

LIQUIDITY SERVICES INC  
Form 10-Q  
May 09, 2014  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended March 31, 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)

(Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report)

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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (section 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 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.

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

The number of shares outstanding of the issuer's common stock, par value \$.001 per share, as of May 2, 2014 was 32,075,793.



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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements.****Liquidity Services, Inc. and Subsidiaries****Consolidated Balance Sheets****(Dollars in Thousands)**

	<b>March 31, 2014 (Unaudited)</b>	<b>September 30, 2013</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 101,766	\$ 95,109
Accounts receivable, net of allowance for doubtful accounts of \$982 and \$891 at March 31, 2014 and September 30, 2013, respectively	27,055	24,050
Inventory	71,640	29,261
Prepaid and deferred taxes	18,993	11,243
Prepaid expenses and other current assets	6,136	4,802
Total current assets	225,590	164,465
Property and equipment, net	12,448	10,380
Intangible assets, net	22,223	28,205
Goodwill	210,824	211,711
Other assets	7,240	6,583
Total assets	\$ 478,325	\$ 421,344
<b>Liabilities and stockholders equity</b>		
Current liabilities:		
Accounts payable	\$ 21,897	\$ 16,539
Accrued expenses and other current liabilities	64,369	34,825
Profit-sharing distributions payable	4,652	4,315
Customer payables	32,116	29,497
Total current liabilities	123,034	85,176
Acquisition earn out payables	18,565	18,390
Deferred taxes and other long-term liabilities	2,248	2,899
Total liabilities	143,847	106,465
Stockholders equity:		
Common stock, \$0.001 par value; 120,000,000 shares authorized; 32,402,148 shares issued and 32,273,582 shares outstanding at March 31, 2014; 31,811,764 shares issued and outstanding at September 30, 2013	31	31
Treasury stock	(3,057)	
Additional paid-in capital	218,955	206,861
Accumulated other comprehensive income	(1,644)	518
Retained earnings	120,193	107,469
Total stockholders equity	334,478	314,879
Total liabilities and stockholders equity	\$ 478,325	\$ 421,344



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

	<b>Three Months Ended March 31,</b>		<b>Six Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Revenue	\$ 102,920	\$ 106,199	\$ 196,390	\$ 207,528
Fee revenue	25,409	24,125	53,887	45,001
Total revenue	128,329	130,324	250,277	252,529
Costs and expenses:				
Cost of goods sold (excluding amortization)	54,273	49,946	101,983	97,068
Profit-sharing distributions	8,299	9,942	18,429	18,352
Technology and operations	29,070	22,407	54,691	44,954
Sales and marketing	10,459	9,973	20,290	20,301
General and administrative	12,435	11,839	24,742	25,807
Amortization of contract intangibles	2,272	2,407	4,679	4,617
Depreciation and amortization	1,973	1,980	3,977	3,967
Acquisition costs	85	212	180	5,588
Total costs and expenses	118,866	108,706	228,971	220,654
Income from operations	9,463	21,618	21,306	31,875
Interest and other (expense) income, net	(79)	(96)	(100)	828
Income before provision for income taxes	9,384	21,522	21,206	32,703
Provision for income taxes	(3,753)	(8,824)	(8,482)	(13,296)
Net income	\$ 5,631	\$ 12,698	\$ 12,724	\$ 19,407
Basic earnings per common share	\$ 0.17	\$ 0.40	\$ 0.39	\$ 0.62
Diluted earnings per common share	\$ 0.17	\$ 0.39	\$ 0.39	\$ 0.59
Basic weighted average shares outstanding	32,231,011	31,561,412	32,187,038	31,522,133
Diluted weighted average shares outstanding	32,321,482	32,331,686	32,489,776	32,692,975

*See accompanying notes to the unaudited consolidated financial statements.*

Table of Contents**Liquidity Services, Inc. and Subsidiaries****Unaudited Consolidated Statements of Comprehensive Income****(Dollars in Thousands)**

	<b>Three Months Ended March 31,</b>		<b>Six Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Net income	\$ 5,631	\$ 12,698	\$ 12,724	\$ 19,407
Other comprehensive income (loss):				
Foreign currency translation	(1,633)	(1,826)	(2,162)	(2,094)
Other comprehensive income (loss), net of taxes	(1,633)	(1,826)	(2,162)	(2,094)
Comprehensive income	\$ 3,998	\$ 10,872	\$ 10,562	\$ 17,313

*See accompanying notes to the unaudited consolidated financial statements.*

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

	Treasury Stock		Common Stock		Additional	Accumulated	Retained	Total
	Shares	Amount	Shares	Amount	Paid-in	Other	Earnings	
					Capital	Comprehensive		
Balance at September 30, 2013			31,811,764	\$ 31	\$ 206,861	\$ 518	\$ 107,469	\$ 314,879
Common stock repurchased	(128,566)	(3,057)						(3,057)
Exercise of common stock options and restricted stock			590,384		2,230			2,230
Compensation expense and incremental tax benefit from grants of common stock options and restricted stock					9,864			9,864
Comprehensive income:								
Net income							12,724	12,724
Foreign currency translation						(2,162)		(2,162)
Balance at March 31, 2014	(128,566)	\$ (3,057)	32,402,148	\$ 31	\$ 218,955	\$ (1,644)	\$ 120,193	\$ 334,478

*See accompanying notes to the unaudited consolidated financial statements.*

Table of Contents**Liquidity Services, Inc. and Subsidiaries****Unaudited Consolidated Statements of Cash Flows****(In Thousands Except Share Data)**

	<b>Six Months Ended March</b>	
	<b>2014</b>	<b>31,</b>
		<b>2013</b>
<b>Operating activities</b>		
Net income	\$ 12,724	\$ 19,407
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,655	8,584
Gain on early extinguishment of debt		(1,000)
Stock compensation expense	6,567	7,302
Provision (benefit) for inventory allowance	291	(733)
Provision (benefit) for doubtful accounts	91	(107)
Incremental tax benefit from exercise of common stock options	(3,296)	(5,376)
Changes in operating assets and liabilities:		
Accounts receivable	(3,096)	(1,891)
Inventory	(42,670)	(3,779)
Prepaid and deferred taxes	(7,750)	(5,295)
Prepaid expenses and other assets	1,305	3,328
Accounts payable	5,358	766
Accrued expenses and other	29,543	(6,019)
Profit-sharing distributions payable	337	273
Customer payables	2,619	586
Acquisition earn out payables	175	(6,168)
Other liabilities	(1,796)	538
Net cash provided by operating activities	9,057	10,416
<b>Investing activities</b>		
Increase in goodwill and intangibles and cash paid for acquisitions		(14,698)
Purchases of property and equipment	(4,950)	(2,521)
Net cash used in investing activities	(4,950)	(17,219)
<b>Financing activities</b>		
Repayment of notes payable		(39,000)
Payment of acquisition contingent liabilities		(8,185)
Proceeds from exercise of common stock options (net of tax)	2,231	504
Repurchases of common stock	(3,057)	
Incremental tax benefit from exercise of common stock options	3,296	5,376
Net cash provided by (used in) financing activities	2,470	(41,305)
Effect of exchange rate differences on cash and cash equivalents	80	524
Net increase (decrease) in cash and cash equivalents	6,657	(47,584)
Cash and cash equivalents at beginning of period	95,109	104,782
Cash and cash equivalents at end of period	\$ 101,766	\$ 57,198
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for income taxes	\$ 12,974	\$ 10,493
Cash paid for interest		2,023
Contingent purchase price accrued		23,146

