

LIQUIDITY SERVICES INC
Form S-1
February 13, 2007

As filed with the Securities and Exchange Commission on February 12, 2007

Registration No. 333-

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

LIQUIDITY SERVICES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

7389
(Primary Standard Industrial
Classification Code Number)

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

1920 L Street, N.W.
6th Floor
Washington, D.C. 20036
(202) 467-6868

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

William P. Angrick, III
Chief Executive Officer
Liquidity Services, Inc.
1920 L Street, N.W.
6th Floor
Washington, D.C. 20036
(202) 467-6868

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Stephen I. Glover
Gibson, Dunn & Crutcher LLP
1050 Connecticut Avenue N.W.
Washington, D.C. 20036-5306
(202) 955-8500

Tracy Kimmel
Keith M. Townsend
King & Spalding LLP
1180 Peachtree Street, NE
Atlanta, Georgia 30309
(404) 572-4600

Edgar Filing: LIQUIDITY SERVICES INC - Form S-1

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

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box.

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

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

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

CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered (1)	Proposed maximum offering price per share (2)	Proposed maximum aggregate offering price (1)(2)	Amount of registration fee
Common Stock, \$0.001 par value per share	6,415,845	\$ 19.45	\$ 124,788,193	\$ 13,352.34

(1) Includes 836,850 shares of common stock that the underwriters have the option to purchase to cover over-allotments, if any.

(2) Estimated solely for the purpose of calculating the amount of the registration fee pursuant to Rule 457(c) under the Securities Act on the basis of the average of the high and low prices of Liquidity Services, Inc.'s common stock as reported by the Nasdaq Global Market on February 5, 2007.

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

Subject to completion, dated February 12, 2007

The information in this preliminary prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

PROSPECTUS

5,579,541 Shares

Common Stock

We are offering for sale 100,000 shares of our common stock. The selling stockholders included in this prospectus are offering an additional 5,479,541 shares of common stock.

Our common stock is listed on the Nasdaq Global Market and traded under the symbol LQDT. The closing price of our common stock on February 9, 2007 was \$22.75.

Investing in our common stock involves risk. See Risk Factors beginning on page 11.

	Per Share		Total	
Public offering price	\$		\$	
Underwriting discounts and commissions	\$		\$	
Proceeds, before expenses, to Liquidity Services, Inc.	\$		\$	
Proceeds, before expenses, to the selling stockholders	\$		\$	

Certain of the selling stockholders have granted the underwriters the right to purchase up to 836,931 additional shares of common stock to cover over-allotments, if any.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the shares on or about _____, 2007.

Friedman Billings Ramsey

CIBC World Markets

RBC Capital Markets

Cantor Fitzgerald & Co.

**Lazard Capital Markets
Stifel Nicolaus**

Oppenheimer & Co.

Prospectus dated _____, 2007

TABLE OF CONTENTS

Edgar Filing: LIQUIDITY SERVICES INC - Form S-1

	Page
<u>Prospectus Summary</u>	1
<u>Risk Factors</u>	11
<u>Forward-Looking Statements</u>	26
<u>Use of Proceeds</u>	27
<u>Dividend Policy</u>	28
<u>Cash and Capitalization</u>	28
<u>Selected Consolidated Financial Data</u>	30
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	35
<u>Business</u>	57
<u>Management</u>	73
<u>Principal Stockholders and Selling Stockholders</u>	87
	Page
<u>Description of Common Stock</u>	89
<u>Shares Eligible for Future Sale</u>	92
<u>Material U.S. Federal Income Tax Considerations for Non-U.S. Holders of Common Stock</u>	93
<u>Underwriting</u>	97
<u>Legal Matters</u>	100
<u>Experts</u>	100
<u>Where You Can Find Additional Information</u>	100
<u>Incorporation of Certain Documents by Reference</u>	101

You should rely only on the information contained in this document or to which we have referred you. We have not, and the underwriters have not, authorized anyone to provide you with different information. This document may only be used where it is legal to sell these securities. The information in this document may only be accurate on the date of this document.

i

PROSPECTUS SUMMARY

The following is a brief summary of selected contents of this prospectus. It does not contain all the information that may be important to you. You should read the entire prospectus, including our consolidated financial statements and related notes incorporated by reference in this prospectus. You should carefully consider, among other things, the matters discussed under the caption Risk Factors before making an investment decision.

Overview

We are a leading online auction marketplace for wholesale, surplus and salvage assets. Our marketplaces provide professional buyers access to a global supply of wholesale, surplus and salvage assets organized into over 500 categories and presented with product information necessary to make more informed bids, including digital images, detailed descriptions and extensive technical information. We enable our corporate and government sellers to enhance their financial returns from the sale of excess assets by providing a liquid marketplace and integrated value-added services, including sales and marketing, logistics and transaction settlement. Our online auction marketplaces are www.liquidation.com, www.govliquidation.com and www.liquibiz.com. We also operate a wholesale industry portal, www.goWholesale.com, that connects advertisers with buyers seeking products for sale and business services.

We believe our ability to create liquid marketplaces for wholesale, surplus and salvage assets generates a continuous flow of goods from our corporate and government sellers and that this flow of goods attracts an increasing number of professional buyers to our marketplaces. During fiscal year 2006, the number of registered buyers grew from approximately 386,000 to approximately 524,000, or 35.7%. By December 31, 2006, the number of registered buyers had grown to approximately 565,000. In fiscal year 2006 and the three months ended December 31, 2006, we generated revenue of \$147.8 million and \$45.2 million, respectively. During the past three fiscal years, we have conducted over 508,000 online transactions generating approximately \$364 million in gross merchandise volume. Our revenue has grown at a compound annual growth rate of approximately 35% for the last four fiscal years, and we have been profitable since fiscal year 2003 and cash flow positive since fiscal year 2002.

