

LIQUIDITY SERVICES INC  
Form 10-K  
November 21, 2014

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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**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, 2014**

**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**

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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

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 whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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 31, 2014 based upon the closing price of the common stock as reported by The NASDAQ Stock Market on such date, was approximately \$691,811.49.

The number of shares outstanding of the issuer's common stock, par value \$.001 per share, as of November 17, 2014 was 29,925,911.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement relating to its 2015 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 operate leading online auction marketplaces for surplus and salvage assets. We enable buyers and sellers to transact in an efficient, online auction environment offering over 500 product categories. Our marketplaces provide professional buyers access to a global, organized supply of surplus and salvage assets presented with customer focused information including digital images and other relevant product information along with services to efficiently complete the transaction. Additionally, we enable our corporate and government sellers to enhance their financial return on excess assets by providing liquid marketplaces 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, energy equipment, industrial capital assets, fleet and transportation equipment, and specialty equipment. Our online auction marketplaces are [www.liquidation.com](http://www.liquidation.com), [www.govliquidation.com](http://www.govliquidation.com), [www.govdeals.com](http://www.govdeals.com), [www.networkintl.com](http://www.networkintl.com), [www.truckcenter.com](http://www.truckcenter.com), [www.secondipity.com](http://www.secondipity.com), and [www.go-dove.com](http://www.go-dove.com).

We believe our ability to create liquid marketplaces for surplus and salvage assets generates a continuing flow of goods from our corporate and government sellers. This valuable and reliable flow of goods in turn attracts an increasing number of professional buyers to our marketplaces. During fiscal year 2014, the number of registered buyers grew from approximately 2,424,000 to approximately 2,615,000, or 7.9%.

During the past three fiscal years, we have conducted over 1,578,000 online transactions generating over \$2.8 billion in gross merchandise volume or GMV. We believe the continuing flow of goods in our marketplaces attracts a growing buyer base which creates a self-sustaining cycle for our buyers and sellers.

In the fiscal year ended September 30, 2014, we generated GMV of \$931.6 million and revenue of \$495.7 million through multiple sources, including transaction fees from sellers and buyers, revenue sharing arrangements, value-added service charges and online advertising fees. Our GMV has grown at a compound annual growth rate of approximately 23% since fiscal year 2006. Additionally, we have been profitable and cash flow positive each year from fiscal year 2003 through fiscal year 2014.

We were incorporated in Delaware in November 1999 as Liquidation.com, Inc. and commenced operations in early 2000.

**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 their reverse supply chain process or systems. The reverse supply chain addresses the redeployment and remarketing of surplus and salvage assets. These assets generally consist of retail customer returns, overstock products and end-of-life goods or capital assets from both the corporate and government sectors. According to the National Retail Federation, a retail industry association, the total value of merchandise returned in the United States for 2013 is estimated to be \$259 billion, up approximately 19% from \$217 billion in 2011.

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The supply of 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.

*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.

*Increasing focus by corporate and government agencies to seek green solutions for surplus assets.* Most organizations appreciate the growing need to be environmentally friendly by improving their management of end of life or surplus goods, including creating the need to repurpose or efficiently redistribute surplus and capital assets to minimize waste and maximize value for themselves and the communities they serve.

*Changing budgetary trends in corporate and governmental entities.* As corporate and governmental entities increasingly are being pressured to enhance efficiencies, while utilizing less resources, surplus and salvage capital assets become a source of funds once liquidated.

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 effective methods and mechanisms for disposal of surplus assets;

experience in managing the reverse supply chain to seek optimal net returns and improve gross margins; and

real time market data on surplus assets as they move through the final steps of the product life cycle.

Traditional methods of surplus and salvage asset disposition include ad-hoc, negotiated direct sales, utilization of individual brokers or sales agents and live on-site auctions. We believe these solutions are generally highly fragmented, geographically dispersed and poorly integrated with supply chain operations. The manual, negotiated and geographically dispersed nature of traditional surplus resale methods results in a lack of pricing transparency for offered goods, multiple brokers/parties ultimately involved in the final disposition and a lower number of potential buyers and bids, which we believe typically leads to lower recovery for sellers.

A significant number of professional buyers seek surplus and salvage assets to sustain their operations and end customers demand. 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 a reliable flow of surplus goods and assets, relying

instead on their own network of industry contacts and fixed-site auctioneers to

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locate, evaluate and purchase specific items of interest. Traditional methods are inefficient for buyers due to the lack of:

global access to an available continuous supply of desired goods and assets;

efficient and inexpensive sourcing processes;

a professionally managed central marketplace with transparent, high quality services;

detailed information and product description for the offered goods; and

pricing transparency or ability to compare asset prices.

The Internet is a global medium enabling millions of people worldwide to share information, communicate and conduct business electronically. Cisco, a virtual networking index, estimates that by 2018, there will be nearly four billion global Internet users (more than 51 percent of the world's population), up from 2.5 billion in 2013. (Source: Cisco VNI Global IP Traffic Forecast, 2013 - 2018). We believe professional buyers of surplus and salvage assets will increasingly use the Internet to identify and source goods available for immediate purchase.

**Our Solution**

Our solution is comprised of our online auction marketplaces and value-added services. Our marketplaces and services are designed to provide sellers a comprehensive solution to quickly bring surplus assets to market and enhance the financial value realized from the sale of their surplus assets while providing buyers with confidence in the reliable flow of goods they purchase. We provide our sellers access to several liquid marketplaces with over 2.6 million professional buyers and a suite of services and logistics capabilities to efficiently manage our clients' reverse supply chain. We seek the optimal methods to maximize our clients' net recovery using channel strategies and dedicated programs to deliver transparent, sustained value.

Through our relationships with sellers, we provide buyers convenient access to a substantial and continuous flow of 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 individual items. Our solution combines leading online marketplaces with a full suite of integrated sales, marketing, merchandising, fulfillment, payment collection, customer support, dispute mediation and logistics services. We provide buyers a convenient method for sourcing surplus and consumer goods. For any given asset, buyers have access 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. This enables our solutions to become the primary source for many of our professional buyers and end-users.

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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 creating a virtual cycle for our buyers and sellers. As of September 30, 2014, we had aggregated over 2,615,000 registered buyers in our marketplaces and access to millions of end-users through a range of existing consumer marketplaces. Aggregating this level of buyer demand and market data 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, 2014 we had over 2,538,000 auction participants in our online auctions from our registered buyers. During fiscal year 2014, we grew our registered buyer base by 7.9% or approximately 191,000. As buyers continue to discover and use our online marketplaces as an effective method to source assets, we believe our solutions 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 surplus or salvage assets. The strengths of our business model include:

*Aggregation of supply and demand for 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, transparent market and the active participation of 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 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 conveniently access our online marketplaces for their entire surplus and salvage asset needs.



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*Integrated and comprehensive solution*

Our marketplaces are designed to provide sellers and buyers with a comprehensive solution for the online sale and purchase of surplus and salvage assets. We offer a full suite of value-added services to simplify the sales and supply chain processes 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 system 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 and supply chain for our sellers reducing complexity while providing the ability to optimize the client's net financial return in the sale of surplus goods and assets. 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. Our buyer services include intelligent alerts, search tools, dynamic pricing, shipping and delivery, secure settlement, live customer support and dispute resolution to enable the most effective methods to source assets for their businesses.

*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 the sale of the assets. Our consignment and profit-sharing arrangements are designed to maximize returns by aligning our economic interests.

*Faster transaction cycle times for our seller and buyers*

We believe our marketplace solutions allow sellers to complete the entire sales process more rapidly than through other liquidation methods by generally reducing the complexities in the reverse supply chain and utilizing our multi-channel strategies to optimize recovery and velocity. As a result, sellers are able to reduce surplus or less valuable inventory quickly, generate additional working capital and reduce the cost of carrying unwanted assets. 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 an informed bid and ensure they quickly and efficiently receive the goods purchased.

*Solutions that promote sustainability and green solutions for improved corporate/government stewardship*

Our solutions provide a range of capabilities that enable corporate and government agencies to directly reduce the amount of waste generated by redistributing end of life products or assets, through our solutions, improving the net financial recovery generated while positively impacting the communities they serve. In aggregate, some of the world's largest forward thinking corporations and government agencies have significantly enhanced their stewardship of communities and the environment by partnering with us.

**Our Strategy**

The focus of our growth strategy is to provide commercial, municipal government, and federal agency clients and buying customers the world's most transparent, innovative and effective online marketplaces and integrated services for surplus assets. Our marketplace platform has already attracted over 2.5 million registered buyers and \$900 million of annual sales and is well positioned to serve any seller for virtually any asset type in every industry sector. Our goal is to develop a multi-billion dollar business by expanding our platform to a diversified base of Fortune 1000 corporations, municipal agencies and small and medium size businesses that can benefit from our global marketplace, buyer liquidity and integrated services.

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The key elements of our growth strategy are to:

*Grow our buyer base and increase active buyer participation on our marketplaces*

We intend to increase the active buyer participation within our consumer goods, commercial capital assets, and municipal government marketplaces, by attracting new buyers and leveraging our base of existing professional buyers. We intend to attract new buyers by using a variety of online and traditional marketing programs while improving the services and experience for our valued professional buyers. In addition, we plan to use the comprehensive buyer profiles, preferences and transactional data we have compiled over the last 15 years to enable us to identify and market highly relevant assets available through our marketplaces to the most likely buyers. We believe these initiatives will help us to increase the total number of auction participants and increase loyalty among our buyer base.

*Increase value and services for existing sellers*

We intend to grow by increasing the number of categories and geographies that we serve to existing sellers as well as providing a broad range of value-added services such as return to vendor programs and data analytics to solve the needs of large client organizations. For many of our sellers, we currently handle only a portion of the available supply of their surplus inventory or assets. In recent years, we have developed trusted relationships with large corporations and government agencies that offer significant growth opportunities by increasing our services offered and share of supply of their surplus assets. In addition, we have partnered with our sellers to identify previously unknown (untapped) flows of surplus assets that can effectively generate greater net returns than their current processes and improve their corporate stewardship. For example, on behalf of a large multinational retailer, we expanded our existing operations in Canada and instituted a sustainability program, enabling our client to realize value for products that were previously land filled, thus creating value for our client while providing an environmentally friendly solution.

*Develop new relationships*

We intend to build upon our client base of the world's largest retailers and manufacturers, our expertise with the DoD and thousands of municipal clients to attract additional corporate and government sellers to our marketplaces. We will extend our platform to partners who would benefit from accessing our marketplace, including dealers, auctioneers, refurbishers, and other principals. We will work with partners under revenue sharing and joint venture relationships with the understanding that the assets will be transacted on our marketplace platform. The vast majority of corporations and government agencies still rely on inefficient, traditional, and less transparent disposition methods for their surplus assets. We believe our demonstrated performance coupled with an expanded sales initiative will allow us to attract additional clients. As part of our ongoing sales initiative, we plan to continue to hire additional professionals and increase our marketing and advertising to the Fortune 1000 companies in our target markets.

*Innovation and technology development*

We are continuing to evolve our technology in order to create a single integrated marketplace platform to support marketing, sales, customer service, operations, financial performance and human capital management. This effort will result in the global implementation of Liquidity Services' best practices across its entire business and a superior customer experience, including more personalized tools for our buyers and sellers. Some of these, such as our Web-site enhancements or features and multi-channel optimization have already enhanced our business. We intend to develop and introduce new tools to further automate our global solution and leverage the scalability of our technology investments across all of our marketplaces, including multi-currency and multi-lingual solutions. In addition to enhancing the features, experience, and service for our buyers and sellers, we seek to

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leverage the increasing insight we gain with each transaction to enhance the recovery value clients realize along with improving the relevancy for our buyers in the reverse supply chain.

*Acquire complementary businesses*

We intend to increase our share of the supply of 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 GoIndustry acquisition, which we completed in July 2012. 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 surplus and salvage consumer goods and capital assets. We operate and enable several marketplaces, including the following:

Our *www.liquidation.com* marketplace enables corporations located in the United States to sell surplus and salvage consumer goods and capital assets. This leading business to business marketplace and our related value-added services are designed to meet the needs of clients by selling their surplus assets to domestic and international buyers.

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 Logistics Agency (DLA) Disposition Services 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.govdeals.com* marketplace enables local and state government entities including city, county and state agencies as well as school boards and public utilities located in the United States to sell surplus and salvage assets. This marketplace and our related services are designed to meet the unique needs of public sector clients selling to domestic and international buyers.

Our *www.networkintl.com* marketplace enables corporations to sell idle, surplus, and scrap equipment in the oil and gas, petrochemical and power generation industries. This market place and our related services are designed to meet the unique needs of energy sector clients.

Our *www.go-dove.com* marketplace enables corporations located in the United States, Europe, and Asia to sell manufacturing surplus and salvage capital assets. This marketplace and our related services are designed to meet the specific needs of manufacturing sector clients by selling their surplus assets to domestic and international buyers.

Our *www.truckcenter.com* marketplace enables corporations located in the United States to sell surplus and salvage transportation assets. This marketplace and our related services are designed to meet the specific needs of companies and financial institutions by selling their surplus transportation assets to domestic and international buyers.

Our 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.



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In addition to these leading business to business marketplaces, we recognize the need to reach end users for some of the assets our clients have entrusted to us. Thus, we have developed the capability to sell products on our client's behalf directly to end-users and/or consumers using a range of existing marketplaces. Our *www.secondipity.com* marketplace provides consumers a trusted source of value products through a socially conscious online experience designed to provide "Better Value, Better Life," through donating a portion of the proceeds of every sale to charity. We also have an established global buyer base that seeks to buy in larger quantities than are offered through our standard auction platform. Thus, we have dedicated sales teams to support their needs and supply chain. These range from a single truckload to ongoing flows for export anywhere in the world, where we market, handle, and support the full disposition on behalf of our buyers. We expect to continue to meet the needs of our clients and to access a growing range of products for all our buyers by enabling our multi-channel strategy to ensure we create the greatest value for assets at the end of their initial product life cycle.

**Our Value-Added Services for Buyers and Sellers**

We have integrated value-added services to simplify the supply chain processes for our buyers and sellers. We believe these services create the greatest operational efficiencies within this element of the supply chain enabling the greatest value for sellers and buyers with the highest level of confidence and transparency in the services we provide. Additionally, we believe these services improve compliance with the various policies, regulations and sale restrictions of our corporate and government sellers while supporting, or greatly enhancing, many corporate or government environmental initiatives.

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

*Merchandising and Channel Optimization* efforts encompass all of the services necessary to prepare merchandise for a successful auction and include the following:

*Channel Optimization* we determine the marketplace and channel sales strategy that creates the greatest value for the individual asset using our real time transaction systems and proprietary data to support ongoing optimization.

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

*Asset lotting and merchandising* we leverage our industry experience to organize the merchandise we receive into size and product combinations that meet buyer preferences within each marketplace and channel.

*Product information enhancement* we provide digital images of the merchandise to be sold and combine the images with relevant information. In order to increase the realized sales value, we also research, collect and use supplemental product information to enhance product descriptions.

*Logistics.* We provide 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 and sellers. In certain circumstances, we will inspect the merchandise and provide condition descriptions to

improve quality and the financial recovery to the client.

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**Testing, data wiping, de-labeling and refurbishment** we test products, wipe electronic data, refurbish and remove labels and product markings from merchandise prior to sale in order to add value to the asset and protect sellers' brand equity and distribution relationships.

**Return to vendor or product disposition to non-sales channels** we will manage the end to end processes for our clients ensuring that returned merchandise is disposed through a variety of disposition requirements including the end to end management of returning products to vendors, charities, or channels outside of our leading marketplace solutions.

**Outbound fulfillment** we can arrange for domestic or international shipping for all merchandise, whether it's a small item or container load for export 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 and reliable 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.

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

**Transaction tracking and reporting** we enable sellers and buyers to track and monitor the status of their transactions throughout the sales process. We support the successful completion of each transaction on behalf of the buyer and seller. We provide a range of comprehensive 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 and recommendations** we 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 ensure informed recommendations whenever we identify a product that fits a buyer's preference. We will alert our buyers based on their preferences when auctions are initially launched or nearing conclusion and based on various other parameters to enable our buyers to see the most relevant products.

