware, and specialty equipment. Our online auction marketplaces are www.liquidation.com, www.govliquidation.com and www.liquibiz.com. We also operate a wholesale industry portal, www.goWholesale.com, that connects advertisers with buyers seeking products for resale and related business services.

We believe our ability to create liquid marketplaces for wholesale, surplus and salvage assets generates a continuous flow of goods from our corporate and government sellers. This flow of goods in turn attracts an increasing number of professional buyers to our marketplaces. During fiscal year 2007, the number of registered buyers grew from approximately 524,000 to approximately 685,000, or 30.7%. During the past three fiscal years, we have conducted over 578,000 online transactions generating approximately \$509 million in gross merchandise volume. Approximately 85% of our initial listings have resulted in a completed cash sale during the past three fiscal years.

In the fiscal year ended September 30, 2007, we generated revenue of \$198.6 million through multiple sources, including transaction fees from sellers and buyers, revenue sharing arrangements, value-added service charges and online advertising fees. Our revenue has grown at a compound annual growth rate of approximately 34% since fiscal year 2003. Additionally, we have been profitable and cash flow positive for each quarter since the fourth quarter of fiscal year 2002.

Industry Overview

While a well-established forward supply chain exists for the procurement of assets, most manufacturers, retailers, corporations and government agencies have not made significant investments in the reverse supply chain process. The reverse supply chain addresses the redeployment and remarketing of wholesale, surplus and salvage assets. These assets generally consist of retail customer returns, overstock products and end-of-life goods from both the corporate and government sectors. According to D.F. Blumberg Associates, Inc., a research and consulting firm, the estimated reverse logistics market in North America will grow from approximately \$38.5 billion in 2004 to over \$63.1 billion in 2008.

The supply of wholesale, surplus and salvage assets in the reverse supply chain results from a number of factors, including:

Supply chain inefficiencies. Forecasting inaccuracies, manufacturer overruns, cancelled orders, evolving market preferences, discontinued product lines, merchandise packaging changes and seasonal fluctuations result in the growth of surplus assets.

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Product innovation. Continuous innovation in technology products, such as computer and office equipment, consumer electronics, and personal communication and entertainment devices, results in a continuous flow of surplus assets.

Return policies of large national and online retailers. The flexible return practices of many large national retailers and online shopping sites result in a continuous supply of returned merchandise, a significant portion of which must be liquidated.

Compliance with government regulations. An increasingly stringent regulatory environment necessitates the verifiable recycling and remarketing of surplus assets that would otherwise be disposed of as waste.

Organizations that manufacture, distribute, sell or use finished goods regularly need to dispose of excess inventory or returned merchandise. We believe the management and remarketing of surplus assets traditionally has been an inefficient process. While many organizations spend considerable resources developing systems and channels supporting the flow of finished goods to their core customers, we believe that many have not historically dedicated significant resources to the reverse supply chain. Factors contributing to these inefficiencies in the reverse supply chain include the lack of:

a centralized and global marketplace to sell bulk products in the reverse supply chain;

awareness of available methods and mechanisms for disposal of surplus assets;

experience in managing the reverse supply chain; and

product information and tracking as surplus assets move through the reverse supply chain.

Traditional methods of surplus asset disposition include ad-hoc, negotiated direct sales, utilization of individual brokers or sales agents and live on-site auctions. We believe brokers specializing in surplus asset disposition are generally highly fragmented, geographically dispersed and predominantly small business owners. The manual, negotiated and geographically dispersed nature of traditional surplus resale methods results in a lack of pricing transparency for offered goods and a lower number of potential buyers and bids, which we believe typically lead to lower recovery rates for sellers.

A significant number of professional buyers seek wholesale, surplus and salvage assets. They include online and offline retailers, convenience and discount stores, value-added resellers such as refurbishers and scrap recyclers, import and export firms and small businesses. Traditionally, these buyers have had limited access to large sellers of surplus assets, relying instead on their own network of industry contacts and fixed-site auctioneers to locate, evaluate and purchase specific items of interest. Traditional methods are inefficient for buyers due to the lack of:

global access to an available supply of desired assets;

efficient and inexpensive sourcing processes;

a professionally managed central marketplace;

detailed information and product description for the offered goods; and

pricing transparency or ability to compare asset prices.

The Internet has emerged as a global medium enabling millions of people worldwide to share information, communicate and conduct business electronically. International Data Corporation (IDC), a provider of global IT research and advice, estimates global business-to-business, or B2B, e-commerce will increase at a compound annual growth rate of 27.9% between 2004 and 2009 from \$2,176 billion to \$7,446 billion.

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(Source: IDC, Worldwide Internet Usage and Commerce 2005-2009 Forecast Version 10.1, Doc #34256, October 2005). We believe professional buyers of wholesale, surplus and salvage assets increasingly will use the Internet to identify and source goods available for immediate purchase.

Our Solution

Our solution is comprised of our online auction marketplaces, value-added services and our wholesale search and advertising portal. Our marketplaces and services are designed to provide sellers with a comprehensive solution to quickly bring surplus assets to market and enhance the financial value realized from the sale of these surplus assets while providing buyers with confidence in the goods they purchase. We provide sellers access to a liquid marketplace with thousands of professional buyers. Through our relationships with sellers, we provide buyers convenient access to a substantial and continuous flow of wholesale, surplus and salvage assets. We provide buyers with products in over 500 categories in lot sizes ranging from full truck loads to pallets, packages and large individual items. Our solution combines centralized marketplaces with a full suite of integrated sales, marketing, merchandising, fulfillment, payment collection, dispute mediation and logistics services. We provide sellers a convenient method of remarketing wholesale, surplus and salvage assets, including preparation of sales information, optional warehousing of goods, settlement and transaction reporting. For any given asset, buyers have access in a centralized location to a detailed product description, product manifest, digital images of a product, relevant transaction history regarding the seller, shipping weights, product dimensions and estimated shipping costs to the buyer's location.

The following chart provides a summary of our online marketplace solution:

We believe our marketplaces benefit over time from greater scale and adoption by our constituents. As of September 30, 2007, we had aggregated approximately 685,000 registered buyers in our marketplaces. Aggregating this level of buyer demand enables us to generate a continuous flow of goods from corporate and government sellers, which in turn attracts an increasing number of professional buyers. During the fiscal year ended September 30, 2007 we had approximately 1,115,000 auction participants in our online auctions from our registered buyers. During fiscal year 2007, we grew our registered buyer base by 30.7% or approximately 161,000. As buyers continue to discover and use our online trading platform as an effective method to source assets, we believe our marketplaces become an increasingly attractive sales channel for corporations and government agencies. We believe this self-reinforcing cycle results in greater transaction volume and enhances the value of our marketplaces.

Competitive Factors

We have created liquid marketplaces for virtually any type, quantity or condition of wholesale, surplus or salvage assets. The strengths of our business model include:

Aggregation of supply and demand for wholesale, surplus and salvage assets

Our ability to aggregate sellers and buyers through our marketplaces is a fundamental strength of our business model. Sellers benefit from a liquid market and more competitive bidding through our large base of professional buyers, which enhances returns. Buyers benefit from our relationships with high-volume, corporate and government sellers, which provides them with continuous access to a comprehensive selection of wholesale, surplus and salvage assets. Our solution eliminates the need for sellers and buyers to rely on the highly fragmented and geographically dispersed group of traditional liquidators. Instead, sellers and buyers can conveniently access our online marketplaces for all of their wholesale, surplus and salvage asset needs.

Integrated and comprehensive solution

Our marketplaces are designed to provide sellers and buyers with a comprehensive solution for the online sale and purchase of wholesale, surplus and salvage assets. We offer a full suite of value-added services to simplify the sales process for sellers and improve the utility of our marketplaces for buyers. For corporate and government sellers, we provide sales, marketing, logistics and customer support services that are fully integrated with our marketplaces, creating operational and informational efficiencies. For many of these sellers, asset disposition is not a core business function to which they desire to dedicate internal resources. With our solution, we manage each step of the transaction for sellers. Sellers simply make goods available at their facilities or deliver them to our distribution centers and we deliver the profits after the sale is completed. We provide a one stop solution to enable professional buyers of any size throughout the world to purchase assets in an efficient manner. For these buyers, we provide a broad range of services to give them the information necessary to make a more informed bid and to ensure that they ultimately receive the goods purchased. Our buyer services include intelligent alerts, search tools, dynamic pricing, shipping and delivery, secure settlement, live customer support and dispute resolution. Our solution also includes our wholesale industry portal, which provides sellers with an opportunity to target advertising to wholesale buyers and provides buyers with access to a single online destination for sourcing wholesale products and related services.

Flexible and aligned transaction model

We offer three primary transaction models to our sellers, consignment, profit-sharing and purchase. Under these models, our compensation is derived from either the gross or net proceeds received from cash sales. Our consignment and profit-sharing arrangements are designed to maximize returns for us and our sellers by aligning our economic interests.

Faster cycle times for our sellers

We believe our marketplace solution allows sellers to complete the entire sales process more rapidly than through traditional auction methods. Our solution generally reduces the sales and marketing cycle as compared to traditional auction methods. As a result, sellers are able to reduce inventory quickly, generate additional working capital and reduce the cost of carrying unwanted assets.

Our Strategy

Our objective is to build upon our position as a leading online marketplace for selling wholesale, surplus and salvage assets. The key elements of our strategy are to continue to:

Grow our buyer base and increase the total number of auction participants

We intend to increase our buyer base and the total number of auction participants and competition within each auction by attracting new buyers and leveraging our database of existing professional buyers. We intend to attract new buyers by using a variety of online and traditional marketing programs. In addition, we plan to use the comprehensive buyer profiles, preferences and transactional data we have compiled over the past several years for our existing professional buyers to enable us to identify and market assets available through our auctions to the most likely buyers. We believe these initiatives will help us to increase the total number of auction participants, lead to higher selling prices and increase loyalty among our buyer base.

Increase penetration of existing sellers

We intend to increase our sales by increasing business with our existing sellers. For many of our sellers, we currently handle only a small portion of the available supply of these assets. In recent years, we have developed relationships with large corporations and government agencies that offer significant growth opportunities by increasing our share of their supply of surplus assets. For example, on behalf of the U.S. Department of Defense, we initially handled sales of its surplus personal property classified as "useable" in the United States and have expanded this relationship to include additional locations and property classifications, such as "useable" surplus property in Germany, as well as "scrap" property in the United States.

Develop new seller relationships

We intend to attract additional corporate and government sellers to our marketplaces. We believe the vast majority of corporations and government agencies still rely on inefficient traditional disposition methods for their surplus assets such as regional auctions or bulk sales to local buyers and liquidators. We believe our demonstrated performance record coupled with an expanded sales and marketing initiative will allow us to attract additional corporate and government sellers. As part of our sales and marketing initiative, we plan to hire additional sales professionals and increase our marketing and advertising to sellers in our target markets.

Develop and enhance features and services

We intend to develop and enhance marketplace features and services that benefit both buyers and sellers. With each completed auction, we gain greater insight into the optimal ways of marketing goods in the reverse supply chain and the needs of buyers and sellers within the wholesale industry. Recent new service offerings, such as inventory assurance screening, automated shipping coordination, return processing for retail sellers and online invoicing, have enhanced our operations and user experience. We intend to continue to develop new tools to further automate our solution in order to enhance the value we provide to buyers and sellers and improve the scalability of our business.