Industry Overview

We believe many manufacturers, retailers, corporations and government agencies focus on the procurement of new goods for initial use or resale but not on the disposal, liquidation and tracking of goods in the reverse supply chain, such as retail customer returns, overstock products and end-of-life goods. We believe that the volume of goods in this reverse supply chain is continuing to increase, driven by accelerating product innovation, supply chain complexity, government regulations and the return policies of national and online retailers. According to D.F. Blumberg Associates, Inc., a research and consulting firm, the estimated reverse logistics market in North America will grow from approximately \$38.5 billion in 2004 to over \$63.1 billion in 2008. In an effort to streamline and improve the efficiency of their disposition activities for surplus and end-of-life assets, federal and state governments have made significant progress toward outsourcing these functions. Similarly, we believe corporations continue to realize that their current supply chain infrastructure is not well suited to cost effectively handle the sale of surplus, salvage, returned and overstocked merchandise.

Traditional methods of wholesale, surplus and salvage asset disposition, such as live on-site auctions and negotiated direct sales, are generally highly fragmented and limited in geographic reach. As a result, buyers are often unaware of or unable to participate in these events, which reduces buyer competition and the ultimate value a seller realizes from a sale. We believe the Internet provides professional buyers of

wholesale, surplus and salvage assets with a more effective and efficient means to identify and source goods available for immediate purchase.

Our Solution

Our solution is comprised of our online auction marketplaces, value-added services and our wholesale search and advertising portal. Our three online marketplaces serve as a transparent and convenient method for the sale of wholesale, surplus and salvage assets and are designed to address the particular requirements of the sellers and professional buyers we serve. Sellers and buyers come together to transact for goods sold as-is, where-is, generally without the discretionary right to return the goods. We organize our products into categories across major industry verticals such as consumer electronics, general merchandise, apparel, scientific equipment, aerospace parts and equipment, technology hardware, and specialty equipment and sell these products in lot sizes ranging from full truck loads to pallets, packages and large individual items.

Our comprehensive solution includes value-added services that simplify the sale process for sellers and enhance the utility of our marketplaces for our buyers. Unlike other online auction websites on which sellers post information and deal directly with the buyer to complete a sale, we manage each step of the transaction. We perform all required pre-sale services such as receiving and lotting merchandise and implementing marketing strategies. In a centralized location, our buyers are provided access to detailed product descriptions, digital images, seller transaction histories, shipping weights and dimensions and estimated shipping costs. After a transaction is executed, we also perform all required post-sale services such as payment collection, settlement and reporting. We believe these value-added services significantly contribute to an enhanced selling price while providing buyers with a secure transaction environment and confidence in the goods they purchase.

We believe our marketplaces benefit over time from greater scale and adoption by our constituents. Aggregating buyer demand enables us to generate a continuous flow of goods from corporate and government sellers, which in turn attracts an increasing number of professional buyers. As buyers continue to discover and use our online trading platform as an effective method to source assets, we believe our marketplaces become an increasingly attractive sales channel for corporations and government agencies. We believe this self-reinforcing cycle results in greater transaction volume and enhances the value of our marketplaces.

In addition to our marketplaces, our wholesale industry portal, www.goWholesale.com, provides a single online destination for buyers to find wholesale products, suppliers and services. We developed this portal to provide advertisers with the ability to reach our growing network of professional buyers.

Our Benefits to Sellers and Buyers

We offer the following key benefits to sellers and buyers:

Benefits to Sellers	Benefits to Buyers
<ul style="list-style-type: none"> • Access to a broad, aggregated buyer audience enhances value realized on the sale of wholesale, surplus and salvage assets 	<ul style="list-style-type: none"> • Marketplaces provide access to a continuous flow of wholesale, surplus and salvage assets
<ul style="list-style-type: none"> • Comprehensive service offerings allow sellers the ability to fully outsource reverse supply chain activities 	<ul style="list-style-type: none"> • Complete product search capabilities with search criteria including keyword, category, lot size, condition and location improve information availability
<ul style="list-style-type: none"> • Profit-sharing arrangements align our interests with those of our sellers 	<ul style="list-style-type: none"> • Intelligent alerts delivered through e-mail provide buyers with notice of upcoming auctions of interest
<ul style="list-style-type: none"> • Online auction environment and liquid marketplaces allow sellers to sell goods in any condition for cash 	<ul style="list-style-type: none"> • Superior product information, including digital images, detailed descriptions with shipping dimensions and extensive technical information, enables more informed bidding
<ul style="list-style-type: none"> • Faster cycle times and greater flexibility than traditional auction methods improve seller recovery on asset sales 	<ul style="list-style-type: none"> • Shipping quotes and services assure buyers can both estimate the cost of delivery in advance of a bid and have the goods delivered
<ul style="list-style-type: none"> • Discrete venue to sell surplus and salvage assets preserves brand value and mitigates channel conflict 	<ul style="list-style-type: none"> • Secure settlement and dispute resolution assure the delivery of goods and provide a means to resolve problems
<ul style="list-style-type: none"> • Transaction platform provides transparent reporting capabilities 	<ul style="list-style-type: none"> • Tracking and reporting tools provide buyers real time transaction information

Our Growth Strategy

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

Grow our buyer base and increase the total number of auction participants. We intend to increase the level of bidding activity and competition within each auction by growing our database of professional buyers and implementing an increased variety of both online and traditional marketing programs to increase buyer participation in our online marketplaces.

Increase penetration of existing sellers. We intend to increase our sales by further penetrating our existing seller relationships to manage and sell an increased share of their available supply of wholesale, surplus and salvage assets.

Develop new seller relationships. We intend to increase our number of corporate and government seller relationships by leveraging our demonstrated performance record and expanded sales and marketing initiative.

Develop and enhance features and services. We intend to utilize the insights gained from our completed auctions to develop and enhance features and services that benefit our buyers and sellers.

Expand our wholesale industry portal and advertising network. We intend to further expand our advertising network and develop products that enable wholesale buyers and sellers to more quickly and easily find, create and organize relevant industry information.

Acquire complementary businesses. We intend to continue our disciplined and targeted acquisition strategy to increase our share of the supply of wholesale, surplus and salvage goods sold by selectively acquiring complementary businesses, such as the STR acquisition which we completed in October 2006.