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

**Dynamic pricing tools, product information, and shipping quotes** we offer multiple dynamic pricing tools including outbid notification, automated bid agent and automatic auction extension. In addition, we provide buyers the information they need to make informed decisions, including product, seller performance, and online shipping quotes to help understand their

landed cost.

Broad and flexible range of shipping/pick-up options we can provide packaging and shipping services for each transaction, whether it is a small item or container loads for export, including buyer pick-up at our premises, for the vast majority of transactions, or support of buyer arranged transportation. We support the most efficient solution for each transaction and each buyer.



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Secure settlement and customer support 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. In addition, we provide full reliable customer support throughout the transaction process.

**Sales and Marketing**

We utilize a direct sales and marketing force to acquire and manage our seller and buyer accounts. As of September 30, 2014, we had 136 sales and 68 marketing personnel. Our sales activities are focused primarily on acquiring new sellers and improving the value to existing sellers. 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 team focuses on building long-term relationships with sellers that we believe will generate recurring transactions. They also leverage our years of experience and market data 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 to optimize their internal processes and net recovery.

*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 transaction activity; special e-mail alerts highlighting specific products of interest; personalized recommendation engines; and convenient search tools that enable a buyer or prospective buyer to find desired items on our online 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



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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 device 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 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 Application Programming Interface (APIs) or other 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 secure and network-secure environment at data centers in Ashburn, Virginia, which is managed by Equinix, Inc., in Houston, Texas, which is managed by CyrusOne, in London, GBR, which is managed by COLT, and in Dallas, Texas, which is managed by Equinix, 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 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 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 and field service operations.

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*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 live chat as well as 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 and field service operations*

Our distribution center and field service operations group performs selected pre-sale and post-sale value-added services at our distribution centers and at seller locations globally. These activities include unloading, manifesting and reporting discrepancies for all received assets and sales preparation of offered assets, including merchandising and organizing offered assets, writing product descriptions, capturing digital images and/or video and providing additional optional value-added services such as product delabeling, data cleaning/wiping, testing, refurbishment and repackaging. Our distribution center and field service 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 surplus and salvage assets is competitive and growing rapidly. We currently compete with:

other e-commerce providers;

auction websites;

government agencies that have created websites to sell 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 surplus and salvage assets. In addition, manufacturers, retailers and additional government agencies may decide to create their own websites to sell their own surplus and salvage assets and those of third parties. Competitive pressures could harm our business, financial condition and operating results.

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.

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**Our Contracts with the U.S. Department of Defense**

We have two material contracts with the DoD under which we acquire, manage and sell government property. 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. The largest contract was originally awarded in June 2001, was renewed in December 2008, was extended in January 2014, and relates to usable surplus property of the DoD turned in to the DLA Disposition Services and located in the United States, Puerto Rico and Guam, such as computers, electronics, office supplies, equipment, aircraft parts, clothing and textiles (the "Surplus Contract"). The second contract was awarded in June 2005 and relates to substantially all scrap property of DoD turned into the DLA Disposition Services, 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 "Scrap Contract").

Under the current (second) Surplus Contract, as amended, we are obligated to purchase all DoD surplus property at 1.8% of Disposition Services' original acquisition value or OAV. The DoD has broad discretion to determine what property will be made available for sale to us under the Surplus Contract and may retrieve or restrict property previously sold to us for national security reasons or if the property is otherwise needed to support the mission of the DoD. The Surplus Contract has a 36 month term, beginning February 2009, with two 12 month renewal options exercisable by the DoD. The DoD has exercised both renewal options. In January 2014, the DoD awarded the Company with a follow-on contract to extend the terms of the second Surplus Contract for a base term of ten months with two one-month renewal option periods.

The DoD, in accordance with the award of the next (third) Surplus Contract, split the contract into a rolling stock and a non-rolling stock contract, with bidding on these two surplus contracts held on April 1 and 2, 2014. On April 1, 2014, the Company was the high bidder for the non-rolling stock surplus contract with a bid equal to 4.35% of the DoD's OAV. The non-rolling stock surplus contract has a base term of two years with four one-year renewal options. Following the bidding event on April 2, 2014 for the DoD rolling stock contract, the Company withdrew from the live auction bidding for this contract. Bidding reached a level that the Company determined would be economically unsustainable under the terms of the new contract, jeopardizing the high level of service the Company has historically provided the agency client. The price the Company will pay for inventory under the new non-rolling stock contract is expected to increase from 1.8% to 4.35% of OAV, resulting in significantly higher Cost of Goods Sold (COGS) in fiscal year 2015 and beyond. Additionally, the Company expects to cease the sale of DoD rolling stock under the new contract, which has historically accounted for approximately 30-35% of the overall revenue for the current DoD Surplus contract, resulting in lower revenue in future periods. The Company will continue to operate its existing DoD surplus contract to sell all useable surplus assets of the DoD, including non-rolling stock assets for the base term ending December 2014, with two additional one-month renewal options.

Under the Scrap Contract, we acquire scrap property at a per pound price and disburse 77% of the profits to the DOD, which we refer to as profit-sharing distributions. As a result of these arrangements, we recognize as revenue the gross proceeds from these sales. 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. The Scrap Contract base term expired in June 2012, subject to the DoD's right to extend for three additional one-year terms. The DoD has exercised all three renewal options.

These 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

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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 DLA Disposition Services contracts, forfeiture of profits, suspension of payments, fines and suspension or debarment from doing business with U.S. federal government agencies.

The Scrap Contract may be terminated by DoD or by us if the rate of return 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 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. The new Surplus Contract contains a provision providing for a mutual termination of the contract for convenience.

The Surplus Contract accounted for 27.2%, 27.7%, and 26.8% of our revenue and 15.5%, 15.0%, and 14.3% of our gross merchandise volume for the fiscal years ended September 30, 2012, 2013 and 2014, respectively. We began operating under the Scrap Contract in August 2005, and it accounted for 16.1%, 13.5%, and 14.4% of our revenue and for 8.9%, 7.0%, and 7.7% of our gross merchandise volume for the fiscal years 2012, 2013 and 2014, 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.

**Our Contracts with Wal-Mart**

In connection with our acquisition of Jacobs Trading, LLC ("Jacobs") on October 1, 2011, we assumed the rights and obligations under a Master Merchandise Salvage Contract (the "Wal-Mart Agreement"). We have the exclusive right to purchase certain consumer products from Wal-Mart that have been removed from the sales stream of its retail operations and we believe this agreement will be the source of a significant portion of our revenue and GMV during its term, which expires on May 16, 2016 and thereafter continues on a month to month basis. In addition, we have other contracts / programs with Wal-Mart. For the year ended September 30, 2014, approximately 11% of our GMV was generated from Wal-Mart under multiple contracts / programs.

**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.

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Furthermore, the growth and demand for online commerce has resulted in 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 sale of this type of merchandise is further regulated by, among others, the U.S. Export Administration Regulations, International Traffic in Arms Regulations 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.govdeals.com*, *www.networkintl.com*, *www.truckcenter.com*, *www.secondipity.com*, and *www.go-dove.com*. We pursue the registration of our trademarks in the U.S. and internationally. 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

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obtain substitute technology of lower quality or at greater cost, which could materially adversely affect 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, 2014, we had 1,049 U.S. employees, including 148 in sales and marketing, 122 in technology, 85 in customer service, 575 in operations and 119 in finance and administration. In addition, as of that date, we had 296 international employees, including 56 in sales and marketing, 19 in technology, 10 in customer service, 173 in operations and 38 in finance and administration.

None of our U.S. employees are covered by collective bargaining agreements and 42% of our non-U.S. employees are covered by collective bargaining agreements or statutory trade union agreements. On June 21, 2014, we entered into a First Collective Agreement with the United Food & Commercial Workers International Union which relates to the employment of employees at our Toronto, Ontario location. The Agreement expires on June 20, 2017. We believe that we have good relationships with our employees. We have never had a work stoppage.

**Available Information**

Our annual, quarterly and current reports, proxy statements, amendments to those reports and other information are also made available free of charge on our website [www.liquidityservicesinc.com](http://www.liquidityservicesinc.com), as soon as reasonably practicable after we electronically file these materials with, or furnish them to, the SEC. We use our website as a channel of distribution for material company information. Important information, including news releases, analyst presentations and financial information regarding the Company is routinely posted on and accessible at [www.liquidityservicesinc.com](http://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 (SEC) 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.



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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 in any particular order and 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 United States Department of Defense and Wal-Mart for a significant portion of our revenue, and if our relationships with these customers are disrupted, we would experience a significant decrease in revenue and income.**

We have two material contracts with the DLA Disposition Services under which we acquire, manage and sell surplus and scrap property of the DoD. If our relationship with the 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 is significantly decreased, we would experience a significant decrease in revenue and have difficulty generating income. The Surplus Contract accounted for 27.2%, 27.7%, and 26.8% of our revenue and 15.5%, 15.0%, and 14.4% of our GMV for the fiscal years ended September 30, 2012, 2013 and 2014, respectively. The Scrap Contract accounted for 16.1%, 13.5%, and 14.4% of our revenue and 8.9%, 7.0%, and 7.7% of our GMV in fiscal year 2012, 2013 and 2014, respectively. We believe that these contracts will continue to be the source of a significant portion of our revenue and GMV during their respective terms. The second Surplus Contract has a three-year base term that expired in February 2012, subject to the DoD's right to extend for two additional one-year terms. The DoD has exercised both extension options. The DoD awarded the Company a follow-on contract to extend the terms of the Surplus Contract for a base term of ten months with two one-month renewal option periods. The Scrap Contract has a seven-year base term that expired in June 2012, subject to the DoD's right to extend for three additional one-year terms. The DoD has exercised its right to extend the performance period of the Scrap Contract to June 2015. The contracts were awarded by the DoD through a competitive bidding process, and we may be required to go through a new competitive bidding process when our existing contracts expire. Under the current (second) Surplus Contract, as amended, we are obligated to purchase all DoD surplus property at 1.8% of Disposition Services' original acquisition value ("OAV"). The DoD has broad discretion to determine what property will be made available for sale to us under the next (third) Surplus Contract and may retrieve or restrict property previously sold to us for national security reasons or if the property is otherwise needed to support the mission of the DoD. The Surplus Contract has a 36 month term, beginning February 2009, with two 12 month renewal options exercisable by the DoD. The DoD has exercised both renewal options. In January 2014, the DoD awarded the Company with a follow-on contract to extend the terms of the second Surplus Contract for a base term of ten months with two one-month renewal option periods. The DoD, in accordance with the award of the next (third) Surplus Contract, split the contract into a rolling stock and a non-rolling stock contract, with bidding on these two surplus contracts held on April 1 and 2, 2014. On April 1, 2014, we were the high bidder for the non-rolling stock surplus contract with a bid equal to 4.35% of the DoD's OAV. The non-rolling stock surplus contract has a base term of two years with four one-year

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renewal options. Following the bidding event on April 2, 2014 for the DoD rolling stock contract, we withdrew from the live auction bidding for this contract. Bidding reached a level that we determined would be economically unsustainable under the terms of the new contract, jeopardizing the high level of service we have historically provided the agency client. The price that we will pay for inventory under the new non-rolling stock contract is expected to increase from 1.8% to 4.35% of OAV, resulting in significantly higher Cost of Goods Sold (COGS) in fiscal year 2015 and beyond. Additionally, we expect to cease the sale of DoD rolling stock under the new contract, which has historically accounted for approximately 30-35% of the overall revenue for the current DoD Surplus contract, resulting in lower revenue in future periods. We will continue to operate our current DoD surplus contract to sell all useable surplus assets of the DoD, including non-rolling stock assets for the base term ending December 2014, with two additional one-month renewal options.

Our Surplus Contract with the DoD allows either party to terminate the contract for convenience. Although our Scrap Contract does not allow the DoD to terminate for convenience, it requires us to meet specified performance benchmarks. The Scrap Contract may be terminated by the 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. The 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. We continue to provide services under our existing contract.

We expect that there will be significant competition to renew our DoD contracts. We may not win any such competitive procurement, as one or more providers may offer to provide the same or similar services at a lower cost. Even if we win the competitive procurement, we could be required to reduce significantly the prices we charge for our services under the new contracts. The failure to win the competitive procurement or a requirement to provide our services at significantly lower prices would materially adversely affect our revenues and have a material adverse effect on our business, prospects, financial condition and results of operations.

In connection with our acquisition of Jacobs Trading, LLC ("Jacobs") on October 1, 2011, we assumed ILJ Enterprises, LLC's rights and obligations under the Master Merchandise Salvage Contract (the "Wal-Mart Agreement") dated as of May 13, 2011 between ILJ Enterprises and Wal-Mart Stores, Inc. We have the exclusive right to purchase certain consumer products from Wal-Mart that have been removed from the sales stream of its retail operations and we believe this agreement will be the source of a significant portion of our revenue and GMV during its term, which expires on May 16, 2016 and thereafter continues on a month to month basis. While our revenue for any future period under the Wal-Mart Agreement may differ from our expectations, we believe that the Wal-Mart Agreement will account for a significant portion of our revenue and our GMV for the 2015 fiscal year. If we breach the Wal-Mart Agreement, Wal-Mart may unilaterally terminate the agreement. If our relationship with Wal-Mart is impaired or the Wal-Mart Agreement is terminated, our revenue and income would be significantly lower than currently expected. In addition, we have other contracts / programs with Wal-Mart. For the year ended September 30, 2014, approximately 11% of our GMV was generated from Wal-Mart under multiple contracts / programs. In addition, we acquire a significant amount of our inventory pursuant to the Wal-Mart Agreement. If our relationship with Wal-Mart is impaired or the Wal-Mart Agreement is terminated, the value of our inventory could be negatively impacted, which would require us to reduce the value of our inventory and have a material adverse effect on our results of operations.

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**Unfavorable findings resulting from a government audit or investigation 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.**

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 Scrap contract provides 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 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 civil and criminal penalties, administrative sanctions and could suffer serious harm to our reputation. Government and law enforcement agencies may also investigate our other activities under our DoD contracts and our company. If such 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. If, as the result of a government audit or investigation, or for any other reason, 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 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 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;

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auction websites;

government agencies that have created websites to sell 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 surplus and salvage assets. In addition, manufacturers, retailers and government agencies may decide to create their own websites to sell their own 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 successfully integrate our acquired businesses and operations and/or fully realize the expected benefits of these acquisitions in the expected time frame, our future operating results may be materially adversely affected.**

The success of our acquisitions depends, in part, on our ability to successfully integrate the acquired businesses and operations with our other businesses and fully realize the anticipated benefits of the acquisitions. If we are not able to achieve these objectives in a cost-effective and timely manner, we may not fully realize the anticipated benefits of the acquisition or it may take us longer to realize the benefits of the acquisition than we expect. Our acquired operations outside the U.S. may present unique challenges or increase our exposure to risks associated with foreign operations, including foreign currency risks and risks associated with local regulatory regimes.

The integration process could result in the loss of key customers or key employees, increase our operating or other costs, decrease our profit margins or disrupt our other businesses, each of which could impair our ability to achieve the anticipated benefits of the acquisition. Our efforts to integrate the acquired businesses will divert management's attention and resources from our other businesses. Any failure to timely realize the anticipated benefits of the acquisition could have a material adverse effect on our revenues, expenses and operating results.

**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.

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**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;

entry into, or the modification, termination or expiration of, material contracts;

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 surplus and salvage assets;

introduction of new or enhanced websites, services or product offerings by us or our competitors, which may impact our margins;

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;

impairment of goodwill or other intangible assets;

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.**

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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 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. Although we carry specific insurance against cybersecurity events, our insurance coverage may be inadequate to compensate us for any related losses we incur. In addition, the implementation of our Liquidity One Transformation plan will require substantial changes to our software and network infrastructure, which could lead to system interruptions, affect our websites and transaction systems and

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further expose us to operational disruptions, which would have a material adverse effect on our results of operations.