*See accompanying notes to the unaudited consolidated financial statements.*



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**Liquidity Services, Inc. and Subsidiaries**

**Notes to the Unaudited Consolidated Financial Statements**

**1. Organization**

Liquidity Services, Inc. and subsidiaries (LSI or the Company) operates leading auction marketplaces 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 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.

**2. Summary of Significant Accounting Policies**

**Unaudited Interim Financial Information**

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial information. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal, recurring adjustments, considered necessary for a fair presentation have been included. The information disclosed in the notes to the consolidated financial statements for these periods is unaudited. Operating results for the three months ended March 31, 2014 are not necessarily indicative of the results that may be expected for the year ending September 30, 2014 or any future period. Fee revenue is revenue earned under the consignment model, as well as other fee revenue, and is presented separately as it accounts for more than 10% of total revenue.

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

**New Accounting Pronouncements**

In February 2013, the FASB issued Accounting Standards Update (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

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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 notes 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 in the Company's fiscal 2014 first quarter. Adoption of the disclosure requirements did not have a significant impact on 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. Generally, 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 expensed 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.

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**Liquidity Services, Inc. and Subsidiaries**

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

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

**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.

**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 1,557,502 unvested restricted shares outstanding at March 31, 2014, which were issued at prices ranging from \$7.48 to \$52.55, of which 235,354 and 181,406, and 249,403 and 543,248 shares have been excluded in the calculation of diluted income per share for the three and six months ended March 31, 2014 and 2013, respectively, due to the difference between the issuance price and the average market price for the period in which they have been outstanding. The Company has also excluded the following stock options in its calculation of diluted income per share because the option exercise prices were greater than the average market prices for the applicable period:

- (a) for the three months ended March 31, 2014, 77,290 options;
- (b) for the six months ended March 31, 2014, 75,387 options;
- (c) for the three months ended March 31, 2013, 121,521 options; and
- (d) for the six months ended March 31, 2013, 121,521 options.

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2014	2013	2014	2013
	(unaudited)			
	(dollars in thousands, except per share amounts)			
Weighted average shares calculation:				
Basic weighted average shares outstanding	32,231,011	31,561,412	32,187,038	31,522,133
Treasury stock effect of options and restricted stock	90,471	770,274	302,738	1,170,842
Diluted weighted average common shares outstanding	32,321,482	32,331,686	32,489,776	32,692,975
Net income	\$ 5,631	\$ 12,698	\$ 12,723	\$ 19,407
Basic income per common share	\$ 0.17	\$ 0.40	\$ 0.39	\$ 0.62
Diluted income per common share	\$ 0.17	\$ 0.39	\$ 0.39	\$ 0.59

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**Liquidity Services, Inc. and Subsidiaries**

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

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

**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, 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 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.

**3. Defense Logistics Agency (DLA) Disposition Services Contracts**

The Company has a Surplus Contract with the DLA Disposition Services in which the base term expired in February 2012 with two one year renewal options. 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 Surplus Contract for a base term of ten months with two one-month renewal option periods. Under the Surplus Contract, the Company is required to purchase all usable surplus property offered to the Company by the Department of Defense at a fixed percentage equal to 1.8% of the DoD's original acquisition value. The Company retains 100% of the profits from the resale of the property and bears all of the costs for the merchandising and sale of the property. Included in Accrued expenses and other current liabilities in the Consolidated Balance Sheet the Company has a liability to the DoD of approximately \$36,434,000 and \$9,257,000 for inventory as of March 31, 2014 and September 30, 2013, respectively. The Surplus Contract contains a provision providing for a mutual termination of the contract for convenience.

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As a result of the Surplus Contract, the Company is the sole remarketer of all DoD surplus turned into the DLA Disposition Services available for sale within the United States, Puerto Rico, and Guam.

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 original acquisition value (OAV). Later this month, the DoD is expected to formally award the contract. 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. Final contract awards are subject to a protest period and a pre-award survey by the DoD regarding the bidder's ability to satisfactorily perform the work in accordance with their technical proposal submitted in step-one of the solicitation. Based on the unofficial April 1-2 bid results, 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, 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 rolling stock and non-rolling stock assets, for the base term ending December 2014, with two additional one-month renewal options.

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**Liquidity Services, Inc. and Subsidiaries**

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

**3. Defense Logistics Agency (DLA) Disposition Services Contracts (continued)**

The Company has a Scrap Contract with the DLA Disposition Services in which the base term expired in June 2012 with three one year renewal options. The DoD has exercised all three renewal options. Under the terms of the Scrap Contract, the Company is required to purchase all scrap government property referred to it by the DLA Disposition Services. The Company distributes to the DLA Disposition Services 77% of the profits realized from the ultimate sale of the inventory, after deduction for allowable expenses, as provided for under the terms of the contract. The Contract also has a performance incentive that allows the Company to receive up to an additional 2% of the profit sharing distribution. This incentive is measured annually on June 30th, and is applied to the prior 12 months. For the three and six months ended March 31, 2014 and 2013 profit-sharing distributions to the DLA Disposition Services under the Scrap Contract were \$8,299,000 and \$18,429,000; and \$9,943,000 and \$18,352,000, respectively, including accrued amounts, as of March 31, 2014 and 2013, of \$4,652,000 and \$4,314,000, respectively. The Scrap Contract may be terminated by either the Company or the DLA Disposition Services if the rate of return performance ratio does not exceed specified benchmark ratios for two consecutive quarterly periods and the preceding twelve months. The Company has performed in excess of the benchmark ratios throughout the contract period through March 31, 2014.

As a result of the Scrap Contract, the Company is the sole remarketer of all U.S. Department of Defense scrap turned into the DLA Disposition Services available for sale within the United States, Puerto Rico, and Guam.

