Off Wall Street

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New Rec: Liquidity Services, Inc. (LQDT: $51.18) July 1, 2012

Position: Sell **Target: $25**

	2Q12a	3Q12e	4Q12e	1Q13e	FY11a	FY12e	FY13e
GMV ($M)	218.4	226.1	218.5	218.0	558.6	842.2	924.0
Revs ($M)	125.7	119.3	114.1	113.4	327.4	465.2	471.0
EPS*	0.52	0.52	0.46	0.39	1.23	1.88	1.73
Y/Y EPS%	101%	1%	84%	6%	116%	53%	-8%
P/E	na	na	na	na	41.7	27.2	29.5
PSR	na	na	na	na	5.1	3.6	3.6
Cons	na	0.46	0.33	0.46	na	1.68	2.08

*Non-GAAP, and excludes discontinued operations. OWS GAAP EPS is $1.68 for FY 12 and $1.38 for FY 13.

Shares Out: 32.8M **Market Cap: $1.7B** **FYE Sept**

Concept:

1. The US Department of Defense (DoD) appears to account for 24% of GMV and 74% of FY 2012 operating profits, much higher than investors realize with respect to operating profits. Recent growth in DoD business appears unsustainable and a material portion of DoD revenue is at risk from base realignments coming to an end and troops returning from Iraq and Afghanistan.
2. LQDT's incremental EBIT margins in its commercial business appear to be much lower than investors realize, and therefore are unlikely to drive the earnings growth investors expect.
3. The company has significant customer concentration in its commercial business, with Walmart and Acer together accounting for an estimated 50% of FY 2012 commercial GMV. Should the company lose one of these contracts, its GMV growth could be significantly impacted.
4. Earnings growth is likely to disappoint as growth in the company's highly profitable DoD business begins to decline and the company realizes lower incremental margins on its commercial business, leading to a materially lower share price.

Summary: Liquidity Services, Inc. (LQDT), based in Washington DC, operates leading online auction marketplaces for surplus and salvage assets. The company sells merchandise under consignment and profit sharing arrangements, as well as for its own account. The most important metric for LQDT is gross merchandise value (GMV), which represents total sales proceeds for all items it sells. LQDT was predominantly a federal government contractor several years ago, with DoD contracts accounting for 77% of GMV in 2005. Although DoD GMV grew from $78M in FY 2005 to $186M in FY 2011, a CAGR of 16%, commercial GMV grew from $24M in FY 2005 to $253M in FY 2011, a CAGR of 48%, becoming a much larger portion of the business. It is worth noting that acquisitions accounted for about 1/3rd of the commercial GMV growth. LQDT also acquired govdeals.com, which caters to state and local governments and now accounts for about 20% of GMV.

Bulls view LQDT as a commercial market penetration story. Management claims its addressable commercial market in the US is about $70 billion, consisting of about $50B in retail and $20B in capital assets. Overall, the liquidation marketplace appears to be growing in the low single digits. Considering the company will only sell about $500M of commercial merchandise in FY 2012, and that it is the second largest company in the liquidation space, bulls see significant opportunity to grow revenues. Indeed, the company's commercial GMV growth has been impressive, but, based on our research, we think the company's organic growth has been slowing considerably, and even if commercial GMV does to outpace "street" estimates, profitability on growth in this market will be much less than what the "street" assumes.

LQDT generated incremental EBIT/GMV of 19% in FY 2011 and about 20% for the past two fiscal quarters, and is expected to generate incremental EBIT/GMV of about 19% for FY 2012, 14% for FY 2013, and 14% for FY 2014. As the company does not break out profitability by end market, the "street" does not appear to worry about the operating margins in the company's various end markets. However, as the growth rates in LQDT's government DoD business are expected to be much less than growth rates in the commercial business, understanding the margins in each of these businesses is crucial to forecasting earnings. In addition, we think LQDT's recent acquisition of Jacobs Trading would raise concerns if investors better understood the true nature of the transaction, which has significantly boosted reported profitability. There appear to be other risks to LQDT as well, such as increasing competition and significant customer concentration.

LQDT has two contracts with the DoD, referred to as the "scrap" and "surplus" contracts. The DoD scrap contract is a profit sharing arrangement under which LQDT retains 23%-25% of net profits on scrap sales, with the DoD picking up a portion of LQDT's costs. Based on our analysis, this contract appears to be generating 20% EBIT/GMV margins, or an estimated 10% and 15% of FY 2012 total company GMV and EBIT. This contract expires in August 2012, but the DoD has already exercised one of three optional one-year extensions, and is expected to exercise the remaining two before rebidding the contract in 2015. There is less financial data available on LQDT's surplus contract, which has been renegotiated with the DoD a number of times over the past several years. It appears with nearly every renegotiation, LQDT has been able to realize higher profits. At this point, LQDT pays the DoD only 1.8% of original cost for surplus items. Based on our analysis, this contract could be generating over 83% gross margin/GMV and 65% EBIT/GMV, yet even at just 65% gross margin/GMV, we estimate this contract will account for an estimated 15% and 59% of FY 2012 total company GMV and EBIT. Importantly, the surplus contract has a term that ends December 2013, and, based on discussions with people familiar with the DoD process, there will be a competitive bid process for a new contract.

Sources tell us that LQDT's DoD business, which grew 25% in FY 2010, 22% in FY 2011, and 15% for the first two quarters of FY 2012, has benefitted significantly from base realignments and the wars in Iraq and Afghanistan. One source, which previously worked for the Defense Logistics Agency (DLA- which manages DoD procurement), described the base realignments as a "windfall" for LQDT. Unfortunately for LQDT, the base realignment program is winding down, with most of the scheduled major base closures completed in late 2011. In addition to base closures, the DoD has been replacing its unarmored vehicle with armored vehicles, to better protect the troops at war, leading to an abundance of unarmored vehicles being sold as surplus. The DoD vehicle budget is dropping dramatically, however, and there should be far fewer surplus vehicles available for sale, as fewer new vehicles are placed into operation. Our analysis suggests that surplus vehicle sales account for about 50% of LQDT's DoD surplus revenues. The wars have also led to elevated levels of other surplus and scrap items available for sale, which should decline as military activity winds down. Also, it is doubtful that LQDT will again win the scrap and surplus contracts as currently structured when they are rebid, as they have become much more lucrative than originally anticipated.

LQDT has relied on a number of acquisitions to supplement its growth over the past several years. Most of the company's acquisitions in the past few years have been made at a price representing only a small fraction of GMV. In October of 2011, however, LQDT acquired Jacobs Trading for $152M. Unlike any of LQDT's previous transactions, LQDT paid 2.1X GMV for Jacobs. Jacobs generated about $73M of GMV, and $18M of EBIT in the TTM prior to its acquisition. With a TTM EBIT margin of 24.5%, significantly higher than the approximate 5% EBIT margins that industry participants say is typical, this acquisition piqued our interest. It turns out that Jacobs has only has about twenty professional employees, according to our sources, and utilizes prisoners and special needs laborers on a contract basis to sort and demark products. Jacobs had less than $1M of PP&E and book value was only about $6.8M, meaning LQDT paid about $7M per professional employee and 22X book value for Jacobs.