Our Government Contracts

We are the exclusive contractor of the Defense Reutilization and Marketing Service, or DRMS, for the sale of surplus and scrap assets of the United States Department of Defense, or DoD, in the United States. In June 2001, we were awarded a competitive-bid exclusive contract under which we acquire, manage and sell all usable surplus property of DoD turned in to DRMS. This contract expires in June 2008 and accounted for 91.0%, 87.5%, 56.6% and 40.9% of our revenue and for 77.5%, 76.5%, 48.3% and 34.7% of our gross merchandise volume for the fiscal years ended September 30, 2004, 2005 and 2006 and the three months ended December 31, 2006, respectively. Total revenue under our DoD surplus property contract has increased at a compound annual growth rate in excess of 17% since fiscal year 2002. In June 2005, we were awarded a competitive-bid exclusive contract under which we acquire, manage and sell substantially all scrap property of DoD turned in to DRMS. This contract expires in 2012, subject to DoD's right to extend for three additional one-year terms, and accounted for 0.4%, 26.5% and 27.7% of our revenue and for 0.3%, 22.6% and 23.5% of our gross merchandise volume in fiscal years 2005, 2006 and the three months ended December 31, 2006, respectively.

Risks Associated with Our Business

We are subject to a number of risks, which you should be aware of before you decide to buy our common stock. These risks are discussed more fully in the "Risk Factors" section of this prospectus beginning on page 11. We depend on contracts with the DoD for a significant portion of our revenue, as described above. If our DoD contracts are terminated or if our relationship with DoD is impaired, we could experience a significant decrease in our revenue and have difficulty generating income. In addition, our ability to increase our revenue and maintain profitability depends on whether we can successfully expand the supply of merchandise available for sale on our online marketplaces and attract and retain active professional buyers to purchase the merchandise. We operate in a highly competitive, rapidly growing online services market for auctioning or liquidating wholesale, surplus and salvage assets. We may not be able to obtain merchandise that meets our buyer's price or selection requirements, which may cause our buyer base to decline or not grow as rapidly as we expect.

Corporate Information

We were incorporated in Delaware in November 1999 as Liquidation.com, Inc. and commenced operations in January 2000. We were renamed Liquidity Services, Inc. in November 2001. Our principal executive offices are located at 1920 L Street, N.W., 6th Floor, Washington D.C. 20036, and our telephone number is (202) 467-6868. Our corporate website is located at www.liquidityservicesinc.com. The information contained in, or that can be accessed through, our website is not part of this prospectus.

Unless otherwise indicated, the terms "Liquidity Services, Inc.," "Liquidity Services," "LSI," "Company," "company," "we," "us" and "our" refer to Services, Inc. and its subsidiaries.

All references to years in this prospectus, unless otherwise noted, refer to our fiscal years, which end on September 30. For example, a reference to "2006," "fiscal 2006" or "fiscal year 2006" means that 12-month period that ended September 30, 2006.

The Offering

Common stock offered by us	100,000 shares
Common stock offered by the selling stockholders	5,479,541 shares
Common stock to be outstanding after the offering	27,812,084 shares
Use of proceeds	Our net proceeds from this offering after deducting estimated expenses will be approximately \$ million. We will use these net proceeds for working capital and general corporate purposes. We will not receive any proceeds from the sale of shares by the selling stockholders.
Nasdaq Global Market symbol	LQDT

The share information in the table above is based on the number of shares outstanding as of February 8, 2007 and excludes:

- 2,306,313 shares issuable upon the exercise of outstanding stock options at a weighted average exercise price of \$11.25 per share; and
- 3,444,000 shares available for future issuance under our 2006 Omnibus Long-Term Incentive Plan.

Except as otherwise noted, all information in this prospectus assumes the underwriters do not exercise their over-allotment option.

Summary Consolidated Financial Data

You should read the following summary consolidated financial data together with our consolidated financial statements and the related notes incorporated by reference in this prospectus and with Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this prospectus. The consolidated statement of operations data for the years ended September 30, 2004, 2005 and 2006 and the consolidated balance sheet data as of September 30, 2005 and 2006 are derived from, and are qualified by reference to, our consolidated financial statements that have been audited by Ernst & Young LLP, an independent registered public accounting firm, and that are incorporated by reference in this prospectus. The consolidated statement of operations data for the three months ended December 31, 2005 and 2006, and the consolidated balance sheet data as of December 31, 2006, are derived from, and are qualified by reference to, our unaudited consolidated financial statements that are incorporated by reference in this prospectus. The consolidated balance sheet data as of September 30, 2004 is derived from our audited consolidated financial statements that are not included or incorporated by reference in this prospectus.

	Year ended September 30,			Three months ended December 31,	
	2004	2005	2006	2005	2006
				(unaudited)	
	(dollars in thousands, except per share data)				
Consolidated Statement of Operations Data:					
Revenue	\$ 75,869	\$ 89,415	\$ 147,813	\$ 32,207	\$ 45,167
Costs and Expenses:					
Cost of goods sold (excluding amortization)	5,743	6,288	12,160	2,367	8,462
Profit-sharing distributions	39,718	48,952	80,253	18,170	18,729
Technology and operations	12,814	14,696	20,081	4,055	7,843
Sales and marketing	4,586	5,503	8,861	1,816	2,964
General and administrative	6,046	7,397	12,073	2,633	3,436
Amortization of contract intangibles		135	813	203	203
Depreciation and amortization	531	586	727	153	273
Total cost and expenses	69,438	83,557	134,968	29,397	41,910
Income from operations	6,431	5,858	12,845	2,810	3,257
Interest income (expense) and other income, net	(621)	(570)	430	(363)	598
Income before provision for income taxes	5,810	5,288	13,275	2,447	3,855
Provision for income taxes	(541)	(1,166)	(5,294)	(979)	(1,542)
Net income	\$ 5,269	\$ 4,122	\$ 7,981	\$ 1,468	\$ 2,313
Basic earnings per common share	\$ 0.31	\$ 0.22	\$ 0.33	\$ 0.08	\$ 0.08
Basic weighted average shares outstanding	16,865,313	19,038,464	24,080,780	19,034,172	27,597,419
Diluted earnings per common share	\$ 0.29	\$ 0.18	\$ 0.31	\$ 0.06	\$ 0.08
Diluted weighted average shares outstanding	18,280,366	22,598,519	26,087,809	22,848,367	28,449,429
Non-GAAP Financial Measures:					
EBITDA(1)	\$ 6,962	\$ 6,579	\$ 14,385	\$ 3,166	\$ 3,733
Adjusted EBITDA(1)	6,115	6,666	15,008	3,175	4,097
Adjusted profit-sharing distributions(2)	40,650	48,952	80,253	18,170	18,729
Adjusted net income(2)	\$ 4,337	\$ 4,122	\$ 7,981	\$ 1,468	\$ 2,313
Supplemental Operating Data:					
Gross merchandise volume(3)	\$ 89,104	\$ 102,210	\$ 173,090	\$ 36,710	\$ 53,200
Completed transactions(4)	141,000	173,000	194,000	47,000	49,000
Total registered buyers(5)	264,000	386,000	524,000	415,000	565,000
Total auction participants(6)	671,000	848,000	993,000	225,000	247,000