Expand our wholesale industry portal business

We intend to further expand our advertising and search engine distribution network and develop products that enable wholesale buyers and sellers to more readily create and organize relevant industry information. As a result, our growing base of advertisers can cost-effectively connect with potential customers of wholesale, surplus and salvage assets. Our wholesale industry portal provides another value-added resource to assist buyers and sellers in sourcing goods and services via the Internet.

Acquire complementary businesses

We intend to increase our share of the supply of wholesale, surplus and salvage goods sold by expanding our operations geographically and across new complementary markets. To support this growth, we intend to continue our disciplined and targeted acquisition strategy. Our approach focuses on identifying target companies that will offer us new or complementary areas of expertise, technology advancements, client bases and geographic territories, such as the STR acquisition which we completed on October 16, 2006. In considering each acquisition scenario, we evaluate the merits of the individual opportunity and determine whether to employ a "buy" or "build" strategy.

Our Marketplaces

Our online auction marketplaces serve as an efficient and convenient method for the sale of wholesale, surplus and salvage assets. Through our online auction sites, sellers and professional buyers come together to transact for goods sold "as-is, where-is," generally without the discretionary right to return the merchandise. Items sold in our marketplaces range from new, used, salvage and scrap materials. We operate the following online marketplaces:

Our *www.liquidation.com* marketplace enables corporations and selected government agencies located in the United States to sell wholesale, surplus and salvage assets. This marketplace and our related services are designed to meet the needs of clients selling to domestic and international buyers, including buyer qualification, brand and channel relationships protection, and shipping and logistics management.

Our *www.govliquidation.com* marketplace enables selected federal government agencies to sell surplus and scrap assets. In addition to goods sold on behalf of other federal agencies, the surplus and scrap assets we sell as the exclusive contractor of the Defense Reutilization and Marketing Service of the U.S. Department of Defense are sold in this marketplace. To satisfy the requirements of U.S. federal government agency sellers, this marketplace incorporates additional terms and conditions of sale, such as U.S. Trade Security Controls clearance for the sale of export-controlled property.

Our *www.liquibiz.com* marketplace enables European-based corporations and government agencies, including the U.K. Ministry of Defense and the U.S. Department of Defense in Germany, to sell goods to European and other international buyers. While all of our marketplaces reach a global buyer base, we recognize that high shipping costs can impact the amount a buyer is willing to bid for goods. As a result, we created this marketplace to geographically align European sellers and buyers. We intend to further expand our operations in Europe through our existing facilities in the United Kingdom and Germany.

Our three online auction marketplaces are designed to address the particular requirements and needs of buyers and sellers. Although our buyers may access and register on a single marketplace, we use numerous cross-marketing and cross-promotional methods to ensure that buyers are exposed to all of our marketplaces and to all product categories in which they have expressed an interest. For example, we display cross-search results for all our marketplaces in response to key word searches in a single marketplace.

Our Value-Added Services

We have integrated value-added services into our solution to simplify the sale process for sellers and improve the utility of our marketplaces for buyers. Unlike other online auction sites on which sellers post information on the auction website and deal directly with the buyer to complete a sale, we manage each step of the transaction. We perform all required pre-sale value-added services such as receiving and lotting of the merchandise and implementing marketing strategies. After an online

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auction transaction is executed, we perform all required post-sale value-added services such as payment collection, settlement and reporting. We believe these services contribute significantly to an enhanced selling price and a higher level of confidence for our buyers. Additionally, we believe these services improve compliance with the various policies, regulations and sale restrictions of our corporate and government sellers. Our employees provide the majority of our value-added services, outsourcing to third-party vendors in limited cases.

Seller services. We offer value-added services to sellers in three areas: (1) sales and marketing, (2) logistics and (3) settlement and customer support.

Sales and marketing. Sales and marketing efforts encompass all of the services necessary to prepare merchandise for a successful auction and include the following:

Marketing and promotion we use a variety of both online and traditional marketing methods to promote our sellers' merchandise and generate interest in each auction.

Asset lotting and merchandising we leverage our industry experience to organize merchandise in lot sizes and product combinations that meet buyer preferences.

Product information enhancement we photograph and upload digital images of the merchandise to be sold and combine the images in a relevant format. In order to increase the realized sales value, we also research, collect and use supplemental product information to enhance product descriptions.

Logistics. We provide standard and optional logistics services designed to support the receipt, handling, transportation and tracking of merchandise offered through our marketplaces, including the following:

Distribution centers we provide sellers with the flexibility of either having us manage the sales process at their location or delivering merchandise to one of our distribution centers.

Inventory management sellers benefit from our management and inventory tracking system designed so that merchandise is received, processed and delivered in a timely manner.

Cataloguing merchandise we catalogue all merchandise, which enables us to provide useful product information to buyers. We provide a detailed manifest for lots containing multiple goods. In certain circumstances, we will inspect the merchandise and provide condition descriptions.

Delabeling we can remove labels and product markings from merchandise prior to sale to protect sellers' brand equity and distribution relationships.

Outbound fulfillment we can arrange for domestic or international shipping for all merchandise, whether located in one of our distribution centers or at a seller's facility.

Settlement and customer support. Settlement and customer support services are designed for successful completion of transactions and include:

Buyer qualification we qualify buyers to ensure their compliance with applicable government or seller mandated terms of sale, as well as to confirm their ability to complete a transaction.

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Collection and settlement we collect all payments on behalf of sellers prior to delivery of any merchandise and only disburse the profits to the seller after the satisfaction of all conditions of a sale.

Transaction tracking and reporting we enable sellers to track and monitor the status of their transactions throughout the sales process. We provide a range of comprehensive

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reporting services to sellers upon the completion of a transaction. Our invoicing and reporting tools can be integrated with the seller's information system, providing a more efficient flow of data.

Customer support and dispute resolution we provide full customer support throughout the transaction process and dispute resolution for our customers if needed.

Buyer services. Many of the services we provide to sellers also benefit buyers by providing them with the information necessary to make a more informed bid and to receive the goods they purchased. Our buyer focused services include the following:

Intelligent alerts we automatically notify buyers of upcoming auctions based on their registered preferences and prior transaction history. Registered preferences can be as broad as a product category or as specific as a part number or key word. We use this information to generate automated notifications whenever we identify a product that fits a buyer's registered preference, when auctions are nearing conclusion and based on various other parameters.

Search tools buyers can search our marketplaces for products based on a variety of criteria including product category, keyword, lot size, product condition, product geographic location and auction ending date.

Dynamic pricing tools we offer multiple dynamic pricing tools including outbid notification, automated bid agent and automatic auction extension. For example, our automatic extension feature allows auctions to continue in set increments until the last bid is received, thus enhancing the pricing of goods.

Shipping quote we provide buyers with the information necessary to estimate the shipping costs associated with their purchase, such as shipping weights, packaging type and product dimensions.

Delivery and shipping we can provide packaging and shipping services for sales transactions.

Secure settlement in addition to qualifying sellers, providing several electronic payment options and serving as a trusted market intermediary, we verify transaction completion, which in turn enhances buyer confidence.

Customer support and dispute resolution we provide full customer support throughout the transaction process and dispute resolution for customers if needed.

Our Wholesale Industry Portal

In June 2004, we launched www.goWholesale.com, a wholesale industry portal supported by advertising and search services. goWholesale.com provides buyers of wholesale, surplus or salvage goods with tools to search for goods on the Internet and provides an avenue for manufacturers, drop shippers, distributors, importers and wholesalers to reach professional buyers. goWholesale.com also provides a single online destination for buyers to find specific products for resale and related business services. We developed this portal to provide advertisers with the ability to reach our growing network of professional buyers. Additionally, we believe that users of this site may have an interest in products offered in our marketplaces.

Our goWholesale.com portal is designed to allow advertisers to reach highly targeted wholesale buyer audiences in a more effective and efficient manner than other major search engine alternatives. Our wholesale industry portal focuses on three broad areas: generating leads for advertisers; providing access to a broad range of industry specific content for professional buyers; and creating an online community for the exchange of information by participants in the wholesale industry.

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Each component of our portal delivers a variety of services, including:

Lead generation	Content	Community
Key word advertising	Wholesale auctions	Community forum
Banner advertising	Industry news	Seller ratings
Seller directory	Classified ads	Web logs (blogs)
Sponsorship	Trade show directory	Web seminars
Newsletter advertising		

Sales and Marketing

We utilize a direct sales and marketing force to acquire and manage our seller accounts. As of September 30, 2007, we had 66 sales and 19 marketing personnel. Our sales activities are focused primarily on acquiring new sellers, and our marketing activities are focused primarily on acquiring new buyers and increasing existing buyer participation.

Sales

Our sales personnel develop seller relationships, establish agreements to provide our services and manage the business accounts on an on-going basis. Our sales representatives focus on building long-term relationships with sellers that we believe will generate recurring transactions. They also leverage our years of experience and database of completed transactions to identify which of our various services would be beneficial to each new or existing seller.

Our sales group is organized to serve three distinct groups of sellers: large corporate accounts, medium to small corporate accounts and government accounts. This approach is based on our experience in understanding and serving the unique needs of each type of seller:

Large corporate sellers. These sellers require a customized approach, using a combination of our industry-focused sales team and our value-added services to create a comprehensive solution.

Medium to small corporate sellers. These sellers are offered a turn-key solution enabling them to self-serve in our marketplaces by accessing tools and resources such as uploading product photographs and descriptions.

Government sellers. These sellers require a customized approach. Sales efforts are both pro-active and re-active, including responding to already structured contract proposal requests and assisting government agencies in developing the appropriate scope of work to serve their needs.

Our sales personnel receive a salary and performance-based commissions.

Marketing

We use a variety of online and traditional marketing to attract and activate professional buyers to maximize the number of bidders participating in our online marketplaces as well as to support our sales team:

Buyer acquisition. We utilize online marketing, including paid search advertising, search engine optimization, affiliate programs and cross promotion on all of our marketplaces to acquire new buyers. We supplement this online marketing with special event print media, classified advertisements and selected direct mail campaigns. Public relations campaigns, participation in trade shows and speaking engagements also complement our overall buyer acquisition efforts.

Buyer participation. We use a variety of tools to increase buyer participation, including: targeted opt-in e-mail newsletters that rely on the buyer's stated categories of interest and past bidding or

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transaction activity; special e-mail alerts highlighting specific products of interest; convenient search tools that enable a buyer or prospective buyer to find desired items on our online marketplaces; and saved search agents that automatically alert registered buyers when items of interest are added to our marketplaces.

Market research. In order to better target buyers by industry segment, geographic location or other criteria, our marketing department has gathered data and information from each of the buyer segments we serve. In addition, the marketing department conducts regular surveys to better understand buyers' behavior and needs. We have a privacy policy and have implemented security measures to protect this information.

Sales support. Our marketing department creates supporting documentation and research to support our sales team in presenting our company to potential sellers and buyers, including sales brochures, white papers and participation in selected trade shows.

All marketing activities are evaluated based on the level of auction participation in our marketplaces and the cost effectiveness of each action.