**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

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

**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 the current (second) Surplus Contract, we are obligated to purchase all DoD surplus property at 1.8% of the original acquisition cost, which varies depending on the type of surplus property being purchased. Under the new non-rolling stock (third) surplus contract, we will be obligated to purchase surplus DoD non-rolling stock at 4.35% of original acquisition cost. Under the Scrap Contract, we acquire scrap property at a per pound price. Declines in commodity prices may also reduce the profit we are able to realize in our scrap business. For example, we may not be able to sell our inventory for amounts above its cost and we may incur a loss in products we handle for our commercial clients. 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.govdeals.com*, *www.networkintl.com*, *www.truckcenter.com*, *www.secondipity.com*, and *www.go-dove.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, but we are pursuing patents. Effective patent, copyright, trademark, service mark, trade secret and domain name protection is expensive to maintain and may require litigation. 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.



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**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), Apache (a web server), and Java 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 on 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. 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.

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**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

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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. As the Department of Defense is one of our clients, our systems may be especially targeted by such malicious attackers. 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. The loss of confidential client information could also expose us to the risk of liability and costly litigation. In addition, if there is any perception that we cannot protect our clients' confidential information, we may lose the ability to retain existing clients and 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 collect and remit sales taxes in all states for shipment of goods from our DoD contracts. We also collect and remit 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,

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any new operation in states in which we currently do not collect and remit sales taxes could subject shipments into such states to state sales taxes under current or future laws.

U.S. Supreme Court decisions restrict the imposition of obligations to collect state and local taxes with respect to sales made over the Internet. However, a number of states have adopted or are considering laws that levy additional taxes on Internet access and electronic commerce transactions. Congress is also considering legislation allowing states to require out-of-state sellers to collect sales and use taxes for electronic commerce transactions. It is not possible to predict with any degree of certainty the outcome of these initiatives or the impact of these initiatives on our business and marketing strategies that we are considering or may consider in the future.

An unfavorable change in U.S. Supreme Court guidance related to sales tax, or a successful assertion by one or more jurisdictions that our sale of merchandise in such jurisdiction is subject to sales or other taxes may result in material tax liabilities, interest and penalties. A change in state or federal laws, or our business model, business strategy, or marketing initiatives may require us to collect sales tax on transactions in which we do not currently collect such tax. These developments, should they occur, may result in a decrease in future sales, may decrease our ability to compete, increase our compliance costs or otherwise harm our business.

**Fraudulent activities involving our websites and disputes relating to transactions on our websites may cause us to lose clients and adversely 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 adversely 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 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,

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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 worldwide financial crisis led to an increase in the overall volatility of the stock market. Despite improved stock market performance, the increased volatility and other broad market and industry factors may adversely affect the market price of our common stock, regardless of our actual operating performance. Other factors that could cause fluctuation in our stock price may include:

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 (or the amendment or loss of such contracts), acquisitions, commercial relationships, strategic partnerships or divestitures;

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

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.

#### **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;

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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:

<b>Purpose</b>	<b>Location</b>	<b>Square Feet</b>	<b>Lease Expiration Date</b>
Corporate Headquarters	Washington, D.C., USA	27,100	September 30, 2019
Warehouse	Cranbury, New Jersey, USA	153,800	November 30, 2015
Warehouse	Dallas, Texas, USA	80,500	May 31, 2015
Warehouse	Plainfield, Indiana, USA	187,700	April 30, 2019
Warehouse	North Las Vegas, Nevada, USA	102,400	March 31, 2016
Administrative	Scottsdale, Arizona, USA	23,536	December 31, 2016
Warehouse	Columbus, Ohio, USA	340,000	February 28, 2019
Warehouse	Oklahoma City, Oklahoma, USA	662,760	June 30, 2015
Storage Lot	Oklahoma City, Oklahoma, USA	130,680	June 30, 2015
Storage Lot	Oklahoma City, Oklahoma, USA	392,040	November 30, 2015
Warehouse	Columbus, Ohio, USA	80,000	December 31, 2014
Administrative	Montgomery, Alabama, USA	11,356	September 30, 2017
Administrative	Houston, Texas, USA	12,422	March 31, 2018
Storage Lot	Fontana, California, USA	130,700	May 31, 2018
Storage Lot	Blue Mound, Texas, USA	727,500	May 31, 2018
Storage Lot	Indianapolis, Indiana, USA	697,000	May 31, 2018
Storage Lot	Atlanta, Georgia, USA	479,200	May 31, 2018
Storage Lot	Wilmington, Delaware, USA	484,000	May 31, 2018
Administrative/Warehouse	Hopkins, Minnesota, USA	275,720	April 30, 2019
Warehouse	Appleton, Minnesota, USA	48,000	Month-to-Month
Warehouse	Hayward, California, USA	44,280	October 31, 2015
Warehouse	Hazelwood, Missouri, USA	21,368	December 31, 2014
Warehouse	Atlanta, Georgia, USA	47,600	May 31, 2015
Administrative	London, GBR	6,036	July 12, 2017
Administrative	Toronto, Canada	45,000	February 28, 2016
Warehouse	Brampton, Canada	53,621	May 31, 2015
Administrative	Calamba City, Philippines	15,500	August 31, 2016

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In addition, we lease various administrative spaces in North America totaling 19,459 square feet square feet, in Europe, 8,181, square feet, and in Asia, 7,829 square feet.

Our servers are housed in data centers in Ashburn, Virginia, which is managed by Equinix, Inc., in Houston, Texas, which is managed by CyrusOne, and in London, GRB, which is managed by COLT.



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**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. On July 14, 2014, Leonard Howard filed a putative class action complaint in the United States District Court for the District of Columbia against the Company and its chief executive officer, chief financial officer, and chief accounting officer, on behalf of shareholders who purchased the Company's common stock between February 1, 2012 and May 7, 2014. The complaint alleges that defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 by, among other things, misrepresenting the Company's growth initiative, growth potential, and financial and operating conditions, thereby artificially inflating its share price, and seeks unspecified compensatory damages and costs and expenses, including attorneys' and experts' fees. On October 14, 2014, the Court appointed Caisse de Dépôt et Placement du Québec and the Newport News Employees' Retirement Fund as co-lead plaintiffs. Plaintiffs are scheduled to file an amended complaint by December 15, 2014. The Company intends to move to dismiss plaintiffs' expected amended complaint. The Company cannot estimate a range of the potential liability, if any, at this time.

**Item 4. Mine Safety Disclosures.**  
**Not applicable.**

Table of Contents**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.

<b>Fiscal year ended September 30, 2013</b>	<b>Low</b>	<b>High</b>
First Quarter	\$ 35.56	\$ 50.74
Second Quarter	\$ 28.62	\$ 44.40
Third Quarter	\$ 28.72	\$ 40.90
Fourth Quarter	\$ 27.26	\$ 38.31
<b>Fiscal year ended September 30, 2014</b>		
First Quarter	\$ 20.37	\$ 33.83
Second Quarter	\$ 20.24	\$ 27.33
Third Quarter	\$ 12.05	\$ 27.14
Fourth Quarter	\$ 12.41	\$ 16.00

As of October 30, 2014, there were approximately 15,350 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. In addition, the credit agreement we entered into on April 30, 2010 contains restrictions on our ability to pay dividends.

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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, 2012, 2013 and 2014 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, 2010 and 2011, and the Consolidated Balance Sheet data as of September 30, 2010, 2011 and 2012 are derived from our audited consolidated financial statements that are not included in this Annual Report on Form 10-K. Certain reclassifications have been made to previously reported financial data to reflect the financial condition, results of operations and cash flows of the Company for discontinued operations.

	Year ended September 30,				
	2010	2011	2012	2013	2014
	(dollars in thousands, except per share data)				
<b>Consolidated Statement of Operations Data:</b>					
Revenue	\$ 249,337	\$ 297,584	\$ 415,829	\$ 404,041	\$ 388,671
Fee revenue	23,678	29,794	59,475	101,815	106,990
Total revenue	273,015	327,378	475,304	505,856	495,661
Costs and expenses:					
Cost of goods sold (excluding amortization)	109,376	126,395	198,123	199,494	211,659
Profit-sharing distributions	41,310	49,318	43,242	35,944	35,055
Technology and operations	45,700	52,178	67,553	90,052	108,940
Sales and marketing	20,381	23,279	31,252	40,170	41,951
General and administrative	23,606	26,484	37,107	48,950	49,428
Amortization of contract intangibles	813	813	7,943	7,265	7,265
Depreciation and amortization	3,609	4,881	6,223	10,109	9,330
Acquisition costs and related fair value adjustments	524	6,702	1,695	5,921	(18,384)
Total costs and expenses	245,319	290,050	393,138	437,905	445,244
Income from continuing operations	27,696	37,328	82,166	67,951	50,417
Interest income (expense) and other income (expense), net	(428)	(1,190)	(2,218)	704	(370)
Income from continuing operations before income taxes	27,268	36,138	79,948	68,655	50,047
Provision for income taxes	12,194	15,459	31,652	27,551	19,657
Income from continuing operations	15,074	20,679	48,296	41,104	30,390
Loss from discontinued operations	(3,061)	(12,167)			
Net income	\$ 12,013	\$ 8,512	\$ 48,296	\$ 41,104	\$ 30,390
Basic earnings (loss) per common share:					
From continuing operations	\$ 0.55	\$ 0.75	\$ 1.57	\$ 1.30	\$ 0.97
From discontinued operations	(0.11)	(0.44)			

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Basic earnings per common share	\$	0.44	\$	0.31	\$	1.57	\$	1.30	\$	0.97
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Diluted earnings (loss) per common share:

From continuing operations	\$	0.55	\$	0.71	\$	1.47	\$	1.26	\$	0.97
From discontinued operations		(0.11)		(0.42)						

Diluted earnings per common share	\$	0.44	\$	0.29	\$	1.47	\$	1.26	\$	0.97
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Basic weighted average shares outstanding		27,098,016		27,736,865		30,854,796		31,616,926		31,243,932
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Diluted weighted average shares outstanding		27,406,883		29,081,933		32,783,079		32,657,236		31,395,301
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**Non-GAAP Financial Measures:**

EBITDA from continuing operations(1)	\$	32,118	\$	43,022	\$	96,332	\$	85,325	\$	67,012
Adjusted EBITDA from continuing operations(1)		40,532		58,860		110,144		104,625		63,013

**Supplemental Operating Data:**

Gross merchandise volume from continuing operations(2)	\$	416,314	\$	548,552	\$	864,226	\$	973,325	\$	931,556
Completed transactions(3)		522,000		475,000		501,000		530,000		547,000
Total registered buyers(4)		1,403,000		1,604,000		2,186,000		2,424,000		2,615,000
Total auction participants(5)		2,247,000		1,936,000		2,105,000		2,458,000		2,538,000

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	As of September 30,				
	2010	2011	2012	2013	2014
	(in thousands)				
<b>Consolidated Balance Sheet Data</b>					
Cash, cash equivalents and short-term investments	\$ 75,939	\$ 128,984	\$ 104,782	\$ 95,109	\$ 62,598
Working capital <sup>(6)</sup>	60,064	111,687	53,194	79,289	77,935
Total assets	164,904	227,807	400,408	421,344	431,718
Total liabilities	52,530	66,394	150,405	106,465	114,735
Total stockholders' equity	112,374	161,413	250,003	314,879	316,983

- (1) EBITDA from continuing operations and adjusted EBITDA from continuing operations 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 income (expense) and other income (expense), 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 stock based compensation expense, acquisition costs such as transaction expenses and changes in earn out estimates, and business realignment expense. 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) Gross merchandise volume is the total sales value of all merchandise sold through our marketplaces during a given period.
- (3) Completed transactions represent the number of auctions in a given period from which we have recorded revenue.
- (4) Total registered buyers as of a given date represent the aggregate number of persons or entities who have registered on one of our marketplaces.
- (5) 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.
- (6) Working capital is defined as current assets minus current liabilities.

We believe non-GAAP financial measures, such as 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 the Scrap Contract beginning in June 2005, the Wal-Mart Contract beginning in October 2011, and an assumed contract associated with the National Electronic Service Association (NESA) acquisition on November 1, 2012. 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 varying federal and state income tax rates, 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.

Share-based payments to employees, including grants of employee stock options, are recognized in the income statement based on their estimated fair values. This expense is a non-cash charge that can fluctuate from year to year depending on the number of awards granted in a given year and, among other variables, the price of the Company's stock on the grant date. Accordingly, we believe adjusting net income for this non-cash stock based compensation expense is useful to investors when evaluating the operating performance of our business.

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We believe adjusting net income for acquisition related transaction expenses and changes in contingent consideration is useful to investors when evaluating the operating performance of our business on a consistent basis from year-to-year.

We believe adjusting net income for business realignment expense is useful to investors when evaluating the operating performance of our business on a consistent basis from year-to-year, as

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these expenses are one-time in nature and have been incurred only once in the financial periods presented.

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.

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 income from continuing operations to EBITDA and adjusted EBITDA from continuing operations for the periods presented.

	Year ended September 30,				
	2010	2011	2012	2013	2014
	(in thousands)				
Net income from continuing operations	\$ 15,074	\$ 20,679	\$ 48,296	\$ 41,104	\$ 30,390
Interest (income) expense and other (income) expense, net	428	1,190	2,218	(704)	370
Provision for income taxes	12,194	15,459	31,652	27,551	19,657
Amortization of contract intangibles	813	813	7,943	7,265	7,265
Depreciation and amortization	3,609	4,881	6,223	10,109	9,330
EBITDA from continuing operations	32,118	43,022	96,332	85,325	67,012
Stock compensation expense	7,891	9,136	12,117	13,379	12,605
Acquisition costs and related fair value adjustments	524	6,702	1,695	5,921	(18,384)
Business realignment expense					1,780

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Adjusted EBITDA from continuing operations	\$	40,533	\$	58,860	\$	110,144	\$	104,625	\$	63,013
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**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 operate leading online auction marketplaces for surplus and salvage assets. We enable buyers and sellers to transact in an efficient, online auction environment offering over 500 product categories. Our marketplaces provide professional buyers access to a global, organized supply of surplus and salvage assets presented with customer focused information including digital images and other relevant product information along with services to efficiently complete the transaction. Additionally, we enable our corporate and government sellers to enhance their financial return on excess assets by providing liquid marketplaces 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, energy equipment, industrial capital assets, fleet and transportation equipment and specialty equipment. Our online auction marketplaces are [www.liquidation.com](http://www.liquidation.com), [www.govliquidation.com](http://www.govliquidation.com), [www.govdeals.com](http://www.govdeals.com), [www.networkintl.com](http://www.networkintl.com), [www.truckcenter.com](http://www.truckcenter.com), [www.secondipity.com](http://www.secondipity.com), and [www.go-dove.com](http://www.go-dove.com).

We believe our ability to create liquid marketplaces for surplus and salvage assets generates a continuous flow of goods from our corporate and government sellers. This valuable and reliable flow of goods in turn attracts an increasing number of professional buyers to our marketplaces. During fiscal year 2014, the number of registered buyers grew from approximately 2,424,000 to approximately 2,615,000, or 7.9%. During the past three fiscal years, we have conducted over 1,578,000 online transactions generating approximately \$2.8 billion in gross merchandise volume or GMV. We believe the continuous flow of goods in our marketplaces attracts a growing buyer base which creates a virtual cycle for our buyers and sellers.

*Our history.* We were incorporated in Delaware in November 1999 as Liquidation.com, Inc. and commenced operations in early 2000. During 2000, we developed our online auction marketplace platform and began auctioning merchandise primarily for small commercial sellers and government agencies. In 2001, we changed our name to Liquidity Services, Inc. In June 2001, we were awarded our first major DoD contract, the Surplus Contract. Under this agreement, we became the exclusive contractor with the DLA Disposition Services, for the sale of usable DoD surplus assets in the United States. In June 2005, we were awarded an additional exclusive contract with the DLA Disposition Services to manage and sell substantially all DoD scrap property. During 2005, we opened our first distribution center in Dallas, Texas and began serving the reverse logistics needs of top 100 retailers.