	As of September 30,			As of
	2004	2005	2006	December 31,
	(in thousands)			2006
	(unaudited)			
Consolidated Balance Sheet Data:				
Cash, cash equivalent and short-term investments	\$ 12,178	\$ 10,378	\$ 66,648	\$ 58,659
Working capital(7)	7,021	4,154	54,082	48,413
Total assets	17,711	26,013	88,038	93,823
Total liabilities	10,333	14,596	22,286	25,007
Redeemable common stock(8)	324	474		
Series C preferred stock	3	3		
Common stock	19	19	27	27
Total stockholders equity	7,054	10,943	65,752	68,816

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

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

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

Edgar Filing: LIQUIDITY SERVICES INC - Form S-1

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

	Year ended September 30,			Three months ended December 31,	
	2004	2005	2006	2005	2006
				(unaudited)	
	(in thousands)				
Profit-sharing distributions	\$ 39,718	\$ 48,952	\$ 80,253	\$ 18,170	\$ 18,729
Adjustment(a)	932				
Adjusted profit-sharing distributions	\$ 40,650	\$ 48,952	\$ 80,253	\$ 18,170	\$ 18,729
Net Income	\$ 5,269	\$ 4,122	\$ 7,981	\$ 1,468	\$ 2,313
Adjustment(a)	(932)				
Adjusted net income	\$ 4,337	\$ 4,122	\$ 7,981	\$ 1,468	\$ 2,313

- (a) the final SurplusBid.com acquisition payment was made in March 2004 and therefore no adjustments were made in fiscal years 2005 and 2006 or the three months ended December 31, 2005 and 2006.
- (3) Gross merchandise volume is the total sales value of all merchandise sold through our marketplaces during a given period.
- (4) Completed transactions represents the number of auctions in a given period from which we have recorded revenue.
- (5) Total registered buyers as of a given date represents the aggregate number of persons or entities who have registered on one of our marketplaces.
- (6) For each auction we manage, the number of auction participants represents the total number of registered buyers who have bid one or more times on that auction, and total auction participants for a given period is the sum of the auction participants in each auction conducted during that period.
- (7) Working capital is defined as current assets minus current liabilities.
- (8) Upon the closing of our initial public offering in February 2006 and the resulting repayment of our \$2.0 million subordinated note, the redemption feature related to these shares of common stock terminated.

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

- The amortization of contract intangibles relate to the amortization of the scrap contract with the DoD beginning in June 2005. Depreciation and amortization expense primarily relates to property and equipment. Both of these expenses are non-cash charges that have significantly fluctuated over the past five years. As a result, we believe that adding back these non-cash charges to net income is useful in evaluating the operating performance of our business on a consistent basis from year-to-year.
- As a result of substantial federal net operating loss carryforwards, or NOLs, we did not incur significant income tax expense until fiscal 2005. With the exhaustion of our remaining federal NOLs during fiscal 2005, we recorded federal income tax expense for the first time, thus significantly decreasing our fiscal 2005 net income relative to prior years. Consequently, we believe that presenting a financial measure that adjusts net income for provision for income taxes is useful to investors when evaluating the operating performance of our business.

- During July 2001, we modified the exercise price of 3,402,794 stock options issued to employees. As a result, we are accounting for the modified stock options from the date of modification to the date the stock options are exercised, forfeited or expire unexercised using variable accounting. Under variable accounting, we revalue compensation costs for the stock options at each reporting period based on changes in the intrinsic value of the stock options. We recorded approximately \$85,000, \$87,000, \$7,000 and \$0, respectively, in stock compensation expenses based on vesting of the fair value of the options for the fiscal years ended September 30, 2004, 2005 and 2006 and the three months ended December 31, 2006, respectively. We will continue to revalue compensation costs for the options based on changes in the fair value of our common stock in future periods. As a result, we present a financial measure that adjusts net income and EBITDA for the stock compensation expense that results solely from the July 2001 modification of these stock options. We believe that it is useful to exclude this expense because it results from a one-time event that requires us to record expense that we are not otherwise required to record in connection with new stock options granted during the same time period. In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment, or Statement 123(R), which is a revision of SFAS No. 123. Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their estimated fair values. Pro forma disclosure is no longer an alternative. We adopted the provisions of Statement 123(R) on October 1, 2005, using the prospective method. Unvested stock based awards issued prior to October 1, 2005, the date that we adopted the provisions of Statement 123(R), were accounted for at the date of adoption using the intrinsic value method originally applied to those awards. We recorded approximately \$616,000 and \$364,000 in stock compensation expenses based on the adoption of Statement 123(R) for the fiscal year ended September 30, 2006 and the three months ended December 31, 2006, respectively. As a result, we present a financial measure that adjusts net income and EBITDA for stock compensation expense.