Technology and Infrastructure

Our marketplaces are fully web-based and can be accessed from any Internet enabled computer by using a standard web browser. Our technology systems enable us to automate and streamline many of the manual processes associated with finding, evaluating, bidding on, paying for and shipping wholesale, surplus and salvage assets. The technology and content behind our marketplaces and integrated value-added services were developed in-house by full-time employees, providing us with control over the marketplaces and the ability to make rapid enhancements to better fit the specific needs of our business and customers. Our marketplaces are supported by a common database architecture and a shared system application. This infrastructure provides:

an efficient channel to sell online through a variety of pricing mechanisms (standard auction, sealed bid, Dutch auction and fixed price);

a scalable back office that enables buyers and sellers to efficiently manage transactions among remote business users by utilizing account management tools, including payment collection, invoicing management, shipping and transaction settlement; and

an input/output agnostic platform, including conduits that enable us to integrate seamlessly with partner enterprise applications of sellers and third party service providers.

We have designed our websites and supporting infrastructure to be highly robust and to support new services and increased traffic. Our servers are fully-managed and hosted in a physically and network-secure environment at data centers in Ashburn, Virginia, which is managed by Equinix, Inc., and in Phoenix, Arizona, which is managed by Limelight Networks, Inc. Every critical piece of our application is fully redundant, and we maintain off-site back-up systems as well as a disaster recovery facility. Our network connectivity offers high performance and scalability to accommodate increases in website traffic. Since January 1, 2003, we have experienced no material service interruptions on our online marketplaces.

Our applications support multiple layers of security, including password-protected log-ins, encryption technology to safeguard information transmitted in web sessions and firewalls to help prevent unauthorized access to our network and servers. We devote significant efforts to protecting our systems from intrusion.

Operations

Supporting large organizations that have a recurring need to sell surplus, wholesale and salvage assets requires systematic processes to enhance the financial value and convenience received by our customers. We believe we have integrated all of the required operational processes into our solution to allow our online auctions to run efficiently and to effectively support our buyers and sellers. Our operations group is comprised of three functions: (1) buyer relations; (2) shipping logistics; and (3) distribution center operations.

Buyer relations

Our buyer relations group supports the completion of buyer transactions by managing the buyer registration and qualification process, answering questions and requests from buyers, collecting buyer payments and resolving disputes. Our websites contain extensive information about buying through our online marketplaces, including an online tutorial regarding the use of our marketplaces, answers to frequently-asked buyer questions and an indexed help section. Buyers are able to contact a customer service representative by e-mail or phone if they need additional support.

Shipping logistics

Our shipping logistics group manages and coordinates inbound and outbound shipping of merchandise for sellers and buyers. We offer, as part of our value-added services, integrated shipping services and price quotes through multiple shipping carriers. In addition, our shipping coordination group personnel monitor the performance and service level of our network of carriers to help ensure speed and quality of service.

Distribution center operations

Our distribution center operations group performs selected pre-sale and post-sale value-added services at our distribution centers and at seller locations. These activities include unloading, manifesting and reporting discrepancies for all received assets and sales preparation of offered assets, including lotting and organizing offered assets, writing product descriptions, capturing digital images and providing additional optional value-added services such as delabeling, cleaning and repackaging. Our distribution center operations group personnel also arrange the outbound shipping or pick-up of purchased assets with our buyers.

Competition

The online services market for auctioning or liquidating wholesale, surplus and salvage assets is competitive and growing rapidly. We currently compete with:

other e-commerce providers, such as Amazon.com, GSI Commerce and Overstock.com;

auction websites such as eBay and uBid;

government agencies that have created websites to sell wholesale, surplus and salvage assets; and

traditional liquidators and fixed-site auctioneers.

We expect our market to become even more competitive as traditional and online liquidators and auctioneers continue to develop online and offline services for disposition, redeployment and remarketing of wholesale, surplus and salvage assets. In addition, manufacturers, retailers and additional government agencies may decide to create their own websites to sell their own wholesale, surplus and salvage assets and those of third parties. Competitive pressures could harm our business, financial condition and operating results.

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Some of our other current and potential competitors have longer operating histories, larger client bases, greater brand recognition and significantly greater financial, marketing and other resources than we do. In addition, some of these competitors may be able to devote greater financial resources to marketing and promotional campaigns, secure merchandise from sellers on more favorable terms, adopt more aggressive pricing or inventory availability policies and devote substantially more resources to website and systems development than we are able to do. Increased competition may result in reduced operating margins and loss of market share. We may not be able to compete successfully against current and future competitors.

Our Contracts with the U.S. Department of Defense

We are the exclusive contractor with the Defense Reutilization and Marketing Service, or DRMS, for the sale of surplus and scrap assets of the U.S. Department of Defense, or DoD, in the United States. This relationship provides a significant supply of goods that we offer to our buyer base through our online marketplace www.govliquidation.com. In support of these contracts, we provide services in over 1 million square feet of military warehouse space at over 150 military bases throughout the United States.

We have two material contracts with DoD under which we acquire, manage and sell government property. The largest contract was awarded in June 2001 and relates to usable surplus property of DoD turned in to DRMS and located in the United States, Puerto Rico and Guam, such as computers, electronics, office supplies, equipment, aircraft parts, clothing and textiles. The second contract was awarded in June 2005 and relates to substantially all scrap property of DoD turned into the DRMS, such as metals, alloys, and building materials. Property sold under the contracts is "demilitarized" prior to sale and does not include weapons or hazardous materials.

The surplus contract expires in June 2008 and accounted for 87.5%, 56.6% and 33.9% of our revenue and 76.5%, 48.3% and 28.8% of our gross merchandise volume for the fiscal years ended September 30, 2005, 2006 and 2007, respectively. The scrap contract expires in August 2012, subject to the DoD's right to extend for three additional one-year terms. We began operating under the scrap contract in August 2005, and it accounted for 0.4%, 26.5% and 27.6% of our revenue and for 0.3%, 22.6% and 23.5% of our gross merchandise volume for fiscal years 2005, 2006 and 2007, respectively. The contracts were awarded in competitive bids conducted by DoD, and we may be required to go through a new competitive bidding process when our existing contracts expire.

Under the surplus property contract, we are obligated to purchase all DoD surplus property at set prices representing a percentage of the original acquisition cost, which varies depending on the type of surplus property being purchased. Under the Scrap Contract, we acquire scrap property at a per pound price. We were initially entitled to approximately 20% of the profits of sale (defined as gross proceeds of sale less allowable operating expenses) under the contracts, and the DoD was entitled to approximately 80% of the profits. We refer to these disbursement payments to DoD as profit-sharing distributions. As a result of these arrangements, we recognize as revenue the gross proceeds from these sales. DoD also reimburses us for actual costs incurred for packing, loading and shipping property under the contracts that we are obligated to pick up from non-DoD locations. On September 12, 2006, we entered into a bilateral contract modification under which the DoD agreed to increase our profit-sharing percentage under the Surplus Contract in exchange for our agreement to implement additional inventory assurance processes and procedures with respect to the sale of demilitarized property. Under the terms of the contract modification, from August 1, 2006 until November 30, 2006, we were entitled to receive 27.5% of the profits under the Surplus Contract and the DoD was entitled to receive 72.5%. Since November 30, 2006, we have been entitled to receive between 25% and 30.5% of the profits, based on the results of an audit of the effectiveness of the inventory controls we implement under the contract modification. On June 1, 2007, we agreed, as provided in the modification to the Surplus Contract that became effective as of September 12, 2006, to provide additional value-added services

with respect to demilitarized property that is returned to the DoD for reutilization. In exchange for our agreement to provide these services, the DoD exercised its existing option to increase our share of net proceeds under the Surplus Contract by 1%.

Under the Scrap Contract, we also have a small business performance incentive based on the number of scrap buyers that are small businesses that would allow us to receive up to an additional 2% of the profit sharing distribution. On May 21, 2007, we entered into a bilateral contract modification under which the DoD agreed to increase the profit-sharing distribution for the Scrap Contract from 20% to 23% effective June 1, 2007, in exchange for our agreement to implement additional inventory assurance processes and procedures with respect to the mutilation of demilitarized scrap property sold.

The contracts require us to satisfy export control and other regulatory requirements in connection with sales. Specifically, for specified categories of property sold under the contracts that are subject to export controls, we are required to (1) obtain an end-use certificate from the prospective buyer describing the nature of the buyer's business, describing the expected disposition and specific end-use of the property, and acknowledging the applicability of pertinent export control and economic sanctions laws and (2) confirm that each buyer has been cleared to purchase export-controlled items. Applicable export controls include the Export Administration Regulations enforced by the Bureau of Industry and Security ("BIS") of the U.S. Department of Commerce, and the International Traffic In Arms Regulations enforced by the Directorate of Defense Trade Controls ("DDTC") of the U.S. Department of State. Our collection, settlement tools and procedures are designed so that transactions for these categories of property cannot be completed until we receive a completed end-use certificate and confirmation of the buyer's trade security controls clearance. In addition, we do not combine export-controlled property into auction lots with property not subject to export controls.

We are also prohibited from selling property to persons or entities that appear on lists of restricted or prohibited parties maintained by the United States or other governments, including the Specially Designated Nationals and Blocked Persons List maintained by the Office of Foreign Assets Control of the U.S. Department of Treasury and the Entity List maintained by BIS, the Denied Persons List maintained by BIS and the Debarred Parties List maintained by DDTC. In addition, we are prohibited from selling to countries, regimes, or nationals that are the target of applicable economic sanctions or other embargoes. As part of each sale, we collect information from potential customers that our systems cross reference against a list of restricted or prohibited parties and countries, regimes, or nationals that are the target of economic sanctions or other embargoes in order to comply with these restrictions. Failure to satisfy any of these export control and other regulatory requirements could subject us to civil and criminal penalties and administrative sanctions, including termination of the DRMS contracts, forfeiture of profits, suspension of payments, fines and suspension or debarment from doing business with U.S. federal government agencies.

The contracts may be terminated by DoD or us if rate of return proceeds performance ratios do not exceed specified benchmark ratios for two consecutive quarterly periods and the preceding twelve months. We have never failed to meet the required benchmark ratios with respect to our contracts during any of the testing periods. DoD also has the right to audit our performance under the contracts. DoD may terminate the contracts and seek other contract remedies in the event of material breaches, provided that it provides us notice and a 30-day opportunity to cure such breaches.

Government Regulation

We are subject to federal and state consumer protection laws, including laws protecting the privacy of customer non-public information and regulations prohibiting unfair and deceptive trade practices. Furthermore, the growth and demand for online commerce has and may continue to result in more stringent consumer protection laws that impose additional compliance burdens on online companies. Many jurisdictions also regulate "auctions" and "auctioneers" and may regulate online auction services.

These consumer protection laws and regulations could result in substantial compliance costs and could interfere with the conduct of our business.

In many states, there is currently great uncertainty about whether or how existing laws governing issues such as property ownership, sales and other taxes, auctions and auctioneering, libel and personal privacy apply to the Internet and commercial online services. These issues may take years to resolve. 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 or regulatory restrictions on our business. These potential restrictions could have an adverse effect on our cash flows and 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.

In connection with our contracts with the U.S. federal government, the U.S. federal government has the right to audit and review our performance on our government contracts, as well as our compliance with applicable laws and regulations. In addition, we sell merchandise under our government contracts, such as scientific instruments, information technology equipment and aircraft parts, that is subject to further government regulations, some of which may require us to obtain an export license in certain circumstances or an end-use certificate from the buyer. In the United States, the sales of this type of merchandise is further regulated by, among others, the U.S. Export Administration Regulations, International Traffic in Arms and the economic sanctions and embargo laws enforced by the Office of Foreign Assets Control Regulations. If a government audit uncovers improper or illegal activities, or if we are alleged to have violated any laws or regulations governing the products we sell under our government contracts, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, denial of export privileges, forfeiture of profits, suspension of payments, fines, and suspension or debarment from doing business with U.S. federal government agencies. See "Risk Factors Unfavorable findings resulting from a government investigation or audit could subject us to a variety of penalties and sanctions, could negatively impact our future operating results and could force us to adjust previously reported operating results."