**4. Acquisitions**

**National Electronic Service Association (NESA)**

On November 1, 2012, the Company acquired the assets and assumed liabilities of National Electronic Service Association (NESA) in an all cash transaction. The acquisition price included an upfront cash payment of approximately \$18.3 million and an earn-out payment. Under the terms of the agreement, the earn-out is based on EBITDA earned by NESA during the 36-48 months after closing. EBITDA growth used in the calculation is capped at 20% of prior period. The Company's estimate for the total payout ranges from zero to a maximum of \$37.7 million. The Company's estimate of the fair value of the earn-out as of the date of acquisition was \$18.0 million. As of March 31, 2014, the Company's best estimate of the fair value of the earn-out is \$18.6 million. NESA is a Canadian provider of returns management, refurbishment and reverse logistics services for high-value consumer products. NESA provides expertise and focused services to Fortune 1000 companies in the management of Consumer Electronics, Telecommunications, and Information Technology products.

Under the acquisition method of accounting, the total estimated purchase price is allocated to NESA's net tangible and intangible assets acquired based on their estimated fair values as of November 1, 2012. Based on management's valuation of the fair value of tangible and intangible assets acquired and liabilities assumed, the purchase price was allocated as follows:

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	<b>Consideration Amount (in thousands)</b>
Cash	\$ 3,760
Goodwill	27,009
Vendor contract intangible asset	3,936
Covenants not to compete	1,400
Other intangible asset	225
Property and equipment	234
Accrued liabilities	(204)
Total consideration	\$ 36,360

Goodwill was created as part of the acquisition as the Company acquired an experienced and knowledgeable workforce, 75% of which is expected to be tax deductible as a result of the asset purchase structure of the transaction. The amount of revenue from NESA since the acquisition date and the related supplemental pro forma information is not significant and it is impracticable for us to determine the amount of earnings for NESA.

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**Liquidity Services, Inc. and Subsidiaries**  
**Notes to the Unaudited Consolidated Financial Statements (Continued)**

**5. Goodwill**

The goodwill of acquired companies is primarily related to the acquisition of an experienced and knowledgeable workforce. The following summarizes the Company's goodwill activity for the periods indicated:

		<b>Goodwill</b> <b>(in thousands)</b>
Balance at September 30, 2013	\$	211,711
Translation adjustments		(887)
Balance at March 31, 2014	\$	210,824

**6. Intangible Assets**

Intangible assets at March 31, 2014 and September 30, 2013 consisted of the following:

	Useful Life (in years)	Gross Carrying Amount	March 31, 2014		September 30, 2013		Net Carrying Amount
			Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	
(dollars in thousands)							
Contract intangibles	2 - 5	\$ 36,806	\$ (21,144)	\$ 15,662	\$ 37,236	\$ (16,696)	\$ 20,540
Brand and technology	3 - 5	5,950	(2,258)	3,692	5,965	(1,666)	4,299
Covenants not to compete	3 - 5	4,348	(1,837)	2,511	4,440	(1,439)	3,001
Patent and trademarks	3 - 10	536	(178)	358	509	(144)	365
Total intangible assets, net				\$ 22,223			\$ 28,205

Future expected amortization of intangible assets at March 31, 2014 was as follows:

Years ending September 30,	Future Amortization (in thousands)
2014 (remaining six months)	\$ 5,205
2015	9,354
2016	6,267
2017	1,246
2018 and after	151
Total	\$ 22,223



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**Liquidity Services, Inc. and Subsidiaries**

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

**7. Debt**

**Senior Credit Facility**

The Company entered into a senior credit facility (the Agreement) with a bank, which provides for borrowings up to \$75.0 million, as amended. On March 11, 2014, the Company amended this credit facility extending the term to May 31, 2015. Borrowings under the Agreement bear interest at an annual rate equal to the 30 day LIBOR rate plus 1.25% (1.404% at March 31, 2014) due monthly. As of September 30, 2013 and March 31, 2014, the Company had no outstanding borrowings under the Agreement, and the Company's borrowing availability was \$67.8 million and \$65.1 million, respectively, due to issued letters of credit for \$7.2 million and \$9.9 million, respectively.

Borrowings under the Agreement are secured by substantially all of the assets of the Company. 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. As of March 31, 2014, the Company was in compliance with these covenants.

**Subordinated Note**

In conjunction with the Jacobs Trading acquisition, the Company issued a \$40,000,000 seller subordinated 5% unsecured note. The note was repaid in full in November 2012. In conjunction with the repayment, the Company received a \$1.0 million discount on the principal. This gain on the early extinguishment of debt has been reflected in interest expense and other income (expense) in the Consolidated Statement of Operations.

**8. Income Taxes**

The Company's interim effective income tax rate is based on management's best current estimate of the expected annual effective income tax rate. The Company estimates that its fiscal year 2014 tax rate will be approximately 40%.

The Company applies the guidance related to uncertainty in income taxes. The Company has concluded that there were no uncertain tax positions identified during its analysis. The Company's policy is to recognize interest and penalties in the period in which they occur in the income tax provision. The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, various state and local

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jurisdictions and in foreign jurisdictions, primarily Canada and the U.K. Currently, the Company is subject to income tax examination for fiscal 2011. The Company anticipates no material tax liability to arise from this examination. The statute of limitations for years prior to fiscal 2010 is now closed. However, certain tax attribute carryforwards that were generated prior to fiscal 2010 may be adjusted upon examination by tax authorities if they are utilized.

Table of Contents**Liquidity Services, Inc. and Subsidiaries****Notes to the Unaudited Consolidated Financial Statements (Continued)****9. Stockholders' Equity****Share Repurchase Program**

The Company's Board of Directors has approved the repurchase of up to \$101.9 million in shares under a share repurchase program. Under the program, the Company is authorized to repurchase the 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 the Company's available cash. The Company's Board of Directors reviews the share repurchase program periodically, the last such review having occurred in February 2014. A summary of the Company's share repurchase activity from fiscal year 2009 to the three months ended December 31, 2013 and March 31, 2014 is as follows:

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
3 Months Ending 12/31/13				31,000,000
3 Months Ending 3/31/14	128,566	\$ 23.87	3,057,000	46,943,000

(1) On December 2, 2008, the Company's Board of Directors approved a share repurchase program, under which the Company was 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, the Company's Board of Directors approved an additional \$10.0 million for the share repurchase program. On May 17, 2012, the Company's Board of Directors approved an additional \$30.0 million for the share repurchase program. On December 12, 2013, the Company's Board of Directors approved an additional approximately \$12.9 million for the share repurchase program. On February 5, 2014, the Company's Board of Directors approved an additional \$19.0 million for the share repurchase program.