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

- We believe 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:

- 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.

Edgar Filing: LIQUIDITY SERVICES INC - Form S-1

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.

	Year ended September 30,			Three months ended December 31,	
	2004	2005	2006	2005	2006
	(unaudited)				
	(in thousands)				
Net income	\$ 5,269	\$ 4,122	\$ 7,981	\$ 1,468	\$ 2,313
Interest expense (income) and other income, net	621	570	(430)	363	(598)
Provision for income taxes	541	1,166	5,294	979	1,542
Amortization of contract intangibles		135	813	203	203
Depreciation and amortization	531	586	727	153	273
EBITDA	6,962	6,579	14,385	3,166	3,733
Stock compensation expense	85	87	623	9	364
Adjustment(1)	(932)				
Adjusted EBITDA	\$ 6,115	\$ 6,666	\$ 15,008	\$ 3,175	\$ 4,097

(1) The adjustment amount for each period equals approximately 80% of the principal payments on the SurplusBid.com note payable made during each period, as described above in footnote 2. No payments were made in fiscal years 2005 and 2006 or the three months ended December 31, 2005 and 2006.

RISK FACTORS

This offering involves a high degree of risk. You should carefully consider the risks described below, together with all of the other information contained in this prospectus or incorporated by reference herein, including the consolidated financial statements and related notes, before making a decision to invest in our common stock. If any of the following risks actually occurs, our business, financial condition or operating results could suffer. As a result, the trading price of our common stock could decline and you may lose all or part of your investment in our common stock.

Risks Related to Our Business

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

We have two material contracts with the Defense Reutilization and Marketing Service, or DRMS, under which we acquire, manage and sell surplus and scrap property of the United States Department of Defense, or DoD. If our relationship with DoD is impaired, we are not awarded new DoD contracts when our current contracts expire, any of our DoD contracts are terminated or the supply of assets under the contracts is significantly decreased, we would experience a significant decrease in revenue and have difficulty generating income. The surplus contract accounted for 91.0%, 87.5%, 56.6% and 40.9% of our revenue and 77.5%, 76.5%, 48.3% and 34.7% of our gross merchandise volume for the fiscal years ended September 30, 2004, 2005 and 2006 and the three months ended December 31, 2006, respectively. We began to operate under the scrap contract in August 2005 and it accounted for 0.4%, 26.5% and 27.7% of our revenue and for 0.3%, 22.6% and 23.5% of our gross merchandise volume in fiscal years 2005 and 2006 and the three months ended December 31, 2006, respectively. We believe that these contracts will continue to be the source of a significant portion of our revenue and gross merchandise volume during their respective terms. The surplus contract expires in June 2008. The scrap contract has a seven-year base term that expires in August 2012, subject to DoD's right to extend for three additional one-year terms. The contracts were awarded by DoD through a competitive bidding process, and we may be required to go through a new competitive bidding process when our existing contracts expire.

Although our contracts with DoD do not allow DoD to terminate for convenience, each contract requires us to meet specified performance benchmarks. The contracts may be terminated by DoD if rate of return performance ratios do not exceed specified benchmark ratios for two consecutive quarterly periods and the preceding 12 months. Although, to date, we have never failed to meet the required benchmark ratios during any of the testing periods, we cannot assure you that we will meet the performance benchmarks in the future. DoD also has the right, after giving us notice and a 30 day opportunity to cure, to terminate the contracts and seek other contract remedies in the event of material breaches.

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

In July 2006, the Government Accountability Office, or GAO, issued a report citing weaknesses in DoD excess inventory control procedures and lax security at selected DoD facilities with respect to surplus property. The GAO report refers to our company and asserts that we failed to verify the appropriate DoD regulatory classifications for certain items we sold and, as a result, we sold items we should have instead returned to the DoD. We believe that, under our DoD contracts, we do not have a contractual responsibility to assign these classifications and believe that the DoD has the contractual obligation to assign these classifications. The GAO report also identified at least 79 buyers that collectively purchased 2,669 sensitive military items and stated that the GAO was referring these sales to federal law enforcement agencies for investigation. These buyers may have acquired these sensitive military items from us. It is

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

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

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

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

- offer sellers liquid marketplaces for their wholesale, surplus and salvage assets;
- offer buyers a sufficient supply of merchandise;
- develop and implement effective sales and marketing strategies;
- comply with regulatory or corporate seller requirements affecting marketing and disposition of certain categories of merchandise;
- efficiently catalogue, handle, store, ship and track merchandise; and
- achieve high levels of seller and buyer satisfaction with the trading experience.

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

The online services market for auctioning or liquidating wholesale, surplus and salvage assets is competitive and growing rapidly. Competitive pressures could affect our ability to attract and retain customers, which could decrease our revenue and negatively affect our operating results. We currently compete with:

- other e-commerce providers, such as Amazon.com, GSICommerce and Overstock.com;
- auction websites, such as eBay, Yahoo! Auctions and uBid;
- government agencies that have created websites to sell wholesale, surplus and salvage assets; and
- traditional liquidators and fixed-site auctioneers.

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

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

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

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

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

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

We may not operate profitably in the future.

We commenced operations in early 2000 and, as a result, have only a limited operating history upon which you can evaluate our business and prospects. Although we have experienced significant revenue growth in recent periods, we may not be able to sustain this growth. If we are not able to sustain this revenue growth, the value of your investment in our common stock may decline.

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

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

- the addition of new buyers and sellers or the loss of existing buyers and sellers;
- the volume, size, timing and completion rate of transactions in our marketplaces;
- changes in the supply and demand for and the volume, price, mix and quality of our supply of wholesale, surplus and salvage assets;
- introduction of new or enhanced websites, services or product offerings by us or our competitors;
- implementation of significant new contracts or DoD inventory control procedures;
- changes in our pricing policies or the pricing policies of our competition;
- changes in the conditions and economic prospects of the e-commerce industry or the economy generally, which could alter current or prospective buyers and sellers priorities;
- technical difficulties, including telecommunication system or Internet failures;
- changes in government regulation of the Internet and e-commerce industry;
- event-driven disruptions such as war, terrorism, disease and natural disasters;
- integration costs related to future acquisitions;
- seasonal patterns in selling and purchasing activity; and
- costs related to acquisitions of technology or equipment.