*Recent initiatives.* On January 17, 2014, we were awarded a sole source follow-on contract that extended the performance period of the Surplus Contract for an additional ten month base period with two one-month renewal option periods, thus, extending the term of the second Surplus Contract until February 2015, assuming both renewal options are included. The surplus property flow from the DoD continues to be higher than historical levels. The mix of property has shifted to lower value smaller unit items, requiring us to rent more space, increase the number of shifts in our distribution centers, and increase our staff. The DoD, in accordance with the award of the next (third) surplus contract, split the contract into a rolling stock and a non-rolling stock contract; with bidding on these two surplus contracts held on April 1 and 2, 2014. On April 1, 2014, we were the high bidder for the non-rolling

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stock surplus contract with a bid equal to 4.35% of the DoD's original acquisition value (OAV). The non-rolling stock surplus contract has a base term of two years with four one-year renewal options. Following the bidding event on April 2, 2014 for the DoD rolling stock contract, we withdrew from the live auction bidding for this contract. Bidding reached a level that we determined would be economically unsustainable under the terms of the new contract, jeopardizing the high level of service we have historically provided the agency client. The price for the non-rolling stock contract is expected to increase from 1.8% to 4.35% of OAV, resulting in significantly higher Cost of Goods Sold (COGS) in fiscal year 2015 and beyond. Additionally, we expect to cease the sale of DoD rolling stock under the new contract, which has historically accounted for approximately 30-35% of the overall revenue for the current DoD Surplus contract, resulting in lower revenue in future periods. Together, this will result in a material impact to our EBITDA in fiscal year 2015 and beyond. We will continue to operate our existing DoD surplus contract to sell all useable surplus assets of the DoD, including non-rolling stock assets for the base term ending December 2014, with two additional one-month renewal options.

As discussed in the beginning of fiscal year 2014, we have undertaken a significant initiative, the LiquidityOne transformation plan, to fully integrate and enhance our marketplaces. We have spent approximately \$7.0 million on this effort and other technology and marketplace-related enhancements during fiscal year 2014. We currently are on plan to create these benefits for our selling clients and buying customers, while increasing efficiencies in operations across all of our marketplace platforms. A significant amount of this product development was completed this fiscal year with the total initiative continuing through fiscal year 2016. We expect our Universal Buyer Registration to be deployed and our data warehouse, which centralizes data collection throughout our marketplaces, to be in production in the first quarter of fiscal year 2015.

On October 1, 2014, we announced that we have realigned our workforce in response to the new terms and scope of our new (third) Surplus Contract for non-rolling stock, and to adjust for the efficiencies realized in our commercial business through ongoing integration efforts to support our future vision and growth. The business realignment includes employee reductions in fiscal year 2015 across the organization, and includes positions related to the support of the DoD surplus business, capital asset and retail supply chain operations, and corporate functions. The business realignment expenses incurred during the fiscal year ended September 30, 2014 include cash costs of \$1.8 million in employee severance and benefit costs. These actions address the new scope of our DoD surplus program and advance our future vision of building an integrated global business and marketplace platform with a singular and superior user experience backed by focused leadership and innovative products and services.

*Our revenue.* We offer our sellers three primary transaction models: a profit-sharing model, a consignment model and a purchase model.

*Profit-sharing model.* Under our profit-sharing model, we purchase inventory from our suppliers and share with them a portion of the profits received from a completed sale in the form of a distribution. Distributions are calculated based on the value received from the sale after deducting allowable costs, such as sales and marketing, technology and operations and other general and administrative costs. Because we are the primary obligor, and take general and physical inventory risks and credit risk under this transaction model, we recognize as revenue the sale price paid by the buyer upon completion of a transaction. Revenue from our profit-sharing model accounted for approximately 16.1%, 13.5%, and 14.4% of our total revenue for the fiscal years ended September 30, 2012, 2013 and 2014, respectively. The merchandise sold under our profit-sharing model accounted for approximately 8.9%, 7.0%, and 7.7% of our GMV for the fiscal years ended September 30, 2012, 2013 and 2014, respectively.

*Consignment model fee revenue.* Under our consignment model, we recognize commission revenue from sales of merchandise in our marketplaces that is owned by others. These

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commissions, which we refer to as seller commissions, represent a percentage of the sale price the buyer pays upon completion of a transaction. We vary the percentage amount of the seller commission depending on the various value-added services we provide to the seller to facilitate the transaction. For example, we generally increase the percentage amount of the commission if we take possession, handle, ship and / or provide enhanced product information for the merchandise. We collect the seller commission by deducting the appropriate amount from the sales proceeds prior to their distribution to the seller after completion of the transaction. Revenue from our consignment model, as well as other fee revenue, accounted for approximately 12.5%, 20.1%, and 21.6% of our total revenue for the fiscal years ended September 30, 2012, 2013 and 2014, respectively, and is recorded as fee revenue in the Consolidated Statement of Operations. The merchandise sold under our consignment model accounted for approximately 52.3%, 59.1%, and 57.7% of our GMV for the fiscal years ended September 30, 2012, 2013 and 2014, respectively.

*Purchase model.* Under our purchase model, we offer our sellers a fixed amount or the option to share a portion of the proceeds received from our completed sales in the form of a distribution. Distributions are calculated based on the value we receive from the sale after deducting a required return to us that we have negotiated with the seller. Because we are the primary obligor, and take general and physical inventory risks and credit risk under this transaction model, we recognize as revenue the sale price paid by the buyer upon completion of a transaction. Revenue from our purchase model accounted for approximately 71.4%, 66.5%, and 64.0% of our total revenue for the fiscal years ended September 30, 2012, 2013 and 2014, respectively. The merchandise sold under our purchase model accounted for approximately 38.8%, 33.9%, and 34.6% of our GMV, for the fiscal years ended September 30, 2012, 2013 and 2014, respectively.

We collect a buyer premium on substantially all of our transactions under all of our transaction models. Buyer premiums are calculated as a percentage of the sale price of the merchandise sold and are paid to us by the buyer. Buyer premiums are in addition to the price of the merchandise. Under our profit-sharing model, we typically share the proceeds of any buyer premiums with our sellers.

*Industry trends.* We believe there are several industry trends impacting the growth of our business including: (1) the increase in the adoption of the Internet by businesses to conduct e-commerce both in the United States and abroad; (2) in the near term the decrease in the volume, innovation, and price of consumer electronic products, resulting in lower supply from our retail clients and lower per unit prices and margins in our retail goods marketplace, although in the long term product we expect innovation in the retail supply chain will increase the pace of product obsolescence and, therefore, the supply of surplus assets; (3) the increase in the volume of returned merchandise handled by both online and offline retailers; (4) the increase in government regulations and the need for corporations to have sustainability solutions is necessitating verifiable recycling and remarketing of surplus assets; (5) the increase in outsourcing by corporate and government organizations of disposition activities for surplus and end-of-life assets as they focus on reducing costs, improving transparency, compliance and working capital flows, and increasingly prefer service providers with a proven track record, innovative scalable solutions and the ability to make a strategic impact in the reverse supply chain, which we expect to increase our seller base; and (6) an increase in buyer demand for surplus merchandise as consumers trade down by purchasing less expensive goods and seek greater value from their purchases, which results in lower per unit prices and margins in our retail goods vertical.

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**Our Seller Agreements**

*Our DoD agreements.* We have two material contracts with the DoD pursuant to which we acquire, manage and sell excess property:

*Surplus Contract.* In June 2001, we were awarded the first Surplus Contract, a competitive-bid exclusive contract under which we acquire, manage and sell all usable DoD surplus personal property turned into the DLA Disposition Services. Surplus property generally consists of items determined by the DoD to be no longer needed, and not claimed for reuse by, any federal agency, such as computers, electronics, office supplies, scientific and medical equipment, aircraft parts, clothing and textiles. We responded to a RFP from the DLA Disposition Services regarding a renewal of the Surplus Contract, and we were awarded the contract. We executed the second Contract on December 18, 2008. The second Surplus Contract was to expire in February 2014. In January 2014, the DoD awarded the Company with a follow-on contract to extend the terms of the second Surplus Contract for a base term of ten months with two one-month renewal option periods. The DoD, in accordance with the award of the next (third) surplus contract, split the contract into a rolling stock and a non-rolling stock contract, with bidding on these two surplus contracts held on April 1 and 2, 2014. On April 1, 2014, we were the high bidder for the non-rolling stock surplus contract with a bid equal to 4.35% of the DoD's original acquisition value (OAV). The non-rolling stock surplus contract has a base term of two years with four one-year renewal options. Following the bidding event on April 2, 2014 for the DoD rolling stock contract, we withdrew from the live auction bidding for this contract. Bidding reached a level that we determined would be economically unsustainable under the terms of the new contract, jeopardizing the high level of service we have historically provided the agency client.

Revenue from our Surplus Contract (including buyer premiums) accounted for approximately 27.2%, 27.7%, and 26.8% of our total revenue for the fiscal years ended September 30, 2012, 2013 and 2014, respectively. The property sold under our Surplus Contract accounted for approximately 15.5%, 15.0%, and 14.3% of our GMV for the fiscal years ended September 30, 2012, 2013 and 2014, respectively.

Under the current Surplus Contract, as amended, we are obligated to purchase all DoD surplus property at 1.8% of Disposition Services' original acquisition value. The DoD has broad discretion to determine what property will be made available for sale to us under the second Surplus Contract and may retrieve or restrict property previously sold to us for national security reasons or if the property is otherwise needed to support the mission of the DoD. The Surplus property flow from the DoD continues to be higher than historical levels. The mix of property has shifted to lower value smaller unit items, requiring us to rent more space, increase the number of shifts in our distribution centers, and increase our staff.

*Scrap Contract.* In June 2005, we were awarded a competitive-bid exclusive contract under which we acquire, manage and sell substantially all scrap property of the DoD turned into the DLA Disposition Services. Scrap property generally consists of items determined by the DoD to have no use beyond their base material content, such as metals, alloys, and building materials. Revenue from our Scrap Contract (including buyer premiums) accounted for approximately 16.1%, 13.5%, and 14.4% of our total revenue for the fiscal years ended September 30, 2012, 2013 and 2014, respectively. The property sold under our Scrap Contract accounted for approximately 8.9%, 7.0%, and 7.7% of our GMV for the fiscal years ended September 30, 2012, 2013 and 2014, respectively. We were required to pay \$5.7 million to the DoD in fiscal 2005 for the right to manage the operations and remarket scrap material in connection with the Scrap Contract. The Scrap Contract base term expired in August 2012, subject to DoD's right to

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extend it for three additional one-year terms. The DoD has exercised all three of the renewal options.

Under the Scrap Contract, we acquire scrap property at a per pound price and we are entitled to 23% of the profits of sale (defined as gross proceeds of sale less allowable operating expenses) and distribute the remaining profits to DoD. We refer to these disbursement payments to DoD as profit-sharing distributions. As a result of this arrangement, 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 Scrap Contract that we are obligated to pick up from non-DoD locations.

Under the second Surplus Contract, executed on December 18, 2008, we are not required to distribute any portion of the profits realized under the Contract, as the second Contract contains a higher fixed percentage price of 1.8% of the DLA Disposition Services' acquisition value to be paid for the property. The DoD has broad discretion to determine what property will be made available for sale to us under the Surplus Contract and may retrieve or restrict property previously sold to us for national security reasons or if the property is otherwise needed to support the mission of the DoD.

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. The profit-sharing distribution for the Scrap Contract is 23% and includes inventory assurance processes and procedures with respect to the mutilation of demilitarized scrap property sold.

*Our Commercial Agreements.*

In connection with our acquisition of Jacobs Trading, LLC ("Jacobs") on October 1, 2011, we assumed the rights and obligations under a Master Merchandise Salvage Contract (the "Wal-Mart Agreement"). We have the exclusive right to purchase certain consumer products from Wal-Mart that have been removed from the sales stream of its retail operations and we believe this agreement will be the source of a significant portion of our revenue and GMV during its term, which expires on May 16, 2016 and thereafter continues on a month to month basis. In addition, we have other contracts / programs with Wal-Mart. For the year ended September 30, 2014, approximately 11% of our GMV was generated from Wal-Mart under multiple contracts / programs.

During fiscal year 2014, we had over 600 corporate clients who each sold in excess of \$10,000 of surplus and salvage assets in our marketplaces. Our agreements with these clients are generally terminable at will by either party.

**Key Business Metrics**

Our management periodically reviews certain key business metrics for operational planning purposes and to evaluate the effectiveness of our operational strategies, allocation of resources and our capacity to fund capital expenditures and expand our business. These key business metrics include:

*Gross merchandise volume.* Gross merchandise volume, or GMV, is the total sales value of all merchandise sold through our marketplaces during a given period. We review GMV because it provides a measure of the volume of goods being sold in our marketplaces and thus the activity of those marketplaces. GMV also provides a means to evaluate the effectiveness of investments that we have made and continue to make, including in the areas of customer support, value-added services, product development, sales and marketing, and operations. The GMV of goods sold in our marketplace during fiscal year 2014 totaled \$931.6 million.

*Completed transactions.* Completed transactions represents the number of auctions in a given period from which we have recorded revenue. Similar to GMV, we believe that completed transactions is a key business metric because it provides an additional measurement of the volume of activity flowing

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through our marketplaces. During the fiscal year ended September 30, 2014, we completed approximately 547,000 transactions.

*Total registered buyers.* We grow our buyer base through a combination of marketing and promotional efforts. A person becomes a registered buyer by completing an online registration process on one of our marketplaces. As part of this process, we collect business and personal information, including name, title, company name, business address and contact information, and information on how the person intends to use our marketplaces. Each prospective buyer must also accept our terms and conditions of use. Following the completion of the online registration process, we verify each prospective buyer's e-mail address and confirm that the person is not listed on any banned persons list maintained internally or by the U.S. federal government. After the verification process, which is completed generally within 24 hours, the registration is approved and activated and the prospective buyer is added to our registered buyer list.

Total registered buyers, as of a given date, represents the aggregate number of persons or entities who have registered on one of our marketplaces. We use this metric to evaluate how well our marketing and promotional efforts are performing. Total registered buyers excludes duplicate registrations, buyers who are suspended from utilizing our marketplaces and those buyers who have voluntarily removed themselves from our registration database. In addition, if we become aware of registered buyers that are no longer in business, we remove them from our database. As of September 30, 2014, we had approximately 2,615,000 registered buyers.

*Total auction participants.* For each auction we manage, the number of auction participants represents the total number of registered buyers who have bid one or more times in that auction. As a result, a registered buyer who bids, or participates, in more than one auction is counted as an auction participant in each auction in which he or she participates. Thus, total auction participants for a given period is the sum of the auction participants in each auction conducted during that period. We use this metric to allow us to compare our online auction marketplaces to our competitors, including other online auction sites and traditional on-site auctioneers. In addition, we measure total auction participants on a periodic basis to evaluate the activity level of our base of registered buyers and to measure the performance of our marketing and promotional efforts. For the fiscal year ended September 30, 2014, approximately 2,538,000 total auction participants participated in auctions on our marketplaces.

### **Critical Accounting Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. A "critical accounting estimate" is one which is both important to the portrayal of our financial condition and results and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. We continuously evaluate our critical accounting estimates. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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*Revenue recognition.* For transactions in our marketplaces, which generate substantially all of our revenue, we recognize revenue when all of the following criteria are met:

a buyer submits the winning bid in an auction and, as a result, evidence of an arrangement exists and the sale price has been determined;

the buyer has assumed risks and rewards of ownership; and

collection is reasonably assured.

Most of our sales are recorded subsequent to payment authorization being received, utilizing credit cards, wire transfers and PayPal, an Internet based payment system, as methods of payments. As a result, we are not subject to significant collection risk, as goods are generally not shipped before payment is received.

