

LIQUIDITY SERVICES INC
Form 10-Q
August 02, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

OR

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

For the transition period from _____ to _____

Commission file number 0-51813

LIQUIDITY SERVICES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	52-2209244
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

6931 Arlington Road, Suite 200, Bethesda, MD 20814

(Address of Principal Executive Offices) (Zip Code)

(202) 467-6868
(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Edgar Filing: LIQUIDITY SERVICES INC - Form 10-Q

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

The number of shares outstanding of the issuer's common stock, par value \$.001 per share, as of August 1, 2018 was 32,123,193.

INDEX

	Page
Part I. FINANCIAL INFORMATION (UNAUDITED)	
Item 1. <u>Consolidated Financial Statements</u>	<u>3</u>
<u>Consolidated Balance Sheets</u>	<u>3</u>
<u>Consolidated Statements of Operations</u>	<u>4</u>
<u>Consolidated Statements of Comprehensive Loss</u>	<u>5</u>
<u>Consolidated Statements of Cash Flows</u>	<u>6</u>
<u>Notes to the Unaudited Consolidated Financial Statements</u>	<u>7</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>21</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>36</u>
Item 4. <u>Controls and Procedures</u>	<u>36</u>
Part II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	<u>38</u>
Item 1A. <u>Risk Factors</u>	<u>38</u>
Item 6. <u>Exhibits</u>	<u>39</u>
<u>SIGNATURES</u>	<u>40</u>

Table of Contents

PART I—FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements.

Liquidity Services, Inc. and Subsidiaries

Consolidated Balance Sheets

(Dollars in Thousands)

	June 30, 2018 (Unaudited)	September 30, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 83,411	\$ 94,348
Short-term investments	10,000	—
Accounts receivable, net of allowance for doubtful accounts of \$531 and \$668 at June 30, 2018 and September 30, 2017, respectively	5,856	11,598
Inventory	12,797	20,736
Prepaid taxes	2,267	2,466
Prepaid expenses and other current assets	6,857	9,774
Total current assets	121,188	138,922
Property and equipment, net	15,952	16,793
Intangible assets, net	397	427
Goodwill	45,316	45,388
Net deferred long-term tax assets	963	962
Other assets	13,624	12,737
Total assets	\$ 197,440	\$ 215,229
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 16,264	\$ 13,099
Accrued expenses and other current liabilities	18,204	30,193
Distributions payable	2,239	3,081
Payables to sellers	28,925	24,383
Total current liabilities	65,632	70,756
Deferred taxes and other long-term liabilities	6,487	11,837
Total liabilities	72,119	82,593
Commitments and contingencies (Note 12)	0	0
Stockholders' equity:		
Common stock, \$0.001 par value; 120,000,000 shares authorized; 32,109,731 shares issued and outstanding at June 30, 2018; 31,503,349 shares issued and outstanding at September 30, 2017	29	29
Additional paid-in capital	231,327	227,264
Accumulated other comprehensive loss	(7,195)	(6,431)
Retained earnings (accumulated deficit)	(98,840)	(88,226)
Total stockholders' equity	125,321	132,636
Total liabilities and stockholders' equity	\$ 197,440	\$ 215,229

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

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

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Revenue	\$32,080	\$ 44,404	\$ 115,464	\$ 144,799
Fee revenue	18,489	21,116	56,345	63,851
Total revenue	50,569	65,520	171,809	208,650
Costs and expenses from operations:				
Cost of goods sold	19,489	30,413	75,847	97,248
Seller distributions	3,936	5,189	11,107	14,697
Technology and operations	13,663	19,639	47,718	62,607
Sales and marketing	8,386	8,273	24,921	27,410
General and administrative	6,763	8,751	21,791	26,836
Depreciation and amortization	1,020	1,365	3,375	4,228
Other operating expenses	452	652	2,222	1,044
Total costs and expenses	53,709	74,282	186,981	234,070
Loss from operations	(3,140)	(8,762)	(15,172)	(25,420)
Interest and other income, net	(47)	(189)	(776)	(291)
Loss before provision (benefit) for income taxes	(3,093)	(8,573)	(14,396)	(25,129)
Provision (benefit) for income taxes	612	41	(3,824)	91
Net loss	\$(3,705)	\$(8,614)	\$(10,572)	\$(25,220)
Basic and diluted loss per common share	\$(0.12)	\$(0.27)	\$(0.33)	\$(0.80)
Basic and diluted weighted average shares outstanding	32,104,368	31,485,599	31,984,222	31,369,077

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

Liquidity Services, Inc. and Subsidiaries

Unaudited Consolidated Statements of Comprehensive Loss

(Dollars in Thousands)

	Three Months		Nine Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Net loss	\$(3,705)	\$(8,614)	\$(10,572)	\$(25,220)
Other comprehensive (loss) income:				
Foreign currency translation	(748)	323	(764)	(68)
Other comprehensive (loss) income, net of taxes	(748)	323	(764)	(68)
Comprehensive loss	\$(4,453)	\$(8,291)	\$(11,336)	\$(25,288)

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

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

	Nine Months Ended June 30,	
	2018	2017
Operating activities		
Net loss	\$(10,572)	\$(25,220)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,375	4,228
Stock compensation expense	4,134	5,462
Provision for inventory allowance	2,092	8,101
Provision for doubtful accounts	191	(1)
Deferred tax benefit	(4,814)	—
Impairment of intangible assets	—	1,028
Change in fair value of financial instruments	90	(749)
Gain from sale of property and equipment	(489)	—
Changes in operating assets and liabilities:		
Accounts receivable	5,551	(1,274)
Inventory	5,847	633
Prepaid and deferred taxes	197	1,356
Prepaid expenses and other assets	1,938	981
Accounts payable	3,165	2,036
Accrued expenses and other current liabilities	(12,149)	(13,422)
Distributions payable	(842)	8,208
Payables to sellers	4,542	(4,971)
Other liabilities	(664)	(662)
Net cash provided by (used in) operating activities	1,592	(14,266)
Investing activities		
Increase in intangibles	(23)	(78)
Purchases of property and equipment, including capitalized software	(2,697)	(6,210)
Proceeds from sales of property and equipment	828	—
Purchase of short-term investments	(10,000)	—
Net cash used in investing activities	(11,892)	(6,288)
Financing activities		
Proceeds from exercise of common stock options (net of tax)	12	93
Net cash provided by financing activities	12	93
Effect of exchange rate differences on cash and cash equivalents	(649)	(117)
Net decrease in cash and cash equivalents	(10,937)	(20,578)
Cash and cash equivalents at beginning of period	94,348	134,513
Cash and cash equivalents at end of period	\$83,411	\$113,935
Supplemental disclosure of cash flow information		
Cash paid (received) for income taxes, net	\$800	\$(931)

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements

1. Organization

Liquidity Services (the “Company”) operates a network of leading ecommerce marketplaces that enable buyers and sellers to transact in an efficient, automated environment offering over 500 product categories. The Company’s marketplaces provide professional buyers access to a global, organized supply of new, surplus, and scrap assets presented with digital images and other relevant product information. Additionally, the Company enables its corporate and government sellers to enhance their financial return on offered assets by providing a liquid marketplace and value-added services that encompass the consultative management, valuation, and sale of surplus assets. The Company's services include program management, valuation, asset management, reconciliation, Return to Vendor ("RTV") and Returns Management Authorization ("RMA"), refurbishment and recycling, fulfillment, marketing and sales, warehousing and transportation, buyer support, and compliance and risk mitigation, as well as self-service tools for its sellers. The Company organizes the products on its marketplaces into categories across major industry verticals such as consumer electronics, general merchandise, apparel, scientific equipment, aerospace parts and equipment, technology hardware, energy equipment, industrial capital assets, fleet and transportation equipment and specialty equipment. The Company’s marketplaces are www.liquidation.com, www.govliquidation.com, www.govdeals.com, www.networkintl.com, www.secondipity.com, www.go-dove.com, www.irondirect.com, and www.auctiondeals.com. The Company has over 10,000 sellers, including Fortune 1000 and Global 500 organizations as well as federal, state, and local government agencies. The Company has three reportable segments, Retail Supply Chain Group (RSCG), Capital Assets Group (CAG), and GovDeals. See Note 13 in the Notes to the Consolidated Financial Statements for Segment Information.

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

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

2. Summary of Significant Accounting Policies

Unaudited Interim Financial Information

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal, recurring adjustments considered necessary for a fair presentation have been included. The information disclosed in the notes to the consolidated financial statements for these periods is unaudited. Operating results for the three and nine months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending September 30, 2018 or for any future period.

In the Consolidated Statements of Operations, revenue from the resale of inventory that the Company purchases from sellers is recognized within “Revenue”. Commission fees from the sale of inventory that the Company sells on a

consignment basis and other non-consignment fee revenue, which is largely made up of service revenue, is recognized within “Fee Revenue”.

New Accounting Pronouncements

Accounting Standards Adopted

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-09, Compensation - Stock Compensation (Topic 718). This update was issued as part of the FASB’s simplification initiative and affects all entities that issue share-based awards to their employees. The amendments in this update cover such

7

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

areas as the recognition of excess tax benefits and deficiencies and an accounting policy election for forfeitures. As part of the new guidance:

• Excess tax benefits and deficiencies arising from share-based awards are reflected in the condensed consolidated statements of operations as income tax expense rather than within stockholders' equity.

• Excess tax benefits will be presented as an operating activity on the statement of cash flows rather than as a financing activity.

A forfeiture election will be made to either estimate forfeitures (similar to the requirement in effect prior to adoption of the update) or recognize actual forfeitures as they occur. Entities will apply the forfeiture election provision using a modified retrospective transition approach, with a cumulative effect adjustment recorded to retained earnings as of the beginning of the period of adoption.

Methods used to satisfy statutory tax withholding requirements by employers who withhold shares upon settlement of an award on behalf of an employee to cover tax obligations are broadened to allow for a range of withholding from the minimum to the maximum statutory allowable amounts.

The Company adopted the provisions of this guidance during the first quarter of fiscal 2018 as follows:

• Excess tax benefits and deficiencies arising from share-based awards are reflected within the Consolidated Statements of Operations as income tax expense; adopted prospectively, with no impact to prior year amounts;

• Excess tax benefits are presented as an operating activity on the statement of cash flows; adopted prospectively with no impact on prior year amounts.

As part of its adoption of ASU 2016-09, the Company made an accounting policy election to change the way in which it accounts for forfeitures of share-based awards. Specifically, beginning in the first quarter of fiscal 2018, the Company recognizes forfeitures of share-based awards as they occur in the period of forfeiture rather than estimating the number of awards expected to be forfeited at the grant date and subsequently adjusting the estimate when awards are actually forfeited. The change in accounting policy resulted in an adjustment to retained earnings as of October 1, 2017 of approximately \$0.2 million.

Accounting Standards Not Yet Adopted

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805). ASU 2017-01 clarifies the definition of a business to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. This guidance will become effective for the Company beginning on October 1, 2018. The amendments in this update should be applied prospectively on or after the effective date. No disclosures are required at transition. The Company does not expect the adoption of this standard to have a material effect upon the consolidated financial statements.

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which supersedes most existing revenue recognition guidance under GAAP. The new standard will change the way the Company recognizes revenue and significantly expand the disclosure requirements for revenue arrangements. The guidance may be adopted either retrospectively or on a modified retrospective basis whereby the new standard would be applied to new and existing arrangements with remaining performance obligations as of the effective date, with a cumulative catch-up adjustment recorded to retained earnings at the effective date for existing arrangements with remaining performance obligations. During the fiscal year ended September 30, 2017, the Company initiated a formal project to assess the new standard, which is being completed in three phases: an assessment phase, a design phase, and an implementation phase. The Company has completed the assessment phase, which consisted of reviewing a representative sample of contracts, engaging in discussions with key stakeholders, and cataloging potential impacts on the Company's accounting policies, financial statements, and systems and processes. The implementation team has apprised both management and the audit committee of project status on a regular basis. As part of the design phase, the Company is performing an in-depth contract review process, and drafting a set of accounting policies in compliance with the new standard. The Company is continuing to evaluate all potential impacts of the new standard, including certain potential accounting impacts that the Company has identified that, require more detailed analysis, including the principal-agent guidance, the transfer of control guidance, and the guidance on when certain services that the Company provides would be considered separate performance obligations. Because this assessment is preliminary and the accounting for revenue recognition is subject to significant judgment, this could change as the Company finalizes its assessment of the new standard. The Company does not yet know and cannot reasonably estimate the quantitative impact of adoption of the new standard on the consolidated financial statements. This guidance will become effective for the Company beginning on October 1, 2018. The Company intends to adopt the new standard on a modified retrospective basis.

In February 2016, the FASB issued ASU 2016-2, Leases. ASU 2016-02 will change the way the Company recognizes its leased assets. ASU 2016-2 will require organizations that lease assets—referred to as "lessees"—to recognize on the balance sheet the assets and liabilities representing the rights and obligations created by those leases. ASU 2016-2 will also require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. The guidance will be effective for the Company beginning on October 1, 2019. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is currently evaluating the new standard and the effect that adoption of the standard is expected to have on the Company's consolidated financial statements and related disclosures.