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

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

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

systems. Any interruptions or failures of our current systems or our ability to communicate with third party systems could negatively affect the demand for our services and our ability to grow our revenue.

14

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

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

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

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

- reduced visibility of order status and package tracking;
- delays in merchandise receipt and delivery;
- increased cost of shipment; and
- reduced shipment quality, which may result in damaged merchandise.

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

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

Our business depends, to a large degree, on effective customer service and distribution center operations. We currently staff DoD warehouse distribution space, for which we do not incur leasing costs, as well as leased commercial warehouse distribution space. These operations could be harmed by several factors, including any material disruption or slowdown at our distribution centers resulting from labor disputes, changes in the terms of our underlying lease agreements or occupancy arrangements in the case of government provided facilities, telecommunications failures, power or service outages, human error, terrorist attacks, natural disasters or other events. In addition, space provided to us by DoD could be re-configured or reduced as a result of DoD's Base Realignment and Closure initiative or other infrastructure reduction initiatives. For example, DRMS has indicated that it plans to reconfigure or reduce the current warehousing functions at a number of DoD sites. A disruption in our customer service and distribution operations, including as a result of DRMS's plans to reconfigure or reduce the current warehousing

functions at several sites, could cause us to lose sellers and buyers, decrease our revenue and harm our operating results.

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

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

- consignment (in which we charge the seller a commission); and
- profit-sharing (in which we purchase merchandise from sellers and share profits).

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

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

Under our profit-sharing model, we purchase merchandise and assume the risk that the merchandise may sell for less than we paid for it. In addition, we occasionally engage in transactions with sellers in which we purchase merchandise without a profit-sharing component. In each case, we assume general and physical inventory and credit risk. These risks are especially significant because some of the goods we sell on our websites are characterized by rapid technological change, obsolescence and price erosion, and because we sometimes make large purchases of particular types of inventory. In addition, we do not receive warranties on the goods we purchase and, as a result, we have to resell or dispose of any returned goods. Historically, the number of disposed goods (which includes returned goods that we have not resold) has been less than 2% of the goods we have purchased.

To manage our inventory successfully, we need to maintain sufficient buyer demand and sell merchandise for a reasonable financial return. We may miscalculate buyer demand and overpay for the acquired merchandise. In the event that merchandise is not attractive to our buyer base, we may be required to take significant losses resulting from lower sale prices, which could reduce our revenue and margins. For example, under our DoD surplus contract, we are obligated to purchase all DoD surplus property at set prices representing a percentage of the original acquisition cost, which varies depending on the type of surplus property being purchased. When we resell property under the contract, historically we were entitled to approximately 20% of the profits of sale (defined as gross proceeds of sale less allowable operating expenses) and DoD was entitled to approximately 80% of the profits for distributions. On September 12, 2006, we entered into a bilateral contract modification under which the DoD agreed to increase our profit-sharing percentage in exchange for our agreement to implement additional inventory assurance processes and procedures with respect to the sale of demilitarized property. Under the terms of the contract modification, from August 1, 2006 until November 30, 2006, we were entitled to receive 27.5% of profits under the surplus contract and DoD was entitled to receive 72.5%. After November 30, 2006, we are entitled to receive between 25% and 30.5% of the profits from sale, based on the results of an audit of the effectiveness of the inventory controls we implement under this contract modification. The scrap contract distribution sharing is unchanged. Historically, the cost of inventory has been approximately 5% of the gross merchandise volume under our profit-sharing model. Occasionally, we are not able to sell our inventory for amounts above its cost and we may incur a loss. As we grow our business, we may choose to increase the amount of merchandise we purchase directly from sellers, thus resulting in increased inventory levels and related risk. Any such increase would require the use of additional working capital and subject us to the additional risk of incurring losses on the sale of that inventory.

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

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

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

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

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

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

Other parties may assert that we have infringed their technology or other intellectual property rights. We use internally developed systems and licensed technology to operate our online auction platform and related websites. Third parties could assert intellectual property infringement claims against us based on our internally developed systems or use of licensed third party technology. Third parties also could assert intellectual property infringement claims against parties from whom we license technology. If we are forced to defend against any infringement claims, whether they are with or without merit or are determined in our favor, we may face costly litigation, diversion of technical and management personnel and/or delays in completion of sales. Furthermore, the outcome of a dispute may be that we would need to change technology, develop non-infringing technology or enter into royalty or licensing agreements. A

switch to different technology could cause interruptions in our business. Internal development of a non-infringing technology may be expensive and time-consuming, if we are able to successfully develop such technology at all. Royalty or licensing agreements, if required, may be unavailable on terms acceptable to us, or at all. Incurrence of any of these costs could negatively impact our operating results.

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

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

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

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

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

We have begun expanding internationally, and in the future we may do so more aggressively. For both the fiscal year ended September 30, 2006 and the three months ended December 31, 2006, international operations accounted for less than 5% of our revenue. International operations subject us to additional risks and challenges, including:

- the need to develop new seller and buyer relationships;
- difficulties and costs of staffing and managing foreign operations;
- changes in and differences between domestic and foreign regulatory requirements;
- price controls and foreign currency exchange rate fluctuations;
- difficulties in complying with export restrictions and import permits;
- reduced protection for intellectual property rights in some countries;
- potentially adverse tax consequences;
- lower per capita Internet usage and lack of appropriate infrastructure to support widespread Internet usage;
- political and economic instability; and
- tariffs and other trade barriers.