Revenue is also evaluated for reporting revenue of gross proceeds when we act as the principal in the arrangement or net of commissions when we act as an agent. In arrangements in which we are deemed to be the primary obligor, bear physical and general inventory risk, and credit risk, we recognize as revenue the gross proceeds from the sale, including buyer's premiums. Arrangements in which we act as an agent or broker on a consignment basis, without taking general or physical inventory risk, revenue is recognized based on the sales commissions that are paid to us by the sellers for utilizing our services; in this situation, sales commissions represent a percentage of the gross proceeds from the sale that the seller pays to us upon completion of the transaction.

We have evaluated our revenue recognition policy related to sales under our profit-sharing model and determined it is appropriate to account for these sales on a gross basis. The following factors were most heavily relied upon in our determination:

We are the primary obligor in the arrangement, and we have general inventory risk.

We are the seller in substance and in appearance to the buyer; the buyer contacts us if there is a problem with the purchase. Only we and the buyer are parties to the sales contract and the buyer has no recourse to the supplier. If the buyer has a problem, he or she looks to us, not the supplier.

The buyer does not and cannot look to the supplier for fulfillment or for product acceptability concerns.

We take title to the inventory upon paying the amount set forth in the contract with the supplier. Such amount is generally a percentage of the supplier's original acquisition cost under our Surplus Contract and certain commercial contracts, a percentage of the supplier's last retail price under certain commercial contracts and varies depending on the type of the inventory purchased or a fixed price per pound under our Scrap Contract.

We are at risk of loss for all amounts paid to the supplier in the event the property is damaged or otherwise becomes unsaleable. In addition, as payments made for inventory are excluded from the calculation for the profit-sharing distribution under our DoD contracts, we effectively bear inventory risk for the full amount paid to acquire the property (*i.e.*, there is no sharing of inventory risk).

In fiscal year 2014, approximately 10.1% of our revenue was generated outside of the U.S.

*Business Combinations.* We recognize all of the assets acquired, liabilities assumed, contractual contingencies, and contingent consideration at their fair value on the acquisition date. Acquisition-related costs are recognized separately from the acquisition and expensed as incurred. Restructuring costs incurred in periods subsequent to the acquisition date are expensed and changes to the fair value of contingent consideration are recorded in the statement of operations subsequent to the acquisition





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date. Subsequent changes to the purchase price (i.e., working capital adjustments) or other fair value adjustments determined during the measurement period are recorded as an adjustment to goodwill. All subsequent changes to a valuation allowance or uncertain tax position that relate to the acquired company and existed at the acquisition date that occur both within the measurement period and as a result of facts and circumstances that existed at the acquisition date are recognized as an adjustment to goodwill. All other changes in valuation allowances are recognized as a reduction or increase to income tax expense.

*Valuation of goodwill and other intangible assets.* We identify and value intangible assets that we acquire in business combinations, such as customer arrangements, customer relationships and non-compete agreements, that arise from contractual or other legal rights or that are capable of being separated or divided from the acquired entity and sold, transferred, licensed, rented or exchanged. The fair value of identified intangible assets is based upon an estimate of the future economic benefits expected to result from ownership, which represents the amount at which the assets could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

We test our goodwill and other intangible assets for impairment annually or more frequently if events or circumstances indicate impairment may exist. Examples of such events or circumstances could include a significant change in business climate, a loss of significant customers, or a significant decline in stock price. We make a qualitative evaluation about the likelihood of goodwill impairment to determine whether we should calculate the fair value of a reporting unit. If our evaluation indicates a likelihood of goodwill impairment, we apply a two-step fair value-based test to assess goodwill for impairment. The first step compares the fair value of a reporting unit to its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the second step is then performed. The second step compares the carrying amount of the reporting unit's goodwill to the fair value of the goodwill. If the fair value of the goodwill is less than the carrying amount, an impairment loss would be recorded in our statements of operations. Intangible assets with definite lives are amortized over their estimated useful lives and are also reviewed for impairment if events or changes in circumstances indicate that their carrying amount may not be realizable.

Our management makes certain estimates and assumptions in order to determine the fair value of net assets and liabilities, including, among other things, an assessment of market conditions, projected cash flows, cost of capital and growth rates, which could significantly impact the reported value of goodwill and other intangible assets. Estimating future cash flows requires significant judgment, and our projections may vary from cash flows eventually realized. The valuations employ a combination of present value techniques to measure fair value, corroborated by comparisons to estimated market multiples. These valuations are based on a discount rate determined by our management to be consistent with industry discount rates and the risks inherent in our current business model.

We cannot predict the occurrence of certain future events that might adversely affect the reported value of goodwill and other intangible assets, which totaled \$226.8 million at September 30, 2014. Such events may include strategic decisions made in response to economic and competitive conditions, the impact of the economic environment on our base of buyers and sellers or material negative changes in our relationships with material customers.

*Income taxes.* We account for income taxes using the asset and liability approach for measuring deferred taxes based on temporary differences between the financial statement and income tax bases of assets and liabilities existing at each balance sheet date using enacted tax rates for the years in which the taxes are expected to be paid or recovered. A valuation allowance is provided to reduce the deferred tax assets to a level that we believe will more likely than not be realized. The resulting net deferred tax asset reflects management's estimate of the amount that will be realized.

We provide for income taxes based on our estimate of federal and state tax liabilities. These estimates include, among other items, effective rates for state and local income taxes, estimates related

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to depreciation and amortization expense allowable for tax purposes, and the tax deductibility of certain other items. Our estimates are based on the information available to us at the time we prepare the income tax provision. We generally file our annual income tax returns several months after our fiscal year-end. Income tax returns are subject to audit by federal, state and local governments, generally years after the returns are filed. These returns could be subject to material adjustments or differing interpretations of the tax laws.

We apply the authoritative guidance related to uncertainty in income taxes. We concluded that there were no uncertain tax positions identified during our analysis.

*Stock-based compensation.* We recognize in the statements of operations 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. We use the Black-Scholes option pricing model to estimate the fair values of share-based payments.

The above list is not intended to be a comprehensive list of all of our accounting estimates. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP, with little need for management's judgment in their application. There are also areas in which management's judgment in selecting any available alternative would not produce a materially different result. See our audited financial statements and related notes, which contain accounting policies and other disclosures required by GAAP.

**Components of Revenue and Expenses**

*Revenue.* We generate substantially all of our revenue from sales of merchandise held in inventory and by retaining a percentage of the proceeds from the sales. Our revenue recognition practices are discussed in more detail in the section above entitled "*Critical Accounting Estimates.*"

*Cost of goods sold (excluding amortization).* Cost of goods sold includes the costs of purchasing and transporting property for auction, as well as credit card transaction fees.

*Profit-sharing distributions.* Our Scrap Contract with the DoD has been structured as a profit-sharing arrangements in which we purchase and take possession of all goods we receive from the DoD at a contractual price per pound. After deducting allowable operating expenses, we disburse to the DoD on a monthly basis a percentage of the profits of the aggregate monthly sales. We retain the remaining percentage of these profits after the DoD's disbursement. We refer to these disbursement payments to the DoD as profit-sharing distributions.

*Technology and operations.* Technology expenses consist primarily of personnel costs related to our programming staff who develop and deploy new marketplaces and continuously enhance existing marketplaces. These personnel also develop and upgrade the software systems that support our operations, such as sales processing. Because our marketplaces and support systems require frequent upgrades and enhancements to maintain viability, we have determined that the useful life for substantially all of our internally developed software is less than one year. As a result, we expense these costs as incurred.

Operations expenses consist primarily of operating costs, including buyer relations, shipping logistics and distribution center operating costs.

*Sales and marketing.* Sales and marketing expenses include the cost of our sales and marketing personnel as well as the cost of marketing and promotional activities. These activities include online marketing campaigns such as paid search advertising.

*General and administrative.* General and administrative expenses include all corporate and administrative functions that support our operations and provide an infrastructure to facilitate our

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future growth. Components of these expenses include executive management and staff salaries, bonuses and related taxes and employee benefits; travel; headquarters rent and related occupancy costs; and legal and accounting fees. The salaries, bonus and employee benefits costs included as general and administrative expenses are generally more fixed in nature than our operating expenses and do not vary directly with the volume of merchandise sold through our marketplaces.

*Amortization of contract intangibles.* Amortization of contract intangibles expense consists of the amortization of our Scrap Contract award during June 2005 and our contract intangibles associated with the Jacobs Trading acquisition on October 1, 2011 and the NESAs acquisition on November 1, 2012. The Scrap Contract required us to purchase the rights to operate the scrap operations of the DoD during the seven year base term of the contract. The intangible asset created from the \$5.7 million purchase was being amortized over 84 months on a straight-line basis and was fully amortized as of September 30, 2012. The amortization period is correlated to the base term of the contract, exclusive of renewal periods. The intangible asset created in conjunction with the Jacobs Trading acquisition is valued at \$33.3 million and is being amortized over 55 months on a straight-line basis. The amortization period is correlated to the base term of the Wal-Mart contract from the acquisition date, exclusive of renewal periods. The vendor contract intangible asset created in conjunction with the NESAs acquisition was valued at \$3.9 million, was amortized over 20 months on a straight-line basis, and was fully amortized as of June 30, 2014. The amortization period was correlated to the base term of the contract, from the acquisition date, exclusive of renewal periods.

*Depreciation and amortization.* Depreciation and amortization expenses consist primarily of the depreciation and amortization of amounts recorded in connection with the purchase of furniture, fixtures and equipment and amortization of intangible assets from our acquisitions.

*Acquisition costs.* Acquisition costs consist of expenses incurred to complete a business combination and adjustments to the fair value of earn-outs.

*Interest income and other expense (income), net.* Interest income and other income (expense), net consists primarily of interest income on cash and short-term investments and interest expense on borrowings under our notes payable and realized gains or losses on short-term investments.

*Income taxes.* During fiscal years 2012, 2013 and 2014, we had an effective income tax rate for continuing operations of approximately 40%, 40% and 39%, respectively, which included federal, state and foreign income taxes. We estimate that our future effective income tax rate will be approximately 40%.

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### **Results of Operations**

The following table sets forth, for the periods indicated, selected statement of operations data expressed as a percentage of revenue.

	Year ended September 30,		
	2012	2013	2014
Revenue	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of goods sold (excluding amortization)	41.7	39.5	42.7
Profit-sharing distributions	9.1	7.1	7.1
Technology and operations	14.2	17.8	22.0
Sales and marketing	6.6	7.9	8.4
General and administrative	7.8	9.7	10.0
Amortization of contract intangibles	1.7	1.4	1.4
Depreciation and amortization	1.3	2.0	1.9
Acquisition costs	0.3	1.2	(3.7)
<b>Total costs and expenses</b>	<b>82.7</b>	<b>86.6</b>	<b>89.8</b>
Income from operations	17.3	13.4	10.2
Interest and other expense (income), net	0.5	(0.2)	0.1
Income from operations before provision for income taxes	16.8	13.6	10.1
Provision for income taxes	6.6	5.5	4.0
Income from operations	10.2%	8.1%	6.1%

### ***Year Ended September 30, 2014 Compared to Year Ended September 30, 2013***

**Revenue.** Revenue decreased \$10.2 million, or 2.0%, to \$495.7 million for the year ended September 30, 2014 from \$505.9 million for the year ended September 30, 2013. This decrease was primarily due to (1) a 9.8% decrease, or \$5.4 million, in our capital asset marketplaces, which primarily utilize the consignment model, as a result of softness in the energy and transportation verticals and (2) a 2.0% decrease, or \$4.1 million, in our DoD contracts, which utilize our purchase and profit-sharing models, as the result of increased property flows of lower value product. The amount of gross merchandise volume decreased \$41.8 million, or 4.3%, to \$931.6 million for the year ended September 30, 2014 from \$973.3 million for the year ended September 30, 2013, primarily due to decreases in our capital assets marketplaces.

**Cost of goods sold (excluding amortization).** Cost of goods sold (excluding amortization) increased \$12.2 million, or 6.1%, to \$211.7 million for the year ended September 30, 2014 from \$199.5 million for the year ended September 30, 2013. As a percentage of revenue, these expenses increased to 42.7% from 39.5%. These increases are primarily due to (1) increased sales of lower value product under our Surplus contract and (2) increased sales in our commercial retail marketplaces with clients using the purchase model.

**Profit-sharing distributions.** Profit-sharing distributions decreased \$0.8 million, or 2.5%, to \$35.1 million for the year ended September 30, 2014 from \$35.9 million for the year ended September 30, 2013. As a percentage of revenue, these expenses were consistent at 7.1%. These decreases are not significant.

**Technology and operations expenses.** Technology and operations expenses increased \$18.9 million, or 21.0%, to \$108.9 million for the year ended September 30, 2014 from \$90.1 million for the year ended September 30, 2013. As a percentage of revenue, these expenses increased to 22.0% from 17.8%. These increases are primarily due to (1) expenses of \$11.0 million in staff and temporary wages, including stock based

compensation, and consultant fees associated with technology marketplace integration and

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enhancement projects; (2) expenses of \$7.1 million for additional warehouse space due to the increase in our inventory; and (3) expenses of \$0.8 million in business realignment costs.

*Sales and marketing expenses.* Sales and marketing expenses increased \$1.8 million, or 4.4%, to \$42.0 million for the year ended September 30, 2014 from \$40.2 million for the year ended September 30, 2013. As a percentage of revenue, these expenses increased to 8.4% from 7.9%. These increases are primarily due to (1) expenses of \$1.3 million in marketing activities; and (2) expenses of \$0.5 million in severance costs related to the business realignment.

*General and administrative expenses.* General and administrative expenses increased \$0.5 million, or 1.0%, to \$49.4 million for the year ended September 30, 2014 from \$48.9 million for the year ended September 30, 2013. As a percentage of revenue, these expenses increased to 10.0% from 9.7%. These increases are primarily due to expenses of \$0.5 million in business realignment costs.

*Amortization of contract intangibles.* Amortization of contract intangibles was consistent at \$7.3 million for the years ended September 30, 2014 and September 30, 2013 and is primarily related to the contract intangible assets created in conjunction with the Jacobs Trading acquisition which was valued at \$33.3 million and is being amortized over 55 months on a straight-line basis.

*Depreciation and amortization expenses.* Depreciation and amortization expenses decreased \$0.8 million, or 7.7%, to \$9.3 million for the year ended September 30, 2014 from \$10.1 million for the year ended September 30, 2013, primarily due to a decrease in amortization expenses of intangible assets during 2014.

*Acquisition costs.* Acquisition costs decreased \$24.3 million to \$18.4 million of income for the year ended September 30, 2014 from \$5.9 million of expense for the year ended September 30, 2013, primarily as a result of the reversal of the NESAs earn-out liability. On November 1, 2012, we acquired the assets and liabilities of NESAs in an all cash transaction. The acquisition price included an upfront cash payment of approximately \$18.3 million and an earn-out payment. Our estimate of the fair value of the earn-out as of the date of acquisition was \$18.0 million out of a possible total earn-out payment of \$37.7 million. Upon a review of the estimate as of June 30, 2014, and based on revised estimates and unfavorable developments in the business, we determined that the fair value of the earn-out from the NESAs acquisition was zero and have reversed the liability of \$18.6 million.

*Interest and other expense (income), net.* Interest and other expense (income), net, increased \$1.1 million, or 152.5%, to \$0.4 million of expense for the year ended September 30, 2014 from \$0.7 million of income for the year ended September 30, 2013, primarily due to the payoff of the \$40 million Jacobs Trading acquisition seller subordinated note in November 2012 for which we received a \$1.0 million early payment discount that was recorded as a gain.

*Provision for income tax expense.* Income tax expense decreased \$7.9 million, or 28.7%, to \$19.7 million for the year ended September 30, 2014 from \$27.6 million for the year ended September 30, 2013, primarily due to the decrease in income before provision for income taxes from operations.

*Net income.* Net income decreased \$10.7 million, or 26.1%, to \$30.4 million for the year ended September 30, 2014 from \$41.1 million for the year ended September 30, 2013.