In January 2017, the FASB issued ASU 2017-04, Intangibles-Goodwill and Other (Topic 350). Under ASU 2017-04 the entity is required to perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity is required to recognize an impairment charge for the amount by which the carrying amount of a reporting unit exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity is required to consider income tax effects from any tax-deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. This guidance will become effective for the Company beginning on October 1, 2020. The Company is currently evaluating the methods of adoption allowed by the new standard.

In March 2017, the FASB issued ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. ASU 2017-07 changes how employers that sponsor defined benefit pension and/or other postretirement benefit plans present the cost of the benefits in the income statement. Under this standard, employers will present the service cost component of net periodic benefit cost in the same income statement line item(s) as other employee compensation costs arising from services rendered during the period. Employers will

present the other components of the net periodic benefit cost separately from the line item(s) that includes the service cost and outside of any subtotal of operating income, if one is presented. This guidance will become effective for the Company beginning on October 1, 2018. The Company is currently evaluating the methods of adoption allowed by the new standard. The Company does not expect the adoption of this standard to have a material effect upon the consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU 2018-02 allows entities to elect to classify from accumulated other comprehensive income (loss) to retained earnings stranded tax effects resulting from the Tax Cuts and Jobs Act enacted on December 22, 2017. An entity that does not elect to reclassify the income tax effects of the Tax Cuts and Jobs Act shall disclose in the period of adoption a statement that the election was not made. This guidance will become effective for the Company beginning on October 1, 2019. The Company is currently evaluating the methods of adoption of the new standard and the effect that adoption of the standard is expected to have on the Company's consolidated financial statements and related disclosures.

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This update is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The update provides new guidance regarding the classification of debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, distributions received from equity method investments, beneficial interests in securitized transactions, and separately identifiable cash flows and application of the predominance principle. This standard will be effective for financial statements issued by public companies for the annual and interim periods beginning after December 15, 2017. Early adoption of the standard is permitted. The Company is currently evaluating the effect that adoption of the standard is expected to have on the Company's consolidated financial statements and related disclosures.

Promissory Note

On September 30, 2015, the Company sold certain assets related to its Jacobs Trading business to Tanager Acquisitions, LLC (the "Buyer"). In connection with the disposition, the Buyer assumed certain liabilities related to the Jacobs Trading business. The Buyer issued a \$12.3 million five-year interest bearing promissory note to the Company. Of the \$12.3 million, \$2.5 million has been repaid. Of the remaining \$9.8 million, \$8.3 million is recorded in Other assets, and \$1.5 million in Prepaid expenses and other current assets as of June 30, 2018.

Risk Associated with Certain Concentrations

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

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

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash in banks over FDIC limits, certificates of deposit, and accounts receivable. The Company deposits its cash with financial institutions that the Company considers to be of high credit quality.

During the nine months ended June 30, 2018, the Company had two material vendor contracts with the Department of Defense (DoD) under which it acquired, managed and sold government property, the Surplus Contract and the Scrap Contract. Revenue from the sale of property acquired, as well as provision of services, under the Surplus Contract accounted for approximately 0.2% and 26.4% of the Company's consolidated revenue for the three months ended June 30, 2018 and 2017, respectively, and for approximately 16.2% and 27.8% of the Company's consolidated revenue for the nine months ended June 30, 2018 and 2017, respectively. Revenue from the sale of property acquired under the Scrap Contract accounted for approximately 12.1% and 12.3% of the Company's consolidated revenue for the three months ended June 30, 2018 and 2017, respectively, and 10.0% and 10.9% of the Company's consolidated

revenue for the nine months ended June 30, 2018 and 2017, respectively. These contracts are included within the Company's CAG segment. See Note 3, Significant Contracts, for further information related to the wind-down of the Surplus Contract.

Additionally, the Company has a vendor contract with Amazon.com, Inc. under which the Company acquires and sells commercial merchandise. The property purchased under this contract represented approximately 41.0% and 25.0% of cost of goods sold for the three months ended June 30, 2018 and 2017, respectively, and 28.5% and 22.1% of cost of goods sold for the nine months ended June 30, 2018 and 2017, respectively. This contract is included within the Company's RSCG segment.

Earnings per Share

The Company calculates net income (loss) per share in accordance with FASB Topic 260 Earnings Per Share (“ASC 260”). Under ASC 260, basic net income (loss) per common share is calculated by dividing net income (loss) by the weighted-average number of common shares outstanding during the reporting period. The weighted average number of shares of common

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

stock outstanding includes vested restricted stock units. Diluted net income (loss) per share reflects the potential dilution that could occur assuming conversion or exercise of all dilutive unexercised stock options and unvested restricted stock units. The dilutive effect of unexercised stock options and unvested restricted stock units was determined using the treasury stock method. Under the treasury stock method, the proceeds received from the exercise of stock options, and the amount of compensation cost for future service not yet recognized by the Company are assumed to be used to repurchase shares of the Company's common stock. Stock options and restricted stock units are not included in the computation of diluted net income (loss) per share when they are antidilutive.

For the three and nine months ended June 30, 2018 and 2017, the basic and diluted weighted average common shares were the same because the inclusion of dilutive securities in the computation of diluted net income would have been anti-dilutive. See Note 7 for outstanding stock options and unvested restricted stock, all of which are anti-dilutive for the three and nine months ended June 30, 2018 and 2017.

The following summarizes the basic and diluted loss per share:

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
	(Unaudited)			
	(dollars in thousands, except per share amounts)			
Weighted average shares calculation:				
Basic weighted average common shares outstanding	32,104,368	31,485,599	31,984,222	31,369,077
Treasury stock effect of options and restricted stock	—	—	—	—
Diluted weighted average common shares outstanding	32,104,368	31,485,599	31,984,222	31,369,077
Net loss	\$(3,705)	\$(8,614)	\$(10,572)	\$(25,220)
Basic and diluted loss per common share	\$(0.12)	\$(0.27)	\$(0.33)	\$(0.80)

Stock-Based Compensation

The Company estimates the fair value of share-based awards on the date of grant. The Company issues stock options and stock appreciation rights with restrictions that lapse upon either the passage of time (service vesting conditions), the achievement of performance targets (performance vesting conditions), or some combination thereof. In addition, the Company issues stock options that vest upon the achievement of certain Company stock price targets (market vesting conditions). The fair value of stock options and stock appreciation rights with service and/or performance vesting conditions is determined using the Black-Scholes option-pricing model. For those stock options with only service vesting conditions, the Company recognizes compensation cost on a straight-line basis over the explicit service period. For stock options with both performance and service vesting conditions, the Company starts recognizing compensation cost over the remaining service period, when it is probable the performance condition will be met.

The Company issues restricted stock units with service vesting conditions, performance vesting conditions, and market vesting conditions, or some combination thereof. For those restricted stock units with only service vesting conditions, the Company recognizes compensation cost on a straight-line basis over the explicit service period. For

restricted stock units with both performance and service vesting conditions, the Company starts recognizing compensation cost over the remaining service period when it is probable the performance condition will be met. The fair value of restricted stock units with service vesting and/or performance vesting is based on the closing price of the Company's common stock on the date of grant.

For the Company's stock options and restricted stock units with market vesting conditions, the ultimate number of shares to be earned depends on the Company's total shareholder return during the performance period. The fair value of these stock options and restricted stock units is estimated on the grant date using a Monte Carlo simulation model. The Company recognizes compensation cost for stock options and restricted stock units with market vesting conditions over the derived service period.

The determination of the fair value of the Company's stock options and stock appreciation rights with service and performance vesting conditions is based on a variety of factors including, but not limited to, the Company's common stock

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

price on the date of grant, expected stock price volatility over the expected life of units, and actual and projected exercise behavior. The determination of the fair value of the Company's stock options and restricted stock units with service and market vesting conditions is based on a variety of factors including, but not limited to, the Company's common stock price on the grant date, expected stock price volatility, risk free interest rate, dividend yield, and projected exercise behavior.

Upon adoption of ASU 2016-09, in the first quarter of fiscal 2018, the Company recognizes forfeitures of share-based awards as they occur in the period of forfeiture rather than estimating the number of awards expected to be forfeited at the grant date and subsequently adjusting the estimate when awards are actually forfeited. The change in accounting policy resulted in an adjustment to retained earnings of \$0.2 million as of October 1, 2017.

Stock options and restricted stock units that contain performance vesting or market vesting conditions are excluded from, diluted earnings per share computations until the applicable contingency is met as of the end of that reporting period.

The Company presents the cash flows from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) as an operating activity in the Consolidated Statements of Cash Flows.

3. Significant Contracts

Historically, the Company had two material vendor contracts with the DoD, the Scrap Contract and the Surplus Contract.

Under the Scrap Contract, the Company is the remarketer of all DoD non-electronic scrap turned into the Defense Logistics Agency (DLA) available for sale within the United States, Puerto Rico, and Guam.

The Scrap contract was awarded to the Company in April 2016. The Scrap Contract has a 36-month base term that commenced in the first quarter of fiscal year 2017, with two 12-month extension options exercisable by the DLA. The base term of the Scrap contract will expire on September 30, 2019. The Company pays a revenue-sharing payment to the DLA under this contract equal to 64.5% of the gross resale proceeds of the scrap property, and the Company bears all of the costs for the sorting, merchandising and sale of the property. The contract contains a provision permitting the DLA to terminate the contract for convenience upon written notice to the Company. The Company commenced operations under this contract in the quarter ended December 31, 2016, the first quarter of fiscal year 2017.

Revenue from the Scrap Contract accounted for approximately 12.1% and 12.3% of the Company's consolidated revenue for the three months ended June 30, 2018 and 2017, respectively, and 10.0% and 10.9% of the Company's consolidated revenue for the nine months ended June 30, 2018 and 2017, respectively.

The Surplus Contract was a competitive-bid contract under which the Company acquired, managed and sold usable DoD surplus personal property turned into the DLA. Surplus property generally consisted of items determined by the DoD to be no longer needed, and not claimed for reuse by any federal agency, such as electronics, industrial equipment, office supplies, scientific and medical equipment, aircraft parts, clothing and textiles. The Surplus Contract required the Company to purchase all usable surplus property offered to the Company by the DoD at 4.35% of the DoD's original acquisition value. The Company retained 100% of the profits from the resale of the property and bore all of the costs for the merchandising and sale of the property. Included in Accrued expenses and other current liabilities in the Consolidated Balance Sheet is a liability to the DoD for the inventory that has not been paid for in the amount of \$0.9 million and \$6.8 million as of June 30, 2018 and September 30, 2017, respectively.

On October 11, 2017, the DLA published a Request for Technical Proposal (“RFTP”) and draft Invitation for Bid (“IFB”) for the sale of surplus, useable non-rolling stock property. The RFTP and IFB related to the DLA’s award of two new term surplus contracts. On December 5, 2017, the DLA determined that the Company was not the high bidder for either of the two contracts. The Company made its final inventory purchase under the Surplus Contract during December 2017, and as of June 30, 2018 has completed its wind-down of the Surplus Contract.

Revenue from the Surplus Contract accounted for approximately 0.2% and 26.4% of the Company's consolidated revenue for the three months ended June 30, 2018 and 2017, respectively, and for approximately 16.2% and 27.8% of the Company's consolidated revenue for the nine months ended June 30, 2018 and 2017, respectively.

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

4. Goodwill

The goodwill of acquired companies is primarily related to the acquisition of an experienced and knowledgeable workforce. The following table presents goodwill balances and foreign currency translation adjustments to those balances during the nine months ended June 30, 2018:

Goodwill (in thousands)	CAG	GovDeals	Total
Balance at September 30, 2017	\$21,657	\$ 23,731	\$45,388
Translation adjustments	(72)	—	(72)
Balance at June 30, 2018	\$21,585	\$ 23,731	\$45,316

As part of the Company's fiscal year 2017 annual goodwill impairment assessment, the Company determined that certain events required performing a step one evaluation of goodwill to identify potential impairment. After performing the step one test, the Company concluded its remaining reporting units with goodwill had fair values, that substantially exceeded their respective book values as of July 1, 2017.

5. Intangible Assets

The components of identifiable intangible assets as of June 30, 2018 and September 30, 2017 are as follows:

	June 30, 2018			September 30, 2017			
	Useful Life (in years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(dollars in thousands)						
Patent and trademarks	3 - 10	793	(396)	397	943	(516)	427
Total intangible assets		\$793	\$ (396)	\$ 397	\$943	\$ (516)	\$ 427

Future expected amortization of intangible assets at June 30, 2018 is as follows:

Years ending September 30,	Future Amortization (in thousands)
2018 Remaining three months	\$ 19
2019	66
2020	64
2021	76
2022 and thereafter	172
Total	\$ 397

Intangible assets amortization expense was approximately \$0.02 million and \$0.3 million for the three months ended June 30, 2018 and 2017, respectively. Intangible assets amortization expense was approximately \$0.1 million and \$0.9 million for the nine months ended June 30, 2018 and 2017, respectively.