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

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

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

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

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

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

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

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

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

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

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

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

We sell merchandise, such as scientific instruments, information technology equipment and aircraft parts, that is subject to export control and economic sanctions laws, among other laws, imposed by the United States and other governments. Such restrictions include the U.S. Export Administration Regulations, the International Traffic in Arms Regulations, and economic sanctions and embargo laws administered by the Office of the Foreign Assets Control. These laws prohibit us from, among other things, selling property to (1) persons or entities that appear on lists of restricted or prohibited parties maintained by the United States or other governments, (2) countries, regimes, or nationals that are the target of applicable economic sanctions or other embargoes, or (3) to certain countries and end users without prior authorization from relevant U.S. government agencies, depending on the export classification status of the property. In addition, for specified categories of property sold under our contracts with the DoD, we are required to (1) obtain an end-use certificate from the prospective buyer describing the nature of the buyer's business, describing the expected disposition and specific end-use of the property, and acknowledging the applicability of pertinent export control and economic sanctions laws and (2) confirm that each buyer has been cleared to purchase export-controlled items.

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

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

We retain highly confidential information on behalf of our clients in our systems and databases. Although we maintain security features in our systems, our operations may be susceptible to hacker interception, break-ins and other disruptions. These disruptions may jeopardize the security of information stored in and transmitted through our systems. We may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches. These issues are likely to become more difficult as we expand our operations. If any compromise of our security were to occur, we may lose clients and our reputation, business, financial condition and operating results could be harmed by the misappropriation of confidential client information. In addition, if there is any perception that we cannot protect our clients' confidential information, we may lose the ability to attract new clients and our revenue could decline.

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

We are subject to increasing regulation at the federal, state and international levels relating to privacy and the use of personal user information. In addition, several states have proposed or enacted legislation

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

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

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

In November 2004, the federal government passed legislation placing a three-year ban on state and local governments' imposition of new taxes on Internet access or electronic commerce transactions. This ban does not prohibit federal, state or local authorities from collecting taxes on our income or from collecting taxes that are due under existing tax rules. Unless the ban is extended, state and local governments may begin to levy additional taxes on Internet access and electronic commerce transactions upon the legislation's expiration in November 2007. An increase in taxes may make electronic commerce transactions less attractive for merchants and businesses, which could result in a decrease in the level of demand for our services.

Currently, decisions of the U.S. Supreme Court restrict the imposition of obligations to collect state and local sales and use taxes with respect to sales made over the Internet. However, a number of states, as well as the U.S. Congress, have been considering various initiatives that could limit or supersede the Supreme Court's position regarding sales and use taxes on Internet sales. If any of these initiatives resulted in a reversal of the Supreme Court's current position, we could be required to collect sales and use taxes in states other than states in which we currently pay such taxes. A successful assertion by one or more local, state or foreign jurisdictions that the sale of merchandise by us is subject to sales or other taxes, could subject us to material liabilities and increase our costs of doing business. To the extent that we cannot pass such costs on to our clients, such taxes could harm our business and decrease our revenue.

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

We are aware that other companies operating online auction or liquidation services have periodically received complaints of fraudulent activities of buyers or sellers on their websites, including disputes over the quality of goods and services, unauthorized use of credit card and bank account information and identity theft, potential breaches of system security, and infringement of third-party copyrights, trademarks and trade names or other intellectual property rights. We may receive similar complaints if sellers or buyers trading in our marketplaces are alleged to have engaged in fraudulent or unlawful activity. In addition, we may suffer losses as a result of purchases paid for with fraudulent credit card data even though the associated financial institution approved payment. In the case of disputed transactions, we may not be able to require users of our services to fulfill their obligations to make payments or to deliver goods. We also may receive complaints from buyers about the quality of purchased goods, requests for reimbursement, or communications threatening or commencing legal actions against us. Negative publicity

generated as a result of fraudulent conduct by third parties or the failure to satisfactorily settle disputes related to transactions on our websites could damage our reputation, cause us to lose clients and affect our ability to grow our business.

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

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

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

We have only been operating as a public company for 12 months. As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. These expenses are associated with our public company reporting requirements and corporate governance requirements, including requirements under the Sarbanes-Oxley Act of 2002, as well as rules implemented by the Securities and Exchange Commission, or SEC, and the Nasdaq Global Market. We expect these rules and regulations to continue to increase our legal and financial compliance costs and to make some activities more time-consuming and costly. As a result, it may be more difficult for us to attract and retain qualified individuals to serve on our board of directors or as executive officers. We cannot predict or estimate the amount of additional costs we may incur as a public company or the timing of such costs.

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

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

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

Because we have recently become a public company, we have limited experience attempting to comply with public company obligations, including Section 404 of the Sarbanes-Oxley Act of 2002.

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the SEC has adopted rules requiring public companies to include a report of management on the company's internal controls over financial reporting in their annual reports on Form 10-K. In addition, the public accounting firm auditing a public company's financial statements must attest to and report on management's assessment of the effectiveness of the company's internal controls over financial reporting. These requirements will first apply to our annual report on Form 10-K for our fiscal year ending on September 30, 2007.

We currently do not have an internal audit group, and we will need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge. Also, we may discover areas of our internal controls that need improvement. We cannot be certain that any remedial measures we take will ensure that we implement and maintain adequate controls over our financial processes and reporting in the future. Any failure to implement required new or improved controls, or difficulties encountered in their implementation could harm our operating results or cause us to fail to meet our reporting obligations. If we are unable to conclude that we have effective internal controls over financial reporting, or if our independent auditors are unable to provide us with an unqualified report as to the effectiveness of our internal controls over financial reporting as of September 30, 2007 and future year ends as required by Section 404, investors could lose confidence in the reliability of our financial statements, which could result in a decrease in the value of our common stock. Failure to comply with Section 404 could potentially subject us to sanctions or investigations by the SEC, Nasdaq or other regulatory authorities.

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

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

- a staggered board of directors;
- a prohibition on actions by our stockholders by written consent;
- limitations on persons authorized to call a special meeting of stockholders;
- the authorization of undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval;
- advance notice procedures required for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders; and
- the requirement that board vacancies be filled by a majority of our directors then in office.

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

Risks Related to This Offering

Our stock price may be volatile and your investment in our common stock could suffer a decline in value.