Intellectual Property

We regard our intellectual property, particularly domain names, copyrights and trade secrets, as critical to our success. We rely on a combination of contractual restrictions and common law copyright and trade secret laws to protect our proprietary rights, know-how, information and technology. These contractual restrictions include confidentiality and non-compete provisions. We generally enter into agreements containing these provisions with our employees, contractors and third parties with whom we have strategic relationships. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our intellectual property without our authorization. We currently are the registered owners of several Internet domain names, including *www.liquidation.com*, *www.govliquidation.com*, *www.liquibiz.com* and *www.goWholesale.com*. We pursue the registration of our trademarks in the U.S. and internationally. We are pursuing patent protection and registration of several of our trademarks. Effective patent, copyright, trademarks, trade secret and domain name protection is expensive to maintain and may require litigation to enforce our intellectual property rights. We seek to protect our domain names in an increasing number of jurisdictions and may not be successful in certain jurisdictions.

We rely on technologies that we license from third parties. These licenses may not continue to be available to us on commercially reasonable terms in the future. As a result, we may be required to obtain substitute technology of lower quality or at greater cost, which could materially adversely effect our business, financial condition, results of operations and cash flows.

We do not believe that our business, sales policies or technologies infringe the proprietary rights of third parties. However, third parties have in the past and may in the future claim that our business, sales policies or technologies infringe their rights. We expect that participants in the e-commerce market will be increasingly subject to infringement claims as the number of services and competitors in the industry grows. Any such claim, with or without merit, could be time consuming, result in costly litigation or an injunction or require us to enter into royalty or licensing agreements. Such royalty or licensing agreements might not be available on terms acceptable to us, or at all or may be prohibited by an injunction. As a result, any such claim of infringement against us could have a material adverse effect upon our business, financial condition, results of operations and cash flows.

Employees

As of September 30, 2007, we had 553 U.S. employees, including 76 in sales and marketing, 28 in technology, 23 in customer service, 364 in operations and 62 in finance and administration. In addition, as of that date, we had 36 international employees (located primarily in the United Kingdom and Germany), including 9 in sales and marketing, 3 in customer service, 19 in operations and 5 in finance and administration.

We believe that we have good relationships with our employees. We have never had a work stoppage, and none of our employees is represented under a collective bargaining agreement or by a union.

Available Information

The address of our website is www.liquidityservicesinc.com.

Cautionary Note Regarding Forward-Looking Statements

This document contains forward-looking statements. These statements are only predictions. The outcome of the events described in these forward-looking statements is subject to known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. These risks and other factors include but are not limited to those listed in Part I, Item 1A ("Risk Factors") and in our other filings with the Securities and Exchange Commission from time to time. You can identify forward-looking statements by terminology such as "may," "will," "should," "could," "would," "expects," "intends," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "continues" or the negative of these terms or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. There may be other factors of which we are currently unaware or deem immaterial that may cause our actual results to differ materially from the forward-looking statements.

All forward-looking statements apply only as of the date of this Annual Report and are expressly qualified in their entirety by the cautionary statements included in this document. Except as may be required by law, we undertake no obligation to publicly update or revise any forward-looking statement to reflect events or circumstances occurring after the date of this Annual Report or to reflect the occurrence of unanticipated events.

Item 1A. Risk Factors.

You should carefully consider the risks described below, together with all of the other information in this Annual Report, including the consolidated financial statements and related notes, before making an investment decision with respect to our common stock. If any of the following risks occur, our business, financial condition or operating results could suffer. As a result, the trading price of our common stock could decline and you may lose all or part of your investment in our common stock. The risks and uncertainties described below are not the only significant risks we may face. Other events that we do not currently anticipate or that we currently deem immaterial also may affect our results of operations and financial condition.

We depend on contracts with the U.S. Department of Defense for a significant portion of our revenue, and if our relationship with this customer is disrupted, we would experience a significant decrease in revenue and income.

We have two material contracts with the Defense Reutilization and Marketing Service, or DRMS, under which we acquire, manage and sell surplus and scrap property of the DoD. If our relationship with DoD is impaired, we are not awarded new DoD contracts when our current contracts expire, any of our DoD contracts are terminated or the supply of assets under the contracts significantly decreased, we would experience a significant decrease in revenue and have difficulty generating income. The surplus contract accounted for 87.5%, 56.6% and 33.9% of our revenue and 76.5%, 48.3% and 28.8% of our gross merchandise volume for the fiscal years ended September 30, 2005, 2006 and 2007, respectively. We began to operate under the scrap contract in August 2005 and it accounted for 0.4%, 26.5% and 27.6% of our revenue and for 0.3%, 22.6% and 23.5% of our gross merchandise volume in fiscal year 2005, 2006 and 2007, respectively. We believe that these contracts will continue to be the source of a significant portion of our revenue and gross merchandise volume during their respective terms. The surplus contract expires in June 2008. The scrap contract has a seven-year base term that expires in August 2012, subject to DoD's right to extend for three additional one-year terms. The contracts were awarded by DoD through a competitive bidding process, and we may be required to go through a new competitive bidding process when our existing contracts expire.

Although our contracts with DoD do not allow DoD to terminate for convenience, each contract requires us to meet specified performance benchmarks. The contracts may be terminated by DoD if rate of return performance ratios do not exceed specified benchmark ratios for two consecutive quarterly periods and the preceding twelve months. Although, to date, we have never failed to meet the required benchmark ratios during any of the testing periods, we cannot assure you that we will meet the performance benchmarks in the future. DoD also has the right, after giving us notice and a 30 day opportunity to cure, to terminate the contracts and seek other contract remedies in the event of material breaches.

Unfavorable findings resulting from a government investigation or audit could subject us to a variety of penalties and sanctions, could negatively impact our future operating results and could force us to adjust previously reported operating results.

In the past, the Government Accountability Office (GAO) has cited weaknesses in DoD excess inventory control procedures and lax security at selected DoD facilities with respect to surplus property. In July 2006, the GAO asserted that we failed to verify the appropriate DoD regulatory classifications for certain items we sold and, as a result, we sold items we should have instead returned to the DoD. We do not believe that we have a contractual responsibility under our DoD contracts to assign these classifications; we believe that the DoD has the contractual obligation to assign these classifications. In July 2006, the GAO also identified buyers that collectively purchased sensitive military items and stated that the GAO was referring these sales to federal law enforcement agencies for investigation. These buyers may have acquired these sensitive military items from us. It is possible that other government

and law enforcement agencies may also investigate these sales, our company and our activities under our DoD contracts. If an investigation alleges that we engaged in improper or illegal activities, we could be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines, and suspension or debarment from doing business with U.S. federal government agencies. We could also suffer serious harm to our reputation if allegations of impropriety are made against us, whether or not these allegations have merit. If we are suspended or debarred from contracting with the federal government generally, or any specific agency, if our reputation or relationship with government agencies is impaired, or if the government otherwise ceases doing business with us or significantly decreases the amount of business it does with us, our revenue and profitability would substantially decrease.

The federal government has the right to audit our performance under our government contracts. Any adverse findings from audits or reviews of our performance under our contracts could result in a significant adjustment to our previously reported operating results. For example, our DoD contracts provide that we share sales profits with the government. The federal government may disagree with our calculation of the profits realized from the sales of government surplus assets and may require us to increase profit-sharing payments to the government that have been made in the past. If this occurs, our past operating margins may be reduced. The results of an audit by the government could significantly limit the volume and type of merchandise made available to us under our contracts with the DoD, resulting in lower gross merchandise volume, revenue, and profitability for our company. If such a government audit uncovers improper or illegal activities, we could be subject to the civil and criminal penalties, administrative sanctions and reputational harm described above. If, as the result of such an audit, we are suspended or debarred from contracting with the federal government generally, or any specific agency, if our reputation or relationship with government agencies is impaired, or if the government otherwise ceases doing business with us or significantly decreases the amount of business it does with us, our revenue and profitability would substantially decrease.

The success of our business depends on our ability to successfully obtain a supply of merchandise for our buyers and to attract and retain active professional buyers to create sufficient demand for our sellers.

Our ability to increase our revenue and maintain profitability depends on whether we can successfully expand the supply of merchandise available for sale on our online marketplaces and attract and retain active professional buyers to purchase the merchandise. Our ability to attract sufficient quantities of suitable merchandise and new buyers will depend on various factors, some of which are out of our control. These factors include our ability to:

offer sellers liquid marketplaces for their wholesale, surplus and salvage assets;

offer buyers a sufficient supply of merchandise;

develop and implement effective sales and marketing strategies;

comply with regulatory or corporate seller requirements affecting marketing and disposition of certain categories of merchandise;

efficiently catalogue, handle, store, ship and track merchandise; and

achieve high levels of seller and buyer satisfaction with the trading experience.

We may not be able to compete successfully against existing or future competitors.

The online services market for auctioning or liquidating wholesale, surplus and salvage assets is competitive and growing rapidly. Competitive pressures could affect our ability to attract and retain

customers, which could decrease our revenue and negatively affect our operating results. We currently compete with:

other e-commerce providers, such as Amazon.com, GSI Commerce and Overstock.com;

auction websites such as eBay and uBid;

government agencies that have created websites to sell wholesale, surplus and salvage assets; and

traditional liquidators and fixed-site auctioneers.

We expect our market to become even more competitive as traditional and online liquidators and auctioneers continue to develop online and offline services for disposition, redeployment and remarketing of wholesale, surplus and salvage assets. In addition, manufacturers, retailers and government agencies may decide to create their own websites to sell their own wholesale, surplus and salvage assets and those of third parties.

Some of our other current and potential competitors have longer operating histories, larger client bases, greater brand recognition and significantly greater financial, marketing and other resources than we do. In addition, some of these competitors may be able to devote greater financial resources to marketing and promotional campaigns, secure merchandise from sellers on more favorable terms, adopt more aggressive pricing or inventory availability policies and devote substantially more resources to website and systems development than we are able to do. Increased competition may result in reduced operating margins and loss of market share. We may not be able to compete successfully against current and future competitors.

If we fail to manage our growth effectively, our operating results could be adversely affected.

We have expanded our operations rapidly since our inception in 1999. Although we currently do not have specific plans for any expansion that would require significant capital investment, in the future we plan to expand our operations further by developing new or complementary services, products, or trading formats and enhancing the breadth and depth of our value-added services. We also plan to continue to expand our sales and marketing, technology and client support organizations. In addition, we will likely need to continue to improve our financial and management controls and our reporting systems and procedures. If we are unable to effectively implement these plans and to otherwise manage our expanding operations, we may not be able to execute our business strategy and our operating results could significantly decrease.

Our business depends on the continued growth of the Internet and e-commerce.

The business of selling merchandise over the Internet, particularly through online trading, is dynamic and relatively new. Growth in the use of the Internet as a medium for consumer commerce may not continue. Concerns about fraud and privacy, increased costs of Internet service, Internet service disruptions and other problems may discourage consumers from engaging in e-commerce. In particular, many traditional buyers and sellers of wholesale, surplus and salvage goods still conduct much of their business in traditional live auctions that do not occur on the Internet, and those buyers and sellers may be hesitant to engage in e-commerce. If the e-commerce industry fails to grow or traditional buyers and sellers of wholesale, surplus and salvage assets are unwilling to conduct business on the Internet, we may be unable to attract customers, which could cause our revenue and operating results to decline.