Table of Contents**Liquidity Services, Inc. and Subsidiaries****Notes to the Unaudited Consolidated Financial Statements (Continued)****9. Stockholders Equity (continued)****2006 Omnibus Long-Term Incentive Plan (the 2006 Plan)**

Under the 2006 Plan, as amended, 10,000,000 shares of common stock were available for issuance. At September 30, 2012, there were 2,553,574 shares remaining reserved for issuance in connection with awards under the 2006 Plan. During fiscal year 2013, the Company granted options to purchase 171,994 shares to employees and directors with exercise prices between \$29.47 and \$46.72, and options to purchase 32,244 shares were forfeited. During fiscal year 2013, the Company granted 997,857 restricted shares to employees and directors at prices ranging from \$29.47 to \$42.47, and 403,083 restricted shares were forfeited. During the twelve months ended September 30, 2013, the Company issued 335,000 restricted shares and cancelled 281,500 issued restricted shares to a non-employee that vest based on performance conditions. At September 30, 2013, there were 1,819,050 shares remaining reserved for issuance in connection with awards under the 2006 Plan. During the six months ended March 31, 2014, the Company issued options to purchase 427,556 shares to employees and directors at prices ranging from \$21.53 to \$24.19, and options to purchase 161,830 shares were forfeited. During the six months ended March 31, 2014, the Company issued 589,656 restricted shares to employees and directors at prices ranging from \$21.53 to \$26.71, and 189,618 restricted shares were forfeited. At March 31, 2014, there were 1,153,286 shares remaining reserved for issuance in connection with awards under the 2006 Plan. The maximum number of shares subject to options or stock appreciation rights that can be awarded under the 2006 Plan to any person is 1,000,000 per year. The maximum number of shares that can be awarded under the 2006 Plan to any person, other than pursuant to an option or stock appreciation right, is 700,000 per year. These restricted shares and options generally vest over a period of one to four years conditioned on continued employment for the incentive period.

**Stock Option Activity**

A summary of the Company's stock option activity for the year ended September 30, 2013, the three months ended December 31, 2013, and the three months ended March 31, 2014 is as follows:

	Options	Weighted-Average Exercise Price
Options outstanding at September 30, 2012	1,675,795	\$ 13.84
Options granted	171,994	35.76
Options exercised	(223,139)	11.35
Options canceled	(32,244)	18.67
Options outstanding at September 30, 2013	1,592,406	16.46
Options granted	348,002	22.60
Options exercised	(52,374)	8.95
Options canceled	(15,747)	30.11
Options outstanding at December 31, 2013	1,872,287	17.70

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Options granted	79,554	21.53
Options exercised	(151,605)	11.65
Options canceled	(146,083)	15.73
Options outstanding at March 31, 2014	1,654,153	18.61
Options exercisable at March 31, 2014	1,035,428	14.94

The intrinsic value and weighted average remaining contractual life in years of outstanding and exercisable options at March 31, 2014 is approximately \$15,084,000 and 6.05 and \$12,956,000 and 4.21, respectively, based on a stock price of \$26.05 on March 31, 2014. Over the last three years, volatility rates have ranged from 50.90% - 60.61%, a dividend rate of 0%, risk free interest rates have ranged from 0.12% - 1.21%, and expected forfeiture rates have ranged from 19.00% - 22.80%.

Table of Contents**Liquidity Services, Inc. and Subsidiaries****Notes to the Unaudited Consolidated Financial Statements (Continued)****9. Stockholders' Equity (Continued)****Restricted Share Activity**

A summary of the Company's restricted share activity for the year ended September 30, 2013, the three months ended December 31, 2013, and the three months ended March 31, 2014 is as follows:

	<b>Restricted Shares</b>	<b>Weighted- Average Fair Value</b>
Unvested restricted shares at September 30, 2012	1,399,609	\$ 22.51
Restricted shares granted	997,857	36.97
Restricted shares vested	(450,514)	21.18
Restricted shares canceled	(403,083)	35.39
Unvested restricted shares at September 30, 2013	1,543,869	28.89
Restricted shares granted	567,331	22.38
Restricted shares vested	(336,271)	22.43
Restricted shares canceled	(100,307)	19.81
Unvested restricted shares at December 31, 2013	1,674,622	28.52
Restricted shares granted	22,325	22.75
Restricted shares vested	(50,134)	32.16
Restricted shares canceled	(89,311)	24.20
Unvested restricted shares at March 31, 2014	1,557,502	28.57

The intrinsic value and weighted average remaining contractual life in years of unvested restricted shares at March 31, 2014 is approximately \$40,573,000 and 8.68, respectively, based on a stock price of \$26.05 on March 31, 2014.

Table of Contents**Liquidity Services, Inc. and Subsidiaries****Notes to the Unaudited Consolidated Financial Statements (Continued)****10. Fair Value Measurement**

The Company measures and records in the accompanying consolidated financial statements certain liabilities at fair value on a recurring basis. Authoritative guidance issued by the FASB establishes a fair value hierarchy for those instruments measured at fair value that distinguishes between assumptions based on market data (observable inputs) and the Company's assumptions (unobservable inputs). On January 1, 2012, the Company adopted ASU 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*, which amended FASB ASC Topic 820, Fair Value Measurement. Adoption of the disclosure requirements did not have a material impact on the Company's financial position or results of operations. The hierarchy consists of three levels:

Level 1	Quoted market prices in active markets for identical assets or liabilities;
Level 2	Inputs other than Level 1 inputs that are either directly or indirectly observable; and
Level 3	Unobservable inputs developed using estimates and assumptions developed by the Company, which reflect those that a market participant would use.

As of March 31, 2014 and September 30, 2013, the Company had no Level 1 or Level 2 assets or liabilities that were recorded at fair value on a recurring basis. As of September 30, 2013 and March 31, 2014, the Company's liability for the earn-out related to the National Electronic Service Association acquisition of \$18,390,000 and \$18,565,000, respectively, is the only liability measured at fair value on a recurring basis and is classified as Level 3 within the fair value hierarchy. The changes in liabilities measured at fair value for which the Company has used Level 3 inputs to determine fair value for the year ended September 30, 2013 and the six months ended March 31, 2014 are as follows (\$ in thousands):

		<b>Level 3 Liabilities</b>
Balance at September 30, 2012	\$	14,511
Acquisition contingent consideration		18,050
Settlements		(19,608)
Change in fair value of contingent consideration		5,437
Balance at September 30, 2013		18,390
Acquisition contingent consideration		
Settlements		
Change in fair value of contingent consideration		175
Balance at March 31, 2014	\$	18,565

When valuing its Level 3 liabilities, the Company gives consideration to operating results, financial condition, economic and/or market events, and other pertinent information that would impact its estimate of the expected earn-out payment. The valuation procedures are primarily based on management's projection of EBITDA for the acquired businesses and applying a discount to the expected earn out payments to estimate fair value. Discount rates range from 2.0% to 6.0% and are based on the Company's cost of borrowing. Changes in the discount rate are not expected

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to have a material impact on the fair value of these liabilities. Because of the inherent uncertainty, this estimated value may differ significantly from the value that would have been used had a ready market for the liability existed, and it is reasonably possible that the difference could be material. Changes in fair value of the Company's Level 3 liabilities are recorded in Acquisition Costs in the Consolidated Statements of Operations.