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

- actual or anticipated variations in quarterly operating results;
- changes in financial estimates by us or by a securities analyst who covers our stock;
- publication of research reports about our company or industry;
- conditions or trends in our industry;
- stock market price and volume fluctuations of other publicly traded companies and, in particular, those whose business involves the Internet and e-commerce;
- announcements by us or our competitors of significant contracts, acquisitions, commercial relationships, strategic partnerships or divestitures;
- announcements by us or our competitors of technological innovations, new services or service enhancements;
- announcements of investigations or regulatory scrutiny of our operations or lawsuits filed against us;
- the passage of legislation or other regulatory developments that adversely affect us, our clients or our industry;
- additions or departures of key personnel;
- sales of our common stock, including sales of our common stock by our directors and officers or specific stockholders; and
- general economic conditions and slow or negative growth of related markets.

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

Future sales of our common stock could cause our stock price to decline.

We and our executive officers and directors are subject to the lock-up agreements described in the Underwriting section and a lock-up period of 90 days after the date of this prospectus. After the expiration of this 90-day period, approximately million of the shares of common stock subject to the lock-up agreements will be eligible for sale in the public market pursuant to Rule 144 under the Securities Act of 1933, or the Securities Act. Friedman, Billings, Ramsey & Co., Inc., CIBC World Markets Corp. and RBC Capital Markets Corporation, on behalf of the underwriters, may release our directors and executive officers from their lock-up agreements with the underwriters at any time and without notice, which would allow for earlier sale of shares in the public market. If our directors or executive officers sell, or the market perceives that our directors or executive officers intend to sell, substantial amounts of our common stock in the public market following this offering, the market price of our common stock could

decline. These sales, or the perception that these sales could occur, might also make it more difficult for you to sell your shares at a time and price that you deem appropriate and for us to sell additional equity securities at a time and price that we deem appropriate.

In addition to the foregoing, we had options to purchase approximately 2,306,313 shares of common stock outstanding, of which 306,837 were exercisable, as of February 8, 2007.

We do not intend to pay dividends on shares of our common stock.

Since becoming a public company on February 22, 2006, we have not paid cash dividends on our stock and currently anticipate that we will continue to retain any future earnings to finance the growth of our business. Therefore, unless and until we pay dividends on our common stock, any gains from your investment in our common stock must come from an increase in its market price.

Insiders will continue to have substantial control over us after this offering, which could limit your ability to influence the outcome of key transactions, including a change in control.

Our principal stockholders, directors and executive officers and entities affiliated with them will own approximately % of the outstanding shares of our common stock after this offering. As a result, these stockholders, acting together, would be able to influence or control matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other extraordinary transactions. These stockholders may have interests that differ from yours and may vote in a way with which you disagree and which may be adverse to your interest. The concentration of ownership could have the effect of delaying, preventing or deterring a change in control of our company, could deprive our stockholders of an opportunity to receive a premium for their common stock as part of a sale of our company and could ultimately affect the market price of our common stock.

We will have broad discretion over the use of proceeds from the issue of shares in this offering, and we may not use these proceeds effectively, which could affect our operating results and cause our stock price to decline.

We will have broad discretion to use the net proceeds to us from this offering, and you will be relying on the judgment of our board of directors and management regarding the application of these proceeds. Although we expect to use a portion of the net proceeds from this offering for working capital and general corporate purposes, we have not allocated these net proceeds for specific purposes. It is possible that the net proceeds will be invested in a way that does not yield a favorable, or any, return for our company.

FORWARD-LOOKING STATEMENTS

Statements contained or incorporated by reference in this prospectus that are not statements of historical fact are forward-looking statements within the meaning of Section 27A of the Securities Act. These statements are only predictions, and we claim the protection of the safe harbor for forward looking statements provided in the Private Securities Litigation Reform Act of 1995. The outcome of the events described in these forward-looking statements is subject to known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. These risks and other factors include but are not limited to those listed under Risk Factors and elsewhere in this prospectus or other documents incorporated by reference herein. You can identify forward-looking statements by terminology such as may, will, should, could, would, expects, intends, plans, anticipates, believes, estimates, predicts, potential, these terms or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. There may be other factors of which we are currently unaware or deem immaterial that may cause our actual results to differ materially from the forward-looking statements.

All forward-looking statements apply only as of the date of this prospectus and are expressly qualified in their entirety by the cautionary statements included in this prospectus. 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 prospectus or to reflect the occurrence of unanticipated events.

USE OF PROCEEDS

The net proceeds from our sale of 100,000 shares of common stock in this offering will be approximately \$ _____ million, after deducting underwriting discounts and commissions and estimated offering expenses, payable by us. We will not receive any proceeds from the sale of shares by selling stockholders. We intend to use the net proceeds from this offering for working capital and general corporate purposes.

The amounts that we actually expend for working capital and other general corporate purposes will vary significantly depending on a number of factors, including future revenue growth, if any, and the amount of cash that we generate from operations. As a result, we will retain broad discretion over the allocation of the net proceeds of this offering.

Pending these uses, we will invest the net proceeds of this offering in short-term interest bearing investment grade securities.

DIVIDEND POLICY

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

CASH AND CAPITALIZATION

The following table sets forth our cash and cash equivalents and our capitalization as of December 31, 2006 on an actual basis and an as adjusted basis to give effect to our sale of shares of common stock in this offering and receipt of our estimated net proceeds from this offering.

You should read this table together with the information under the headings "Selected Consolidated Financial Data," "Use of Proceeds" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained elsewhere in this prospectus, as well as with the audited consolidated financial statements and related notes incorporated by reference in this prospectus.

	As of December 31, 2006			
	Actual		As Adjusted	
	(unaudited, in thousands)			
Cash, cash equivalents and short term investments	\$	58,659	\$	
Total debt and capital lease obligations, including current portion		69		69
Stockholders' equity:				
Common stock, \$0.001 value; 120,000,000 shares authorized; 27,617,555 shares issued and outstanding, actual; and 27,717,555 shares issued and outstanding, as adjusted		28		28
Additional paid-in capital		56,601		
Accumulated other comprehensive income		361		361