We may not operate profitably in the future.

We commenced operations in early 2000 and, as a result, have only a limited operating history upon which you can evaluate our business and prospects. Although we have experienced significant

revenue growth in recent periods, we may not be able to sustain this growth. If we are not able to sustain this revenue growth, the value of your investment in our common stock may decline.

Our quarterly operating results have fluctuated in the past and may do so in the future, which could cause volatility in our stock price.

Our prior operating results have fluctuated due to changes in our business and the e-commerce industry. Similarly, our future operating results may vary significantly from quarter to quarter due to a variety of factors, many of which are beyond our control. You should not rely on period-to-period comparisons of our operating results as an indication of our future performance. Factors that may affect our quarterly operating results include the following:

the addition of new buyers and sellers or the loss of existing buyers and sellers;

the volume, size, timing and completion rate of transactions in our marketplaces;

changes in the supply and demand for and the volume, price, mix and quality of our supply of wholesale, surplus and salvage assets;

introduction of new or enhanced websites, services or product offerings by us or our competitors;

implementation of significant new contracts;

changes in our pricing policies or the pricing policies of our competitors;

changes in the conditions and economic prospects of the e-commerce industry or the economy generally, which could alter current or prospective buyers' and sellers' priorities;

technical difficulties, including telecommunication system or Internet failures;

changes in government regulation of the Internet and e-commerce industry;

event-driven disruptions such as war, terrorism, disease and natural disasters;

seasonal patterns in selling and purchasing activity; and

costs related to acquisitions of technology or equipment.

Our operating results may fall below the expectations of market analysts and investors in some future periods. If this occurs, even temporarily, it could cause volatility in our stock price.

Our operating results depend on our websites, network infrastructure and transaction processing systems. Service interruptions or system failures could negatively affect the demand for our services and our ability to grow our revenue.

Any system interruptions that affect our websites or our transaction systems could impair the services that we provide to our sellers and buyers. In addition, our systems may be vulnerable to damage from a variety of other sources, including telecommunications failures, power outages, malicious human acts and natural disasters. Improving the reliability and redundancy of our systems may be expensive, reduce our margins and may not be successful in preventing system failures. Our services are also substantially dependent on systems provided by third

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parties, over whom we have little control. We have occasionally experienced interruptions to our services due to system failures unrelated to our own systems. Any interruptions or failures of our current systems or our ability to communicate with third party systems could negatively affect the demand for our services and our ability to grow our revenue.

If we do not respond to rapid technological changes or upgrade our systems, we could fail to grow our business and our revenue could decrease.

To remain competitive, we must continue to enhance and improve the functionality and features of our e-commerce business. Although we currently do not have specific plans for any upgrades that would require significant capital investment, in the future we will need to improve and upgrade our technology, transaction processing systems and network infrastructure in order to allow our operations to grow in both size and scope. Without such improvements, our operations might suffer from unanticipated system disruptions, slow transaction processing, unreliable service levels, or impaired quality or delays in reporting accurate financial information, any of which could negatively affect our reputation and ability to attract and retain sellers and buyers. We may also face material delays in introducing new services, products and enhancements. The Internet and the e-commerce industry are rapidly changing. If competitors introduce new products and services using new technologies or if new industry standards and practices emerge, our existing websites and our proprietary technology and systems may become obsolete. In addition, the expansion and improvement of our systems and infrastructure may require us to commit substantial financial, operational and technical resources, with no assurance our business will increase. If we fail to respond to technological change or to adequately maintain, expand, upgrade and develop our systems and infrastructure in a timely fashion our ability to grow could be limited and our revenue could decrease.

Shipment of merchandise sold in our marketplaces could be delayed or disrupted by factors beyond our control and we could lose buyers and sellers as a result.

We rely upon third party carriers such as United Parcel Services, or UPS, for timely delivery of our merchandise shipments. As a result, we are subject to carrier disruptions and increased costs due to factors that are beyond our control, including labor difficulties, inclement weather, terrorist activity and increased fuel costs. In addition, we do not have a long-term agreement with UPS or any other third party carriers, and we cannot be sure that our relationship with UPS will continue on terms favorable to us, if at all. If our relationship with UPS is terminated or impaired or if UPS is unable to deliver merchandise for us, we would be required to use alternative carriers for the shipment of products to our buyers. We may be unable to engage alternative carriers on a timely basis or on terms favorable to us, if at all. Potential adverse consequences include:

reduced visibility of order status and package tracking;

delays in merchandise receipt and delivery;

increased cost of shipment; and

reduced shipment quality, which may result in damaged merchandise.

Any failure to receive merchandise at our distribution centers or deliver products to our buyers in a timely and accurate manner could lead to client dissatisfaction and cause us to lose sellers and buyers.

A significant interruption in the operations of our customer service system or our distribution centers could harm our business and operating results.

Our business depends, to a large degree, on effective customer service and distribution center operations. We currently staff DoD warehouse distribution space, for which we do not incur leasing costs, as well as leased commercial warehouse distribution space. These operations could be harmed by several factors, including any material disruption or slowdown at our distribution centers resulting from labor disputes, changes in the terms of our underlying lease agreements or occupancy arrangements in the case of government provided facilities, telecommunications failures, power or service outages, human error, terrorist attacks, natural disasters or other events. In addition, space provided to us by

DoD could be re-configured or reduced as a result of DoD's Base Realignment and Closure initiative or other infrastructure reduction initiatives.

If our transaction models are not accepted by our clients or alternative transaction models are developed, we could lose clients and our revenue and our profitability could decline.

Our services are offered to sellers using the following three primary transaction models:

consignment (in which we charge the seller a commission);

profit-sharing (in which we purchase merchandise from sellers and share profits); and

purchase (in which we purchase merchandise from sellers and, in some cases, share a portion of the profits with the seller after we have received an adequate return on our investment).

We also collect a buyer's premium, or a commission paid by the buyer, on substantially all completed transactions. It is possible that new transaction models that are not compatible with our business model or our marketplaces may be developed and gain widespread acceptance. Alternative transaction models could cause our revenue and margins to decline. In addition, if current and potential customers do not recognize the benefits of our transaction models, activity in our marketplaces may decline or develop more slowly than we expect, which may limit our ability to grow our revenue or cause our revenue to decline.

If we fail to accurately predict our ability to sell merchandise in which we take inventory risk and credit risk, our margins may decline as a result of lower sale prices from such merchandise.

Under our profit-sharing and purchase model, we purchase merchandise and assume the risk that the merchandise may sell for less than we paid for it. We assume general and physical inventory and credit risk. These risks are especially significant because some of the goods we sell on our websites are characterized by rapid technological change, obsolescence and price erosion, and because we sometimes make large purchases of particular types of inventory. In addition, we do not receive warranties on the goods we purchase and, as a result, we have to resell or dispose of any returned goods. Historically, the number of disposed goods (which includes returned goods that we have not resold) has been less than 2% of the goods we have purchased.

To manage our inventory successfully, we need to maintain sufficient buyer demand and sell merchandise for a reasonable financial return. We may miscalculate buyer demand and overpay for the acquired merchandise. In the event that merchandise is not attractive to our buyer base, we may be required to take significant losses resulting from lower sale prices, which could reduce our revenue and margins. For example, under our DoD surplus contract, we are obligated to purchase all DoD surplus property at set prices representing a percentage of the original acquisition cost, which varies depending on the type of surplus property being purchased. When we resell property under the contract, historically we were entitled to approximately 20% of the profits of sale (defined as gross proceeds of sale less allowable operating expenses) and DoD was entitled to approximately 80% of the profits for distributions. From August 1, 2006 until November 30, 2006, the Company was entitled to receive 27.5% of the profits and DRMS was entitled to 72.5% of the profits from the sale of goods under this contract. Since November 30, 2006, the Company has been entitled to receive between 25% and 30.5% of the profits, based on the results of an audit of the effectiveness of the inventory controls the Company implements under the contract modification. On June 1, 2007, the Company agreed, as provided in the modification to the Surplus Contract that became effective as of September 12, 2006, to provide additional value-added services with respect to demilitarized property that is returned to the DoD for reutilization. In exchange for the agreement to provide these services, the DoD exercised its existing option to increase the Company's share of net proceeds under the Surplus Contract by 1%. On May 21, 2007, the DoD agreed to increase the profit-sharing distribution for the Scrap Contract, from

20% to 23% effective June 1, 2007, in exchange for the Company's agreement to implement additional inventory assurance processes and procedures with respect to the mutilation of demilitarized scrap property sold by the Company. Historically, the cost of inventory has been approximately 5% of the gross merchandise volume under our profit-sharing model. Occasionally, we are not able to sell our inventory for amounts above its cost and we may incur a loss. As we grow our business, we may choose to increase the amount of merchandise we purchase directly from sellers, thus resulting in increased inventory levels and related risk. Any such increase would require the use of additional working capital and subject us to the additional risk of incurring losses on the sale of that inventory.

We may be unable to adequately protect or enforce our intellectual property rights, which could harm our reputation and negatively impact the growth of our business.

We regard our intellectual property, particularly domain names, copyrights and trade secrets, as critical to our success. We rely on a combination of contractual restrictions and copyright and trade secret laws to protect our proprietary rights, know-how, information and technology. Despite these protections, it may be possible for a third party to copy or otherwise obtain and use our intellectual property without authorization or independently develop similar intellectual property.

We currently are the registered owners of several Internet domain names, including *www.liquidation.com*, *www.govliquidation.com*, *www.liquibiz.com* and *www.goWholesale.com*. We pursue the registration of our domain names in the U.S. and internationally. We currently do not have any patents or registered copyrights, trademarks or service marks, but we are pursuing patents and registration of such intellectual property. Effective patent, copyright, trademark, service mark, trade secret and domain name protection is expensive to maintain and may require litigation. We seek to protect our domain names in an increasing number of jurisdictions and may not be successful in doing so in certain jurisdictions. Our competitors may adopt trade names or domain names similar to ours, thereby impeding our ability to promote our marketplaces and possibly leading to client confusion. In addition, we could face trade name or trademark or service mark infringement claims brought by owners of other registered or unregistered trademarks or service marks, including trademarks or service marks that may incorporate variations of our marketplace names. Any claims related to our intellectual property or client confusion related to our marketplaces could damage our reputation and negatively impact the growth of our business.

Our inability to use software licensed from third parties or our use of open source software under license terms that interfere with our proprietary rights could disrupt our business.

We use software licensed from third parties, including some software, known as open source software, that we use without charge. We currently use the following open source software: Linux (an operating system), MySQL (database software), PERL (an interpreter) and Apache (a web server), and we may in the future use additional open source software. In the future, these licenses to third party software may not be available on terms that are acceptable to us, or at all. Our inability to use third-party software could result in disruptions to our business, or delays in the development of future services or enhancements of existing services, which could impair our business. In addition, the terms of certain open source software licenses may require us to provide modified versions of the open source software, which we develop, if any, or any proprietary software that incorporates all or a portion of the open source software, if any, to others on unfavorable license terms that are consistent with the open source license term. If we are required to license our proprietary software in accordance with the foregoing, our competitors and other third parties could obtain access to our intellectual property, which could harm our business.