6. Income Taxes

On December 22, 2017, the Tax Act was signed into law. The Tax Act reduces the corporate tax rate from 35% to 21%. During the three months ending December 31, 2017, the Company revised its estimated annual effective tax rate to reflect this change in the statutory rate. The rate change is administratively effective at the beginning of the Company's 2018 fiscal year, using a blended rate of 24.53%. At June 30, 2018, the Company had not yet completed its accounting for the tax effects of the Tax Act; however, in the following cases the Company has made a provisional estimate of the Tax Act's effects. The Company recognized a tax benefit of \$3.5 million for the period ended December 31, 2017 as a result of adjusting its deferred tax balance

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

to reflect the new corporate tax rate. In addition, the Tax Act makes the alternative minimum tax (“AMT”) credit refundable in tax years beginning after 2017 and before 2022. As a result of this change, the Company reduced its valuation allowance on its AMT credits and recognized an income tax benefit of \$1.7 million.

The effect of the international provisions of the Tax Act, which establish a territorial tax system and subjects certain foreign earnings on which US tax is currently deferred to a one-time transition tax, is uncertain. As a result, the Company has not recorded any provisional amounts in its financial statements for the three and nine months ending June 30, 2018.

The Company’s interim effective income tax rate is based on management’s best current estimate of the Company’s expected annual effective income tax rate. The Company recorded a pre-tax loss in the first nine months of fiscal year 2018 and its corresponding effective tax rate is approximately -8.6% before recognition of a \$5.2 million tax benefit resulting from the new Tax Act netted against a \$0.1 million charge for interest related to the federal income tax examination for fiscal years 2013 through 2015 which was closed during the second quarter of 2018. The \$5.2 million benefit resulted from the reduction to the Company’s deferred tax balance to reflect the new corporate tax rate and reduction to its valuation allowance on AMT credits.

The Company applies the authoritative guidance related to uncertainty in income taxes. ASC 740 states that a benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolution of any related appeals or litigation processes, on the basis of technical merits. The Company records unrecognized tax benefits as a reduction to its deferred tax asset for its net operating loss carryforward. The Company identified no new uncertain tax positions during the nine months ended June 30, 2018. The Company’s policy is to recognize interest and penalties in the period in which they occur in the income tax provision. The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, various state and local jurisdictions and in foreign jurisdictions, primarily Canada and the U.K. During the nine months ended June 30, 2018, the Company closed the examination of its federal and state income tax returns for fiscal years 2012 through 2015 and incurred a \$0.1 million tax charge to close out the examination of its federal income tax returns for fiscal years 2013 through 2015. As of June 30, 2018, none of the Company’s federal or state income tax returns are under examination. The statute of limitations for U.S. federal income tax returns for years prior to fiscal 2014 is now closed. However, certain tax attribute carryforwards that were generated prior to fiscal 2014 may be adjusted upon examination by tax authorities if they are utilized.

7. Stockholders’ Equity

Share Repurchase Program

The Company is authorized to repurchase issued and outstanding shares of its common stock under a share repurchase program approved by the Company’s Board of Directors. Share repurchases may be made through open market purchases, privately negotiated transactions or otherwise, at times and in such amounts as management deems appropriate. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements and other market conditions. The repurchase program may be discontinued or suspended at any time and will be funded using available cash. The Company’s Board of Directors reviews the share repurchase program from time to time, the last such review having occurred in May 2016. The Company did not repurchase shares under this program during the nine months ended June 30, 2018 or 2017. As of June 30, 2018, the Company may repurchase an additional \$10.1 million in shares under this program.

2006 Omnibus Long-Term Incentive Plan (the 2006 Plan)

Under the 2006 Omnibus Long-Term Incentive Plan, or the 2006 Plan, as amended, 13,000,000 shares of common stock were available for issuance as of September 30, 2016. On February 23, 2017, at the Company's annual meeting of stockholders, the stockholders approved amendments to the 2006 Plan to increase the number of shares available for issuance under the 2006 Plan by 3,300,000, to a total of 16,300,000 shares. The 2006 Plan has a fungible share pool so that awards other than options or stock appreciation rights granted would be counted as 1.5 shares from the shares reserved for issuance.

The maximum number of shares subject to options or stock appreciation rights that can be awarded under the 2006 Plan to any person is 1,000,000 per year. The maximum number of shares that can be awarded under the 2006 Plan to any person, other than pursuant to an option or stock appreciation right, is 700,000 per year. The Company issues stock appreciation rights with restrictions that lapse upon either the passage of time (service vesting), achievement of performance targets (performance vesting), or some combination of these conditions. For those stock appreciation rights with only service vesting

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

conditions, the Company recognizes compensation cost on a straight-line basis over the explicit service period. For awards subject to both performance and service vesting conditions, the Company starts recognizing compensation cost over the remaining service period, when it is probable the performance vesting condition will be met. The stock appreciation rights that include only service vesting conditions generally vest over a period of one to four years conditioned on continued employment for the incentive period.

Cash-Settled Stock Appreciation Rights

During the nine months ended June 30, 2018, the Company did not issue any cash-settled stock appreciation rights. During the nine months ended June 30, 2018, 87,084 cash-settled stock appreciation rights were exercised, and 358,660 cash-settled stock appreciation rights were forfeited. As of June 30, 2018, 1,007,889 cash-settled stock appreciation rights were outstanding. During fiscal year 2017, the Company issued 218,550 cash-settled stock appreciation rights at the price of \$10.30, and 234,313 cash-settled stock appreciation rights were forfeited. Cash-settled stock appreciation rights are recorded as liability awards.

Stock Option Activity

A summary of the Company's stock option activity for the nine months ended June 30, 2018, and year ended September 30, 2017 is as follows:

	Options	Weighted-Average Exercise Price
Options outstanding at September 30, 2016	1,708,487	\$ 13.91
Options granted	232,845	9.18
Options exercised	(12,421)	7.41
Options canceled	(223,938)	13.00
Options outstanding at September 30, 2017	1,704,973	13.43
Options granted	546,644	4.71
Options exercised	(1,762)	6.63
Options canceled	(297,147)	12.54
Options outstanding at June 30, 2018	1,952,708	\$ 11.13
Options exercisable at June 30, 2018	1,137,727	\$ 14.88

The intrinsic value and weighted average remaining contractual life in years of outstanding and exercisable options at June 30, 2018 is approximately \$1.1 million and 6.12 years, and \$0.06 million and 5.2 years, respectively, based on a stock price per share of \$6.55 on June 30, 2018. Over the last three years, volatility rates have ranged from 51.49% to 58.59%, the dividend rate has been 0%, risk free interest rates have ranged from 0.47% to 2.17% and expected forfeiture rates have ranged from 0% to 23.54%. Upon adoption of ASU 2016-09, beginning in the first quarter of fiscal 2018, the Company recognizes forfeitures of share-based awards as they occur in the period of forfeiture rather than estimating the number of awards expected to be forfeited at the grant date and subsequently adjusting the estimate when awards are actually forfeited.

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

Restricted Share Activity

A summary of the Company's restricted share activity for the nine months ended June 30, 2018, and year ended September 30, 2017 is as follows:

	Restricted Shares	Weighted- Average Fair Value
Unvested restricted shares at September 30, 2016	2,661,245	\$ 9.34
Restricted shares granted	849,352	8.78
Restricted shares vested	(748,266)	11.04
Restricted shares canceled	(571,900)	9.81
Unvested restricted shares at September 30, 2017	2,190,431	8.42
Restricted shares granted	517,561	6.59
Restricted shares vested	(604,620)	9.23
Restricted shares canceled	(501,122)	8.89
Unvested restricted shares at June 30, 2018	1,602,250	\$ 7.38

The intrinsic value and weighted average remaining contractual life in years of unvested restricted stock units at June 30, 2018 was approximately \$10.5 million and 8.32 years, respectively, based on a stock price per share of \$6.55 on June 30, 2018.

8. Fair Value Measurement

The Company measures and records in the accompanying consolidated financial statements certain assets and liabilities at fair value on a recurring basis. Authoritative guidance issued by the FASB establishes a fair value hierarchy for those instruments measured at fair value that distinguishes between assumptions based on market data (observable inputs) and the Company's assumptions (unobservable inputs). The hierarchy consists of three levels:

Level 1 Quoted market prices in active markets for identical assets or liabilities;

Level 2 Inputs other than Level 1 inputs that are either directly or indirectly observable; and

Level 3 Unobservable inputs developed using estimates and assumptions developed by the Company, which reflect those that a market participant would use.

As of June 30, 2018, and September 30, 2017, the Company had no Level 1 or Level 2 assets or liabilities measured at fair value. As of September 30, 2017, the Company had financial assets that were measured at fair value and were classified as Level 3 assets within the fair value hierarchy. The Company elected to record the financial assets using the fair value option under ASC 825, Financial Instruments. These financial assets represented the value of rights the Company holds from its participation in certain principal transactions in the Company's commercial business, where a third-party partner owns the underlying assets to be sold, and the Company has contributed funds to the partner towards purchasing those underlying assets. These assets were included in Prepaid expenses and other current assets in the Consolidated Balance Sheets. The changes in financial assets measured at fair value for which the Company has used Level 3 inputs to determine fair value for the quarter ended June 30, 2018 are as follows (dollars in thousands):

Level

3

Edgar Filing: LIQUIDITY SERVICES INC - Form 10-Q

Assets

Balance at September 30, 2017	\$ 491
Acquisition of financial assets	—
Settlements	(401)
Change in fair value of financial assets	(90)
Balance at June 30, 2018	\$ —

During the nine months ended June 30, 2018, the Company recognized a loss of approximately \$0.1 million on its financial assets.

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

When valuing its Level 3 assets, the Company gives consideration to asset condition, economic and/or market events, and other pertinent information that would impact its estimate of the expected generated proceeds. The valuation procedures are primarily based on management's projection of the value of the assets securing the financial investment. Management's estimation of the fair value of these assets is based on the best information available in the circumstances and may incorporate management's own assumptions around market demand for these assets which could involve a level of judgment, taking into consideration a combination of internal and external factors. Changes in fair value of the Company's Level 3 assets are recorded in Other operating expense in the Consolidated Statements of Operations.

The Company's financial assets not measured at fair value are cash and cash equivalents (which includes cash and commercial paper with original maturities of less than 90 days), certificates of deposit, accounts receivable, and a promissory note. The Company believes the carrying values of these instruments approximates fair value.

9. Defined Benefit Pension Plan

Certain employees of Liquidity Services UK Limited ("GoIndustry"), which the Company acquired in July 2012, are covered by the Henry Butcher Pension Fund and Life Assurance Scheme (the "HB Pension Fund"), a qualified defined benefit pension plan.

The net periodic benefit recognized for the three and nine months ended June 30, 2018 and 2017 included the following components:

	Three Months Ended June 30,		Nine Months Ended June 30,	
Qualified Defined Benefit Pension Plan	2018	2017	2018	2017
	(dollars in thousands)			
Service cost	\$—	\$—	\$—	\$—
Interest cost	158	148	493	436
Expected return on plan assets	(242)	(213)	(750)	(623)
Settlement cost	—	—	(8)	—
Total net periodic (benefit)	\$(84)	\$(65)	\$(265)	\$(187)

10. Guarantees

During the second quarter of 2015, the Company issued a guarantee to GoIndustry (the "Subsidiary") and the Trustees (the "Trustees") of the HB Pension Fund. Under the arrangement, the Company irrevocably and unconditionally (a) guarantees to the Trustees punctual performance by the Subsidiary of all its Guaranteed Obligations, defined as all present and future obligations and liabilities (whether actual or contingent and whether owed jointly or severally in any capacity whatsoever) of the Company to make payments to the HB Pension Fund up to a maximum of 10 million British pounds, (b) undertakes with the Trustees that, whenever the Subsidiary does not pay any amount when due in respect of its Guaranteed Obligations, it must immediately on demand by the Trustees pay that amount as if it were the principal obligor; and (c) indemnifies the Trustees as an independent and primary obligation immediately on demand

against any cost, charge, expense, loss or liability suffered or incurred by the Trustees if any payment obligation guaranteed by it is or becomes unenforceable, invalid or illegal; the amount of the cost, charge, expense, loss or liability under this indemnity will be equal to the amount the Trustees would otherwise have been entitled to recover on the basis of a guarantee. The guarantee is a continuing guarantee that will extend to the ultimate balance of all sums payable by the Company in respect of its Guaranteed Obligations. As of June 30, 2018, the Company's plan assets exceeded plan liabilities by approximately \$2.1 million. As of September 30, 2017, the Company's plan assets exceeded plan liabilities by approximately \$1.9 million. The funded status of the HB Pension Fund as of September 30, 2017, was disclosed in Note 12, Defined Benefit Pension Plan, to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended September 30, 2017.