The Company's financial assets not measured at fair value are cash and cash equivalents (which includes cash and commercial paper with original maturities of less than 90 days). We believe the carrying value approximates fair value due to the short term maturity of these instruments.

Table of Contents**Liquidity Services, Inc. and Subsidiaries****Notes to the Unaudited Consolidated Financial Statements (Continued)****11. Defined Benefit Pension Plan**

Certain employees of GoIndustry, which the Company acquired in July 2012, are covered by a qualified defined benefit pension plan.

The net periodic benefit cost recognized for the three and six months ended March 31, 2014 and 2013, included the following components:

Qualified Defined Benefit Pension Plan	Three Months Ended March 31,		Six Months Ended March 31,	
	2014	2013	2014	2013
	(dollars in thousands)			
Service cost				
Interest cost	\$ 286	\$ 265	\$ 566	\$ 538
Expected return on plan assets	(336)	(264)	(658)	(531)
Amortization of prior service cost				
Amortization of actuarial (gain)/loss				
Amortization of transitional obligation/(asset)				
Total net periodic benefit cost	\$ (50)	\$ 1	\$ (92)	\$ 7

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**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 the factors set forth in our Annual Report on Form 10-K for the year ended September 30, 2013 and subsequent filings with the Securities and Exchange Commission. You can identify forward-looking statements by terminology such as may, will, should, could, would, expects, intends, plans, anticipates, believes, estimates, predicts, potential, continues or the negative of these terms or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. There may be other factors of which we are currently unaware or deem immaterial that may cause our actual results to differ materially from the forward-looking statements.*

*All forward-looking statements attributable to us or persons acting on our behalf apply only as of the date of this document 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 document or to reflect the occurrence of unanticipated events.*

*The following discussion should be read in conjunction with our consolidated financial statements and related notes and the information contained elsewhere in this document.*

**Overview**

*About us.* We operate leading 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 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), and [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 flow of goods in turn attracts an increasing number of professional buyers to our marketplaces. During the 12 months ended March 31, 2014, the number of registered buyers grew from approximately 2,307,000 to approximately 2,524,000, or 9.4%.

*Recent initiatives.* 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). Later this month, the DoD is expected to formally award the contract. 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. Final contract awards are subject to a protest period and a pre-award survey by the DoD regarding the bidder's ability to satisfactorily perform the work in accordance with their technical proposal submitted in step-one of the solicitation. Because the contracting process is not complete, we cannot at this time provide a revised forecast on future financial results. However, based on the unofficial April 1-2 bid results, 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 rolling stock and non-rolling stock assets, for the base term ending December 2014, with two additional one-month renewal options.

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As discussed in the beginning of fiscal year 2014, we have undertaken a significant initiative to fully integrate and enhance our marketplaces. We anticipated spending an additional \$7.0 million to \$9.0 million on this effort 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. We expect a significant amount of this product development to be completed this fiscal year with the total initiative being completed during fiscal year 2015.

*Our revenue.* We generate substantially all of our revenue by retaining a percentage of the proceeds from the sales we manage for our sellers. 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 direct 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 12.8% and 14.4% of our total revenue for the three and six months ended March 31, 2014. The merchandise sold under our profit-sharing model accounted for approximately 7.2% and 7.8% of our gross merchandise volume, or GMV, for the three and six months ended March 31, 2014.

- *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 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 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 19.8% and 21.5% of our total revenue for the three and six months ended March 31, 2014. The merchandise sold under our consignment model accounted for approximately 52.7% and 56.7% of our GMV for the three and six months ended March 31, 2014.

- *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 67.4% and 64.1% of our total revenue for the three and six months ended March 31, 2014. The merchandise sold under our purchase model accounted for approximately 40.1% and 35.5% of our GMV for the three and six months ended March 31, 2014.

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,

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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 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) as a result of the economic downturn, 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 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). Later this month, the DoD is expected to formally award the contract. 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. Final contract awards are subject to a protest period and a pre-award survey by the DoD regarding the bidder's ability to satisfactorily perform the work in accordance with their technical proposal submitted in step-one of the solicitation. Revenue from our second Surplus Contract (including buyer premiums) accounted for approximately 30.1% and 27.4% of our total revenue for the three and six months ended March 31, 2014. The property sold under our second Surplus Contract accounted for approximately 17.0% and 14.8% of our GMV for the three and six months ended March 31, 2014.

Under the second 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. During the three months ended March 31, 2014, our inventory acquired under the second Surplus Contract increased significantly as a result of a surge of property provided by the DoD.

- *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. 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. Following the DoD's exercise of all three renewal options, the Scrap Contract expires in June 2015. Revenue from our Scrap Contract (including buyer premiums) accounted for approximately 12.8% and 14.4% of our total revenue for the three and six months ended March 31, 2014. The property sold under our Scrap Contract accounted for approximately 7.2% and 7.8% of our GMV for the three and six months ended March 31, 2014.

Under the Scrap Contract, we acquire scrap property at a per pound price and disburse to the DLA Disposition Services a percentage of the profits realized from the sale of the inventory, after deduction for allowable expenses. We refer to these disbursement payments to the DoD as profit-sharing distributions. As a result of these arrangements, we recognize as revenue the gross proceeds from these sales. The DoD also reimburses us for actual costs incurred for packing, loading and shipping property under the Scrap and original Surplus Contracts that we are

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

*Our Wal-Mart Contracts.* We have various contracts with Wal-Mart Stores, Inc. (Wal-Mart), pursuant to which 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. All of these agreements have customary commercial terms, which generally expire within a year and allow both parties to terminate for convenience with reasonable notice. As a result of the Jacobs Trading acquisition, we also have a long-term contract with Wal-Mart that does not provide for termination for convenience. The term of this agreement expires on May 16, 2016 and thereafter continues on a month to month basis.

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*Our commercial agreements.* We have over 600 corporate clients each of which has sold in excess of \$10,000 of surplus and salvage assets in our marketplaces during the last twelve months. 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 marketplaces during the three and six months ended March 31, 2014 and March 31, 2013, totaled \$227.2 million and \$461.6 million, and \$259.1 million and \$492.5 million, respectively.