It appears that most of Jacobs' value comes from a contract with Walmart that accounts for about 70% of revenues. Coincidentally, Irwin Jacobs, the former owner of Jacobs Trading, is said to be close friends with Lee Scott of Walmart. It is unclear whether the contract was executed at arms length, just a few months prior to this acquisition, but given Jacobs' profitability, one has to wonder. Anecdotally, we have been told by one of LQDT's competitors that certain Walmart personnel involved in the reverse supply chain were furious when LQDT acquired Jacobs, as it became clear just how favorable the contract was for LQDT, presumably at Walmart's expense. We have also been told that Walmart has moved some of its uncontracted volumes away from Jacobs since this acquisition occurred. When this contract expires in 2016, we doubt it will be renewed on similar terms, if at all. We also wonder whether Jacobs' use of prison labor is consistent with Walmart's corporate policies, which in many cases appear to disallow contractors from employing prisoners.

Based on our analysis, we think the Jacobs acquisition significantly boosted non-DoD EBIT in the first two quarters of FY 2012. Importantly, this y/y benefit is due to anniversary in October 2012. In our opinion, considering the lack of substance of Jacobs as a company, we question whether LQDT's allocation of intangible assets to goodwill should have been so high, at $110M, and the allocation of intangible assets to its vendor contract so low at $33M. Given the likely unsustainable level of profitability due to contracts that appear to reflect above market terms, we think the value of the Jacobs acquisition would more appropriately be in the contracts, not the company. It is our experience that in situations such as this, goodwill is often written off in future years when contracts expire. In our opinion, this appears to be an example of a company buying earnings for the next several years, while capitalizing the expense as goodwill.

LQDT also has significant customer concentration, in addition to its DoD exposure. Walmart is expected to account for about 20% of the company's estimated FY 2012 commercial GMV, and we have been told that Acer, which began selling through LQDT around November of 2011, could account for more than $150M-$200M, or 30%-40% of FY 2012 commercial GMV. If our sources are correct, our analysis suggests the company may not have organically grown non-DoD revenues for the past two quarters, when excluding Acer. Anecdotally, we are told that Acer may be unhappy with LQDT, after taking the contract away from Seneca Data, but we have not been able to verify this. We have also been told that Acer does not have any firm commitments to LQDT. The loss of any one of these customers could significantly affect LQDT's ability to grow. Conversely, there is also a risk that LQDT could land another material contract.

LQDT recently announced the acquisition of DoveBid, a UK company that resells manufacturing assets, a new vertical for LQDT. We wonder, why would LQDT step out of its core market if there were indeed so many great investing opportunities in its existing market? DoveBid's results have been deteriorating over the past two years and FCF has been unimpressive. We think it is also worth noting that LQDT has been unsuccessful in previous international endeavors. DoveBid is expected to add about $200M to annual GMV, and the company has guided for EPS accretion of $0.01-0.03 for FY 2013 (we assume $0.05).

Our analysis suggests that together, the two DoD contracts, which will only account for about 24% of FY 2012 GMV, will account for about 74% of FY 2012 EBIT. With Jacobs accounting for another 9% of estimated GMV and 17% of estimated EBIT for FY 2012, it suggests the balance of the business is only generating EBIT/GMV margins of about 2% and accounting for just 9% of total company EBIT. While this may come as a surprise to some, a number of industry sources with whom we spoke expressed skepticism that LQDT was making money, given its high cost structure. With the DoD business expected to decline, and Jacobs expected to flat-line (Jacobs is running at full capacity), and with low incremental DoD EBIT/GMV margins, it appears unlikely that the company would realize mid teens incremental EBIT/GMV margins for the next several years, as investors expect. Instead, we think incremental EBIT margins will be much lower, and that the company is likely to significantly miss investor expectations for profits. Insider selling would appear to support our concerns about the company's future profitability. Insiders have sold more than $110 million of stock since 2011. To put this in perspective, this amounts to about 6% of the LQDT's current market capitalization.

While investors may think LQDT has very strong supply and customer relationships, our sources tell us that, in this industry, everything comes down to price, and that there is virtually no seller or buyer loyalty. Retailers are also getting smarter about the reverse supply chain, as they realize that marginal proceeds on what, in many cases, used to go to landfills can have a significant impact on overall operating margins if sold through other channels. Some retailers have even established their own websites to sell returned items. Walmart has begun to allocate floor space to sell returned items at a fraction of the cost of a new item. These returned items are often undistinguishable from new items. Most of our industry contacts think that the already thin commercial margins are likely to shrink further in the coming years. We have heard that LQDT has lost significant business from Amazon and Dick's Sporting Goods, as competitors have offered better terms. We have also heard that Walmart has begun to move some volumes away from LQDT subsequent to the acquisition of Jacobs.

The "street" thinks LQDT will grow GMV at about 45% in 2012 and 23% in 2013 (excluding the DoveBid acquisition). Although we think the company will surpass the FY 2012 estimates for GMV, we think FY 2013 will disappoint. We estimate GMV will grow by 51% for FY 2012 and by 10% for FY 2013. We exclude the acquisition of DoveBid, as does the "street," which we expect to add about $200M of GMV to FY 2013, assuming the deal closes prior to the end of FY 2012. "Street" estimates for non-GAAP EPS are for $1.68 for FY 2012 and $2.10 for FY 2013. While we think the company will make about $1.88 in FY 2012, we think this is more than baked into the company's valuation. We think FY 2013 EPS will be about $1.73 (excluding $0.05 EPS accretion for DoveBid acquisition), disappointing investors significantly, as the profitable DoD business slows.

Based on our analysis, about 70% of LQDT's FY 2013 earnings will come from its DoD business. At about 10X DoD's estimated earnings contribution of $1.21 to EPS, similar to where most defense companies are trading, we think LQDT's DoD business is worth about $12 per share. About 18% of earnings appear to be coming from Jacobs, which we regard as very low quality, and it remains unclear what will happen to Jacob's profitability once its contract with Walmart expires. We think Jacobs is probably worth about what LQDT paid for it, suggesting a value to LQDT of about $5 per share ($152M/32.8M shares), which would equate to an earnings multiple of about 16X ($18.2M EBIT tax effected at 40%= $0.31 EPS). Unfortunately for investors, this leaves only about $0.21 in non-DoD earnings, excluding Jacobs, to be valued. At a 20X multiple of FY 2013, which we think would be very generous, this amounts to about another $4 per share. Together, this suggests LQDT might be worth about $21 on a sum of the parts basis. Given the lack of earnings growth that our analysis suggests, the poor quality of the earnings, and the customer concentration risks, we think this is an appropriate value for the business. Nevertheless, we are initiating our position with a target of $25, which represents market multiple of 14X 2013 earnings, assuming the company generates $1.78 of EPS in FY 2013, including $0.05 accretion from the DoveBid acquisition.