11. Business Realignment Expenses

During the fourth quarter of fiscal year 2017, the Company began to restructure its CAG business. The restructuring plan resulted in a reduction in force across a number of departments, including Sales, Marketing and Operations in both the US and

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

in Europe. In connection with this restructuring, on September 25, 2017 the Company terminated the employment of the President of the CAG business and provided a severance package to the executive in the amount of \$0.3 million. Overall, severance costs associated with this restructuring amounted to approximately \$0.9 million. In addition, the restructuring plan calls for the closure of several offices and legal entities in Europe and Asia. Legal and administrative costs associated with the restructuring amounted to \$0.1 million.

The Company continued to implement its CAG cost cutting initiatives during the nine months ended June 30, 2018. In addition, as discussed in Note 3, Significant Contracts, the Company was not the high bidder for the new surplus contracts, and therefore completed winding down operations of the Surplus Contract during the nine months ended June 30, 2018. As a result, the Company recognized an additional \$1.5 million in restructuring costs during the first nine months of fiscal 2018, \$1.0 million of which related to severance and occupancy cost as a result of the loss of the Surplus Contract. Restructuring costs associated with the restructuring plan were recognized within the other operating expense (income) line item in the consolidated statement of operations. This activity is included within employee severance and benefit costs in the table below.

During fiscal year 2017, the Company reorganized its IronDirect business. As a result, the Company recorded approximately \$0.9 million of net expense related to the impairment of long-lived assets associated with the IronDirect business, as well as a fair value adjustment. The impairment was comprised of \$1.2 million of impairment of contract intangibles, and \$0.6 million of impairment of fixed assets. This expense was netted against a \$0.9 million reversal of an earn-out liability. In addition to these impairments, and the restructuring of its IronDirect business model, the Company terminated the employment of the President and incurred severance costs of approximately \$0.1 million, which is included within employee severance and benefit costs in the table below. During the first nine months ended June 30, 2018, the Company recorded restructuring costs of approximately \$0.1 million related to occupancy and certain onerous contract costs related to its IronDirect business.

On June 16, 2017, the Company entered into an agreement to sub-lease 18,412 square feet of office space at 6931 Arlington Road, Bethesda, Maryland. The sub-lease commenced September 29, 2017 and will expire April 30, 2023. On the sub-lease commencement date, the Company relocated its headquarters from 1920 L Street NW, Washington DC, to the new Bethesda location. The Company ceased using the previous location as of September 30, 2017 and recognized a \$2.0 million cease-use charge in its consolidated statements of operations at September 30, 2017, under the Other operating expenses line item. During the nine months ended June 30, 2018, the Company paid down the cease-use charge in the amount of approximately \$0.8 million. This activity is presented under occupancy cost in the table below.

During the nine months ended June 30, 2018, the Company recognized an additional \$0.5 million in severance cost primarily related to the restructuring of its Corporate IT department. This is recorded within the Corporate & Other line item below.

The table below sets forth the significant components of and activity in the liability for business realignment initiatives during the nine months ended June 30, 2018, on a segment and consolidated basis:

(in thousands)	Liability Balance at September 30, 2017	Business Realignment Expenses	Cash Payments	Liability Balance at June 30, 2018
Employee severance and benefit costs:				
CAG	\$ 793	\$ 910	\$(1,644)	\$ 59
Corporate & Other	399	462	(850)	11
Total employee severance and benefit costs	1,192	1,372	(2,494)	70
Occupancy and other costs:				
CAG	—	675	(188)	487

Edgar Filing: LIQUIDITY SERVICES INC - Form 10-Q

Corporate & Other	1,988	35	(841)	1,182
Total occupancy and other costs	1,988	710	(1,029)	1,669
Total business realignment	\$ 3,180	\$ 2,082	\$(3,523)	\$ 1,739

The \$2.1 million in employee severance and occupancy cost per the table above is recorded in Other operating expenses (income) in the Consolidated Statements of Operations. Of this \$2.1 million in cost, approximately \$0.9 million is associated

18

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

with general and administrative, \$0.2 million with sales and marketing, and \$1.0 million with technology and operations activities.

The Company expects that the remaining liability balance at June 30, 2018, of approximately \$1.7 million, will be paid during fiscal years 2018 and 2019.

12. Legal Proceedings

Howard v. Liquidity Services, Inc., et al., Civ. No. 14-1183 (D. D. C. 2014).

On July 14, 2014, Leonard Howard filed a putative class action complaint in the United States District Court for the District of Columbia (the “District Court”) against the Company and its chief executive officer, chief financial officer, and chief accounting officer, on behalf of stockholders who purchased the Company's common stock between February 1, 2012 and May 7, 2014. The complaint alleged that the defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 by, among other things, misrepresenting the Company's growth initiative, growth potential, and financial and operating conditions, thereby artificially inflating the Company's stock price, and sought unspecified compensatory damages and costs and expenses, including attorneys’ and experts’ fees. On October 14, 2014, the Court appointed Caisse de Dépôt et Placement du Québec and the Newport News Employees’ Retirement Fund as co-lead plaintiffs. The plaintiffs filed an amended complaint on December 15, 2014, which alleges substantially similar claims, but which does not name the chief accounting officer as a defendant. On March 2, 2015, the Company moved to dismiss the amended complaint for failure to state a claim or plead fraud with the requisite particularity. On March 31, 2016, the Court granted that motion in part and denied it in part. Only the claims related to the Company's retail division were not dismissed. On May 16, 2016, the defendants answered the amended complaint, denying all allegations of wrong-doing. Plaintiffs’ class certification motion was granted, and defendants’ motion for partial summary judgment was denied, on September 6, 2017. On June 19, 2018, the parties reached agreement to settle this action, including the dismissal and release of all claims against all defendants, in exchange for the payment by the Company’s insurance carriers of \$17 million to plaintiffs and the class. The agreement was submitted to the District Court and was preliminarily approved on June 20, 2018. Final approval of the settlement will be decided at a hearing before the District Court scheduled for October 5, 2018 after notice to the class and other customary conditions are satisfied. There can be no assurance that the settlement will be approved and, even if approved, whether the conditions to effectiveness will be satisfied.

In re Liquidity Services, Inc. Derivative Litigation, Civ. No. 2017-0080-JTL (Del. Ch.).

On February 2, 2017, plaintiff David Girardi filed a putative derivative complaint in the Court of Chancery of the State of Delaware (the “Court of Chancery”), and on February 7, 2017, plaintiff Harold Slingerland filed a putative derivative complaint in the Court of Chancery. On March 9, 2017, plaintiffs Girardi and Slingerland filed a consolidated putative derivative complaint in the Court of Chancery, purportedly on the Company’s behalf. The consolidated complaint names as defendants the Company’s chief executive officer and chief financial officer, as well as certain other individuals who served on the Company’s Board of Directors between 2012 and 2014, and seeks recovery from those individuals, not from us. The complaint asserts that, among other things, the defendants breached their fiduciary duties to the Company and its stockholders by causing or allowing the Company to make the same misstatements that are alleged in the amended complaint in the Howard action, and for alleged trading in Company securities while in possession of material non-public information. On November 27, 2017, the Court of Chancery granted the defendants’ motion to dismiss.

Following the dismissal of the putative derivative action discussed above, former plaintiffs Girardi and Slingerland sent the Company a letter dated January 5, 2018 (the “Shareholder Demand”) demanding that the Board of Directors take action to remedy purported breaches of fiduciary duties allegedly related to the claims asserted in the above-discussed securities class action and derivative actions. The Company acknowledged the Shareholder Demand on January 22, 2018. The Company’s Board of Directors has delegated to a special committee of the Board, comprised of independent directors who are not named in the letter, the initial evaluation of and the formulation of recommendations to the Board with respect to the Shareholder Demand. The special committee has retained counsel to assist and advise it in connection with its work.

13. Segment Information

The Company provides operating results in three reportable segments: GovDeals, Capital Assets Group (CAG), and Retail Supply Chain Group (RSCG). These three segments constitute 98% of the Company's revenue as of June 30, 2018, and

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

each offers separately branded marketplaces to enable sellers to achieve channel marketing objectives to reach buyers. Across its segments, the Company offers its sellers two primary transaction models as well as a suite of services, and our revenues vary depending upon the models employed and the level of service required. A description of the reportable segments follows:

The GovDeals reportable segment provides self-service solutions in which sellers list their assets for sale without relying on our services, and it consists of marketplaces that enable local and state government entities including city, county and state agencies, as well as commercial businesses located in the United States and Canada to sell surplus and salvage assets. GovDeals also offers a suite of services that includes asset sales and marketing services. This segment includes the Company's GovDeals.com and AuctionDeals.com marketplaces.

The CAG reportable segment provides full-service solutions to sellers and it consists of marketplaces that enable federal government agencies as well as commercial businesses to sell surplus, salvage, and scrap assets. The assets that the Company receives as a contractor of the DLA of the Department of Defense (DoD) are sold in this segment. CAG also offers a suite of services that includes surplus management, asset valuation, and asset sales and marketing services. Commercial sellers are located worldwide. This segment includes the Company's Network International, GoIndustry DoveBid, and Government Liquidation marketplaces.

The RSCG reportable segment consists of marketplaces that enable corporations located in the United States and Canada to sell surplus and salvage consumer goods and retail capital assets. RSCG also offers a suite of services that includes returns management, asset recovery, and eCommerce services. This segment includes the Company's Liquidation.com, Liquidation.com DIRECT, and Secondipity marketplaces.

Corporate & Other primarily consists of the Company's IronDirect and former TruckCenter operating segments which are not individually significant, as well as elimination adjustments. The TruckCenter business consisted of land-based, live auctions for fleet and transportation equipment. On January 30, 2017, the Company exited the TruckCenter land-based, live auction business in order to focus its time and resources on its ecommerce marketplace strategy. IronDirect offers buyers access to construction equipment, parts and services through a single ecommerce marketplace.

Decisions concerning the allocation of the Company's resources are made by the Company's Chief Operating Decision Maker ("CODM"), which is the Company's CEO, with oversight by the Board of Directors. The Company reports segment information based on the internal performance measures used by the CODM to assess the performance of each operating segment in a given period. In connection with that assessment, the CODM uses segment gross profit to evaluate the performance of each segment. Gross profit is calculated as total revenue less cost of goods sold and seller distributions.

The amount of our revenue that came from sales outside of the U.S. for the three months ended June 30, 2018 and 2017 was 14.5% and 10.0%, respectively. The amount of our revenue that came from sales outside of the U.S. for the nine months ended June 30, 2018 and 2017 was 12.9% and 11.3%, respectively.

The following table sets forth certain financial information for the Company's reportable segments and Corporate & Other:

Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements — (Continued)

	Three Months		Nine Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
GovDeals:				
Revenue	\$8,421	\$7,464	\$22,554	\$19,901
Gross profit	\$7,795	\$7,023	\$20,927	\$18,670
CAG:				
Revenue	\$15,011	\$34,400	\$72,230	\$113,978
Gross profit	\$9,911	\$17,418	\$39,973	\$56,961
RSCG:				
Revenue	\$26,343	\$23,528	\$73,742	\$72,029
Gross profit	\$9,305	\$7,398	\$24,649	\$22,566
Corporate & Other:				
Revenue	\$794	\$128	\$3,283	\$2,742
Gross profit	\$133	\$(1,921)	\$(694)	\$(1,492)
Consolidated:				
Revenue	\$50,569	\$65,520	\$171,809	\$208,650
Gross profit	\$27,144	\$29,918	\$84,855	\$96,705

The following table presents a reconciliation between the Company's reportable segments and the Company's consolidated results:

	Three Months		Nine Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Reconciliation:				
Gross profit	\$27,144	\$29,918	\$84,855	\$96,705
Operating Expenses	30,284	38,680	100,027	122,125
Interest and other income, net	(47)	(189)	(776)	(291)
Provision (benefit) for income taxes	612	41	(3,824)	91
Net loss	\$(3,705)	\$(8,614)	\$(10,572)	\$(25,220)

14. Subsequent Event

On July 10, 2018, the Company acquired all of the outstanding stock of Machinio Corporation, a privately owned company based in Chicago, Illinois, for net cash consideration of approximately \$16.7 million, equity consideration of approximately \$2.0 million, and contingent consideration payable in 2020 of up to \$5.0 million. Machinio operates a global online platform for listing used equipment for sale in the construction, machine tool, transportation, printing and agriculture sectors.

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

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements. These statements are only predictions. The outcome of the events described in these forward-looking statements is subject to known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. These risks and other factors include but are not limited to the factors set forth in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017 and subsequent filings with the Securities and Exchange Commission. You can identify forward-looking statements by terminology such as “may,” “will,” “should,” “could,” “would,” “expects,” “intend,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “potential,” “continues” or the negative of these terms or other comparable terminology. Although

we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. There may be other factors of which we are currently unaware or deem immaterial that may cause our actual results to differ materially from the forward-looking statements.