Assertions that we infringe on intellectual property rights of others could result in significant costs and substantially harm our business and operating results.

Other parties may assert that we have infringed their technology or other intellectual property rights. We use internally developed systems and licensed technology to operate our online auction platform and related websites. Third parties could assert intellectual property infringement claims against us based on our internally developed systems or use of licensed third party technology. Third parties also could assert intellectual property infringement claims against parties from whom we license technology. If we are forced to defend against any infringement claims, whether they are with or without merit or are determined in our favor, we may face costly litigation, diversion of technical and management personnel and/or delays in completion of sales. Furthermore, the outcome of a dispute may be that we would need to change technology, develop non-infringing technology or enter into royalty or licensing agreements. A switch to different technology could cause interruptions in our business. Internal development of a non-infringing technology may be expensive and time-consuming, if we are able to successfully develop such technology at all. Royalty or licensing agreements, if required, may be unavailable on terms acceptable to us, or at all. Incurrence of any of these costs could negatively impact our operating results.

If we do not retain our senior management, we may not be able to achieve our business objectives.

Our future success is substantially dependent on the continued service of our senior management, particularly William P. Angrick, III, our chief executive officer and Jaime Mateus-Tique, our chief operating officer. We do not have key-person insurance on any of our officers or employees. The loss of any member of our existing senior management team could damage key seller relationships, result in the loss of key information, expertise or know-how, lead to unanticipated recruitment and training costs and make it more difficult to successfully operate our business and achieve our business goals.

If we are unable to attract and retain skilled employees, we might not be able to sustain our growth.

Our future success depends on our ability to continue to attract, retain and motivate highly skilled employees, particularly employees with sales, marketing, operations and technology expertise. Competition for employees in our industry is intense. We have experienced difficulty from time to time in attracting the personnel necessary to support the growth of our business, and we may experience similar difficulties in the future. If we are unable to attract, assimilate and retain employees with the necessary skills, we may not be able to grow our business and revenue.

Our international operations subject us to additional risks and challenges that could harm our business and our profitability.

We have begun expanding internationally, and in the future we may do so more aggressively. For the fiscal year ended September 30, 2007, international operations accounted for less than 5% of our revenue. International operations subject us to additional risks and challenges, including:

the need to develop new seller and buyer relationships;

difficulties and costs of staffing and managing foreign operations;

changes in and differences between domestic and foreign regulatory requirements;

price controls and foreign currency exchange rate fluctuations;

difficulties in complying with export restrictions and import permits;

reduced protection for intellectual property rights in some countries;

potentially adverse tax consequences;

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lower per capita Internet usage and lack of appropriate infrastructure to support widespread Internet usage;

political and economic instability; and

tariffs and other trade barriers.

We cannot assure you that we will be successful in our efforts in foreign countries. Some of these factors may cause our international costs to exceed our domestic costs of doing business. Failure to adequately address these risks could decrease our profitability and operating results.

We may make acquisitions that require significant resources and could be unsuccessful.

In the future, we may acquire other businesses, products and technologies to complement our current business. We may not be able to identify, negotiate, finance, complete or integrate any future acquisition successfully. Acquisitions involve a number of risks, including possible adverse effects on our operating results, diversion of management's attention, inability to retain key employees of the acquired business and risks associated with unanticipated events or liabilities, some or all of which could disrupt our business and reduce the likelihood that we will receive the anticipated benefits of the acquisition in the amount or the time frame that we expect.

Should we be unable successfully to integrate a new business, we could be required either to dispose of the operation or restructure the operation. In either event, our business could be disrupted and we may not achieve the anticipated benefits of the acquisition. In addition, future transactions could result in potentially dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities or amortization of expenses, or write-offs of goodwill, any of which could harm our financial condition and operating results. Future transactions may also require us to obtain additional financing, which may not be available on favorable terms or at all.

We may need additional financing in the future, which may not be available on favorable terms, if at all.

We may need additional funds to finance our operations, as well as to enhance our services, fund our expansion, respond to competitive pressures or acquire complementary businesses or technologies. However, our business may not generate the cash needed to finance such requirements. If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our existing stockholders would be reduced, and these securities may have rights, preferences or privileges senior to those of our common stock. If adequate funds are not available or are not available on acceptable terms, our ability to enhance our services, fund our expansion, respond to competitive pressures or take advantage of business opportunities would be significantly limited, and we might need to significantly restrict our operations.

We face legal uncertainties relating to the Internet in general and to the e-commerce industry in particular and may become subject to costly government regulation.

The laws and regulations related to the Internet and e-commerce are evolving. These laws and regulations relate to issues such as user privacy, freedom of expression, pricing, fraud, quality of products and services, taxation, advertising, intellectual property rights and information security. Laws governing issues such as property ownership, copyrights and other intellectual property issues, taxation, libel and defamation, obscenity and personal privacy could also affect our business. Laws adopted prior to the advent of the Internet may not contemplate or address the unique issues of the Internet and related technologies and it is not clear how they will apply. Current and future laws and regulations could increase our cost of doing business and/or decrease the demand for our services.

Our auction business may be subject to a variety of additional costly government regulations.

Many states and other jurisdictions have regulations governing the conduct of traditional "auctions" and the liability of traditional "auctioneers" in conducting auctions, which may apply to online auction services. In addition, certain states have laws or regulations that expressly apply to online auction services. We expect to continue to incur costs in complying with these laws and could be subject to fines or other penalties for any failure to comply with these laws. We may be required to make changes in our business to comply with these laws, which could increase our costs, reduce our revenue, cause us to prohibit the listing of certain items, or otherwise adversely affect our financial condition or operating results.

In addition, the law regarding the potential liability of an online auction service for the activities of its users is not clear. We cannot assure you that users of our websites will comply with our terms and conditions or with laws and regulations applicable to them and their transactions. It is possible that we may be subject to allegations of civil or criminal liability for any unlawful activities conducted by sellers or buyers. Any costs we incur as a result of any such allegations, or as a result of actual or alleged unlawful transactions using our marketplaces, or in our efforts to prevent any such transactions, may harm our opportunities for future revenue growth. In addition, any negative publicity we receive regarding any such transactions or allegations may damage our reputation, our ability to attract new sellers and buyers and our business.

Certain categories of merchandise sold on our marketplaces are subject to government restrictions.

We sell merchandise, such as scientific instruments, information technology equipment and aircraft parts, that is subject to export control and economic sanctions laws, among other laws, imposed by the United States and other governments. Such restrictions include the U.S. Export Administration Regulations, the International Traffic in Arms Regulations, and economic sanctions and embargo laws administered by the Office of the Foreign Assets Control Regulations. These restrictions prohibit us from, among other things, selling property to (1) persons or entities that appear on lists of restricted or prohibited parties maintained by the United States or other governments or (2) countries, regimes, or nationals that are the target of applicable economic sanctions or other embargoes. In addition, for specified categories of property sold under our contracts with the DoD, we are required to (1) obtain an end-use certificate from the prospective buyer describing the nature of the buyer's business, describing the expected disposition and specific end-use of the property, and acknowledging the applicability of pertinent export control and economic sanctions laws and (2) confirm that each buyer has been cleared to purchase export-controlled items.

We may incur significant costs or be required to modify our business to comply with these requirements. If we are alleged to have violated any of these laws or regulations we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines, and suspension or debarment from doing business with U.S. federal government agencies. In addition, we could suffer serious harm to our reputation if allegations of impropriety are made against us, whether or not true.

Our business may be harmed if third parties misappropriate our clients' confidential information.

We retain highly confidential information on behalf of our clients in our systems and databases. Although we maintain security features in our systems, our operations may be susceptible to hacker interception, break-ins and other disruptions. These disruptions may jeopardize the security of information stored in and transmitted through our systems. We may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches. These issues are likely to become more difficult as we expand our operations. If any compromise of our security were to occur, we may lose clients and our reputation, business, financial

condition and operating results could be harmed by the misappropriation of confidential client information. In addition, if there is any perception that we cannot protect our clients' confidential information, we may lose the ability to attract new clients and our revenue could decline.

If we fail to comply with increasing levels of regulation relating to privacy, our business could suffer harm.

We are subject to increasing regulation at the federal, state and international levels relating to privacy and the use of personal user information. In addition, several states have proposed or enacted legislation to limit uses of personal information gathered online or require online services to establish privacy policies. Data protection regulations and enforcement efforts may restrict our ability to collect demographic and personal information from users, which could be costly or harm our marketing efforts. Such regulations, along with increased government or private enforcement, may increase the cost of growing our business and require us to expend significant capital and other resources. Our failure to comply with these federal, state and international laws and regulations could subject us to lawsuits, fines, criminal penalties, statutory damages, adverse publicity and other costs could decrease our profitability.

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

We are currently required to pay sales taxes in all states for shipment of goods from our DoD contracts. We also pay sales or other similar taxes in respect of shipments of other goods into states in which we have a substantial presence. In addition, as we grow our business, any new operation in states in which we currently do not pay sales taxes could subject shipments into such states to state sales taxes under current or future laws.

In October 2007, the federal government extended until November 2014 a ban on state and local governments' imposition of new taxes on Internet access or electronic commerce transactions. This ban does not prohibit federal, state or local authorities from collecting taxes on our income or from collecting taxes that are due under existing tax rules. Unless the ban is further extended, state and local governments may begin to levy additional taxes on Internet access and electronic commerce transactions upon the legislation's expiration. An increase in taxes may make electronic commerce transactions less attractive for merchants and businesses, which could result in a decrease in the level of demand for our services.

Currently, decisions of the U.S. Supreme Court restrict the imposition of obligations to collect state and local sales and use taxes with respect to sales made over the Internet. However, a number of states, as well as the U.S. Congress, have been considering various initiatives that could limit or supersede the Supreme Court's position regarding sales and use taxes on Internet sales. If any of these initiatives resulted in a reversal of the Supreme Court's current position, we could be required to collect sales and use taxes in states other than states in which we currently pay such taxes. A successful assertion by one or more local, state or foreign jurisdictions that the sale of merchandise by us is subject to sales or other taxes, could subject us to material liabilities and increase our costs of doing business. To the extent that we pass such costs on to our clients, could harm our business and decrease our revenue.

Fraudulent activities involving our websites and disputes relating to transactions on our websites may cause us to lose clients and affect our ability to grow our business.

We are aware that other companies operating online auction or liquidation services have periodically received complaints of fraudulent activities of buyers or sellers on their websites, including

disputes over the quality of goods and services, unauthorized use of credit card and bank account information and identity theft, potential breaches of system security, and infringement of third-party copyrights, trademarks and trade names or other intellectual property rights. We may receive similar complaints if sellers or buyers trading in our marketplaces are alleged to have engaged in fraudulent or unlawful activity. In addition, we may suffer losses as a result of purchases paid for with fraudulent credit card data even though the associated financial institution approved payment. In the case of disputed transactions, we may not be able to require users of our services to fulfill their obligations to make payments or to deliver goods. We also may receive complaints from buyers about the quality of purchased goods, requests for reimbursement, or communications threatening or commencing legal actions against us. Negative publicity generated as a result of fraudulent conduct by third parties or the failure to satisfactorily settle disputes related to transactions on our websites could damage our reputation, cause us to lose clients and affect our ability to grow our business.

False or defamatory statements transmitted through our services could harm our reputation and affect our ability to attract clients.