Table of Contents***Year Ended September 30, 2013 Compared to Year Ended September 30, 2012***

**Revenue.** Revenue increased \$30.6 million, or 6.4%, to \$505.9 million for the year ended September 30, 2013 from \$475.3 million for the year ended September 30, 2012. This increase was primarily due to (1) a 10.0% increase, or \$24.1 million, in our commercial marketplaces as a result of the acquisitions of GoIndustry in July 2012, and NESAs on November 1, 2012; (2) a 28.5% increase, or \$3.5 million, in our state and local government (GovDeals) marketplace; and (3) a 9.3% increase, or \$11.8 million increase in our Surplus Contract as a result of increased property flow from the DoD. These increases were offset in part by a 10.9% decrease, or \$8.4 million in our DoD Scrap Contract as a result of decreasing property flow from the DoD. The amount of gross merchandise volume increased \$109.1 million, or 12.6%, to \$973.3 million for the year ended September 30, 2013 from \$864.2 million for the year ended September 30, 2012, primarily due to (1) the acquisition of GoIndustry in July 2012; and (2) a 16.7% increase, or \$22.0 million in our state and local government marketplace.

**Cost of goods sold (excluding amortization).** Cost of goods sold (excluding amortization) increased \$1.4 million, or 0.7%, to \$199.5 million for the year ended September 30, 2013 from \$198.1 million for the year ended September 30, 2012. As a percentage of revenue, these expenses decreased to 39.5% from 41.7%, primarily as a result of the acquisition of GoIndustry which primarily utilizes the consignment model.

**Profit-sharing distributions.** Profit-sharing distributions decreased \$7.3 million, or 16.9%, to \$35.9 million for the year ended September 30, 2013 from \$43.2 million for the year ended September 30, 2012. As a percentage of revenue, these expenses decreased to 7.1% from 9.1%. These decreases were primarily due to decreasing property flow from the DoD Scrap contract and lower commodity prices.

**Technology and operations expenses.** Technology and operations expenses increased \$22.5 million, or 33.3%, to \$90.1 million for the year ended September 30, 2013 from \$67.6 million for the year ended September 30, 2012. As a percentage of revenue, these expenses increased to 17.8% from 14.2%. These increases are primarily due to (1) expenses of \$14.6 million related to the activity of GoIndustry and NESAs; and (2) expenses of \$7.9 million in staff and temporary wages, including stock based compensation, and consultant fees associated with technology infrastructure projects.

**Sales and marketing expenses.** Sales and marketing expenses increased \$8.9 million, or 28.5%, to \$40.2 million for the year ended September 30, 2013 from \$31.3 million for the year ended September 30, 2012. As a percentage of revenue, these expenses increased to 7.9% from 6.6%. These increases are primarily due to expenses of \$8.1 million related to the activity of GoIndustry and NESAs.

**General and administrative expenses.** General and administrative expenses increased \$11.8 million, or 31.9%, to \$48.9 million for the year ended September 30, 2013 from \$37.1 million for the year ended September 30, 2012. As a percentage of revenue, these expenses increased to 9.7% from 7.8%. These increases are primarily due to (1) expenses of \$9.3 million related to the activity of GoIndustry and NESAs; and (2) \$2.4 million of expenses associated with increases in general corporate expenses.

**Amortization of contract intangibles.** Amortization of contract intangibles decreased \$0.6 million, or 8.5%, to \$7.3 million for the year ended September 30, 2013 from \$7.9 million for the year ended September 30, 2012, as a result of the contract intangible associated with the DoD contract being fully amortized during 2013.

**Depreciation and amortization expenses.** Depreciation and amortization expenses increased \$3.9 million, or 62.4%, to \$10.1 million for the year ended September 30, 2013 from \$6.2 million for the year ended September 30, 2012, primarily due to additional depreciation expense resulting from the purchases of \$5.5 million and \$6.8 million of property and equipment during the fiscal years ended September 30, 2013 and 2012, respectively.

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*Acquisition costs.* Acquisition costs increased \$4.2 million to \$5.9 million for the year ended September 30, 2013 from \$1.7 million for the year ended September 30, 2012, primarily due to the increase of \$5.1 million for the fair value of the Jacobs Trading earn out liability.

*Interest and other expense (income), net.* Interest and other expense (income), net, increased \$2.9 million, or 131.7%, to \$0.7 million of income for the year ended September 30, 2013 from \$2.2 million of expense for the year ended September 30, 2012, primarily due to the payoff of the \$40 million Jacobs Trading acquisition seller subordinated note which bears interest at 5% for which we received a \$1.0 million early payment discount that was recorded as a gain.

*Provision for income tax expense.* Income tax expense decreased \$4.1 million, or 13.0%, to \$27.6 million for the year ended September 30, 2013 from \$31.7 million for the year ended September 30, 2012, primarily due to the decrease in income before provision for income taxes from operations.

*Net income.* Net income decreased \$7.2 million, or 14.9%, to \$41.1 million for the year ended September 30, 2013 from \$48.3 million for the year ended September 30, 2012 for the reasons noted above.

### **Liquidity and Capital Resources**

Historically, our primary cash needs have been working capital (including capital used for inventory purchases), which we have funded primarily through cash generated from operations. As of September 30, 2014, we had approximately \$62.6 million in cash and cash equivalents and \$64.9 million available under our \$75.0 million senior credit facility, due to issued letters of credit for \$10.1 million; \$1.0 million of our availability under this facility is set aside as a contractual obligation under our DoD Scrap Contract. In fiscal year 2013, we utilized \$41.0 million to repay the seller subordinated 5.0% note, including accrued interest, associated with the Jacobs Trading acquisition and \$18.3 million to close the NESAs acquisition.

Our Board of Directors has approved the repurchase of up to \$101.9 million in shares under a share repurchase program. Under the program, we are authorized to repurchase our issued and outstanding shares of common stock. Share repurchases may be made through open market purchases, privately negotiated transactions or otherwise, at times and in such amounts as management deems appropriate. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements and other market conditions. The repurchase program may be discontinued or suspended at any time, and will be funded using our available cash. Our Board of Directors reviews the share repurchase program periodically, the last such review having



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occurred in February 2014. A summary of our share repurchase activity from fiscal year 2009 to the year ended September 30, 2014 is as follows:

Fiscal Year Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Cash Paid for Shares Purchased	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(1)
2009	707,462	\$ 5.50	\$ 3,874,000	\$ 6,126,000
2010	1,225,019	\$ 11.53	14,471,000	1,655,000
2011	229,575	\$ 15.39	3,541,000	18,114,000
2012	505,067	\$ 59.41	30,000,000	18,114,000
2013				31,000,000
2014	2,962,978	\$ 15.90	\$ 44,873,000	\$ 5,127,000

(1)

On December 2, 2008, our Board of Directors approved a share repurchase program, under which we were authorized to repurchase up to \$10.0 million of the issued and outstanding shares of common stock. On each of February 2, 2010, November 30, 2010 and May 31, 2011, our Board of Directors approved an additional \$10.0 million for the share repurchase program. On May 17, 2012, our Board of Directors approved an additional \$30.0 million for the share repurchase program. On December 12, 2013, our Board of Directors approved an additional approximately \$12.9 million for the share repurchase program. On February 5, 2014, our Board of Directors approved an additional \$19.0 million for the share repurchase program.

*Senior credit facility.* We maintain a \$75.0 million senior credit facility due May 31, 2015. The senior credit facility bears an annual interest rate of 30 day LIBOR plus 1.25%. As of September 30, 2014, we had no outstanding indebtedness under our senior credit facility and our borrowing availability was \$64.9 million due to issued letters of credit for \$10.1 million; \$1.0 million of our availability under this facility is set aside as a contractual obligation under our DoD Scrap Contract. The obligations under our senior credit facility are unconditionally guaranteed by us and each of our existing and subsequently acquired or organized subsidiaries (other than our subsidiary organized to service our DoD Scrap contract) and secured on a first priority basis by security interests (subject to permitted liens) in substantially all assets owned by us, and each of our other domestic subsidiaries, subject to limited exceptions. The Agreement contains certain financial and non-financial restrictive covenants including, among others, the requirements to maintain a minimum level of earnings before interest, income taxes, depreciation and amortization (EBITDA) and a minimum debt coverage ratio. Our credit agreement contains a number of affirmative and restrictive covenants including limitations on mergers, consolidations and dissolutions, sales of assets, investments and acquisitions, indebtedness and liens, and dividends and other restricted payments. As of September 30, 2014, we were in full compliance with the terms and conditions of our credit agreement.

*Subordinated note.* In conjunction with the Jacobs Trading acquisition, we issued a \$40,000,000 seller subordinated 5% unsecured note. We repaid this note in November 2012.

Substantially all of our sales are recorded subsequent to receipt of payment authorization, utilizing credit cards, wire transfers and PayPal, an Internet based payment system, as methods of payments. As a result, we are not subject to significant collection risk, as goods are generally not shipped before payment is received.

Table of Contents***Changes in Cash Flows: 2014 Compared to 2013***

Net cash provided by operating activities from decreased \$34.1 million to \$11.9 million for the year ended September 30, 2014 from \$46.7 million for the year ended September 30, 2013. For the year ended September 30, 2014, net cash provided by operating activities primarily consisted of net income of \$30.4 million, depreciation and amortization expense of \$16.6 million, stock compensation expense of \$12.6 million and a net increase in accounts payable, accrued expenses and other liabilities of \$20.6 million, offset in part by the NESA earn-out liability reversal of \$18.4 million, a net increase in accounts receivable, inventory and prepaid expense of \$47.4 million, and provisions for inventory allowance, doubtful accounts, deferred tax benefit, and incremental tax from exercises of common stock options of \$2.6 million, net. For the year ended September 30, 2013, net cash provided by operating activities primarily consisted of net income of \$41.1 million, depreciation and amortization expense of \$17.4 million, stock compensation expense of \$13.4 million, offset in part by net decreases in accounts payable, accrued expenses and other liabilities of \$6.5 million (including \$9.2 million for the payment of the Jacobs Trading earn-out), provisions for inventory allowance, doubtful accounts, deferred tax benefit, and incremental tax from exercises of common stock options of \$17.0 million, net, a net increase in accounts receivable, inventory and prepaid expense of \$0.7 million, and \$1.0 million from early extinguishment of debt.

Net cash used in investing activities was \$7.7 million for the year ended September 30, 2014 and \$20.2 million for the year ended September 30, 2013. Net cash used in investing activities in fiscal 2014 consisted primarily of net cash paid for acquisitions and an increase of goodwill and intangibles of \$0.2 million, and capital expenditures of \$7.5 million for purchases of equipment and leasehold improvements. Net cash used in investing activities in fiscal 2013 consisted primarily of net cash paid for acquisitions net of cash acquired and an increase of goodwill and intangibles of \$14.7 million, and capital expenditures of \$5.5 million for purchases of equipment and leasehold improvements.

Net cash used in financing activities was \$36.9 million for the year ended September 30, 2014, \$36.1 million for the year ended September 30, 2013. Net cash used in financing activities in fiscal 2014 consisted primarily of \$44.9 million in stock repurchases, offset in part by proceeds from the exercise of common stock options and the incremental tax benefit from the exercise of common stock options of \$8.0 million. Net cash used by financing activities in fiscal 2013 consisted primarily of \$39.0 million for the repayment of the Jacobs Trading note payable and \$8.2 million for the payment of the Jacobs Trading earn-out, offset in part by \$2.5 million from exercises of common stock options and the tax benefit of \$8.6 million.

***Changes in Cash Flows: 2013 Compared to 2012***

Net cash provided by operating activities from continuing operations decreased \$5.9 million to \$46.7 million for the year ended September 30, 2013 from \$52.6 million for the year ended September 30, 2012. For the year ended September 30, 2013, net cash provided by operating activities from continuing operations primarily consisted of income from continuing operations of \$41.1 million, depreciation and amortization expense of \$17.4 million, stock compensation expense of \$13.4 million, offset in part by a net decreases in accounts payable, accrued expenses and other liabilities of \$6.5 million (including \$9.2 million for the payment of the Jacobs Trading earn-out), provisions for inventory allowance, doubtful accounts, deferred tax benefit, and incremental tax from exercises of common stock options of \$17.0 million, net, a net increase in accounts receivable, inventory and prepaid expense of \$0.7 million, and \$1.0 million from early extinguishment of debt. For the year ended September 30, 2012, net cash provided by operating activities from continuing operations primarily consisted of income from continuing operations of \$48.3 million, depreciation and amortization expense of \$14.1 million, stock compensation expense of \$12.1 million, a net increase in accounts receivable, inventory and prepaid expense of \$16.2 million, offset in part by a net decrease in accounts payable, accrued expenses and other liabilities of \$20.4 million, and a net increase in the provision for doubtful

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accounts, inventory allowance, deferred tax benefit, and incremental tax from exercise of common stock options of \$17.7 million.

Net cash used in investing activities was \$20.2 million for the year ended September 30, 2013 and \$78.6 million for the year ended September 30, 2012. Net cash used in investing activities in fiscal 2013 consisted primarily of net cash paid for acquisitions net of cash acquired and an increase of goodwill and intangibles of \$14.7 million, and capital expenditures of \$5.5 million for purchases of equipment and leasehold improvements. Net cash used in investing activities in fiscal 2012 consisted primarily of net cash paid for acquisitions net of cash acquired and an increase of goodwill and intangibles of \$71.8 million, and capital expenditures of \$6.8 million for purchases of equipment and leasehold improvements.

Net cash used in financing activities was \$36.1 million for the year ended September 30, 2013, and net cash provided by financing activities was \$2.4 million for the year ended September 30, 2012. Net cash used by financing activities in fiscal 2013 consisted primarily of \$39.0 million for the repayment of the Jacobs Trading note payable and \$8.2 million for the payment of the Jacobs Trading earn-out, offset in part by \$2.5 million from exercises of common stock options and the tax benefit of \$8.6 million. Net cash provided by financing activities in fiscal 2012 consisted primarily of \$15.5 million from exercises of common stock options and the tax benefit of \$16.9 million, offset in part by \$30.0 million for stock repurchases.

*Capital Expenditures.* Our capital expenditures consist primarily of computers and purchased software, office equipment, furniture and fixtures, and leasehold improvements. The timing and volume of such capital expenditures in the future will be affected by the addition of new customers or expansion of existing customer relationships. We expect capital expenditures to range from \$6.0 million to \$7.0 million in the fiscal year ending September 30, 2014. We intend to fund those expenditures primarily from operating cash flows. Our capital expenditures for the year ended September 30, 2013 were \$5.5 million. As of September 30, 2013, we have no outstanding commitments for capital expenditures.

We believe that our existing cash and cash equivalents will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors including our rate of revenue growth, the timing and extent of spending to support development efforts, the expansion of sales and marketing activities, the development and deployment of new marketplaces, the introduction of new value added services and the costs to establish additional distribution centers. Although we are currently not a party to any definitive agreement with respect to potential investments in, or acquisitions of, complementary businesses, products or technologies, we may enter into these types of arrangements in the future, which could also require us to seek additional equity or debt financing. The sale of additional equity securities or convertible debt securities would result in additional dilution to our stockholders. Additional debt would result in increased interest expense and could result in covenants that would restrict our operations. There is no assurance that such financing, if required, will be available in amounts or on terms acceptable to us, if at all.

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**Contractual and Commercial Commitments**

The table below represents our significant commercial commitments as of September 30, 2014. Operating leases, which represent commitments to rent office and warehouse space in the United States, are not reflected on our balance sheets.

	Total	Less than 1 year	1 to 3 years	3 to 5 Years	5+ years
	(in thousands)				
Operating leases	\$ 30,065	\$ 10,457	\$ 13,012	\$ 6,596	\$
Total contractual cash obligations	\$ 30,065	\$ 10,457	\$ 13,012	\$ 6,596	\$

**Off-Balance Sheet Arrangements**

We do not have any transactions, obligations or relationships that could be considered material off-balance sheet arrangements.

**Inflation**

Inflation generally affects us by increasing our cost of labor and equipment. We do not believe that inflation had any material effect on our results of operations during the fiscal years ended September 30, 2012, 2013 and 2014.