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

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

Overview

About us. We manage, value, and sell inventory and equipment for business and government clients by operating a network of leading ecommerce marketplaces that enable buyers and sellers to transact in an efficient, automated environment offering over 500 product categories. Our marketplaces provide professional buyers access to a global, organized supply of new, surplus, and scrap assets presented with digital images and other relevant product information. Additionally, we enable corporate and government sellers to enhance their financial return on offered assets by providing a liquid marketplace and value-added services that encompass the consultative management, valuation, and sale of surplus assets. Our broad range of services include program management, valuation, asset management, reconciliation, Return to Vendor ("RTV") and Returns Management Authorization ("RMA"), refurbishment and recycling, fulfillment, marketing and sales, warehousing and transportation, buyer support, and compliance and risk mitigation, as well as self-service tools. We organize the products on our marketplaces into categories across major industry verticals such as consumer electronics, general merchandise, apparel, scientific equipment, aerospace parts and equipment, technology hardware, energy equipment, industrial capital assets, fleet and transportation equipment and specialty equipment. Our network of marketplaces includes: www.liquidation.com, www.govliquidation.com, www.govdeals.com, www.networkintl.com, www.secondipity.com, www.go-dove.com, www.irondirect.com, and www.auctiondeals.com. We have over 10,000 sellers, including Fortune 1000 and Global 500 organizations as well as federal, state, and local government agencies. We have three reportable segments, Retail Supply Chain Group (RSCG), Capital Assets Group (CAG), and GovDeals. See Note 13 in the Notes to the Consolidated Financial Statements for Segment Information.

We believe our ability to create liquid marketplaces for surplus and salvage assets generates a continuous flow of goods from our corporate and government sellers. This flow of goods in turn attracts an increasing number of professional buyers to our marketplaces. During the twelve months ended June 30, 2018, the number of registered buyers grew from 3,106,000 to 3,275,000, or approximately 5.4%.

On July 10, 2018, Liquidity Services acquired 100% of Machinio Corp., a privately-owned company based in Chicago, Illinois, with a second office in Berlin, Germany. Machinio operates a global online platform for listing used equipment for sale in the construction, machine tool, transportation, printing and agriculture sectors.

Our revenue. Substantially all of our revenue is earned through the following transaction models.

Purchase model. Under our purchase transaction model, we recognize revenue within the Revenue line item on the Consolidated Statements of Operations from the resale of inventory that we purchased from sellers. We consider these sellers to be our vendors. We pay our vendors either a fixed amount or a portion of the net or gross proceeds received from our completed sales based on the value we receive from the sale, in some cases, after deducting a required return

to us that we have negotiated with the seller. Because we are the primary obligor and take general and physical inventory risks and credit risk under this transaction model, we recognize as revenue the sale price paid by the buyer upon completion of a transaction. The proceeds paid by buyers also include transaction fees, referred to as buyer premiums. Revenue from our purchase transaction model accounted for approximately 63.4% and 67.2% of our total revenue for the three and nine months ended June 30, 2018, respectively. These amounts include revenue earned from the sale of property obtained under the Scrap Contract, which accounted for approximately 12.1% and 10.0% of our total revenue for the three and nine months ended June 30, 2018, respectively. The price we paid the DLA for the property purchased under the Scrap Contract is based on a revenue share model. One of our key operating metrics is gross merchandise volume, or GMV, a non-GAAP financial measure which we define as the total sales value of all merchandise sold by us or our sellers through our marketplaces and other channels during a given period of time. The merchandise sold under our

purchase transaction model accounted for approximately 19.4% and 23.5% of our GMV for the three and nine months ended June 30, 2018, respectively.

Consignment model — fee revenue. Under our consignment transaction model, we enable our sellers to sell goods they own in our marketplaces and we charge them a commission fee based on the gross or net proceeds received from such sales. The revenue from our consignment transaction model is recognized within the Fee Revenue line item on the Consolidated Statements of Operations. Our commission fee revenue, which we refer to as seller commissions, represents a percentage of the sales price the buyer pays upon completion of a transaction. We vary the percentage amount of the seller commission depending on the various value-added services we provide to the seller to facilitate the transaction. For example, we generally increase the percentage amount of the commission if we take possession, handle, ship, or provide enhanced product information for the merchandise. In most cases we collect the seller commission by deducting the appropriate amount from the sales proceeds prior to the distribution to the seller after completion of the transaction. In addition to seller commissions, we also collect buyer premiums. Revenue from our consignment model accounted for approximately 34.7% and 29.8% of our total revenue for the three and nine months ended June 30, 2018, respectively. The merchandise sold under our consignment model accounted for approximately 80.6% and 76.5% of our total GMV for the three and nine months ended June 30, 2018, respectively.

We also earn non-consignment fee revenue, which is largely made up of service revenue related to our Surplus Contract. This revenue is recognized within the Fee revenue line item on our Consolidated Statements of Operations. We collect a buyer premium on most of the transactions under the transaction models we offer to sellers. Buyer premiums are calculated as a percentage of the sale price of the merchandise sold and are paid to us by the buyer. Buyer premiums are in addition to the price of the merchandise.

Industry trends. We believe there are several industry trends positively impacting the growth of our business including: (1) the ability for businesses to conduct ecommerce via the Internet both in the United States and abroad, which continues to mature; (2) the increase in the volume of returned merchandise handled both online and in stores as online and omni-channel retail grow as a percentage of overall retail sales; (3) the increase in government regulations and the need for corporations to have sustainability solutions necessitating verifiable recycling and remarketing of surplus assets; (4) the increase in outsourcing by corporate and government organizations of disposition activities for surplus and end-of-life assets as they focus on reducing costs, improving transparency, compliance and working capital flows, and increasingly prefer service providers with a proven track record, innovative scalable solutions and the ability to make a strategic impact in the reverse supply chain, which we expect to increase our seller base; and (5) in the long-term we expect innovation in the retail supply chain will increase the pace of product obsolescence and, therefore, the supply of surplus assets.

Our Vendor Agreements

Our DoD agreements. Historically, we had two material vendor contracts with the DoD, the Scrap Contract and the Surplus Contract.

- Scrap Contract. On April 8, 2016, the Defense Logistics Agency (DLA) awarded us the second Scrap Contract. Under the second Scrap Contract, we acquire scrap property from the DLA and pay the DLA a revenue-sharing payment equal to 64.5% of the gross resale proceeds. The Scrap Contract is a competitive-bid contract under which we acquire, manage and sell all non-electronic scrap property of the DoD turned into the DLA. Scrap property generally consists of items determined by the DoD to have no use beyond their base material content, such as metals, alloys, and building materials. We bear all of the costs for the sorting, merchandising and sale of the property. The second Scrap Contract has a 36-month base term, commencing in the first quarter of fiscal year 2017, with two 12-month extension options exercisable by the DLA. Transactions under this contract follow the purchase transaction model described above.

Resale of scrap property that we purchased under the Scrap Contract accounted for approximately 12.1% and 12.3% of our revenue for the three months ended June 30, 2018 and 2017, respectively, and approximately 10.0%, and 10.9% of our revenue for the nine months ended June 30, 2018 and 2017, respectively. The property sold under the Scrap Contract accounted for approximately 3.7% and 5.0% of our GMV for the three months ended June 30, 2018 and 2017, respectively, and approximately 3.7% and 4.7% of our GMV for the nine months ended June 30, 2018 and 2017, respectively. This contract is included within our CAG segment.

•**Surplus Contract.** The Surplus Contract was a competitive-bid contract under which we acquired, managed and sold usable DoD surplus personal property turned into the DLA. Surplus property generally consisted of items determined by the DoD to be no longer needed, and not claimed for reuse by any federal agency, such as electronics, industrial equipment, office supplies, scientific and medical equipment, aircraft parts, clothing and textiles. The Surplus Contract required us to purchase all usable surplus property offered to the Company by the DoD at 4.35% of the DoD's original acquisition value. We retained 100% of the profits from the resale of the property and bore all of the costs for the merchandising and sale of the property.

On October 11, 2017, the DLA published a Request for Technical Proposal (“RFTP”) and draft Invitation for Bid (“IFB”) for the sale of surplus, useable non-rolling stock property. The RFTP and IFB related to the DLA’s award of two new term surplus contracts. On December 5, 2017, the DLA determined that we were not the high bidder for either of the two contracts. As a result, we made our final inventory purchase under the Surplus Contract during December 2017, and as of June 30, 2018 had wound down the Surplus contract. The Surplus Contract accounted for \$74.6 million, or 27.6% of revenue in fiscal year 2017, \$58.1 million or 27.8% of revenue in the nine months ended June 30, 2017, and \$27.9 million or 16.2% of revenue in the nine months ended June 30, 2018. The property sold under the Surplus Contract accounted for approximately 0.1% and 8.5% of our GMV for the three months ended June 30, 2018 and 2017, respectively, and 5.4% and 9.3% of our GMV in the nine months ended June 30, 2018 and 2017. Transactions under the Surplus Contract followed the purchase transaction model described above. This contract is included within our CAG segment.

The lost profits from the wind-down and expiration of the Surplus Contract were offset by benefits from the reorganization and realignment efforts in fiscal 2017, as well as in the nine months ended June 30, 2018 (see Note 11 Business realignment expenses). The wind-down impact of the Surplus Contract is offset by the reorganization efforts within our CAG Commercial business and Corporate functions, and our realignment of our TruckCenter and IronDirect businesses.

We recorded approximately \$1.0 million of severance and occupancy cost during the nine months ended June 30, 2018, as a result of the restructuring and realignment efforts undertaken due to the loss of the Surplus Contract. The wind-down was completed as of June 30, 2018.

Our commercial agreements. We have a vendor contract with Amazon.com, Inc. under which we acquire and sell commercial merchandise. The property we purchased under this contract represented approximately 41.0%, and 25.0% of cost of goods sold for the three months ended June 30, 2018 and 2017, respectively, and approximately 28.5%, and 22.1% of cost of goods sold for the nine months ended June 30, 2018 and 2017, respectively. This contract is included within our RSCG segment.

Key Business Metrics

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

Gross merchandise volume. Gross merchandise volume, or GMV, is the total sales value of all merchandise sold by us or our sellers through our marketplaces or by us through other channels during a given period of time. We review GMV because it provides a measure of the volume of goods being sold in our marketplaces and thus the activity of those marketplaces. GMV also provides a means to evaluate the effectiveness of investments that we have made and continue to make, including in the areas of buyer and seller support, product development, sales and marketing, and operations. See Results of Operations for further information on GMV.

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

Total registered buyers, as of a given date, represent the aggregate number of persons or entities who have registered on one of our marketplaces. We use this metric to evaluate how well our marketing and promotional efforts are performing.

24

Total registered buyers exclude duplicate registrations, buyers who are suspended from utilizing our marketplaces and those buyers who have voluntarily removed themselves from our registration database. In addition, if we become aware of registered buyers that are no longer in business, we remove them from our database. As of June 30, 2018, and September 30, 2017, we had 3,275,000 and 3,171,000 registered buyers, respectively.

Total auction participants. For each auction we manage, the number of auction participants represents the total number of registered buyers who have bid one or more times in that auction. As a result, a registered buyer who bids, or participates, in more than one auction is counted as an auction participant in each auction in which he or she participates. Thus, total auction participants for a given period is the sum of the auction participants in each auction conducted during that period. We use this metric to allow us to compare our online auction marketplaces to our competitors, including other online auction sites and traditional on-site auctioneers. In addition, we measure total auction participants on a periodic basis to evaluate the activity level of our base of registered buyers and to measure the performance of our marketing and promotional efforts. During the three months ended June 30, 2018 and 2017, 512,000 and 577,000, respectively, total auction participants participated in auctions on our marketplaces. During the nine months ended June 30, 2018 and 2017, 1,580,000 and 1,740,000, respectively, total auction participants participated in auctions on our marketplaces. Largely as a result of the wind-down of the Surplus Contract, there has been a decrease in auction participants during fiscal 2018 compared with fiscal 2017.

Completed transactions. Completed transactions represents the number of auctions in a given period from which we have recorded revenue. Similar to GMV, we believe that completed transactions is a key business metric because it provides an additional measurement of the volume of activity flowing through our marketplaces. During the three months ended June 30, 2018 and 2017, we completed 121,000 and 134,000 transactions, respectively. During the nine months ended June 30, 2018 and 2017, we completed 361,000 and 407,000 transactions, respectively. Largely as a result of the wind-down of the Surplus Contract, there has been a decrease in completed transactions during fiscal 2018 compared with fiscal 2017.

Non-GAAP Financial Measures

EBITDA and Adjusted EBITDA. EBITDA is a supplemental non-GAAP financial measure and is equal to net income plus interest and other (income) expense, net; provision for income taxes; and depreciation and amortization. Interest and other (income) expense, net, can include non-operating gains and losses, such as from foreign currency fluctuations and disposals of fixed assets. Our definition of Adjusted EBITDA differs from EBITDA because we further adjust EBITDA for stock-based compensation expense, acquisition costs such as transaction expenses and changes in earn out estimates, business realignment expense, deferred revenue purchase accounting adjustments, and goodwill and long-lived asset impairment.