The law relating to the liability of online services companies for information carried on or disseminated through their services is currently unsettled. Claims could be made against online services companies under both the U.S. and foreign law for defamation, libel, invasion of privacy, negligence, copyright or trademark infringement, or other theories based on the nature and content of the materials disseminated through their services. Our *goWholesale.com* website allows users to make comments regarding the online auction industry in general and other users and their merchandise in particular. Although all such comments are generated by users and not by us, we are aware that claims of defamation or other injury have been made against other companies operating auction services in the past and could be made in the future against us for comments made by users. If we are held liable for information provided by our users and carried on our service, we could be directly harmed and may be forced to implement measures to reduce our liability. This may require us to expend substantial resources or discontinue certain service offerings, which could negatively affect our operating results. In addition, the increased attention focused upon liability issues as a result of these lawsuits and legislative proposals could harm our reputation and affect our ability to attract clients.

Our stock price has been volatile, and your investment in our common stock could suffer a decline in value.

The market prices of the securities of e-commerce companies have been extremely volatile and have overall declined significantly since early 2000. Broad market and industry factors may adversely affect the market price of our common stock, regardless of our actual operating performance. Factors that could cause fluctuation in the stock price may include, among other things:

actual or anticipated variations in quarterly operating results;

changes in financial estimates by us or by a securities analyst who covers our stock;

publication of research reports about our company or industry;

conditions or trends in our industry;

stock market price and volume fluctuations of other publicly traded companies and, in particular, those whose business involves the Internet and e-commerce;

announcements by us or our competitors of significant contracts, acquisitions, commercial relationships, strategic partnerships or divestitures;

announcements by us or our competitors of technological innovations, new services or service enhancements;

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announcements of investigations or regulatory scrutiny of our operations or lawsuits filed against us;

the passage of legislation or other regulatory developments that adversely affect us, our clients or our industry;

additions or departures of key personnel;

sales of our common stock, including sales of our common stock by our directors and officers or specific stockholders; and

general economic conditions and slow or negative growth of related markets.

Volatility in the market price of shares may prevent investors from being able to sell their shares of common stock at prices they view as attractive. In the past, securities class action litigation has often been instituted against companies following periods of volatility in their stock price. This type of litigation could result in substantial costs and divert our management's attention and resources.

Our costs have increased significantly over our prior two fiscal years as a result of operating as a public company.

We have only been operating as a public company since February 2006. As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. These expenses are associated with our public company reporting requirements and corporate governance requirements, including requirements under the Sarbanes-Oxley Act of 2002, as well as new rules implemented by the SEC, the Public Company Accounting Oversight Board and The Nasdaq Stock Market, or NASDAQ. We expect these rules and regulations to continue to increase our legal and financial compliance costs and to make some activities more time-consuming and costly. As a result, it may be more difficult for us to attract and retain qualified individuals to serve on our board of directors or as executive officers. We cannot predict or estimate the amount of additional costs we may incur as a public company or the timing of such costs.

Our disclosure controls and procedures may not prevent or detect all errors or acts of fraud.

We are subject to the periodic reporting requirements of the Securities Exchange Act of 1934, or the Exchange Act. Our disclosure controls and procedures are designed to reasonably assure that information required to be disclosed by us in reports we file or submit under the Exchange Act is accumulated and communicated to management, recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. We believe that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by an unauthorized override of the controls. Accordingly, because of the inherent limitations in our control system, misstatements due to error or fraud may occur and not be detected.

We have limited experience complying with public company obligations, including Section 404 of the Sarbanes-Oxley Act of 2002.

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the SEC has adopted rules requiring public companies to include a report of management on the company's internal controls over financial reporting in their annual reports on Form 10-K. In addition, the public accounting firm auditing a public company's financial statements must attest to and report on the effectiveness of the

company's internal controls over financial reporting. We currently do not have an internal audit group, and we will need to continue to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge. Also, in the future we may discover areas of our internal controls that need improvement. We cannot be certain that any remedial measures we take will ensure that we implement and maintain adequate controls over our financial processes and reporting in the future. Any failure to implement required new or improved controls, or difficulties encountered in their implementation could harm our operating results or cause us to fail to meet our reporting obligations. If we are unable to conclude that we have effective internal controls over financial reporting, or if our independent auditors are unable to provide us with an unqualified report as to the effectiveness of our internal controls over financial reporting in future year ends as required by Section 404, investors could lose confidence in the reliability of our financial statements, which could result in a decrease in the value of our common stock. Failure to comply with Section 404 could potentially subject us to sanctions or investigations by the SEC, NASDAQ or other regulatory authorities.

Some provisions of our charter, bylaws and Delaware law inhibit potential acquisition bids that you may consider favorable.

Our corporate documents and Delaware law contain provisions that may enable our board of directors to resist a change in control of our company even if a change in control were to be considered favorable by you and other stockholders. These provisions include:

a staggered board of directors;

a prohibition on actions by our stockholders by written consent;

limitations on persons authorized to call a special meeting of stockholders;

the authorization of undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval;

advance notice procedures required for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders; and

the requirement that board vacancies be filled by a majority of our directors then in office.

These provisions could discourage, delay or prevent a transaction involving a change in control of our company. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors of your choosing and cause us to take other corporate actions you desire.

Item 1B. Unresolved Staff Comments.

Not Applicable

Item 2. Properties.

We do not own any real property. We lease the following properties:

Purpose	Location	Square Feet	Lease Expiration Date
Corporate Headquarters	Washington, D.C.	13,000	January 31, 2013
Administrative	Washington, D.C.	9,300	September 30, 2011
Warehouse	Cranbury, New Jersey	49,000	December 31, 2009
Warehouse	North Las Vegas, Nevada	54,000	January 31, 2009
Warehouse	Dallas, Texas	81,000	July 31, 2011
Warehouse	Plainfield, Indiana	94,000	July 31, 2011
Warehouse	Fullerton, California	117,000	Two-thirds of the space will expire on August 31, 2009 and the remaining one-third will expire on July 10, 2011
Warehouse	Sacramento, California	21,000	May 31, 2010
Warehouse	Stafford, England	84,000	Half the space will expire on November 30, 2010, and the remaining half will expire on August 31, 2011
Headquarters for UK	Chippenham, England	1,863	November 30, 2010
Warehouse	Schwaig, Germany	36,000	Short-term or month to month basis
Headquarters for DoD	Scottsdale, Arizona	11,000	September 30, 2008.

Our servers are housed in data centers in Ashburn, Virginia, which is managed by Equinix, Inc., and in Phoenix, Arizona, which is managed by Limelight Networks, Inc.

Item 3. Legal Proceedings.

From time to time, we may become involved in litigation relating to claims arising in the ordinary course of our business. There are no claims or actions pending or threatened against us that, if adversely determined, would in our judgment have a material adverse effect on us.

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

No matters were submitted to a vote of security holders during the quarter ended September 30, 2007.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**Price Range of Common Stock**

Our common stock has been traded on The NASDAQ Stock Market under the symbol LQDT since February 23, 2006. The following table sets forth the intra-day high and low per share bid price of our common stock as reported by The NASDAQ Stock Market for the periods indicated.

Fiscal year ended September 30, 2006	Low	High
First Quarter	N/A	N/A
Second Quarter	\$ 10.00	\$ 13.70
Third Quarter	\$ 12.24	\$ 19.95
Fourth Quarter	\$ 8.66	\$ 17.11
Fiscal year ended September 30, 2007		
First Quarter	\$ 13.35	\$ 21.50
Second Quarter	\$ 16.61	\$ 24.23
Third Quarter	\$ 16.49	\$ 22.00
Fourth Quarter	\$ 10.84	\$ 19.17

As of December 7, 2007, there were approximately 4,200 holders of record of our common stock.

Dividend Policy

Since becoming a public company on February 22, 2006, we have not paid cash dividends on our stock and currently anticipate that we will continue to retain any future earnings to finance the growth of our business.

Issuer Purchases of Equity Securities

We did not repurchase any of our equity securities during the fiscal year ended September 30, 2007.

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Item 6. Selected Financial Data.

You should read the following selected consolidated financial data together with our consolidated financial statements and the related notes, and with "Management's Discussion and Analysis of Financial Condition and Results of Operations," included elsewhere in this Annual Report on Form 10-K. The consolidated statement of operations data for the years ended September 30, 2005, 2006 and 2007 are derived from, and are qualified by reference to, our consolidated financial statements that have been audited by Ernst & Young LLP, an independent registered public accounting firm, and that are included in this Annual Report on Form 10-K. The consolidated statement of operations data for the years ended September 30, 2003 and 2004, and the consolidated balance sheet data as of September 30, 2003, 2004 and 2005 are derived from our audited consolidated financial statements that are not included in this Annual Report on Form 10-K.

	Year ended September 30,				
	2003	2004	2005	2006	2007
(dollars in thousands, except per share data)					
Consolidated Statement of Operations Data:					
Revenue	\$ 60,719	\$ 75,869	\$ 89,415	\$ 147,813	\$ 198,620
Costs and expenses:					
Cost of goods sold (excluding amortization)	4,481	5,743	6,288	12,160	47,043
Profit-sharing distributions	30,427	39,718	48,952	80,253	69,638
Technology and operations	10,358	12,814	14,696	20,081	33,417
Sales and marketing	3,798	4,586	5,503	8,861	13,203
General and administrative	5,810	6,046	7,397	12,073	16,901
Amortization of contract intangibles	1,862		135	813	813
Depreciation and amortization	465	531	586	727	1,302
Total costs and expenses	57,201	69,438	83,557	134,968	182,317
Income from operations	3,518	6,431	5,858	12,845	16,303
Interest income (expense) and other income, net	(391)	(621)	(570)	430	2,176
Income before provision for income taxes	3,127	5,810	5,288	13,275	18,479
Provision for income taxes	(351)	(541)	(1,166)	(5,294)	(7,460)
Net income	\$ 2,776	\$ 5,269	\$ 4,122	\$ 7,981	\$ 11,019
Basic earnings per common share	\$ 0.19	\$ 0.31	\$ 0.22	\$ 0.33	\$ 0.40
Basic weighted average shares outstanding	14,428,121	16,865,313	19,038,464	24,080,780	27,768,679
Diluted earnings per common share	\$ 0.17	\$ 0.29	\$ 0.18	\$ 0.31	\$ 0.39
Diluted weighted average shares outstanding	16,124,927	18,280,366	22,598,519	26,087,809	28,146,923
Non-GAAP Financial Measures:					
EBITDA(1)	\$ 5,845	\$ 6,962	\$ 6,579	\$ 14,385	\$ 18,418
Adjusted EBITDA(1)	3,750	6,115	6,666	15,008	20,361
Adjusted profit-sharing distributions(2)	32,522	40,650	48,952	80,253	69,638
Adjusted net income(2)	\$ 681	\$ 4,337	\$ 4,122	\$ 7,981	\$ 11,019

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Year ended September 30,

Supplemental Operating Data:

Gross merchandise volume(3)	\$	72,305	\$	89,104	\$	102,210	\$	173,090	\$	233,579
Completed transactions(4)		123,000		141,000		173,000		194,000		212,000
Total registered buyers(5)		150,000		264,000		386,000		524,000		685,000
Total auction participants(6)		552,000		671,000		848,000		993,000		1,115,000

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As of September 30,

	2003	2004	2005	2006	2007
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(in thousands)

Consolidated Balance Sheet Data:

Cash, cash equivalents and short-term investments	\$ 10,450	\$ 12,178	\$ 10,378	\$ 66,648	\$ 61,609
Working capital(7)	3,780	7,021	4,154	54,082	61,762
Total assets	13,715	17,711	26,013	88,038	111,142
Total liabilities	9,984	10,333	14,596	22,286	29,108
Redeemable common stock(8)		324	474		
Series C preferred stock		3	3		
Common stock	16	19	19	27	28
Total stockholders' equity	3,731	7,054	10,943	65,752	82,034

(1) EBITDA and adjusted EBITDA are supplemental non-GAAP financial measures. GAAP means generally accepted accounting principles in the United States. EBITDA is equal to net income plus (a) interest expense (income) and other income, net; (b) provision for income taxes; (c) amortization of contract intangibles; and (d) depreciation and amortization. Our definition of adjusted EBITDA is different from EBITDA because we further adjust EBITDA for: (a) stock based compensation expense; and (b) a portion of the SurplusBid.com acquisition payments, as described below under footnote 2. For a description of our use of EBITDA and adjusted EBITDA and a reconciliation of these non-GAAP financial measures to net income, see the discussion and related table below.