Borrow information: LQDT

Supply Quantity	Quantity On Loan	Available to Borrow	Date
7.7 mm	1.9 mm	6.0 mm	6.27.12

Source: Data Explorers

Background:

Liquidity Services (LQDT), based in Washington DC, was founded in 1999, and completed an IPO in 2006. The company participates in the Reverse Supply Chain market, including the Retail Supply Chain, Industrial Capital Assets and the Public Sector. Assets consist of retail customer returns, overstock products, and end-of-life goods or capital assets from both the corporate and government sectors. LQDT operates six online auction marketplaces: www.liquidation.com, www.govliquidation.com, www.govdeals.com, www.networkintl.com, www.truckcenter.com, and www.secondipity.com. Through these sites, LQDT enables buyers and sellers to transact in over 500 product categories. A rough breakdown of the sales by product category is as follows: 30%-35% consumer electronics, 20%-25% apparel/accessories/shoes, with computers, networking equipment, DIY Hardware tools and jewelry making up the balance.

The four seller, or supplier, categories can be broken down by GMV in FY 2011 as follows: 58.8% commercial sellers, 16.9% GovDeals, 15.5% DoD Surplus and 8.8% DoD Scrap. For FY 2011, 45% of GMV was sold under consignment arrangements, 15% was sold under a profit sharing arrangement, and 40% of GMV was sold on the company’s account. The profit sharing model is employed currently only for the scrap contract with the DoD. Under the purchase model, the entire sales price would be considered revenue, whereas under the consignment model, only the fee earned would be considered revenue. Given the three pricing models, management believes that GMV, not revenue, is the primary driver of profits. The company discloses revenue and GMV by market segment, but only discloses profitability on a consolidated basis.

In 2001, LQDT was awarded the DoD Surplus Contract, whereby the company became the exclusive contractor with the DLA Disposition Services for the sale of usable DoD surplus assets in the U.S. There have been many changes to the contract structure on the DoD Surplus side of the business. The original contract, awarded in June 2001, was a profit sharing arrangement, whereby LQDT was entitled to 20% of the profits from a sale (profits determined after allocating allowable operating expenses). This contract was modified a number of times over the ensuing years. Between August 1, 2006 and November 30, 2006 the company received 27.5% of the profits. This was changed on November 30, 2006 to a range of 25.0%-30.5%, with the higher share being tied to the effectiveness of inventory controls put in place. The contract was modified yet again in June 2007, whereby the company would get an incremental 1% of the profits due to incremental services it was to provide. The profit allocated to LQDT was then increased to 39.5% for the period June 18, 2008 until December 17, 2008. LQDT then signed a new contract on that would commence after December 17, 2008, whereby the structure changed from a profit sharing model to a purchase model. LQDT would be required to purchase 100% of the DoD's surplus goods at a fixed price of 3.26% of original cost. Sometime in 2009, that contract was amended, whereby the purchase price was cut from 3.26% to just 1.8% of original cost.

In 2005, LQDT was awarded the DoD scrap contract. This contract gives LQDT the exclusive right to all scrap product that is turned into the DLA Disposition Services. This is a pure profit-sharing arrangement, where LQDT initially kept between 20%-22% of the profits. On May 21, 2007, the contract was modified to 23%-25% of the profit. The 25% is awarded if LQDT sells the scrap to a certain number of small businesses. LQDT has historically been successful at meeting that requirement, and we expect that to continue. This contract base term expires in August 2012, but the DoD has already exercised one of three one year optional extensions, meaning the contract will run until August of 2015 if all extensions are executed. GMV in this division is driven by volumes, and by the value of the scrap commodities such as steel, iron and copper.

During 2003, LQDT introduced its www.uksurplus.com site to manage and sell surplus property from the UK Ministry of Defense. The contract expired November 30, 2010, and was not renewed. The company tried to expand its presence in Europe with the 2008 acquisition of Geneva. In 2009 it lost a major UK client to M&A, and our contacts tell us that the prior owner of Geneva became a competitor and took a lot of the business away from LQDT. Management ceased its UK operations completely in 2011.

During 2004, LQDT launched its wholesale industry portal, www.goWholesale.com in the U.S., which connected advertisers with buyers seeking products for resale. That portal has since been closed and never represented a substantial piece of business for LQDT.

During 2005 LQDT opened its first distribution center to provide basic reverse logistics to top 100 retailers. During 2006 it acquired STR, a remarketer of reverse supply chain merchandise. During 2008, it acquired GovDeals, to address the state and local government surplus market. During 2010, it acquired Network International, addressing surplus and used equipment in the oil and gas, petrochemical and power generation industries. During 2011, it acquired Truckcenter.com, LLC, a leading marketplace for the sale of idle, surplus and used fleet and transportation equipment, and Jacob's Trading, a direct competitor with a long term contract with Wal-Mart. Wal-Mart now represents 33% of LQDT's commercial business.

Discussion:

1. LQDT's DoD business, which should decline due to winding down of base realignments and fewer troops returning from wars, appears to account for most of the company profits.

LQDT's two DoD contracts appear to drive a significant portion of its profitability. Although the company does not break out profitability by contract, source, or by end market, there are enough financial data points available to reasonably estimate the DoD scrap profitability. The company discloses revenue, GMV, the % of GMV by contract (i.e. DoD scrap GMV), as well as the "profit sharing" outflow it pays the DoD. Since we know from company disclosures that the company gets to keep 23%-25% of DoD scrap profits, and management commentary suggests it has been realizing the maximum amount of profits under this contract, we can back into the profits to the company generated by the contract. Note that, for purposes of calculating the company's share of profits, the contract allows the company to allocate all relevant operating expenses, so the net profit really is the net profit.

Table 1: OWS estimated DoD scrap contribution to EBIT:

	2011	2012e	2013e
Scrap GMV	83.5	81.8	77.7
Profit Sharing Distribution to DoD	49.3	48.3	45.9
Implied total profits based on 25% payout	65.8	64.5	61.2
LQDT's share of scrap profits	16.4	16.1	15.3
Estimated EBIT/GMV	19%	20%	20%
Total company non-GAAP EBIT	52.6	106.3	100.6
Scrap EBIT as a % of total company non-GAAP EBIT	31%	15%	15%
Scrap as a % of GMV	16%	10%	8%

*- GMV based on calculations from company disclosures. Profits based on OWS analysis.

Based on our analysis the company's scrap contract accounted for about 16% of GMV and 31% of EBIT for FY 2011, and is on track to account for about 10% of GMV and 15% of EBIT for FY 2012.