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

Depreciation and amortization expense primarily relates to property and equipment, and the amortization of intangible assets. These expenses are non-cash charges that have fluctuated significantly over the past five years. As a result, we believe that adding back these non-cash charges to net income is useful in evaluating the operating performance of our business on a consistent basis from year-to-year.

As a result of varying federal and state income tax rates, we believe that presenting a financial measure that adjusts net income for provision for income taxes is useful to investors when evaluating the operating performance of our business on a consistent basis from year to year.

The authoritative guidance for stock-based compensation requires all share-based payments to employees, including grants of employee stock options, restricted stock and stock appreciation rights to be recognized in the income statement based on their estimated fair values. We believe adjusting net income for this stock-based compensation

expense is useful to investors when evaluating the operating performance of our business on a consistent basis from year to year.

The authoritative guidance related to business combinations requires the recognition of contingent consideration so that it is recognized at the time of acquisition rather than when it is probable and disallows the capitalization of transaction costs. We believe adjusting net income for these acquisition related expenses is useful to investors when evaluating the operating performance of our business on a consistent basis from year to year.

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

We believe isolating non-cash charges, such as amortization and depreciation, and other items, such as impairment costs incurred outside our ordinary course of business, provides additional information about our cost structure, and, over time, helps track our performance.

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

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

Our management uses EBITDA and Adjusted EBITDA:

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

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

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

to evaluate the effectiveness of our operational strategies; and

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

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

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

The table below reconciles income to EBITDA and Adjusted EBITDA from continuing operations for the periods presented.

	Three Months		Nine Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
	(In thousands)			
	(Unaudited)			
Net loss	\$(3,705)	\$(8,614)	\$(10,572)	\$(25,220)
Interest and other income, net	(47)	(189)	(776)	(291)
Provision (benefit) for income taxes	612	41	(3,824)	91
Depreciation and amortization	1,020	1,365	3,375	4,228
EBITDA	(2,120)	(7,397)	(11,797)	(21,192)
Stock compensation expense	1,436	1,563	4,134	5,462
Acquisition costs and impairment of long-lived assets*	204	886	204	886
Business realignment expenses*	249	(234)	2,073	906
Adjusted EBITDA	\$(231)	\$(5,182)	\$(5,386)	\$(13,938)

* Acquisition costs and impairment of long-lived assets and business realignment expenses, which are excluded from Adjusted EBITDA, are included in Other operating expenses on the Statements of Operations. See Note 11 to Notes to Consolidated Financial Statements for further detail.

Critical Accounting Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. A “critical accounting estimate” is one

which is both important to the portrayal of our financial condition and results and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. We continuously evaluate our critical accounting estimates. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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

- a buyer submits the winning bid in an auction and, as a result, evidence of an arrangement exists, and the sale price has been determined;
- the buyer has assumed risks and rewards of ownership; and
- collection is reasonably assured.

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

Fee revenue is principally revenue earned under the consignment model and is presented separately as it accounts for more than 10% of total revenue.

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

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

• We are the primary obligor in the arrangement.

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

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

• We have general inventory risk.

We take title to the inventory upon paying the amount set forth in the contract with the supplier. Such amount is generally a percentage of the supplier's original acquisition cost and varies depending on the type of the inventory purchased or a fixed nominal amount under our Scrap contract.

- We are at risk of loss for all amounts paid to the supplier in the event the property is damaged or otherwise becomes unsaleable.

The amount of our revenue that came from sales outside of the U.S. for the three months ended June 30, 2018 and 2017 was 14.5% and 10.0%, respectively. The amount of our revenue that came from sales outside of the U.S. for the nine months ended June 30, 2018 and 2017 was 12.9% and 11.3%, respectively.

Inventory. Inventory consists of products available for sale and is valued at net realizable value. This valuation requires us to make judgments based on currently available information about expected recoverable value.

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

We test our goodwill for impairment annually or more frequently if events or circumstances indicate impairment may exist. Examples of such events or circumstances could include a significant change in business climate, a loss of significant sellers or buyers, or a significant decline in stock price. We make a qualitative evaluation about the likelihood of goodwill impairment to determine whether we should calculate the fair value of a reporting unit. If our evaluation indicates a likelihood of goodwill impairment in one of our four reporting units, which are the same as our four operating segments (RSCG, CAG, GovDeals, and IronDirect), we apply a two-step fair value-based test to assess goodwill for impairment of our four reporting units. The first step compares the fair value of a reporting unit to its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, we perform the second step, which compares the carrying amount of the

reporting unit's goodwill to the implied fair value of the goodwill. If the fair value of the goodwill is less than the carrying amount, an impairment loss would be recorded in our statements of operations. Intangible assets with definite lives are amortized over their estimated useful lives and are also reviewed for impairment if events or changes in circumstances indicate that their carrying amount may not be realizable.

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

Determining the fair value of a reporting unit requires the exercise of significant judgment, including judgments about the appropriate discount rates, terminal growth rates, weighted average costs of capital, exit multiples, and the amount and timing of expected future cash flows. The judgments used in determining the fair value of our reporting units are based on significant unobservable inputs which causes the determination of the implied fair value of goodwill to fall within level three of the GAAP fair value hierarchy. The cash flows employed in the discounted cash flow analysis are based on the most recent budgets, forecasts, and business plans as well as various growth rate assumptions for years beyond the current business plan period. Discount rate assumptions are based on an assessment of the risk inherent in the future revenue streams and cash flows of the reporting unit. Various factors, including the failure to successfully implement our business plan for any of our reporting units, as well as other factors beyond our control, could have a negative effect on the fair value of such reporting unit, and increase the risk of further impairments of goodwill in the future.

A reporting unit represents a component of an operating segment that (a) constitutes a business, (b) has discrete financial information, and (c) has its performance reviewed by management. We have four reporting units-RSCG, CAG, GovDeals, and IronDirect.

As part of our fiscal year 2017 annual impairment assessment performed as of July 1, 2017, we believed that certain events required performing a step one evaluation of goodwill to identify potential impairment. As a result of the step one test, we determined that our reporting units with goodwill had fair values as of September 30, 2017, that substantially exceeded their respective book values.

We cannot predict the occurrence of certain future events that might adversely affect the reported value of goodwill and other intangible assets, which totaled 45.7 million at June 30, 2018. Such events may include strategic decisions made in response to economic and competitive conditions, the impact of the economic environment on our base of buyers and sellers or material negative changes in our relationships with material customers.

Income taxes. We account for income taxes using the asset and liability approach for measuring deferred taxes based on temporary differences between the financial statement and income tax bases of assets and liabilities existing at each balance sheet date using enacted tax rates for the years in which the taxes are expected to be paid or recovered. We recognize deferred tax assets to the extent that we believe that these assets are more likely than not to be realized. In making such determination, we consider all available positive and negative evidence to estimate whether future taxable income will be generated to permit use of the existing deferred tax asset. A significant piece of subjective negative evidence that we evaluated as of September 30, 2017 was the cumulative loss incurred over the three-year period ended September 30, 2017, and projected losses in the near-term future. Such objective evidence limited our ability to consider other subjective evidence, such as our projections for future growth.

On the basis of our evaluation of our deferred tax assets as of September 30, 2017, we recorded a charge of \$10.1 million to our valuation allowance during the fiscal year ended September 30, 2017. Staff Accounting Bulletin 118 provides guidance on accounting for the tax effects of the Tax Cuts and Jobs Act (the "Tax Act") signed into law on December 22, 2017. To the extent that a company's accounting for certain income tax effects of the Tax Act is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements. Accordingly, during the nine months ended June 30, 2018, we recorded a provisional reduction of \$10.1 million to our valuation allowance. The reduction is comprised of \$13.0 million for the re-measurement of deferred tax assets at the newly enacted tax rate and \$1.7 million for the recognition of tax credits resulting from the repeal of the alternative minimum tax, netted against a charge of \$4.6 million for net operating losses generated during the nine months ended June 30, 2018.

We apply the authoritative guidance related to accounting for uncertainty in income taxes. A benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, on the basis of the technical merits. During the nine months ended June 30, 2018, we did not identify new uncertain tax benefits.

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

Stock-based compensation. We recognize all share-based payments to employees, including grants of employee stock options, in the statements of operations based on their estimated fair values. We use the Black-Scholes option pricing model as well as a Monte Carlo simulation to estimate the fair values of certain share-based payments.

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

Components of Revenue and Expenses

Revenue. We generate a large portion of our revenue from the proceeds of sales of merchandise held in inventory. We also generate commission revenue from sales in our marketplaces of merchandise that is owned by others. Our revenue recognition practices are discussed in more detail in the section above entitled "Critical Accounting Estimates."

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

Seller distributions. Under the current Scrap Contract, we acquire scrap property from the DLA for resale and pay the DLA a revenue-sharing payment equal to 64.5% of the gross resale proceeds. We bear all of the costs for the sorting, merchandising and sale of the property.

Technology and operations. Technology expenses consist primarily of the cost of technical staff who develop, deploy, and maintain our marketplaces and corporate infrastructure. These personnel also develop and upgrade the software systems that support our operations, such as sales processing. Technology expenses also includes certain costs associated with our LiquidityOne platform. Because our marketplaces and support systems require frequent upgrades and enhancements to maintain viability, we have determined that the useful life for certain internally developed software is less than one year. As a result, we expense those costs as incurred. However, where we determine that the useful life of the internally developed software will be greater than one year, we capitalize development costs in accordance with ASC 350. As such, we are capitalizing certain development costs associated with our LiquidityOne platform. At the end of the first quarter of fiscal 2017, we determined that a seller and buyer management module of the LiquidityOne platform was ready for its intended use. As such, we began amortizing the associated capitalized costs during the second quarter of fiscal year 2017. During the fourth quarter of fiscal year 2017, we launched our Network International energy marketplace on the new LiquidityOne platform. As such, we determined that additional modules of the LiquidityOne platform were ready for their intended use and began amortizing the associated

capitalized costs during the fourth quarter of fiscal year 2017. During the first quarter of fiscal 2018, we completed development of our new Return to Vendor ("RTV") module of the LiquidityOne platform and began amortizing the associated capitalized costs during that quarter.

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

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

General and administrative. General and administrative expenses include all corporate and administrative functions that support our operations and provide an infrastructure to facilitate our future growth. Components of these expenses include

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

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

Other operating expenses (income). Other operating expenses (income) includes the change in fair value of financial assets and liabilities, as well as business realignment expenses, including those associated with restructuring initiatives and the exit of certain business operations.

Interest and other (income) expense, net. Interest and other (income) expense, net, consists of interest income on the note receivable related to the sale of the Jacobs Trading business, impacts of foreign currency fluctuations, and gains and losses on the sale of fixed assets.

Income taxes. For interim income tax reporting, we estimate our annual effective tax rate and apply this effective tax rate to our year to date pre-tax (loss) income. Our effective income tax rate before discrete items was -8.6% for the nine months ended June 30, 2018. The 2018 effective tax rate differed from the statutory federal rate of 24.5% primarily as a result of the valuation allowance charge and the impact of foreign, state, and local income taxes and permanent tax adjustments.