*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 March 31, 2014 and September 30, 2013, we had approximately 2,524,000 and 2,424,000 registered buyers, respectively.

*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 three and six months ended March 31, 2014 and March 31, 2013, approximately 665,000 and 1,268,000, and 643,000 and 1,209,000, total auction participants participated in auctions on our marketplaces, respectively.

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*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 through our marketplaces. During the three and six months ended March 31, 2014 and March 31, 2013, we completed approximately 132,000 and 261,000, and 138,000 and 267,000 transactions, respectively.

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**Non-GAAP Financial Measures**

*EBITDA and adjusted EBITDA.* EBITDA is a supplemental non-GAAP financial measure and is equal to net income plus interest expense and other (income) expense, net; provision for income taxes; amortization of contract intangibles; and depreciation and amortization. Our definition of adjusted EBITDA differs from EBITDA because we further adjust EBITDA for stock-based compensation expense and acquisition costs.

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

- The amortization of contract intangibles relates to amortization of the contract related intangible assets associated with the Jacobs Trading acquisition on October 1, 2011 and the 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 fluctuated significantly 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.
- The authoritative guidance requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their estimated fair values. 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.
- The authoritative guidance related to business combinations requires the recognition of contingent consideration so that it is recognized at the time of acquisition rather than when it is probable and disallows the capitalization of transaction costs. Accordingly, we believe adjusting net income for these acquisition related expenses is useful to investors when evaluating the operating performance of our business on a consistent basis from year-to-year.
- We believe these measures 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:

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- 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.

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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 net income to EBITDA and adjusted EBITDA for the periods presented.

	Three Months Ended March 31,		Six Months Ended March 31,	
	2014	2013	2014	2013
	(In thousands) (unaudited)			
Net income	\$ 5,631	\$ 12,698	\$ 12,724	\$ 19,407
Interest and other expense (income), net	79	96	100	(828)
Provision for income taxes	3,753	8,824	8,482	13,296
Amortization of contract intangibles	2,272	2,407	4,679	4,617
Depreciation and amortization	1,973	1,980	3,977	3,967
<b>EBITDA</b>	<b>13,708</b>	<b>26,005</b>	<b>29,962</b>	<b>40,459</b>
Stock compensation expense	2,908	2,935	6,567	7,302
Acquisition costs	85	212	180	5,588
<b>Adjusted EBITDA</b>	<b>\$ 16,701</b>	<b>\$ 29,152</b>	<b>\$ 36,709</b>	<b>\$ 53,349</b>

**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 online 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.

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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. In 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.
  
- 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 have general inventory risk.
  
- 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 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).

*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. Generally, 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. 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 or a loss of significant customers. 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.

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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 \$233.0 million at March 31, 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 apply the authoritative guidance related to accounting for uncertainty in income taxes. We concluded that there were no uncertain tax positions identified during our analysis.

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 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.

*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 arrangement 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.

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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 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 contract intangibles associated with the Jacobs Trading acquisition on October 1, 2011 and the NESAs transaction on November 1, 2012. The intangible asset created in conjunction with the acquisition of Jacobs Trading 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 is valued at \$3.9 million and is being amortized over 20 months, on a straight-line basis. The amortization period is 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 and other expense (income), net.* Interest and other expense (income), net, consists primarily of miscellaneous expenses and fees and a \$1.0 million benefit related to the early payoff of the subordinated note payable in November, 2012.

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

Table of Contents**Results of Operations**

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2014	2013	2014	2013
Revenue	100.0%	100.0%	100.0%	100.0%
Costs and expenses:				
Cost of goods sold (excluding amortization)	42.3	38.3	40.7	38.4
Profit-sharing distributions	6.5	7.6	7.4	7.3
Technology and operations	22.6	17.2	21.9	17.8
Sales and marketing	8.1	7.7	8.1	8.0
General and administrative	9.7	9.1	9.9	10.2
Amortization of contract intangibles	1.8	1.8	1.8	1.8
Depreciation and amortization	1.5	1.5	1.6	1.6
Acquisition costs	0.1	0.2	0.1	2.2
Total costs and expenses	92.6	83.4	91.5	87.3
Income from operations	7.4	16.6	8.5	12.7
Interest and other (expense) income, net	(0.1)	(0.1)	(0.0)	0.3
Income from operations before provision for income taxes	7.3	16.5	8.5	13.0
Provision for income taxes	(2.9)	(6.8)	(3.4)	(5.3)
Income from operations	4.4%	9.7%	5.1%	7.7%

***Three Months Ended March 31, 2014 Compared to Three Months Ended March 31, 2013***

**Revenue.** Revenue decreased \$2.0 million, or 1.5%, to \$128.3 million for the three months ended March 31, 2014 from \$130.3 million for the three months ended March 31, 2013, which is not significant. There were no material offsetting changes in revenue during the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The amount of gross merchandise volume decreased \$31.9 million, or 12.3%, to \$227.2 million for the three months ended March 31, 2014 from \$259.1 million for the three months ended March 31, 2013, primarily due to a decrease in our commercial capital assets vertical, which utilizes the consignment model resulting in an immaterial effect on revenue.

**Cost of goods sold (excluding amortization).** Cost of goods sold (excluding amortization) increased \$4.4 million, or 8.8%, to \$54.3 million for the three months ended March 31, 2014 from \$49.9 million for the three months ended March 31, 2013. As a percentage of revenue, cost of goods sold (excluding amortization) increased to 42.3% from 38.3%. These increases are primarily due to the increased property flow of smaller value assets under our Surplus Contract.

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*Profit-sharing distributions.* Profit-sharing distributions decreased \$1.6 million, or 16.5%, to \$8.3 million for the three months ended March 31, 2014 from \$9.9 million for the three months ended March 31, 2013. As a percentage of revenue, profit-sharing distributions decreased to 6.5% from 7.6%. These decreases are due to a decline in the Scrap Contract sales.

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*Technology and operations expenses.* Technology and operations expenses increased \$6.7 million, or 29.7%, to \$29.1 million for the three months ended March 31, 2014 from \$22.4 million for the three months ended March 31, 2013. As a percentage of revenue, technology and operations expenses increased to 22.6% from 17.2%. These increases are primarily due to (1) expenses of \$4.2 million in staff and temporary wages, including stock based compensation, and consultant fees associated with technology marketplace integration and enhancement projects; and (2) expenses of \$2.5 million for additional warehouse space, due to growth in our inventory.