The company does not provide any profitability data on its DoD surplus contract in its current financial statements. However, the DoD surplus contract used to be a profit sharing arrangement. From 2001 to 2008, the percentage of net profits LQDT retained increased from 20% to 39.5%. As with the scrap contract, the profits were calculated after LQDT allocated allowable operating costs. In late 2008, the structure of the contract was changed to a purchase and resale contract, whereby LQDT would pay 3.26% of original cost for surplus goods purchased from the DoD. In 2009, the contract was amended so that LQDT paid only 1.8% of original cost. The one common theme in these contract negotiations appears to be that, with each iteration, LQDT made more money. The only point where there is any question about increasing profitability is when the structure changed from a profit sharing contract to a buy and sell contract.

To estimate surplus profits, we took a random sample of auction items from the www.govliquidation.com website. The website provides information on closed auctions and includes the original value of the items. Per our review, the average value recouped was 6.7% of the original cost, compared to the 1.8% that LQDT contractually pays the DoD for the goods. This means the company realized a gross margin of about 73% on sampled items. In addition, LQDT's buyer customers pay 10%-20% in additional fees when purchasing from govliquidation.com, so gross margins could be as high as 83%-93%, based on our calculations. While there could be some unsalable items, we have been told by a knowledgeable individual that less than 1% of items purchased are unsalable. For FY 2011, operating expenses (excluding "non-GAAP" items) were about 18% of GMV. Based on our analysis, LQDT's DoD surplus operating margins could be as high as 65% (73% gross margin + 10% low end of buyer fees – 18% operating expenses). While this estimate could be on the high end, the evidence suggests that the company's EBIT/GMV margins for its DoD surplus business are somewhere between the midpoint of 30% profits under the various profit sharing arrangements and the 65% that we calculated. For purposes of our analysis, we conservatively assume the DoD surplus gross margins are about 65% or about 20% less than our calculations would support. This would have resulted in EBIT margins for DoD surplus of about 47% for FY 2011, increasing to 50% for FY 2012, as the company benefits from increased economies of scale.

Table 2: OWS estimated DoD surplus contribution to EBIT:

	2011	2012e	2013e
Surplus GMV	103.5	124.3	107.1
Estimated surplus gross margin as a % of GMV	65.0%	65.0%	65.0%
Opex as a % of GMV, excluding contract amortization and goodwill impairment	18%	14%	14%
Estimated EBIT/GMV	47%	51%	51%
Estimated EBIT contribution	48.9	63.0	55.2
Total company non-GAAP EBIT	52.6	106.3	100.6
As a % of total company EBIT	93%	59%	55%
As a % of GMV	19%	15%	12%

*- revenue based on calculations from company disclosures. Profits based on OWS analysis.

Based on our analysis, the company's surplus contract accounted for about 19% of GMV and 93% of total operating profits for FY 2011, and is on track to account for about 15% of GMV and 59% of operating profits for FY 2012.

Together, based on our analysis, we estimate that the DoD scrap and surplus contracts accounted for about 35% of GMV and 124% of operating profits for FY 2011 and should account for about 25% of GMV and 74% of operating profits for FY 2012. This calls into question the profitability of the remaining businesses, about which we go into detail in discussion point #3.

2. LQDT's DoD surplus and scrap GMV and profits have been boosted by base realignment and closures and the wars in Iraq and Afghanistan, but DoD GMV should decline

Sources tell us that LQDT has benefitted significantly from the 2005 Base Closure and Realignment Commission (BRAC). BRAC is an agency of the US government, which disposes of unnecessary US DoD real estate. The goal is to increase efficiency in line with Congressional and DoD objectives. More than 350 installations have been closed through five BRAC rounds (1989, 1991, 1993, 1995, and 2005). These closures have resulted in significant amounts of surplus and scrap items to be sold. The most recent base closures were required to be completed by September of 2011. Per a review of the major bases to be closed as a result of the 2005 BRAC, it appears that about 80% were closed in late 2011, most of which were closed in the back half of the year. Sources tell us that BRAC was a windfall for LQDT.

Sources estimate that BRAC accounted for a significant percentage of surplus goods for FY 2011 and FY 2012, and they expect these amounts to decline. Unfortunately, for LQDT and other potential bidders on the DoD contracts, it appears unlikely that there will be another BRAC series of base closures anytime soon. Although the 2005 BRAC recommended that Congress authorize another round of BRAC in 2015, the Pentagon's calls for base closures have met objections from the House Armed Services Committee, which voted 44 to 18 against another round of BRAC. Military brass is concerned more base closures would lessen the effectiveness of the military. In addition, it appears that the 1995 BRAC cost $6.6 billion and led to just $6.4 billion in savings. The 2005 BRAC cost $32.4 million with an estimated savings of $13.7 billion over the next 20 years. Because the BRAC closures did not result in any significant savings in the past, there seems to be little incentive to continue the process. Even if another BRAC round does occur, it is unlikely to lead to further base closures until later this decade.

The wars in Iraq and Afghanistan also contributed materially to scrap and surplus revenues over the past several years, according to our sources. First, the US military has been buying significant amounts of armored vehicles to protect troops in the field of battle, particularly the MRAP vehicles, which are designed to protect troops from mines and IEDs. As a result, the military has been disposing of surplus unarmored vehicles over the past several years, which now appears to be coming to an end. To put this in perspective, Oshkosh Corporation, which manufactures military vehicles, grew its defense revenue from $1.9B in 2008 to $7.2B in 2010. Its defense revenue declined to $4.3B in 2011 and is expected to decline to about $2B by around 2013, suggesting there will be far fewer new vehicles placed into service, which in turn should lead to far fewer vehicles to sell as surplus. While there appears to be some delay between getting new vehicles and selling old surplus vehicles, sources tell us that surplus sales should be either peaking now, or peaking very soon. Per our review of the website, it appears LQDT is selling about 800 military trucks per month with a final value of about $6,000 per truck, based on our review of a number of auctions. At this rate, the sales of surplus military vehicles appears to be running at about $58M per year, or nearly half of estimated FY 2012 surplus GMV. Our analysis suggests these vehicles are selling for about 8% of original cost, on average.

In addition to the armored vehicle programs, when troops return from the field of battle, supplies, medical equipment, etc. often come along with them. The average monthly boots on the ground in Afghanistan and Iraq peaked in 2008 at 187,900. 1,600 returned to the U.S. in 2009, 34,500 in 2010, and 45,600 in 2011. 38,700 are expected to return to the U.S. in 2012, leaving 67,500 on the ground. We estimate that these troops have boosted DoD GMV by about 10%-15%. This benefit is dwindling and will likely become a headwind. Incrementally, a reliable source thinks that the surplus product that still remains overseas is in poor quality. These goods are being scrapped and sold in Kuwait, not under LQDT's domain.