**New Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board (FASB) issued a new standard that will change the way we recognize revenue and significantly expand the disclosure requirements for revenue arrangements. The new standard will be effective for us beginning on October 1, 2017, and may be adopted either retrospectively or on a modified retrospective basis whereby the new standard would be applied to new and existing arrangements with remaining performance obligations as of the effective date, with a cumulative catch-up adjustment recorded to retained earnings at the effective date for existing arrangements with remaining performance obligations. Early adoption is not permitted. We are currently evaluating the methods of adoption allowed by the new standard and the effect that adoption of the standard is expected to have on our consolidated financial statements and related disclosures. As a result, our evaluation of the effect of the new standard will likely extend over several future periods.

In February 2013, the FASB issued ASU 2013-02, *Comprehensive Income (Topic 220) Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, which amends existing guidance by requiring that additional information be disclosed about items reclassified out of accumulated other comprehensive income. The additional information includes separately stating the total change for each component of other comprehensive income and separately disclosing both current-period other comprehensive income and reclassification adjustments. Entities are also required to present, either on the face of the income statement or in the note to the financial statements, significant amounts reclassified out of accumulated other comprehensive income as separate line items of net income but only if the entire amount reclassified must be reclassified to net income in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity must cross-reference to other disclosures that provide additional detail about those amounts. ASU 2013-02 was effective for interim and annual periods beginning after December 15, 2012, which for the Company was our fiscal 2014 first quarter. We do not believe the adoption of this update will have a material impact on our financial statements.

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**Item 7A. Quantitative and Qualitative Disclosures about Market Risk.**

*Interest rate sensitivity.* We had \$40.0 million of fixed 5% unsecured subordinated debt as of September 30, 2012, which we repaid in fiscal year 2013, and thus do not have any related interest rate exposure. Our investment policy requires us to invest funds in excess of current operating requirements. The principal objectives of our investment activities are to preserve principal, provide liquidity and maximize income consistent with minimizing risk of material loss.

*Exchange rate sensitivity.* We consider our exposure to foreign currency exchange rate fluctuations to be minimal, as approximately ten percent of our sales are denominated in foreign currencies. We have not engaged in any hedging or other derivative transactions to date.

**Item 8. Financial Statements and Supplemental Data.**

Annual Financial Statements and Selected Financial Data: The consolidated financial statements and accompanying notes listed in Part IV, Item 15(a)(1) of this Annual Report on Form 10-K are included elsewhere in this Annual Report.

**Item 9. Changes in and Disagreement with Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. Controls and Procedures.**

Attached as exhibits to this Form 10-K are certifications of our Chief Executive Officer and Chief Financial Officer, which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended. This "Controls and Procedures" section includes information concerning the controls and controls evaluation referred to in the certifications. The report of Ernst & Young LLP, our independent registered public accounting firm, regarding management's assessment of internal control over financial reporting, and its audit of our internal control over financial reporting is set forth below in this section. This section should be read in conjunction with the certifications and the Ernst & Young LLP report for a more complete understanding of the topics presented.

**Evaluation of Disclosure Controls and Procedures**

We conducted an evaluation of the effectiveness of the design and operation of our "disclosure controls and procedures" as of the end of the period covered by this Form 10-K. The controls evaluation was conducted under the supervision and with the participation of management, including our Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer. Disclosure controls are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, such as this Form 10-K, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls are also designed to reasonably assure that such information is accumulated and communicated to our management, including the Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer, as appropriate to allow timely decisions regarding required disclosure. Our quarterly evaluation of disclosure controls includes an evaluation of some components of our internal control over financial reporting, and internal control over financial reporting is also separately evaluated on an annual basis for purposes of providing the management report which is set forth below.

The evaluation of our disclosure controls included a review of the controls' objectives and design, our implementation of the controls and their effect on the information generated for use in this Form 10-K. In the course of the controls evaluation, we reviewed identified data errors, control problems or indications of potential fraud and, where appropriate, sought to confirm that appropriate

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corrective actions, including process improvements, were being undertaken. This type of evaluation is performed on a quarterly basis so that the conclusions of management, including the Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer, concerning the effectiveness of the disclosure controls can be reported in our periodic reports on Form 10-Q and Form 10-K. Many of the components of our disclosure controls are also evaluated on an ongoing basis by our finance organization. The overall goals of these various evaluation activities are to monitor our disclosure controls, and to modify them as necessary. Our intent is to maintain the disclosure controls as dynamic systems that change as conditions warrant.

Based upon the controls evaluation, our Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer have concluded that, as of the end of the period covered by this Form 10-K, our disclosure controls were effective to provide reasonable assurance that information required to be disclosed in our Securities Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC, and that material information related to Liquidity Services and our consolidated subsidiaries is made known to management, including the Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer, particularly during the period when our periodic reports are being prepared. We reviewed the results of management's evaluation with the Audit Committee of our Board of Directors.

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

Our management is responsible for establishing and maintaining effective internal control over financial reporting to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles; and (iii) provide reasonable assurance regarding authorization to effect the acquisition, use or disposition of company assets, as well as the prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Management assessed our internal control over financial reporting as of September 30, 2014, the end of our fiscal year. Management based its assessment on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 Framework). Management's assessment included evaluation of such elements as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies and our overall control environment. This assessment is supported by testing and monitoring performed by our finance organization.

Based on this assessment, management has concluded that our internal control over financial reporting was effective as of the end of the fiscal year to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

Our independent registered public accounting firm, Ernst & Young LLP, independently assessed the effectiveness of the company's internal control over financial reporting. Ernst & Young LLP has issued an attestation report, which is included at the end of this section.

**Inherent Limitations on Effectiveness of Controls**

A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system

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must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Other inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

**Changes in Internal Control over Financial Reporting**

On a quarterly basis we evaluate any changes to our internal control over financial reporting to determine if material changes occurred. There were no changes in our internal controls over financial reporting during the quarterly period ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Board of Directors and Stockholders of  
Liquidity Services, Inc. and Subsidiaries

We have audited Liquidity Services, Inc. and subsidiaries' internal control over financial reporting as of September 30, 2014, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the COSO criteria). Liquidity Services, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Liquidity Services, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of September 30, 2014, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Liquidity Services, Inc. and subsidiaries as of September 30, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for each of the three years in the period ended September 30, 2014 of Liquidity Services, Inc. and subsidiaries and our report dated November 21, 2014 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

McLean, Virginia  
November 21, 2014

**Item 9B. Other Information.**

None.



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**PART III**

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

Incorporated by reference from the Company's Proxy Statement relating to its 2014 Annual Meeting of Stockholders to be filed with the SEC within 120 days after September 30, 2014.

**Code of Ethics, Governance Guidelines and Committee Charters**

We have adopted a *Code of Business Conduct and Ethics* that applies to all Liquidity Services employees. The *Code of Business Conduct and Ethics* is available on our website.

**Item 11. Executive Compensation.**

Incorporated by reference from the Company's Proxy Statement relating to its 2015 Annual Meeting of Stockholders to be filed with the SEC within 120 days after September 30, 2014.

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

Incorporated by reference from the Company's Proxy Statement relating to its 2015 Annual Meeting of Stockholders to be filed with the SEC within 120 days after September 30, 2014.

**Item 13. Certain Relationship and Related Transactions, and Director Independence.**

Incorporated by reference from the Company's Proxy Statement relating to its 2015 Annual Meeting of Stockholders to be filed with the SEC within 120 days after September 30, 2014.

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

Incorporated by reference from the Company's Proxy Statement relating to its 2015 Annual Meeting of Stockholders to be filed with the SEC within 120 days after September 30, 2014.

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**PART IV**

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

	<b>Page</b>
(a)(1) The following financial statements are filed as part of this report: <u>Report of Independent Registered Public Accounting Firm</u>	<u>59</u>
Financial Statements covered by the Report of Independent Registered Public Accounting Firm: <u>Consolidated Balance Sheets as of September 30, 2014 and 2013</u>	<u>60</u>
<u>Consolidated Statements of Operations for the years ended September 30, 2014, 2013 and 2012</u>	<u>61</u>
<u>Consolidated Statements of Comprehensive Income for the years ended September 30, 2014, 2013 and 2012</u>	<u>62</u>
<u>Consolidated Statements of Changes in Stockholders' Equity for the years ended September 30, 2014, 2013 and 2012</u>	<u>63</u>
<u>Consolidated Statements of Cash Flows for the years ended September 30, 2014, 2013 and 2012</u>	<u>64</u>
<u>Notes to the Consolidated Financial Statements</u>	<u>65</u>
(a)(2) The following financial statement schedule is filed as part of this report: Schedules for the three years ended September 30, 2012, 2013 and 2014:  <u>II Valuation and Qualifying Accounts</u>	<u>95</u>
All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required or are inapplicable and therefore have been omitted.	
(a)(3) The documents required to be filed as exhibits to this report under Item 601 of Regulation S-K are listed in the Exhibit Index included elsewhere in this report, which list is incorporated herein by reference.	

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders of  
Liquidity Services, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Liquidity Services, Inc. and subsidiaries as of September 30, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for each of the three years in the period ended September 30, 2014. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Liquidity Services, Inc. and subsidiaries at September 30, 2014 and 2013, and the consolidated results of their operations and their cash flows for each of the three years in the period ended September 30, 2014, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Liquidity Services, Inc. and subsidiaries' internal control over financial reporting as of September 30, 2014, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated November 21, 2014 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

McLean, Virginia  
November 21, 2014

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**Liquidity Services, Inc. and Subsidiaries**  
**Consolidated Balance Sheets**  
(Dollars in Thousands)

	September 30,	
	2014	2013
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 62,598	\$ 95,109
Accounts receivable, net of allowance for doubtful accounts of \$1,042 and \$891 in 2014 and 2013, respectively	21,688	24,050
Inventory	78,478	29,261
Prepaid and deferred taxes	16,777	11,243
Prepaid expenses and other current assets	5,156	4,802
Total current assets	184,697	164,465
Property and equipment, net	12,283	10,380
Intangible assets, net	17,099	28,205
Goodwill	209,656	211,711
Other assets	7,983	6,583
Total assets	\$ 431,718	\$ 421,344
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Accounts payable	\$ 15,994	\$ 16,539
Accrued expenses and other current liabilities	44,484	34,825
Profit-sharing distributions payable	4,740	4,315
Customer payables	41,544	29,497
Total current liabilities	106,762	85,176
Acquisition earn out payable		18,390
Other long-term liabilities	7,973	2,899
Total liabilities	114,735	106,465
Stockholders' equity:		
Common stock, \$0.001 par value; 120,000,000 shares authorized; 29,668,150 shares issued and outstanding at September 30, 2014; 31,811,764 shares issued and outstanding at September 30, 2013	28	31
Additional paid-in capital	204,704	206,861
Accumulated other comprehensive (loss) income	(3,451)	518
Retained earnings	115,702	107,469
Total stockholders' equity	316,983	314,879

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Total liabilities and stockholders' equity	\$ 431,718	\$ 421,344
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*See accompanying notes to the consolidated financial statements.*

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**Liquidity Services, Inc. and Subsidiaries**  
**Consolidated Statements of Operations**  
(Dollars in Thousands Except Share and Per Share Data)

	Year ended September 30,		
	2014	2013	2012
Revenue	\$ 388,671	\$ 404,041	\$ 415,829
Fee revenue	106,990	101,815	59,475
Total revenue from operations	495,661	505,856	475,304
Costs and expenses from operations:			
Cost of goods sold (excluding amortization)	211,659	199,494	198,123
Profit-sharing distributions	35,055	35,944	43,242
Technology and operations	108,940	90,052	67,553
Sales and marketing	41,951	40,170	31,252
General and administrative	49,428	48,950	37,107
Amortization of contract intangibles	7,265	7,265	7,943
Depreciation and amortization	9,330	10,109	6,223
Acquisition costs	(18,384)	5,921	1,695
Total costs and expenses	445,244	437,905	393,138
Income from operations	50,417	67,951	82,166
Interest and other expense (income), net	370	(704)	2,218
Income before provision for income taxes	50,047	68,655	79,948
Provision for income taxes	19,657	27,551	31,652
Net income	\$ 30,390	\$ 41,104	\$ 48,296
Basic earnings per common share	\$ 0.97	\$ 1.30	\$ 1.57
Diluted earnings per common share	\$ 0.97	\$ 1.26	\$ 1.47

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Basic weighted average shares outstanding	31,243,932	31,616,926	30,854,796
Diluted weighted average shares outstanding	31,395,301	32,657,236	32,783,079

*See accompanying notes to the consolidated financial statements.*

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**Liquidity Services, Inc. and Subsidiaries**  
**Consolidated Statements of Comprehensive Income**  
**(In Thousands)**

	Year ended September 30,		
	2014	2013	2012
Net income	\$ 30,390	\$ 41,104	\$ 48,296
Other comprehensive (loss) income:			
Defined benefit pension plan unrecognized amounts, net of taxes	(927)	563	584
Foreign currency translation	(3,042)	(1,291)	610
Other comprehensive (loss) income, net of taxes	(3,969)	(728)	1,194
Comprehensive income	\$ 26,421	\$ 40,376	\$ 49,490

*See accompanying notes to the consolidated financial statements.*



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**Liquidity Services, Inc. and Subsidiaries**  
**Consolidated Statements of Changes in Stockholders' Equity**  
(In Thousands Except Share Data)

	Treasury Stock		Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
	Shares	Amount	Shares	Amount				
Balance at September 30, 2011	(2,162,056)	\$ (21,884)	31,192,608	\$ 29	\$ 124,886	\$ 52	\$ 58,330	\$ 161,413
Common stock repurchase	(505,067)	(29,999)						(29,999)
Common stock retired	2,667,123	51,883	(2,667,123)		(11,622)		(40,261)	
Exercise of common stock options and restricted stock			1,712,455	1	15,490			15,491
Stock consideration paid for acquisition			900,171	1	24,537			24,538
Compensation expense and incremental tax benefit from grant of common stock options and restricted stock					29,070			29,070
Net income							48,296	48,296
Defined benefit pension plan unrecognized amounts, net of taxes						584		584
Foreign currency translation						610		610
Balance at September 30, 2012			31,138,111	31	182,361	1,246	66,365	250,003
Exercise of common stock options and restricted stock			673,653		2,532			2,532
Compensation expense and incremental tax benefit from grant of common stock options and restricted stock					21,968			21,968
Net income							41,104	41,104
Defined benefit pension plan unrecognized amounts, net of taxes						563		563
Foreign currency translation and other						(1,291)		(1,291)
Balance at September 30, 2013			31,811,764	\$ 31	\$ 206,861	\$ 518	\$ 107,469	\$ 314,879
Common stock repurchase	(2,962,978)	(44,870)		(3)				(44,873)
Common stock retired	2,962,978	44,870	(2,962,978)		(22,713)		(22,157)	
Exercise of common stock options and restricted stock			819,364		4,146			4,146
Compensation expense and incremental tax benefit from grant of common stock options and restricted stock					16,410			16,410
Net income							30,390	30,390
Defined benefit pension plan unrecognized amounts, net of taxes						(927)		(927)
Foreign currency translation						(3,042)		(3,042)
Balance at September 30, 2014		\$	29,668,150	\$ 28	\$ 204,704	\$ (3,451)	\$ 115,702	\$ 316,983

*See accompanying notes to the consolidated financial statements.*



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**Liquidity Services, Inc. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
(In Thousands)