Results of Operations

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

	Three Months		Nine Months	
	Ended June 30,		Ended June 30,	
	2018	2017	2018	2017
Revenue	100.0 %	100.0 %	100.0 %	100.0 %
Costs and expenses from operations:				
Cost of goods sold	38.5	46.4	44.1	46.6
Seller distributions	7.8	7.9	6.5	7.0
Technology and operations	27.0	30.0	27.8	30.0
Sales and marketing	16.6	12.6	14.5	13.1
General and administrative	13.4	13.4	12.7	12.9
Depreciation and amortization	2.0	2.1	2.0	2.0
Other operating expenses	0.9	1.0	1.3	0.5
Total costs and expenses	106.2	113.4	108.9	112.1
Loss from operations	(6.2)	(13.4)	(8.9)	(12.1)
Interest and other income, net	(0.1)	(0.3)	(0.5)	(0.1)
Loss before (provision) benefit for income taxes	(6.1)	(13.1)	(8.4)	(12.0)
Provision (benefit) for income taxes	1.2	0.1	(2.2)	—
Net loss	(7.3)%	(13.2)%	(6.2)%	(12.0)%

Edgar Filing: LIQUIDITY SERVICES INC - Form 10-Q

The following table presents segment GMV, revenue, gross profit, and gross profit margin for the periods indicated (dollars in thousands):

	Three Months Ended June 30,		Nine Months Ended June 30,		
	2018	2017	2018	2017	
GovDeals:					
GMV	\$85,415	\$75,527	\$225,996	\$195,866	
Total revenue	8,421	7,464	22,554	19,901	
Gross profit	7,795	7,023	20,927	18,670	
Gross profit margin	92.6	% 94.1	% 92.8	% 93.8	%
CAG:					
GMV	43,841	55,113	144,002	197,710	
Total revenue	15,011	34,400	72,230	113,978	
Gross profit	9,911	17,418	39,973	56,961	
Gross profit margin	66.0	% 50.6	% 55.3	% 50.0	%
RSCG:					
GMV	33,550	30,053	97,857	86,122	
Total revenue	26,343	23,528	73,742	72,029	
Gross profit	9,305	7,398	24,649	22,566	
Gross profit margin	35.3	% 31.4	% 33.4	% 31.3	%
Corporate & Other:					
GMV	787	178	3,273	4,613	
Total revenue	794	128	3,283	2,742	
Gross profit	133	(1,921)	(694)	(1,492)	
Gross profit margin	16.8	% (1,500.8)%	(21.1)%	(54.4)%	
Consolidated:					
GMV	163,593	160,871	471,128	484,311	
Total revenue	50,569	65,520	171,809	208,650	
Gross profit	27,144	29,918	84,855	96,705	
Gross profit margin	53.7	% 45.7	% 49.4	% 46.3	%

Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

Segment Results

GovDeals. Revenue from our GovDeals segment increased 12.8%, or \$1.0 million, due to additional sales volume from existing sellers and an increase in the number of new sellers. GMV from this segment increased 13.1%, or \$9.9 million, due to additional sales volume from existing sellers and an increase in the number of new sellers. Gross profit within this segment increased 11.0%, or \$0.8 million, to \$7.8 million for the three months ended June 30, 2018, from \$7.0 million for the three months ended June 30, 2017, due to the new business. As a percentage of revenue, gross profit decreased to 92.6% for the three months ended June 30, 2018, from 94.1% for the three months ended June 30, 2017. Gross profit is calculated as total revenue less cost of goods sold and seller distributions.

CAG. Revenue from our CAG segment decreased 56.4%, or \$19.4 million. Approximately \$17.2 million of this change was due to the wind-down of the Surplus contract. Additionally, the Scrap Contract experienced a lower volume of goods sold, as well as a change in mix of commodities to lower value commodities. The lower volume and unfavorable mix were partially offset by improved commodity prices. Also contributing to the decrease in revenue is a slight reduction in overall sales volume within our CAG Commercial business. GMV from our CAG segment decreased 20.5%, or \$11.3 million. The wind-down of the Surplus contract resulted in a decrease of approximately \$13.6 million. Also contributing to the decrease is

the lower volume of goods sold, as well as a change in mix of commodities to lower value commodities under the Scrap contract, partially offset by improved commodity prices. These overall reductions were partially offset by an increase in GMV of \$4.3 million from our CAG Commercial business. Gross profit within the CAG segment decreased 43.1%, or \$7.5 million, to \$9.9 million for the three months ended June 30, 2018, from \$17.4 million for the three months ended June 30, 2017. This decrease can primarily be attributed to the wind-down of the Surplus Contract and lower sales volumes described above. As a percentage of revenue, gross profit increased to 66.0% for the three months ended June 30, 2018 from 50.6% for the three months ended June 30, 2017.

RSCG. Revenue from our RSCG segment increased 12.0%, or \$2.8 million, due to increases in revenue from both the purchase and consignment transaction models. GMV from our RSCG segment increased 11.6%, or \$3.5 million, due to increases in GMV in both the purchase and consignment transaction models. Gross profit within the RSCG segment increased 25.8%, or \$1.9 million for the three months ended June 30, 2018, due to the increases in revenue described above. As a percentage of revenue, gross profit increased to 35.3%, from 31.4%.

Corporate & Other. The increase in revenue of \$0.7 million is attributable to increases in revenue from IronDirect. Gross profit within Corporate & Other increased \$2.1 million over the prior year, attributable to a \$1.9 million inventory reserve recorded within IronDirect during the third quarter of fiscal 2017.

Consolidated Results

Total Revenue. Total consolidated revenue decreased \$14.9 million, or 22.7%, to \$50.6 million for the three months ended June 30, 2018, from \$65.5 million for the three months ended June 30, 2017, due to a \$19.4 million decrease in revenue from our CAG segment, partially offset by a \$2.8 million increase in revenue from our RSCG segment, a \$1.0 million increase in revenue from our GovDeals segment, and a \$0.7 million increase in revenue from Corporate & Other. Total consolidated GMV increased \$2.7 million, or 1.7%, to \$163.6 million for the three months ended June 30, 2018, from \$160.9 million for the three months ended June 30, 2017, primarily due to a \$3.5 million increase in GMV from our RSCG segment, a \$9.9 million increase in GMV from our GovDeals segment, and a \$0.6 million increase within Corporate & Other, partially offset by an \$11.3 million decrease in GMV from our CAG segment.

Cost of goods sold. Cost of goods sold decreased \$10.9 million, or 35.9%, to \$19.5 million for the three months ended June 30, 2018, from \$30.4 million for the three months ended June 30, 2017. Approximately \$10.3 million of this decrease is attributable to the wind-down of the Surplus Contract. In addition, cost of goods sold decreased \$1.4 million due to the exit of the TruckCenter land-based, live auction business, partially offset by an increase of approximately \$0.9 million from our IronDirect business. Resulting from the wind-down of the Surplus Contract, as a percentage of revenue, cost of goods sold decreased to 38.5% from 46.4%.

Seller distributions. Seller distributions decreased \$1.3 million, or 25.0%, to \$3.9 million for the three months ended June 30, 2018, from \$5.2 million for the three months ended June 30, 2017, due to lower sales under our Scrap Contract during the three months ended June 30, 2018. As a percentage of revenue, seller distributions decreased to 7.8%, from 7.9%.

Technology and operations expenses. Technology and operations expenses decreased \$5.9 million, or 30.1%, to \$13.7 million for the three months ended June 30, 2018, from \$19.6 million for the three months ended June 30, 2017, due to a decrease in operations related costs of approximately \$3.4 million, largely the result of business realignment activities. The remaining \$2.5 million reduction in these costs can be attributed to reductions in technology costs from internal IT labor, as well as lower fees from external contractors and other service providers. As a percentage of revenue, technology and operations expenses decreased to 27.0%, from 30.0%.

Sales and marketing expenses. Sales and marketing expenses increased \$0.1 million, or 1.2%, to \$8.4 million for the three months ended June 30, 2018, from \$8.3 million for the three months ended June 30, 2017, which is not significant. As a percentage of revenue, sales and marketing expenses increased to 16.6%, from 12.6%.

General and administrative expenses. General and administrative expenses decreased \$2.0 million, or 22.7%, to \$6.8 million for the three months ended June 30, 2018, from \$8.8 million for the three months ended June 30, 2017. This decrease includes reductions in overall staff cost of approximately \$1.8 million resulting from business realignment and restructuring initiatives. As a percentage of revenue, general and administrative expenses remained flat at 13.4%.

Depreciation and amortization expenses. Depreciation and amortization expenses decreased \$0.4 million, or 28.6%, to \$1.0 million for the three months ended June 30, 2018, from \$1.4 million for the three months ended June 30, 2017, due to an intangible asset having been fully amortized in fiscal 2017.

Other operating expenses. Other operating expenses reflected an expense of approximately \$0.5 million in the three months ended June 30, 2018, which consisted of restructuring costs (for further information, see Note 11 to the Consolidated Financial Statements included in this Report) of approximately \$0.3 million, and acquisition related costs of approximately \$0.2 million. In the three months ended June 30, 2017, Other operating expense of \$0.7 million represents \$0.9 million related to the impairment of long-lived assets, offset by a \$0.2 million adjustment to expenses relating to the exit of certain TruckCenter operations.

Interest and other income, net. Interest and other income, net, increased \$0.2 million over prior year, which is not significant.

Provision (benefit) for income taxes. Provision (benefit) for income taxes increased \$0.5 million, to a provision of \$0.6 million for the three months ended June 30, 2018, from a provision of \$0.04 million for the three months ended June 30, 2017, due to the impact of foreign, state, and local taxes and permanent tax adjustments.

Net loss. Net loss for the three months ended June 30, 2018 was \$3.7 million, compared to \$8.6 million for the three months ended June 30, 2017.

Nine Months Ended June 30, 2018 Compared to Nine Months Ended June 30, 2017

Segment Results

GovDeals. Revenue from our GovDeals segment increased 13.3%, or \$2.7 million, due to additional sales volume from existing sellers and an increase in the number of new sellers. GMV from this segment increased 15.4%, or \$30.1 million, also due to additional sales volume from existing sellers and an increase in the number of new sellers. Gross profit within this segment increased 12.1%, or \$2.3 million, to \$20.9 million for the nine months ended June 30, 2018, from \$18.7 million for the nine months ended June 30, 2017, due to the new business. As a percentage of revenue, gross profit slightly decreased to 92.8%, from 93.8% in the prior year. Gross profit is calculated as total revenue less cost of goods sold and seller distributions.

CAG. Revenue from our CAG segment decreased 36.6%, or \$41.7 million. Approximately \$30.2 million of this change is due to the wind-down of the Surplus Contract. Additionally, the Scrap Contract experienced a lower volume of goods sold, as well as a change in mix of commodities to lower value commodities. The lower volume and unfavorable mix were partially offset by improved commodity prices. Also contributing to the decrease is lower sales volume within our CAG Commercial business for both purchase and consignment transaction models. GMV from our CAG segment decreased 27.2%, or \$53.7 million. The wind-down of the Surplus contract resulted in a decrease of approximately \$19.4 million. Approximately \$28.8 million of the decrease in GMV related to our CAG Commercial business for both purchase and consignment transaction models. A lower volume of goods sold under our Scrap Contract, as well as a change in mix of commodities to lower value commodities sold under that contract, partially offset by improved commodity prices, led to a further decrease in GMV. Gross profit within the CAG segment decreased 29.8%, or \$17.0 million, to \$40.0 million for the nine months ended June 30, 2018, from \$57.0 million for the nine months ended June 30, 2017. This decrease can be attributed to the wind-down of the Surplus Contract and lower sales volumes described above. As a percentage of revenue, gross profit increased to 55.3%, from 50.0%.

RSCG. Revenue from our RSCG segment increased 2.4%, or \$1.7 million. The increase is driven by the growth in consignment model transaction revenue. GMV from our RSCG segment increased 13.6%, or \$11.7 million. The increase is attributable to growth in our consignment model transaction GMV during fiscal 2018. The lower overall increase in revenue compared to the increase in GMV is due to a change in mix from purchase to consignment model transactions. Gross profit within the RSCG segment increased 9.2%, or \$2.1 million for the nine months ended

June 30, 2018, due to the overall increase in revenue described above. As a percentage of revenue, gross profit increased to 33.4%, from 31.3%.

Corporate & Other. Revenue from Corporate & Other primarily relates to IronDirect and certain TruckCenter operations. The increase in revenue of \$0.5 million is made up of a \$2.4 million increase in revenue related to our IronDirect business, offset by a \$2.0 million decrease in revenue related to our decision to exit certain TruckCenter operations in January 2017. Gross profit within Corporate & Other increased \$0.8 million over prior year, attributable to a \$1.9 million inventory reserve recorded within IronDirect during the third quarter of fiscal 2017, and a \$0.4 million increase in gross profit related to our decision to exit certain TruckCenter operations in January 2017.

Consolidated Results

Total Revenue. Total consolidated revenue decreased \$36.9 million, or 17.7%, to \$171.8 million for the nine months ended June 30, 2018, from \$208.7 million for the nine months ended June 30, 2017, due to a \$41.7 million decrease in revenue from our CAG segment, partially offset by a \$0.5 million increase in revenue from Corporate & Other, a \$2.7 million increase in revenue from our GovDeals segment, and a \$1.7 million increase in revenue from our RSCG segment. Total consolidated GMV decreased \$13.2 million, or 2.7%, to \$471.1 million for the nine months ended June 30, 2018, from \$484.3 million for the nine months ended June 30, 2017, due to a \$53.7 million decrease in GMV from our CAG segment, a \$1.3 million decrease within Corporate & Other, partially offset by a \$30.1 million increase in GMV from our GovDeals segment, and an \$11.7 million increase in GMV from our RSCG segment.

Cost of goods sold. Cost of goods sold decreased \$21.4 million, or 22.0%, to \$75.8 million for the nine months ended June 30, 2018, from \$97.2 million for the nine months ended June 30, 2017. Approximately \$18.7 million of this decrease is attributable to a lower volume of sales under our Surplus Contract during the nine months ended June 30, 2018, due to the wind-down of that contract. The remainder of this decrease is due to a lower volume of purchase transactions within our CAG Commercial business, as well as the exit of the TruckCenter land-based, live auction business in fiscal 2017, partially offset by increased cost of goods sold within our IronDirect business. As a percentage of revenue, cost of goods sold decreased to 44.1% of revenue, from 46.6%.