Our sources tell us that the sales of surplus and scrap items from BRAC, Iraq, and Afghanistan are in the final stages. Although difficult to determine exactly when revenues will decline, we are confident it will be in the next several quarters, based on our research. We are modeling total DoD GMV growth of 9% for FY 2012 and a decline of -10% for FY 2013, with the year over year comps going negative in F1Q 13. We expect DoD EBIT to increase by 17% in FY 2012 due to increased company scale and decline by -11% in FY 2013. Given the factors we have identified, we think our projections are relatively conservative, and that DoD revenues could decline even more than our forecast.

Table 3: OWS DoD scrap and surplus projections:

	FY11	FY12e	FY13e	FY 11'/12'	FY 12'/13'
Surplus GMV	103.5	124.3	107.1	20%	-14%
Scrap GMV	83.5	81.8	77.7	-2%	-5%
Total DoD GMV	187.0	206.1	184.8	10%	-10%
Estimated Surplus EBIT	48.9	63.0	55.2	29%	-13%
Estimated Scrap EBIT	16.4	16.1	15.3	-2%	-5%
Total DoD EBIT	65.33	79.15	70.46	21%	-11%

*- GMV calculations based on company disclosures. Profit analysis based on OWS analysis.

3. Non-DoD profitability is less than investors think, and incremental margins driven by commercial will be less than investors expect.

Several sources suggested to us that LQDT's Non-DoD business has not been profitable. We were skeptical of this notion, particularly given the impressive incremental margins the company has been generating on a year over year basis for the past two quarters. After we better understood the profitability of the company's DoD business, however, we were more inclined to think that our sources might, indeed, be correct in their assertions regarding LQDT's non-DoD profitability.

Table 4: OWS estimated non-DoD profitability:

	FY10	FY11	F1Q12	F2Q12
GMV				
Commercial purchase- Jacobs	-	-	19.0	19.0
Commercial purchase-non-Jacobs	88.3	109.5	28.3	40.0
Commercial consignment- Network Intl	15.0	49.0	12.7	13.2
Commercial consignment- Truckcenter	-	14.0	10.0	10.0
Commercial consignment other	64.5	74.8	33.8	46.3
Govdeals- consignment	82.8	111.6	24.9	36.9
Total Non-DoD GMV	250.6	358.9	128.7	165.3
Total company EBIT	28.1	52.6	21.2	29.4
Estimated DoD EBIT	38.4	65.3	18.5	21.2
Estimated non-DoD EBIT	(10.3)	(12.8)	2.7	8.2
Est non-DoD EBIT/GMV	-4.1%	-3.6%	2.1%	5.0%
Incremental non-DoD EBIT/GMV	na	-2.3%	13.8%	14.2%

*- based on OWS analysis. Non-GAAP EBIT numbers exclude amortization of intangibles, acquisition costs, and impairments. Excludes discontinued operations.

It appears that incremental non-DoD EBIT/GMV margins were negative, -2.3% for FY 2011, but increased dramatically to 13.8% for 1Q 12, and 14.2% for Q2 12. Notably, incremental margins have been much higher in the past two quarters, since the company acquired Jacobs Trading. Upon review of the Jacobs Trading acquisition, which we detail in discussion point #4, it appears that Jacobs has an above market contract (it seems unclear that this contract was arms length) with Walmart, and appears to be generating unsustainable margins. Jacobs TTM EBIT margins as of the time of the acquisition were 24%, which we think had a material impact on non-DoD EBIT and EBIT/GMV margins.

Table 5: OWS estimated non-DoD profitability excluding Jacobs Trading

	2010	2011	F1Q12	F2Q12
Non-DoD GMV, excluding Jacobs Trading	263.9	358.9	109.7	146.3
Total non-DoD EBIT	(10.2)	(12.8)	2.7	8.2
Estimated Jacobs Trading EBIT*	-	-	4.6	4.6
Non-DoD EBIT, excluding Jacobs Trading	(10.2)	(12.8)	(1.8)	3.7
EBIT/GMV	-4%	-4%	-2%	3%
Incremental EBIT margins		-3%	7%	11%

*- based on Jacobs TTM EBIT margin prior to being acquired

Non-DoD incremental EBIT/GMV appears to have been boosted significantly by the Jacobs Trading acquisition. Excluding the Jacobs acquisition, it appears LQDT's non-DoD business generated incremental EBIT/GMV of about 7% for F1Q12 and 11% for F2Q12, after generating negative incremental EBIT/GMV of -3% for FY 2011. Interestingly, non-DoD GMV excluding Jacobs increased by an estimated $28M y/y from $82M for F1Q11 to $110M, and by an estimated $60M from $86M for F2Q11 to $146M for F212. We estimate that the acquisition of Truckcenter in late FY 2011 added an additional $10M in both F1 Q12 and F2Q 12, so excluding acquisitions, it appears non-DoD GMV grew by about $18M y/y for F1Q 12 and by about $50M y/y for F2Q 12. Sources tell us that Acer, one of the largest computer manufacturers in the world, switched to LQDT for liquidating, from using Seneca Data, mid F1Q12, and sources think Acer is currently liquidating about $150M-$200M in GMV per year of computers though LQDT. If this is the case, it appears the company has been able to generate good returns from signing up Acer, which could account for all of the organic growth in GMV and EBIT over the past two quarters. Excluding Acer, the company does not appear to have generated much organic growth. Sources tell us that Acer has not been pleased with the amount of proceeds LQDT is generating on its behalf for product, which we detail in discussion point #5.

Sources are skeptical that LQDT can continue to generate anything more than mid single digit incremental operating margins. Although the company has generated 7% and 11% incremental operating margins for the past two quarters, on a year over year basis, it appears this is the result of signing Acer at very favorable terms (although we are also told Acer has no contract locking them into LQDT). We think that this is critical information, as investors generally view LQDT as a high growth commercial ecommerce play, and are expecting non-DoD businesses to help drive mid teens incremental EBIT/GMV margins. Given our modest expectations for the DoD business, we think incremental margins for the company, once Acer anniversaries, will be in the mid single digits, at most, and that sort of profitability will significantly disappoint investors. We think that, when investors come to realize the extent of LQDT's reliance on the DoD business, they will not award LQDT such a high multiple, and will assign a multiple more typical of defense related businesses. It is worth noting that, as the defense business declines, the non-DoD business will have to pick up a higher percentage of the operating costs, which we think will negatively impact incremental EBIT/GMV in FY 2013.