	2014	2013	2012
<b>Operating activities</b>			
Net income	\$ 30,390	\$ 41,104	\$ 48,296
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	16,595	17,374	14,166
Gain on early extinguishment of debt		(1,000)	
Change in fair value of earn out liability	(18,390)	5,437	(664)
Stock compensation expense	12,605	13,379	12,117
Provision (benefit) for inventory allowance	271	(1,122)	884
Provision (benefit) for doubtful accounts	151	(357)	117
Deferred tax expense (benefit)	828	(6,852)	(1,719)
Incremental tax benefit from exercise of common stock options and restricted stock	(3,805)	(8,588)	(16,953)
Changes in operating assets and liabilities:			
Accounts receivable	2,211	(7,466)	(1,596)
Inventory	(49,488)	(7,470)	(132)
Prepaid and deferred taxes, current	(2,829)	14,243	17,432
Prepaid expenses and other assets	2,735	(26)	458
Accounts payable	(545)	6,542	(7,570)
Accrued expenses and other	9,659	(2,341)	(8,534)
Profit-sharing distributions payable	425	274	(3,226)
Customer payables	12,046	(4,768)	2,510
Acquisition earn out payable		(11,422)	(3,162)
Other liabilities	(1,003)	(198)	205
Net cash provided by operating activities from continuing operations	11,856	46,743	52,629
Net cash used by operating activities from discontinued operations			(483)
Net cash provided by operating activities	11,856	46,743	52,146
<b>Investing activities</b>			
Cash paid for acquisitions and increase in goodwill and intangibles	(141)	(14,730)	(71,796)
Purchases of property and equipment	(7,539)	(5,463)	(6,793)
Net cash used in investing activities	(7,680)	(20,193)	(78,589)
<b>Financing activities</b>			
Principal repayments of debt		(39,000)	
Repurchases of common stock	(44,873)		(29,999)
Proceeds from exercise of common stock options (net of tax)	4,146	2,532	15,491
Incremental tax benefit from exercise of common stock options and restricted stock	3,805	8,588	16,953
Payment of acquisition contingent liabilities		(8,185)	
Net cash (used in) provided by financing activities	(36,922)	(36,065)	2,445
Effect of exchange rate differences on cash and cash equivalents	235	(158)	(309)

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Net (decrease) increase in cash and cash equivalents	(32,511)	(9,673)	(24,307)
Cash and cash equivalents at beginning of year	95,109	104,782	129,089

Cash and cash equivalents at end of year \$ 62,598 \$ 95,109 \$ 104,782

**Supplemental disclosure of cash flow information**

Cash paid for income taxes	\$ 18,108	\$ 16,760	\$ 14,482
Cash paid for interest		2,034	117
Note payable issued in connection with acquisition			40,000
Contingent purchase price accrued		18,390	7,438

*See accompanying notes to the consolidated financial statements.*

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**Liquidity Services, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

**1. Organization**

Liquidity Services, Inc. and subsidiaries (LSI or the Company) is a leading online auction marketplace for surplus and salvage assets. LSI enables buyers and sellers to transact in an efficient, automated online auction environment offering over 500 product categories. The Company's marketplaces provide professional buyers access to a global, organized supply of surplus and salvage assets presented with digital images and other relevant product information. Additionally, LSI enables its 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. LSI organizes its products into categories across major industry verticals such as consumer electronics, general merchandise, apparel, scientific equipment, aerospace parts and equipment, technology hardware, energy equipment, industrial capital assets, fleet and transportation equipment and specialty equipment. The Company's online auction marketplaces are [www.liquidation.com](http://www.liquidation.com), [www.govliquidation.com](http://www.govliquidation.com), [www.govdeals.com](http://www.govdeals.com), [www.networkintl.com](http://www.networkintl.com), [www.truckcenter.com](http://www.truckcenter.com), [www.secondipity.com](http://www.secondipity.com), and [www.go-dove.com](http://www.go-dove.com). LSI has one reportable segment consisting of operating auction marketplaces for sellers and buyers of surplus, salvage and scrap assets. In fiscal year 2014, approximately 10.1% of the Company's revenue was generated outside of the U.S.

The Company's operations are subject to certain risks and uncertainties associated with technology-oriented companies including, but not limited to, the Company's dependence on use of the Internet, the effect of general business and economic trends, its susceptibility to rapid technological change, actual and potential competition by entities with greater financial resources, and the potential for the U.S. Government agencies from which the Company has derived a significant portion of its inventory to change the way they conduct their surplus disposition or to otherwise not renew their contracts with the Company.

The Company has evaluated subsequent events through the date that these financial statements were issued and filed with the Securities and Exchange Commission.

**2. Summary of Significant Accounting Policies**

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

**Principles of Consolidation and Basis of Presentation**

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Certain prior period amounts have been reclassified to conform to the current year's presentation. All intercompany balances and transactions have been eliminated in consolidation.

The accompanying consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. In addition, in the opinion of management, all adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation of the results for the periods presented have been included.

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**Liquidity Services, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

**Discontinued Operations**

In determining whether a group of assets disposed (or to be disposed) of should be presented as discontinued operations, the Company makes a determination of whether the group of assets being disposed of comprises a component of the entity; that is, whether it has historical operations and cash flows that can be clearly distinguished (both operationally and for financial reporting purposes). The Company also determines whether the cash flows associated with the group of assets have been significantly (or will be significantly) eliminated from the ongoing operations of the Company as a result of the disposal transaction and whether the Company has no significant continuing involvement in the operations of the group of assets after the disposal transaction. If these determinations can be made affirmatively, the results of operations of the group of assets being disposed of (as well as any gain or loss on the disposal transaction) are aggregated for separate presentation apart from continuing operating results of the Company in the consolidated financial statements.

**Business Combinations**

The Company recognizes all of the assets acquired, liabilities assumed, contractual contingencies, and contingent consideration at their fair value on the acquisition date. Acquisition-related costs are recognized separately from the acquisition and expensed as incurred. Restructuring costs incurred in periods subsequent to the acquisition date are expensed when incurred. Subsequent changes to the purchase price (*i.e.*, working capital adjustments) or other fair value adjustments determined during the measurement period are recorded as an adjustment to goodwill, with the exception of contingent consideration, which is recognized in the statement of operations in the period it is modified. All subsequent changes to a valuation allowance or uncertain tax position that relate to the acquired company and existed at the acquisition date that occur both within the measurement period and as a result of facts and circumstances that existed at the acquisition date are recognized as an adjustment to goodwill. All other changes in valuation allowances are recognized as a reduction or increase to income tax expense or as a direct adjustment to additional paid-in capital as required.

**Cash and Cash Equivalents**

The Company considers all highly liquid securities purchased with an initial maturity of three months or less to be cash equivalents.

**Accounts Receivable**

Accounts receivable are recorded at the invoiced amount and are non-interest bearing. The Company maintains an allowance for doubtful accounts to reserve for potentially uncollectible receivables. Allowances are based on management's judgment, which considers historical experience and specific knowledge of accounts where collectability may not be probable. The Company makes provisions based on historical bad debt experience, a specific review of all significant outstanding invoices and an assessment of general economic conditions.

**Inventory**

Inventory consists of property obtained for resale, generally through the online auction process, and is stated at the lower of cost or market. Cost is determined using the specific identification method. Charges for unsellable inventory are included in cost of goods sold in the period in which they have been determined to occur.

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**Liquidity Services, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

**Property and Equipment**

Property and equipment is recorded at cost, and depreciated and amortized on a straight-line basis over the following estimated useful lives:

Computers and purchased software	One to five years
Office equipment	Three years
Furniture and fixtures	Five to seven years
Leasehold improvements	Shorter of lease term or useful life

**Intangible Assets**

Intangible assets primarily consist of contract acquisition costs, covenants not to compete, and other intangible assets associated with acquisitions (see Note 4). Intangible assets are amortized using the straight-line method over their estimated useful lives, ranging from three to seven years.

**Impairment of Long-Lived Assets**

Long-lived assets, including amortizable intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. If an impairment indicator is present, the Company evaluates recoverability by comparing the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If the assets are impaired, the impairment recognized is measured by the amount by which the carrying amount exceeds the estimated fair value of the assets.

**Goodwill**

Goodwill is reviewed for impairment annually or more frequently if events or circumstances indicate impairment may exist. Examples of such events or circumstances could include a significant change in business climate or the loss of a significant customer. In evaluating goodwill for impairment, the Company first assesses qualitative factors to determine whether it is more than likely than not (that is, a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount. If the Company concludes that it is not more likely than not that the fair value of the reporting unit is less than its carrying value, no further testing of goodwill assigned to the reporting unit is required. However, if the Company concludes that it is more likely than not that the fair value of a reporting unit is less than its carrying value, the Company applies a two-step fair value-based test to assess goodwill for impairment. The first step compares the fair value of a reporting unit to its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the second step is then performed. The second step compares the carrying amount of the reporting unit's goodwill to the fair value of the goodwill. If the fair value of the goodwill is less than the carrying amount, an impairment loss would be recorded in the statement of operations.

**Revenue Recognition**

The Company recognizes revenue when all of the following criteria are met:

a buyer submits the winning bid in an auction and, as a result, evidence of an arrangement exists and the sale price has been determined;

the buyer has assumed the risks and rewards of ownership; and

collection is reasonably assured.





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**Liquidity Services, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

Revenue is also evaluated for reporting revenue of gross proceeds as the principal in the arrangement or net of commissions as an agent. In arrangements in which the Company is deemed to be the primary obligor, bears physical and general inventory risk, and credit risk, LSI recognizes as revenue the gross proceeds from the sale, including buyer's premiums. The Company has evaluated its revenue recognition policy related to sales under LSI's profit-sharing model and determined it is appropriate to account for these sales on a gross basis. In the Company's evaluation, the Company relied most heavily upon its status as primary obligor in the sales relationship and the fact that the Company has general inventory risk.

In arrangements in which the Company acts as an agent or broker on a consignment basis, without taking physical or general inventory risk, revenue is recognized based on the sales commissions that are paid to the Company by the sellers for utilizing LSI's services; in this situation, sales commissions represent a percentage of the gross proceeds from the sale that the seller pays to the Company upon completion of the transaction. Such revenue as well as other fee revenue is presented as Fee Revenue in the Consolidated Statements of Operations.

The Company collects and remits sales taxes on merchandise that it purchases and sells, and reports such amounts under the net method in its Consolidated Statements of Operations.

**Cost of Goods Sold**

Cost of goods sold includes the costs of purchasing and transporting property for auction as well as credit card transaction fees. The Company purchases the majority of its inventory at a percentage of the supplier's original acquisition cost under the Surplus and certain commercial contracts, a percentage of the supplier's last retail price under certain commercial contracts and varies depending on the type of the inventory purchased or a fixed price per pound under the Scrap Contract. Title for the inventory passes to the Company at the time of purchase and the Company bears the risks and rewards of ownership. The Company does not have title to assets sold on behalf of its commercial or government customers when it receives only sales commission revenue and, as such, recognizes no cost of goods sold associated with those sales. Cost of goods sold also includes shipping and handling costs and amounts paid by customers for shipping and handling.

**Risk Associated with Certain Concentrations**

The Company does not perform credit evaluations for the majority of its buyers. However, substantially all sales are recorded subsequent to payment authorization being received. As a result, the Company is not subject to significant collection risk, as most goods are not shipped before payment is received.

For consignment sales transactions, funds are collected from buyers and are held by the Company on the sellers' behalf. The funds are included in cash and cash equivalents in the consolidated financial statements. The Company releases the funds to the seller, less the Company's commission and other fees due, after the buyer has accepted the goods or within 30 days, depending on the state where the buyer and seller conduct business. The amount of cash held on behalf of the sellers is recorded as customer payables in the accompanying Consolidated Balance Sheets.

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents in banks over FDIC limits, and accounts receivable.

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**Liquidity Services, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

The Company deposits its cash with financial institutions that the Company considers to be of high credit quality.

For the years ended September 30, 2014, 2013, and 2012, approximately 11%, 11%, and 20% of the Company's Gross Merchandise Volume (GMV) was generated from Wal-Mart under multiple contracts / programs.

**Income Taxes**

The Company accounts for income taxes using an asset and liability approach for measuring deferred taxes based on temporary differences between the financial statement and income tax bases of assets and liabilities existing at each balance sheet date using enacted tax rates for the years in which the taxes are expected to be paid or recovered. A valuation allowance is provided to reduce the deferred tax assets to a level that the Company believes will more likely than not be realized. The resulting net deferred tax asset reflects management's estimate of the amount that will be realized.

The Company applies the authoritative guidance related to uncertainty in income taxes. The Company has concluded that there were no uncertain tax positions identified during its analysis.

**Stock-Based Compensation**

The Company estimates the fair value of share-based awards on the date of grant. The fair value of stock options is determined using the Black-Scholes option-pricing model. The fair value of restricted stock awards is based on the closing price of the Company's common stock on the date of grant. The determination of the fair value of the Company's stock option awards and restricted stock awards is based on a variety of factors including, but not limited to, the Company's common stock price, expected stock price volatility over the expected life of awards based on historical realized volatility, and actual and projected exercise behavior. Additionally, the Company has estimated forfeitures for share-based awards at the dates of grant based on historical experience, adjusted for future expectation. The forfeiture estimate is revised as necessary if actual forfeitures differ from materially these estimates.

The Company issues restricted stock awards where restrictions lapse upon either the passage of time (service vesting), achieving performance targets, or some combination of these restrictions. For those restricted stock awards with only service conditions, the Company recognizes compensation cost on a straight-line basis over the explicit service period. For awards with both performance and service conditions, the Company starts recognizing compensation cost over the remaining service period, when it is probable the performance condition will be met. For stock awards that contain performance vesting conditions, the Company excludes these awards from diluted earnings per share computations until the contingency is met as of the end of that reporting period. For awards to non-employees (who are not directors), the Company records compensation cost when the performance condition is met. The Company presents the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) as a financing activity with a corresponding operating cash outflow in the Consolidated Statements of Cash Flows.

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**Liquidity Services, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

**Advertising Costs**

Advertising expenditures are expensed as incurred. Advertising costs charged to expense were \$7,229,000, \$4,560,000, and \$4,939,000 for the years ended September 30, 2014, 2013 and 2012, respectively.

**Fair Value of Financial Instruments**

Cash and cash equivalents, accounts receivable, accounts payable, profit-sharing distributions payable, and customer payables reported in the Consolidated Balance Sheets approximate their fair values.

**Foreign Currency Translation**

The functional currency of the Company's foreign subsidiaries is the local currency. The translation of the subsidiary's financial statements into U.S. dollars is performed for balance sheet accounts using exchange rates in effect at the balance sheet date and for revenue and expense accounts using an average exchange rate during the period. The resulting translation adjustments are recognized in accumulated other comprehensive income, a separate component of stockholders' equity. Realized foreign currency transaction gains and losses for 2012, 2013 and 2014 are included in interest expense and other expense (income), net in the consolidated statements of operations.

**Earnings per Share**

Basic net income attributable to common stockholders per share is computed by dividing net income attributable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted net income attributable to common stockholders per share includes the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The Company had 1,399,609 unvested restricted shares, which were issued at prices ranging from \$7.48 - \$52.55, during the years ended September 30, 2012, 2011, 2010, and 2009, of which all have been included in the calculation of diluted income per share for the year ended September 30, 2012. The Company had 1,543,869 unvested restricted shares, which were issued at prices ranging from \$7.48 - \$52.55, during the years ended September 30, 2013, 2012, 2011, 2010, and 2009, of which 383,831 have been included in the calculation of diluted income per share for the year ended September 30, 2013. The Company had 1,897,827 unvested restricted shares, which were issued at prices ranging from \$7.48 - \$52.55, during the years ended September 30, 2014, 2013, 2011, 2010, and 2009, of which 341,137 have been included in the calculation of diluted income per share for the year ended September 30, 2014. The Company has also not included the following stock options in the calculation of diluted income per share because the option exercise prices were greater than the average market prices for the applicable periods:

- (a) for the fiscal year ended September 30, 2014 - 836,303 options;
- (b) for the fiscal year ended September 30, 2013 - 151,291 options; and
- (c) for the fiscal year ended September 30, 2012 - 0 options.

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**Liquidity Services, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

The following summarizes the potential outstanding common stock of the Company as of the dates set forth below:

	2014	September 30, 2013	2012
	(dollars in thousands except per share and share data)		
Weighted average shares calculation:			
Basic weighted average shares outstanding	31,243,932	31,616,926	30,854,796
Treasury stock effect of options and restricted stock	151,369	1,040,310	1,928,283
Diluted weighted average common shares outstanding	31,395,301	32,657,236	32,783,079
Net income	\$ 30,390	\$ 41,104	\$ 48,296