*Sales and marketing expenses.* Sales and marketing expenses increased \$0.5 million, or 4.9%, to \$10.5 million for the three months ended March 31, 2014 from \$10.0 million for the three months ended March 31, 2013. As a percentage of revenue, sales and marketing expenses increased to 8.1% from 7.6%. These increases are primarily due to expenses of \$0.4 million in staff wages, including stock based compensation.

*General and administrative expenses.* General and administrative expenses increased \$0.6 million, or 5.0%, to \$12.4 million for the three months ended March 31, 2014 from \$11.8 million for the three months ended March 31, 2013. As a percentage of revenue, general and administrative expenses increased to 9.7% from 9.1%. These increases are primarily due to expenses of \$0.8 million in staff wages, including stock based compensation, offset in part by a \$0.2 million decrease in overhead expenses as a result of consolidating and closing some offices.

*Amortization of contract intangibles.* Amortization of contract intangibles was primarily related to the contract intangible asset 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. Amortization of contract intangibles for the three months ended March 31, 2014 and March 31, 2013, was \$2.3 million and \$2.4 million, respectively.

*Depreciation and amortization expenses.* Depreciation and amortization expenses were consistent at \$2.0 million for the three months ended March 31, 2014 and March 31, 2013.

*Acquisition costs.* Acquisition costs decreased \$0.1 million, or 60.0%, to \$0.1 million for the three months ended March 31, 2014 from \$0.2 million for the three months ended March 31, 2013, which is not significant.

*Interest and other expense (income), net.* Interest and other expense (income), net, was consistent at \$0.1 million of expense for the three months ended March 31, 2014 and 2013.

*Provision for income tax expense.* Income tax expense decreased \$5.0 million, or 57.5%, to \$3.8 million for the three months ended March 31, 2014 from \$8.8 million for the three months ended March 31, 2013, primarily due to the decrease in income before provision for income taxes.

*Net income.* Net income decreased \$7.1 million, or 55.7%, to \$5.6 million for the three months ended March 31, 2014 from \$12.7 million for the three months ended March 31, 2013.



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***Six Months Ended March 31, 2014 Compared to Six Months Ended March 31, 2013***

*Revenue.* Revenue decreased \$2.2 million, or 0.9%, to \$250.3 million for the six months ended March 31, 2014 from \$252.5 million for the six months ended March 31, 2013, which is not significant. There were no material offsetting changes in revenue during the six months ended March 31, 2014 compared to the six months ended March 31, 2013. The amount of gross merchandise volume decreased \$30.9 million, or 6.3%, to \$461.6 million for the six months ended March 31, 2014 from \$492.5 million for the six months ended March 31, 2013, primarily due to a decrease in our commercial capital assets vertical, which utilizes the consignment model resulting in an immaterial effect on revenue.

*Cost of goods sold (excluding amortization).* Cost of goods sold (excluding amortization) increased \$4.9 million, or 5.1%, to \$102.0 million for the six months ended March 31, 2014 from \$97.1 million for the six months ended March 31, 2013. As a percentage of revenue, cost of goods sold (excluding amortization) increased to 40.7% from 38.4%. These increases are primarily due to expansion of our Canadian business, which utilizes the purchase model.

*Profit-sharing distributions.* Profit-sharing distributions were consistent at \$18.4 million for the six months ended March 31, 2014 and 2013. As a percentage of revenue, profit-sharing distributions increased to 7.4% from 7.3%, which is not significant.

*Technology and operations expenses.* Technology and operations expenses increased \$9.7 million, or 21.7%, to \$54.7 million for the six months ended March 31, 2014 from \$45.0 million for the six months ended March 31, 2013. As a percentage of revenue, technology and operations expenses increased to 21.9% from 17.8%. These increases are primarily due to (1) expenses of \$7.4 million in staff and temporary wages, including stock based compensation, and consultant fees associated with technology marketplace integration and enhancement projects; and (2) expenses of \$2.3 million in additional warehouse space due to growth in our inventory.

*Sales and marketing expenses.* Sales and marketing expenses were consistent at \$20.3 million for the six months ended March 31, 2014 and 2013. As a percentage of revenue, sales and marketing expenses increased to 8.1% from 8.0%, which is not significant.

*General and administrative expenses.* General and administrative expenses decreased \$1.1 million, or 4.1%, to \$24.7 million for the six months ended March 31, 2014 from \$25.8 million for the six months ended March 31, 2013. As a percentage of revenue, general and administrative expenses decreased to 9.9% from 10.2%. These decreases are primarily due to streamlining our GoIndustry global operations and lowering our external general and administrative expenses.

*Amortization of contract intangibles.* Amortization of contract intangibles was primarily related to the contract intangible asset 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. Amortization of contract intangibles for the six months ended March 31, 2014 and March 31, 2013, was \$4.7 million and \$4.6 million, respectively.

*Depreciation and amortization expenses.* Depreciation and amortization expenses were consistent at \$4.0 million for the six months ended March 31, 2014 and March 31, 2013.

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*Acquisition costs.* Acquisition costs decreased \$5.4 million, or 96.8%, to \$0.2 million, for the six months ended March 31, 2014 from \$5.6 million for the six months ending March 31, 2013, primarily due to recording an additional \$5.1 million for the Jacobs Trading earn out liability in the three months ended December 31, 2012.

*Interest and other expense (income), net.* Interest and other expense (income), net, increased \$0.9 million to \$0.1 million of expense for the six months ended March 31, 2014 from \$0.8 million of income for the six months ended March 31, 2013, primarily due to the \$1.0 million discount received for the early payoff of the \$40 million Jacobs Trading acquisition seller subordinated note.

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*Provision for income tax expense.* Income tax expense decreased \$4.8 million, or 36.2%, to \$8.5 million for the six months ended March 31, 2014 from \$13.3 million for the six months ended March 31, 2013, primarily due to the decrease in income before provision for income taxes.

*Net income.* Net income decreased \$6.7 million, or 34.4%, to \$12.7 million for the six months ended March 31, 2014 from \$19.4 million for the six months ended March 31, 2013.

**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 March 31, 2014, we had approximately \$101.8 million in cash and cash equivalents and \$65.1 million available under our \$75.0 million senior credit facility, due to issued letters of credit for \$9.9 million; \$1.0 million of our availability under this facility is set aside as a contractual obligation under our DoD Scrap Contract.

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 the 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 occurred in February 2014. A summary of our share repurchase activity from fiscal year 2009 to the three months ended December 31, 2013 and March 31, 2014 is as follows:

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
3 Months Ending 12/31/13				31,000,000
3 Months Ending 3/31/14	128,566	\$ 23.87	3,057,000	46,943,000

(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.

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Most 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.