Table 6: OWS non-DoD GMV and EBIT projections:

	F3Q12e	F4Q12e	FY12e	FY13e
GMV estimates				
Commercial purchase- Jacobs	19.0	19.0	76.0	76.0
Commercial purchase-non-Jacobs	33.1	27.8	129.2	142.4
Commercial consignment- Network Intl	13.8	14.3	53.9	59.3
Commercial consignment- Truckcenter	10.0	10.0	40.0	44.0
Commercial consignment other	55.5	59.1	194.7	239.6
Govdeals- consignment	43.3	36.9	142.0	177.5
Total Non-DoD GMV	174.7	167.1	635.7	738.7
Estimated non-DoD EBIT	9.2	7.0	27.2	30.2
EBIT/GMV	5.3%	4.2%	4.3%	4.1%
Incremental EBIT/GMV	14.8%	14.6%	14.4%	2.9%**

*- based on OWS estimates

4. Analysis of Jacobs Trading acquisition

LQDT has relied on acquisitions to supplement its growth over the past several years. LQDT acquired Network International for $15M in June of 2010, which added $45m to GMV, or a multiple of 0.33X price/GMV. LQDT also acquired Truckcenter for $18M in June of 2011, which added about $50M in GMV, or a multiple of 0.36X price/GMV. Most recently, LQDT acquired Jacobs Trading for a multiple of about 2.1X price/GMV (excluding the potential earn-out which could raise the price) and recently announced it would acquire Dove Bid, a UK company, for an estimated 0.15X price/GMV. We think the company's recent acquisition of Jacob is very interesting for a number of reasons.

LQDT acquired Jacobs Trading on October 1, 2011. Jacobs had generated about $73M of GMV, $18.3M of EBITDA, and $18M EBIT in the TTM prior to its acquisition. As the EBIT margin of about 24.5% is materially higher than we would have expected, we sought to learn more about the substance of Jacobs. It turns out that Jacobs has only has about 20 employees, according to our sources, and utilizes prisoners and special needs laborers on a contract basis to sort and demark products. We note that some companies have policies against using prison labor, which could impact whether they will deal with LQDT. Jacobs only had $847,000 of PP&E as of the date of the acquisition, and its pre-acquisition book value was only about $6.8M. This means that LQDT paid about $7M per employee and 22X book value for Jacobs.

Table 7: Jacobs Trading balance acquisition details:

	10/1/11
Jacobs Trading acquisition price	152,724
A/R	4,710
Inventory	6,059
Prepaid expenses	120
PP&E	847
Accounts payable	(1,837)
Accrued liabilities	(3,101)
Book value	6,798
Goodwill	110,226
Vendor contract intangible	33,300
Covenants not to compete	2,400
Intangible assets & goodwill	145,926

About 70% of Jacobs revenues come from Walmart. Coincidentally, Irwin Jacobs, the former owner of Jacobs Trading, is said to be close friends with Lee Scott of Walmart. It is unclear whether the contract was executed at arms length, but, given Jacob's profitability, one has to wonder. It would be difficult for any outsider to determine whether or not Jacobs' contract with Walmart went through the ordinary process of approval. Anecdotally, we have been told by one of LQDT's competitors that some Walmart personnel involved in the reverse supply chain were furious when LQDT acquired Jacobs, as it became clear just how favorable the contract was for LQDT, presumably at Walmart's expense. Fortunately for LQDT, it appears most of Jacobs Walmart business is committed through the beginning of 2016. When this contract expires, we doubt it will be renewed on similar terms, if at all.

As detailed in discussion point #3, we think the Jacobs acquisition significantly boosted non-DoD EBIT in the first two quarters of FY 2012. Importantly, this benefit is due to anniversary in October 2012. In our opinion, given the lack of substance of Jacobs, we question whether the company's allocation of intangible assets to goodwill should have been so high, at $110M, and the allocation of intangible assets to its vendor contract so low at $33M. Given the likely unsustainable level of profitability due to contracts that appear to reflect above market terms, the value of the Jacobs acquisition would more appropriately be in the contracts, not the company. It is our experience that in situations such as this, goodwill is often written off in future years when contracts expire. This appears to be an example of a company buying earnings for the next several years while capitalizing the expense as goodwill, in our opinion.

5. LQDT has significant customer concentration risk, and the loss of any one of its major customers could be problematic.

LQDT's DoD contracts are both likely to be rebid in the next few years. Its DoD surplus contract, which we estimate will account for about 15% of GMV and 60% of EBIT in FY 2012, expires in December 2013. We have been told by sources that this contract will be put out to bid. LQDT's scrap contract, which we estimate will account for about 10% of GMV and 15% of EBIT in FY 2012, expires in August 2012, but the DoD has exercised the first of three one-year term extensions, and assuming it exercises the remaining two, the contract will run to August of 2015. With competition intensifying, we think it is likely that either LQDT loses this business, or wins it under much less profitable arrangements.

LQDT's Walmart business may also be at risk. Prior to the acquisition of Jacobs Trading, Walmart accounted for more than 10% of total GMV. As about 70% of Jacobs Trading GMV comes from Walmart as of the acquisition date, Walmart now accounts for about 15% of total GMV and about 20% of non-DoD GMV. As we noted above, sources tell us that, when the acquisition of Jacobs Trading occurred, some Walmart employees were surprised at the level of profits at Jacobs Trading, which relies heavily on Walmart, and some questioned whether this contract was executed at arms length. We have been hearing that Walmart is slowly moving some business away from LQDT, as it seeks to have less buyer concentration in its reverse supply chain. Given the terms of Walmart's contract with Jacobs Trading, we think it unlikely that this contract will be renewed as it currently stands. We also note that Walmart has a history of squeezing its business partners, so it would not be surprising if the company threatens to take away its non-contracted business to apply leverage to renegotiate its contract with Jacobs Trading, which now accounts for about half of LQDT's business with Walmart.

Around November of 2011, Acer started selling its refurbished inventory exclusively through LQDT. Acer had been in a long-term agreement with Seneca Data, whereby Seneca Data was responsible for the refurbishment and selling of the product. When the two companies had a falling out last year, Acer decided to have its refurbishment done by a company based in Mexico, and gave LQDT the exclusive right to sell the product once it was refurbished. Our source tells us that LQDT had promised Acer it would be more profitable to sell through LQDT. LQDT does not take possession and serves solely as a broker. Our sources also say that Acer does not have a long-term contract with LQDT, and, so far, has not been pleased with the net proceeds it has been receiving for its product. Our sources say that Acer sells about $150MM-$200MM of refurbished product per year, which is being handled by LQDT. If these numbers are accurate, it means that Acer accounted for about 25% of the company's commercial GMV over the past two quarters, and nearly all of the non-DoD organic growth. If Acer chooses to do business elsewhere, the company would have to find significant other business with which to replace it.