(2) In June 2001, we acquired certain assets and assumed certain liabilities of SurplusBid.com, Inc. and its affiliates for \$7.5 million, including SurplusBid.com's surplus contract with the DoD. The SurplusBid.com acquisition price was paid over 33 months in accordance with the terms of the purchase agreement. At the same time, we were awarded our current surplus contract with the DoD. Our surplus contract required monthly profit-sharing distributions to the DoD under the contract to be reduced by the amount of the monthly SurplusBid.com acquisition payments. This resulted in a temporary non-recurring reduction in our profit-sharing distributions to the DoD and a significant increase in our net income during the 33 month period from June 2001 to March 2004. The total amount of the SurplusBid.com acquisition payment was recorded as a note payable in our consolidated balance sheet in fiscal 2001, discounted to a present value of approximately \$6.5 million. The discount of approximately \$1 million was accreted as interest expense over the term of the acquisition payments.

As a result, we present two supplemental non-GAAP financial measures, adjusted profit-sharing distributions and adjusted net income, to eliminate the impact of the SurplusBid.com acquisition payments on our operating results. These measures are prepared by increasing the profit-sharing distributions line item in our statements of operations by DoD's portion of the principal payments on the SurplusBid.com note payable made during each period (*i.e.*, approximately 80% of the principal payments). We do not add back the accreted interest portion of the SurplusBid.com acquisition payments when adjusting distributions and net income because the accreted interest is already included in interest expense and other income in our consolidated statements of operations. We believe adjusted profit-sharing distributions and adjusted net income are useful to investors because they eliminate an item that we do not consider indicative of our core operating performance due to its temporary, non-recurring nature. We also believe it is important to provide investors with the same metrics used by management to measure core operating performance.

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The table below reconciles profit-sharing distributions and net income to such item's adjusted presentation for the periods presented.

	Year ended September 30,				
	2003	2004	2005(a)	2006(a)	2007(a)
	(in thousands)				
Profit-sharing distributions	\$ 30,427	\$ 39,718	\$ 48,952	\$ 80,253	\$ 69,638
Adjustment	2,095	932			
Adjusted profit-sharing distributions	\$ 32,522	\$ 40,650	\$ 48,952	\$ 80,253	\$ 69,638
Net income	\$ 2,776	\$ 5,269	\$ 4,122	\$ 7,981	\$ 11,019
Adjustment	(2,095)	(932)			
Adjusted net income	\$ 681	\$ 4,337	\$ 4,122	\$ 7,981	\$ 11,019

(a)

The final SurplusBid.com acquisition payment was made in March 2004 and therefore no adjustments relating to this payment were made in fiscal years 2005, 2006 and 2007.

- (3) Gross merchandise volume is the total sales value of all merchandise sold through our marketplaces during a given period.
- (4) Completed transactions represent the number of auctions in a given period from which we have recorded revenue.
- (5) Total registered buyers as of a given date represent the aggregate number of persons or entities who have registered on one of our marketplaces.
- (6) For each auction we manage, the number of auction participants represents the total number of registered buyers who have bid one or more times on that auction, and total auction participants for a given period is the sum of the auction participants in each auction conducted during that period.
- (7) Working capital is defined as current assets minus current liabilities.
- (8) Upon the closing of our initial public offering and the resulting repayment of our \$2.0 million subordinated note, the redemption feature related to these shares of common stock terminated.

We believe EBITDA and adjusted EBITDA are useful to an investor in evaluating our performance for the following reasons:

The amortization of contract intangibles relates to the amortization of SurplusBid.com's surplus contract with the DoD during fiscal years 2001 to 2003, and amortization of the scrap contract beginning in June 2005. Depreciation and amortization expense primarily relates to property and equipment. Both of these expenses are non-cash charges that have significantly fluctuated over the past five years. As a result, we believe that adding back these non-cash charges to net income is useful in evaluating the operating performance of our business on a consistent basis from year-to-year.

As a result of substantial federal net operating loss carryforwards, or NOLs, we did not incur significant income tax expense until fiscal 2005. With the exhaustion of our remaining federal NOLs during fiscal 2005, we recorded federal income tax

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expense for the first time, thus significantly decreasing our fiscal 2005 net income relative to prior years. Consequently, we believe that presenting a financial measure that adjusts net income for provision for income taxes is useful to investors when evaluating the operating performance of our business.

During July 2001, we modified the exercise price of 3,402,794 stock options issued to employees. As a result, we are accounting for the modified stock options from the date of modification to the date the stock options are exercised, forfeited or expire unexercised using variable accounting. Under variable accounting, we revalue compensation costs for the stock options at

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each reporting period based on changes in the intrinsic value of the stock options. We recorded approximately \$85,000, \$87,000, \$7,000 and \$1,000, respectively, in stock compensation expenses based on vesting of the fair value of the options for the years ended September 30, 2004, 2005, 2006 and 2007. We will continue to revalue compensation costs for the options based on changes in the fair value of our common stock in future periods. We believe that it is useful to exclude this expense because it results from a one-time event that requires us to record expense that we are not otherwise required to record in connection with new stock options granted during the same time period. In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised 2004), *Share-Based Payment*, or Statement 123(R), which is a revision of SFAS No. 123. Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their estimated fair values. Pro forma disclosure is no longer an alternative. We adopted the provisions of Statement 123(R) on October 1, 2005, using the prospective method. Unvested stock based awards issued prior to October 1, 2005, the date that we adopted the provisions of Statement 123(R), were accounted for at the date of adoption using the intrinsic value method originally applied to those awards. We recorded approximately \$616,000 and \$1,942,000 in stock compensation expenses based on the adoption of Statement 123(R) for the years ended September 30, 2006 and 2007. As a result, we present a financial measure that adjusts net income and EBITDA for the stock compensation expense.

As discussed above, the requirement under our surplus contract with the DoD that monthly profit-sharing distributions to the DoD be reduced by the monthly SurplusBid.com acquisition payments resulted in a temporary non-recurring reduction in our profit-sharing distributions and a significant increase in our net income and EBITDA during the 33 month period from July 2001 to March 2004. As a result, we believe that it is useful to exclude a portion of these profit-sharing distributions from adjusted EBITDA because the payments will not recur in future periods and were unrelated to our core operations.

We believe EBITDA and adjusted EBITDA are important indicators of our operational strength and the performance of our business because they provide a link between profitability and operating cash flow.

We also believe that analysts and investors use EBITDA and adjusted EBITDA as supplemental measures to evaluate the overall operating performance of companies in our industry.

Our management uses EBITDA and adjusted EBITDA:

as measurements of operating performance because they assist us in comparing our operating performance on a consistent basis as they remove the impact of items not directly resulting from our core operations;

for planning purposes, including the preparation of our internal annual operating budget;

to allocate resources to enhance the financial performance of our business;

to evaluate the effectiveness of our operational strategies; and

to evaluate our capacity to fund capital expenditures and expand our business.

EBITDA and adjusted EBITDA as calculated by us are not necessarily comparable to similarly titled measures used by other companies. In addition, EBITDA and adjusted EBITDA: (a) do not represent net income or cash flows from operating activities as defined by GAAP; (b) are not necessarily indicative of cash available to fund our cash flow needs; and (c) should not be considered as alternatives to net income, income from operations, cash provided by operating activities or our other financial information as determined under GAAP.

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We prepare adjusted EBITDA by adjusting EBITDA to eliminate the impact of items that we do not consider indicative of our core operating performance. You are encouraged to evaluate these adjustments and the reasons we consider them appropriate for supplemental analysis. As an analytical tool, adjusted EBITDA is subject to all of the limitations applicable to EBITDA. Our presentation of adjusted EBITDA should not be construed as an implication that our future results will be unaffected by unusual or non-recurring items.

The table below reconciles net income to EBITDA and adjusted EBITDA for the periods presented.

	Year ended September 30,				
	2003	2004	2005	2006	2007
	(in thousands)				
Net income	\$ 2,776	\$ 5,269	\$ 4,122	\$ 7,981	\$ 11,019
Interest expense (income) and other income, net	391	621	570	(430)	(2,176)
Provision for income taxes	351	541	1,166	5,294	7,460
Amortization of contract intangibles	1,862		135	813	813
Depreciation and amortization	465	531	586	727	1,302
	5,845	6,962	6,579	14,385	18,418
EBITDA					
Stock compensation expense		85	87	623	1,943
Adjustment(1)	(2,095)	(932)			
	3,750	6,115	6,666	15,008	20,361
Adjusted EBITDA					

- (1) The adjustment amount for each period equals approximately 80% of the principal payments on the SurplusBid.com note payable made during each period, as described above in footnote 2. No payments were made in fiscal years 2005, 2006, and 2007.

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

The following discussion should be read in conjunction with our consolidated financial statements and related notes and the information contained under the caption "Selected Consolidated Financial Data" contained elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could vary materially from those indicated, implied, or suggested by these forward-looking statements as a result of many factors, including those discussed under "Risk Factors" and elsewhere in this Annual Report on Form 10-K.

Overview

About us. We are a leading online auction marketplace for wholesale, surplus and salvage assets. We enable buyers and sellers to transact in an efficient, automated online auction environment offering over 500 product categories. Our marketplaces provide professional buyers access to a global, organized supply of wholesale, surplus and salvage assets presented with digital images and other relevant product information. Additionally, we enable our corporate and government sellers to enhance their financial return on excess assets by providing a liquid marketplace and value-added services that integrate sales and marketing, logistics and transaction settlement into a single offering. We organize our products into categories across major industry verticals such as consumer electronics, general merchandise, apparel, scientific equipment, aerospace parts and equipment, technology hardware, and specialty equipment. Our online auction marketplaces are www.liquidation.com, www.govliquidation.com and www.liquibiz.com. We also operate a wholesale industry portal, www.goWholesale.com, that connects advertisers with buyers seeking products for resale and related business services.

We believe our ability to create liquid marketplaces for wholesale, surplus and salvage assets generates a continuous flow of goods from our corporate and government sellers. This flow of goods in turn attracts an increasing number of professional buyers to our marketplaces. During fiscal year 2007, the number of registered buyers grew from approximately 524,000 to approximately 685,000, or 30.7%. During the past three fiscal years, we have conducted over 578,000 online transactions generating approximately \$509 million in gross merchandise volume. Approximately 85% of our initial listings have resulted in a completed cash sale during the past three fiscal years.

Our history. We were incorporated in Delaware in Nov