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*Changes in Cash Flows: Six Months Ended March 31, 2014 Compared to Six Months Ended March 31, 2013*

Net cash provided by operating activities was \$9.1 million and \$10.4 million for the six months ended March 31, 2014 and 2013, respectively. For the six months ended March 31, 2014, net cash provided by operating activities primarily consisted of net income of \$12.7 million, depreciation and amortization expense of \$8.7 million, stock compensation expense of \$6.6 million, and a net increase in accounts payable, accrued expenses and other liabilities of \$36.2 million, offset in part by a net increase in accounts receivable, inventory and prepaid assets of \$52.2 million, and provisions for inventory allowance, doubtful accounts, and incremental tax from exercises of common stock options of \$2.9 million, net. For the six months ended March 31, 2013, net cash provided by operating activities primarily consisted of net income of \$19.4 million, depreciation and amortization expense of \$8.6 million, stock compensation expense of \$7.3 million, offset in part by a net increase in accounts receivable, inventory and prepaid assets of \$7.7 million, a net decrease in accounts payable, accrued expenses and other liabilities of \$10.0 million (including \$11.4 million for the payment of the Jacobs Trading earn-out), provisions for inventory allowance, doubtful accounts, and incremental tax from exercises of common stock options of \$6.2 million, net, and \$1.0 million from early extinguishment of debt.

Net cash used in investing activities was \$5.0 million and \$17.2 million for the six months ended March 31, 2014 and 2013, respectively. Net cash used in investing activities for the six months ended March 31, 2014 consisted primarily of \$5.0 million for purchases of equipment and leasehold improvements. Net cash used in investing activities for the six months ended March 31, 2013 consisted primarily of \$14.7 million for the acquisition of NESA and capital expenditures of \$2.5 million for purchases of equipment and leasehold improvements.

Net cash provided by financing activities was \$2.5 million for the six months ended March 31, 2014. Net cash used in financing activities for the six months ended March 31, 2013 was \$41.3 million. Net cash provided by financing activities for the six months ended March 31, 2014 consisted primarily of proceeds from the exercise of common stock options including the tax benefit of \$5.6 million, offset in part by \$3.1 million in stock repurchases. Net cash used in financing activities for the six months ended March 31, 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 the proceeds from the exercise of common stock options including the tax benefit of \$5.9 million.

*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 \$7.0 million to \$8.0 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 six months ended March 31, 2014 were \$5.0 million. As of March 31, 2014, we had no outstanding commitments for capital expenditures.

*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 March 31, 2014, we had no outstanding indebtedness under our senior credit facility and our borrowing availability was \$65.1 million due to issued letters of credit for \$9.9 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 March 31, 2014, we were in full compliance with the terms and conditions of our credit agreement.

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*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.

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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.

**Off-Balance Sheet Arrangements**

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

**Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

*Interest rate sensitivity.* We had \$40.0 million of fixed rate 5% unsecured subordinated debt which we repaid in November 2012, and no debt as of March 31, 2014, 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 less than five percent of our GMV is denominated in foreign currencies. We have not engaged in any hedging or other derivative transactions to date.

**Item 4. Controls and Procedures.**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

During the most recent fiscal quarter, there has not occurred any change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

As of March 31, 2014, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer, our Chief Financial Officer, and our Chief Accounting Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer concluded that our disclosure controls and procedures were effective and were operating to provide reasonable assurance that the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer, principal financial officer, and principal accounting officer, as appropriate to allow timely decisions regarding required disclosure.

Table of Contents**PART II OTHER INFORMATION****Item 1. Legal Proceedings.**

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

**Item 1A. Risk Factors.**

*In addition to the other information set forth in this report, you should carefully consider the factors set forth in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended September 30, 2012, which could materially affect our business, financial condition or future results. The risks described in our Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.*

**Item 2. Purchases of Equity Securities by the Issuer.****Issuer Purchases of Equity Securities**

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(1)
January 1 to January 31, 2014				\$ 31,000,000
February 1 to February 28, 2014	128,566	\$ 23.87	128,566	\$ 46,943,000
March 1 to March 31, 2014				\$ 46,943,000
<b>Total</b>	<b>128,566</b>		<b>128,566</b>	

(1) On February 5, 2014, our Board of Directors approved an additional \$19.0 million for the share repurchase program.

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**Item 6. Exhibits.**

<b>Exhibit No.</b>	<b>Description</b>
3.1	Fourth Amended and Restated Certificate of Incorporation, incorporated herein by reference to Exhibit 3.1 to Amendment No. 2 to the Company's Registration Statement on Form S-1 (Registration No. 333-129656), filed with the SEC on January 17, 2006.
3.2	Amended and Restated Bylaws, incorporated herein by reference to Exhibit 3.2 to Amendment No. 2 to the Company's Registration Statement on Form S-1 (Registration No. 333-129656), filed with the SEC on January 17, 2006.
10.1	Letter from DLA Disposition Services, dated November 21, 2013, relating to Contract for Multi-Year Sale of Surplus Scrap Material at Locations Nationwide (Sales Contract Number 99-4001-0004), effective as of June 9, 2005 between the Company and DLA Disposition Services, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the SEC on December 4, 2013.
10.2	Supplemental Agreement No. 8, dated January 17, 2014, relating to the modification of Surplus Usable Property Sales Contract (Sales Contract Number 08-0001-0001), as amended, between the Company and DLA Disposition Services, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the SEC on January 21, 2014.
10.3	Notice of Award, Statement, and Release Document, dated January 17, 2014, relating to Surplus Usable Property Sales Contract (Sales Contract Number 08-0001-0001), as amended, between the Company and DLA Disposition Services, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the SEC on January 21, 2014.
10.4	Third Amendment to Financing and Security Agreement dated March 11, 2014, by and between Liquidity Services, Inc. and Bank of America, N.A., incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the SEC on March 11, 2014.
10.5	Second Amended and Restated Revolving Credit Note, dated March 11, 2014, issued by Liquidity Services, Inc. to Bank of America, N.A., incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, filed with the SEC on March 11, 2014.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
31.3	Certification of Chief Accounting Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.3	Certification of Chief Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following materials from the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, formatted in Extensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Changes in Stockholders' Equity, (iv) Consolidated Statements of Cash Flows, and (v) Notes to Consolidated Financial Statements.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on May 9, 2014.

LIQUIDITY SERVICES, INC.  
(Registrant)

By: /s/ William P. Angrick, III  
William P. Angrick, III  
*Chairman of the Board of Directors  
and Chief Executive Officer*

By: /s/ James M. Rallo  
James M. Rallo  
*Chief Financial Officer and Treasurer*

By: /s/ Kathryn A. Domino  
Kathryn A. Domino  
*Chief Accounting Officer*