6. Competition is increasing in the liquidation marketplace

The liquidation marketplace is fiercely competitive. LQDT has thousands of competitors in this fragmented market. The only company larger than LQDT, from what we can tell, is Genco, which appears to sell about $1.5B of GMV per year. Interestingly, LQDT generally dismisses Genco as a smaller competitor, but our research suggests Genco is a much larger competitor in the liquidation marketplace. Other well established competitors in the business are B-Stock, Via Trading, Channel Control Merchants, Ingram Micro, DHL Global Forwarding, Essex, Seneca Data, and Property Room, but none of these, apart from Genco, appears to come close to the amount of volume when compared to LQDT. Ebay recently entered the market with a B2B offering, but it is too early to know whether Ebay will have the same success as it has had in B2C and C2C. Notably, B Stock is run by a former executive of Ebay. There are also a number of smaller competitors, which may have revenues that approach $100M, and that concentrate on the export market. We are told that the companies that target the export market routinely break vendor policies about exporting certain products, so it is unlikely that LQDT, as a public company, could enter this space effectively, either on its own or by acquiring such a company.

We spoke with a number of sources in the reverse supply chain marketplace. Some of these work for liquidators and others for retailers. The common theme in the industry is that, increasingly, sellers want to get the best price in the most efficient manner. There appears to be no loyalty among buyers and sellers and generally, sellers will go to the buyer who offers the most money. It is also worth noting that sellers like to diversify within the reverse supply chain in order to create competitive bidding for their products. Items are generally commoditized and operating margins are typically in the low single digits. Some participants operate with margins as low as 1%-2%. Often, the buyers have little overhead, so economies of scale are not too important. Buyers can get product by the palette, by the truckload, etc.

Retailers appear to be getting smarter with respect to the reverse supply chain. Walmart, for example, now allocates floor space at its retail stores, where it sells returned items to customers at a fraction of the cost of a new product. Often, the returned products look and function like new, and are virtually indiscernible to the customer who may pay 50% of retail for a returned product. When the same product is liquidated through a company like LQDT, the retailer would recoup only about 10%-20%. As other retailers adopt similar strategies such as adding floor space to sell higher valued returned items, it will likely lead to fewer high value products being sold through the reverse supply chain liquidators. While retailers become smarter about the reverse supply chain, LQDT's competitors are also growing and seeking to take share. Net profits are typically 5% or less on GMV. Most of our sources expect these profits to contract in the next several years, as competition continues to intensify. As a result, we think it is unlikely that LQDT will be able to drive incremental EBIT margins in its commercial business beyond 5% over the long term.

7. LQDT's acquisition of DoveBid

LQDT's planned acquisition of DoveBid for $31M may have surprised some investors. DoveBid generated about $211M GMV in 2011. While the acquisition will add a material amount of GMV to LQDT, it may be a risky acquisition. LQDT's previous foray into the international markets generated losses, and given that DoveBid has been generating losses on its own for the past several years, we wonder why LQDT would step outside of its core market to make this acquisition. LQDT expects to get $0.01-$0.03 of earnings accretion from DoveBid in FY 2013. It plans to get DoveBid to profitability by eliminating some senior management positions, including the CEO. However, cutting further costs may be difficult, as Dove Bid has about 300 employees in twenty different countries, and LQDT has announced it intends to keep all of the offices open. And based on a review of prior years financials, LQDT may have difficulty getting DoveBid to profitability.

Table 8: Historical DoveBid results and OWS forecasted contributions:

Revenue	2009	2010	2011
Europe	24.5	22.9	18.3
North America	35.6	33.6	27.9
Asia Pacific	7.8	6.1	5.9
Total revenue	67.9	62.6	52.1
Operating profit (before tax)			
Europe	0.5	2.1	0.5
North America	1.2	4.5	0.3
Asia Pacific	0.8	(0.3)	0.2
Corporate	(3.5)	(4.9)	(5.1)
Total operating profit	(1.0)	1.4	(4.1)
Tangible book value	(9.9)	(8.9)	(14.4)
FCF			
Cash from operations	3.4	(6.0)	(10.8)
Capex	(0.2)	(0.1)	(0.3)
Sale of PP&E	0.1	0.8	0.1
Purchase of intangibles	(0.6)	(1.0)	(0.8)
FCF	2.7	(6.3)	(11.8)

*- based on Dove Bid financial statements translated to US dollars

Dove Bid appears to be a deteriorating business. Revenues and operating profits declined in 2011, and the company last reported tangible book value of negative -$14M. FCF has been sharply negative, with the company burning $12M in 2011. Despite the unimpressive financials, however, we assume DoveBid will exceed LQDT expectations, and that DoveBid will be able to contribute $0.05 of accretion in FY 2013. Given LQDT's previous lack of success internationally, this could prove to be very optimistic.

8. Insider selling has been significant

Since the beginning of 2011, insiders have sold about $110 million in stock. While the CEO still does own 5.9 million shares, he has liquidated more than 600,000 shares, for $32 million, and recently filed to sell another 2.5 million shares over the next two years. James Mateus-Tique, the former COO, has sold more than $12 million in stock this year, reducing his holding to 212,657 shares, down from 1 million shares. The CFO has been steadily selling, and owns just 600 shares. Thomas Burton, the COO of DoD Surplus LLC, liquidated his last 10,000 shares on May 31, 2012. Franklin Kramer, a former Assistant U.S. Secretary of Defense for International Affairs and LQDT board member since 2001, sold $8 million in stock on May 15. Eric Dean, the Chief Information Officer, sold $8 million in stock over the past 6 months.

9. Recent results.

LQDT reported FQ2 12 results that meaningfully beat consensus. The "adjusted" earnings were $0.52 vs. consensus of $0.38 and guidance of $0.28-0.32. This was driven by higher auction sales (GMV of $218.4 million vs. guidance of $165-$175 million), as well as by "adjusted" EBITDA that was $30.9 million vs. guidance of $18.5-$20.5 million, due to the higher than expected sales as well as 300bps of margin outperformance. As we detailed above, the main drivers of outperformance appear to be peaking DoD revenues, benefits from the Jacobs acquisition, and benefits from picking up Acer. The acquisition of Jacobs and obtaining Acer as a customer will anniversary in FQ1 12, making the comps thereafter much more difficult.

10. OWS financial assumptions vs. "street."

The "street" forecasts GMV to increase from about $807M for FY 2012 to $990M for FY 2013 (excluding DoveBid acquisition). Our forecast for GMV is higher than the "street" at $840M for FY 2012, but lower than the "street" at $911M for FY 2013 (excluding DoveBid acquisition). The "street" does not do a very good job breaking down GMV by source, such as DoD, nor does it do much in the way of detailing the disparity of margins from different revenue streams, so it is not clear what "street" analysts expect the growth rates of each revenue stream to be. However, the "street" does expect incremental EBIT/GMV in the mid 'teens for the next several years. As we think the high margin DoD business will begin to decline, and that the margins in the commercial business are not as high as investors think, we expect incremental EBIT/GMV to be disappointing. We think, due primarily to the decline in DoD revenues, which will be replaced with low margin commercial business, that non GAAP EBIT will decline in absolute dollars from about $105M for FY 2012 to about $97M for FY 2013. We expect this to result in significant earnings disappointments.