Seller distributions. Seller distributions decreased \$3.6 million, or 24.5%, to \$11.1 million for the nine months ended June 30, 2018, from \$14.7 million for the nine months ended June 30, 2017, due to lower sales under our Scrap Contract during the nine months ended June 30, 2018. As a percentage of revenue, seller distributions decreased to 6.5%, from 7.0%.

Technology and operations expenses. Technology and operations expenses decreased \$14.9 million, or 23.8%, to \$47.7 million for the nine months ended June 30, 2018, from \$62.6 million for the nine months ended June 30, 2017, due to a decrease in operations related costs of approximately \$9.5 million, largely the result of business realignment activities. The remaining \$5.4 million reduction in these costs can be attributed to a reduction in technology costs from internal IT labor, as well as lower fees from external contractors and other service providers. As a percentage of revenue, technology and operations expenses decreased to 27.8%, from 30.0%.

Sales and marketing expenses. Sales and marketing expenses decreased \$2.5 million, or 9.1%, to \$24.9 million for the nine months ended June 30, 2018, from \$27.4 million for the nine months ended June 30, 2017, due to a decrease in marketing labor and promotional spending as a result of certain business realignment and restructuring initiatives. As a percentage of revenue, sales and marketing expenses increased to 14.5%, from 13.1% in the prior year.

General and administrative expenses. General and administrative expenses decreased \$5.0 million, or 18.7%, to \$21.8 million for the nine months ended June 30, 2018, from \$26.8 million for the nine months ended June 30, 2017. Included within this decrease are reductions in overall staff cost of approximately \$3.8 million resulting from business realignment and restructuring initiatives. The remaining reduction in these costs can be attributed to lower non-income tax regulatory costs, and a decrease in certain lease costs. As a percentage of revenue, general and administrative expenses slightly decreased to 12.7%, from 12.9% in the prior year.

Depreciation and amortization expenses. Depreciation and amortization expenses decreased \$0.8 million, or 19.0%, to \$3.4 million for the nine months ended June 30, 2018, from \$4.2 million for the nine months ended June 30, 2017, due to an intangible asset having been fully amortized in fiscal 2017.

Other operating expenses. Other operating expenses reflected an expense of approximately \$2.2 million in the nine months ended June 30, 2018, which consisted of approximately \$2.1 million of restructuring cost (for further information, see Note 11 to the Consolidated Financial Statements included in this Report), \$0.2 million of acquisition related cost, a \$0.1 million loss on the value of a right we held from our participation in certain principal transactions

in the CAG commercial business, slightly offset by \$0.1 million of other income. In the nine months ended June 30, 2017, Other operating expense of \$1.0 million represents \$0.9 million of expenses relating to the exit of certain TruckCenter operations, and a \$0.9 million impairment charge on long-lived assets, offset by a \$0.8 million increase in the value of a right we held from our participation in a principal transaction in the Company's CAG business.

Interest and other income, net. Interest and other income, net, increased \$0.5 million over prior year, to \$0.8 million for the nine months ended June 30, 2018. Interest and other income, net, includes a gain on sale of equipment of approximately \$0.5 million.

Provision (benefit) for income taxes. Provision (benefit) for income taxes increased \$3.9 million, to a benefit of \$3.8 million for the nine months ended June 30, 2018, from a provision of \$0.1 million for the nine months ended June 30, 2017,

due to a decrease in the deferred tax balance resulting from the newly enacted lower corporate tax rate, a reduction to the valuation allowance, and the impact of foreign, state, and local taxes and permanent tax adjustments.

Net loss. Net loss for the nine months ended June 30, 2018 was \$10.6 million, compared to \$25.2 million for the nine months ended June 30, 2017.

Liquidity and Capital Resources

Historically, our primary cash needs have been working capital (including capital used for inventory purchases), which we have funded through cash generated from operations. As of June 30, 2018, we had approximately \$83.4 million in cash.

On July 10, 2018, Liquidity Services acquired 100% of Machinio Corp. The consideration paid to the sellers was approximately \$16.7 million in net cash, equity consideration of approximately \$2.0 million, and contingent consideration payable in 2020 in an amount up to \$5.0 million.

Throughout the quarter, we have continued to advance the design and development of our LiquidityOne platform, services and analytical tools intended to enable our clients to maximize bottom-line return and transform their supply chain into a high-performing business function. During the fourth quarter of fiscal year 2017, we launched our Network International energy marketplace on the new LiquidityOne platform. Beginning in fiscal 2019, we plan to launch further marketplaces onto the platform. We will continue to incur additional costs throughout the duration of this initiative to implement the new platform and educate our employees and clients about the initiative.

The effects of the international provisions of the Tax Act, which establishes a territorial tax system and subject certain foreign earnings on which US tax is currently deferred to a one-time transition tax is uncertain and requires additional analysis. As a result, the Company has not recorded any provisional amounts in the financial statements for the nine months ended June 30, 2018 and will re-evaluate its existing accounting position to indefinitely reinvest unremitted foreign earnings. The amount of such unremitted foreign earnings was approximately \$7.8 million as of June 30, 2018. As of June 30, 2018, and September 30, 2017, approximately \$15.4 million and \$14.9 million, respectively, of cash and cash equivalents was held overseas.

We are authorized to repurchase issued and outstanding shares of our common stock under a share repurchase program approved by our Board of Directors. Share repurchases may be made through open market purchases, privately negotiated transactions or otherwise, at times and in such amounts as management deems appropriate. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements and other market conditions. The repurchase program may be discontinued or suspended at any time and will be funded using our available cash. We did not repurchase shares under this program during the nine months ended June 30, 2018 or 2017. As of June 30, 2018, we may repurchase an additional \$10.1 million in shares under this program.

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

Changes in Cash Flows: Nine Months Ended June 30, 2018 Compared to Nine Months Ended June 30, 2017

Net cash provided by operating activities was \$1.6 million for the nine months ended June 30, 2018, as compared to net cash used by operating activities of \$14.3 million for the nine months ended June 30, 2017. The \$15.9 million increase in cash provided by operations between periods was attributable to improved profitability as well as changes

in working capital primarily from collections of receivables and sales of inventory.

Net cash used in investing activities was \$11.9 million for the nine months ended June 30, 2018, and \$6.3 million for the nine months ended June 30, 2017. Net cash used in investing activities for the nine months ended June 30, 2018 consisted of the purchase of certificates of deposit in the amount of \$10.0 million, as well as expenditures for capitalized software, purchases of equipment, and leasehold improvements. Net cash used in investing activities for the nine months ended June 30, 2017 consisted of expenditures for capitalized software, purchases of equipment, and leasehold improvements.

Net cash provided by financing activities was \$0.01 million for the nine months ended June 30, 2018, and net cash provided by financing activities was \$0.09 million for the nine months ended June 30, 2017. Net cash provided by financing activities consisted primarily of proceeds from the exercise of common stock options.

Capital Expenditures. Our capital expenditures consist primarily of capitalized software, computers and purchased software, office equipment, furniture and fixtures, and leasehold improvements. Capitalized software includes costs associated with our LiquidityOne platform. The timing and volume of such capital expenditures in the future will be affected by the addition of new customers or expansion of existing customer relationships, as well as our development of our LiquidityOne platform. We intend to fund those expenditures primarily from operating cash flows. Our capital expenditures for the nine months ended June 30, 2018 were \$2.7 million. As of June 30, 2018, we had no outstanding commitments for capital expenditures.

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

Off-Balance Sheet Arrangements

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Interest rate sensitivity. We had no debt as of June 30, 2018, and thus do not have any related interest rate exposure. Our investment policy requires us to invest funds in excess of current operating requirements. The principal objectives of our investment activities are to preserve principal, provide liquidity and maximize income consistent with minimizing risk of material loss.

Exchange rate sensitivity. Because of the number of countries and currencies we operate in, movements in currency exchange rates may affect our results. We report our operating results and financial condition in U.S. dollars. Our U.S. operations earn revenues and incur expenses primarily in U.S. dollars. Outside the United States, we predominantly generate revenues and expenses in the local currency. When we translate the results and net assets of these operations into U.S. dollars for reporting purposes, movements in exchange rates will affect reported results and net assets.

Item 4. Controls and Procedures.

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

During the nine months ended June 30, 2018, as part of our LiquidityOne platform project, we continued to roll out a new enterprise resource planning system to additional areas of the company. The roll-out resulted in changes to certain internal controls over financial reporting. There have not been any further changes in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

As of June 30, 2018, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer (Principal Financial Officer), of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer (Principal Financial Officer) concluded that our disclosure controls and procedures were effective and were operating to provide reasonable assurance that the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer, principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

Howard v. Liquidity Services, Inc., et al., Civ. No. 14-1183 (D. D. C. 2014).

On July 14, 2014, Leonard Howard filed a putative class action complaint in the United States District Court for the District of Columbia (the “District Court”) against our Company and its chief executive officer, chief financial officer, and chief accounting officer, on behalf of stockholders who purchased our common stock between February 1, 2012 and May 7, 2014. The complaint alleged that the defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 by, among other things, misrepresenting our growth initiative, growth potential, and financial and operating conditions, thereby artificially inflating our stock price, and sought unspecified compensatory damages and costs and expenses, including attorneys’ and experts’ fees. On October 14, 2014, the Court appointed Caisse de Dépôt et Placement du Québec and the Newport News Employees’ Retirement Fund as co-lead plaintiffs. The plaintiffs filed an amended complaint on December 15, 2014, which alleges substantially similar claims, but which does not name the chief accounting officer as a defendant. On March 2, 2015, we moved to dismiss the amended complaint for failure to state a claim or plead fraud with the requisite particularity. On March 31, 2016, the Court granted that motion in part and denied it in part. Only the claims related to our retail division were not dismissed. On May 16, 2016, the defendants answered the amended complaint, denying all allegations of wrong-doing. Plaintiffs’ class certification motion was granted, and defendants’ motion for partial summary judgment was denied, on September 6, 2017. On June 19, 2018, the parties reached agreement to settle this action, including the dismissal and release of all claims against all defendants, in exchange for the payment by our insurance carriers of \$17 million to plaintiffs and the class. The agreement was submitted to the District Court and preliminarily approved on June 20, 2018. Final approval of the settlement will be decided at a hearing before the District Court scheduled for October 5, 2018 after notice to the class and other customary conditions are satisfied. There can be no assurance that the settlement will be approved and, even if approved, whether the conditions to effectiveness will be satisfied.

In re Liquidity Services, Inc. Derivative Litigation, Civ. No. 2017-0080-JTL (Del. Ch.).

On February 2, 2017, plaintiff David Girardi filed a putative derivative complaint in the Court of Chancery of the State of Delaware (the “Court of Chancery”), and on February 7, 2017, plaintiff Harold Slingerland filed a putative derivative complaint in the Court of Chancery. On March 9, 2017, plaintiffs Girardi and Slingerland filed a consolidated putative derivative complaint in the Court of Chancery, purportedly on our behalf. The consolidated complaint names as defendants our chief executive officer and chief financial officer, as well as certain other individuals who served on our Board of Directors between 2012 and 2014, and seeks recovery from those individuals, not from us. The complaint asserts that, among other things, the defendants breached their fiduciary duties to us and our stockholders by causing or allowing us to make the same misstatements that are alleged in the amended complaint in the Howard action, and for alleged trading in our securities while in possession of material non-public information. On November 27, 2017, the Court of Chancery granted the defendants’ motion to dismiss.

Following the dismissal of the putative derivative action discussed above, former plaintiffs Girardi and Slingerland sent us a letter dated January 5, 2018 (the “Shareholder Demand”) demanding that the Board of Directors take action to remedy purported breaches of fiduciary duties allegedly related to the claims asserted in the above-discussed securities class action and derivative actions. We acknowledged the Shareholder Demand on January 22, 2018. Our Board of Directors has delegated to a special committee of the Board, comprised of independent directors who are not named in the letter, the initial evaluation of and the formulation of recommendations to the Board with respect to the Shareholder Demand. The special committee has retained counsel to assist and advise in connection with its work.

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors set forth in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017, which could materially affect our business, financial condition or future results. The risks described in our Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 6. Exhibits.

Exhibit Description

2.1 Stock Purchase Agreement, dated July 10, 2018, by and among the Company, Machinio, Corp., the stockholders of Machinio, Corp., and Shareholder Representative Services., LLC.*

3.1 Fourth Amended and Restated Certificate of Incorporation, incorporated herein by reference to Exhibit 3.1 to Amendment No. 2 to the Company's Registration Statement on Form S-1 (Registration No. 333-129656), filed with the SEC on January 17, 2006.

3.2 Amended and Restated Bylaws dated August 2, 2016.

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 The following materials from the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2018, formatted in Extensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements.

Filed herewith.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on August 2, 2018.

LIQUIDITY SERVICES, INC.
(Registrant)

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

By: /s/ Jorge A. Celaya
Jorge A. Celaya
Executive Vice President and Chief Financial Officer

By: /s/ Samuel M. Guzman, Jr.
Samuel M. Guzman, Jr.
Vice President and Chief Accounting Officer