11. Valuation:

The "street" thinks LQDT will grow GMV by about 45% in 2012 and 23% in 2013 (excluding the DoveBid acquisition). Although we think the company will surpass the FY 2012 estimates for GMV, we think FY 2013 will disappoint. We estimate GMV will grow by 53% for FY 2012 and by 10% for FY 2013. We exclude the acquisition of Dove, as does the "street," which we model to add about $200M of GMV to FY 2013, assuming the deal closes prior to the end of FY 2012. "Street" estimates for non-GAAP EPS are for $1.68 for FY 2012 and $2.10 for FY 2013. While we think the company will make non-GAAP earnings of about $1.88 in FY 2012, we think this is more than baked into the company's valuation. We think FY 2013 EPS will be about $1.73 (excluding $0.05 EPS accretion for Dove Bid acquisition), significantly disappointing investors, as the profitable DoD business slows.

Based on our analysis, about 70% of LQDT's FY 2013 earnings will come from its DoD business. Most defense companies are trading around 10X earnings, from what we can tell, so we think it would be reasonable to award this portion of the earnings stream, an estimated $1.21 contribution to EPS, a defense multiple of about 10X, suggesting a valuation of $12 per share. We think this could prove generous, as the defense market becomes more challenging and the company's DoD contracts are likely rebid, potentially leading to contract losses or reduced profits in the next few years. Importantly, the DoD surplus contract, which will account for an estimated 55% of FY 2013 earnings, expires at the end of 2013 and there is a chance the company could lose it. About 18% of earnings appears to be coming from Jacobs, which we regard as very low quality, and it remains unclear as to what will happen to Jacob's profitability once its contract with Walmart expires. We think Jacobs is probably worth about what LQDT paid for it, suggesting a value to LQDT of about $5 per share ($152M/32.8M shares), which would equate to an earnings multiple of about 16X ($18.2M EBIT tax effected at 40%= $0.31 EPS). Unfortunately for investors, this leaves only about $0.21 in non-DoD earnings, excluding Jacobs, to be valued. At a 20X multiple of FY 2013, which we think would be very generous, this amounts to about another $4 per share.

Together, our sum of the parts valuation suggests that LQDT might be worth about $21/share. Given the lack of earnings growth that our analysis suggests, the poor quality of the earnings, and the customer concentration risks, we think this is an appropriate value for the business. Nevertheless, to be conservative, we are initiating our position with a target of $25, which is a market multiple of 14X 2013 earnings, assuming the company generates $1.78 of EPS in FY 2013, which includes $0.05 accretion from the Dove Bid acquisition.

12. Risks to thesis

The main risk to our thesis is that the company is able to acquire earnings, such as what the company did with the Jacobs Acquisition. However, there do not appear to be very many large competitors, particularly ones that have such profitable contracts as Jacobs does.

A secondary risk to our thesis is that DoD GMV stays high longer than we expect. Although very difficult to forecast exactly when it will decline, we are convinced, based on discussions with knowledgeable sources, that DoD GMV is in the process of peaking and will decline soon.

13. OWS projections

OWS annual projections:

	FY09a	FY10a	FY11a	FY12e	FY13e
Revenue	219.0	273.0	327.4	415.1	415.5
Fee revenue	-	-	-	50.0	55.4
Total revenue	219.0	273.0	327.4	465.2	471.0
COGS, excluding amortization	75.0	109.4	126.4	189.5	197.7
Profit sharing distributions	43.7	41.3	49.3	49.0	46.9
Technology & operations	43.6	45.7	52.2	63.7	66.2
Sales and marketing	17.4	20.4	23.3	27.5	28.4
G&A	20.1	23.6	26.5	32.7	34.4
Amortization of contract intangibles	0.8	0.8	0.8	8.0	8.0
D&A	2.7	3.6	4.9	6.3	7.8
Acquisition costs & impairments	-	0.5	6.7	(6.7)	-
Total cost and expenses	203.3	245.3	290.1	370.2	389.4
Operating income	15.7	27.7	37.3	95.0	81.6
Interest expense and other	0.5	(0.4)	(1.2)	(2.1)	(2.0)
Pre-tax income	16.2	27.3	36.1	92.9	79.6
Income taxes	7.8	12.2	15.5	37.2	31.5
Net income	8.4	15.1	20.7	55.6	48.2
Shares	27.8	27.4	29.1	32.9	34.1
GAAP EPS	0.30	0.55	0.71	1.67	1.38

Y/Y change %	FY10a	FY11a	FY12e	FY13e
Revenue	25%	20%	27%	0%
Fee revenue	na	na	na	11%
Total revenue	25%	20%	42%	1%
COGS, excluding amortization	46%	16%	50%	4%
Profit sharing distributions	-6%	19%	-1%	-4%
Technology & operations	5%	14%	22%	4%
Sales and marketing	17%	14%	18%	3%
G&A	17%	12%	24%	5%
Amortization of contract intangibles	0%	0%	889%	0%
D&A	36%	35%	30%	23%
Acquisition costs & impairments	na	1179%	-200%	-100%
Total cost and expenses	21%	18%	28%	5%
Operating income	77%	35%	154%	-14%
Interest expense and other	-177%	204%	77%	-5%
Pre-tax income	69%	32%	157%	-14%
Income taxes	57%	27%	141%	-16%
Net income	80%	37%	169%	-13%
Shares	-2%	6%	13%	4%
GAAP EPS	84%	29%	135%	-17%

As a % of revenue	FY09a	FY10a	FY11a	FY12e	FY13e
Revenue	100%	100%	100%	89%	88%
Fee revenue	0%	0%	0%	11%	12%
Total revenue	100%	100%	100%	100%	100%
COGS, excluding amortization	34%	40%	39%	41%	42%
Profit sharing distributions	20%	15%	15%	11%	10%
Technology & operations	20%	17%	16%	14%	14%
Sales and marketing	8%	7%	7%	6%	6%
G&A	9%	9%	8%	7%	7%
Amortization of contract intangibles	0%	0%	0%	2%	2%
D&A	1%	1%	1%	1%	2%
Acquisition costs & impairments	0%	0%	2%	-1%	0%
Total cost and expenses	93%	90%	89%	80%	83%
Operating income	7%	10%	11%	20%	17%
Interest expense and other	0%	0%	0%	0%	0%
Pre-tax income	7%	10%	11%	20%	17%
Income taxes	4%	4%	5%	8%	7%
Net income	4%	6%	6%	12%	10%

OWS quarterly projections:

	F1Q12a	F2Q12a	F3Q12	F4Q12	F1Q13	F2Q1e	F3Q13	F4Q13
Revenue	96.2	112.2	105.7	101.0	100.4	109.6	102.9	102.7
Fee revenue	9.8	13.6	13.6	13.1	13.1	13.7	14.4	14.2
Total revenue	106.0	125.7	119.3	114.1	113.4	123.3	117.3	116.9
COGS, excluding amort	43.3	55.0	47.5	43.7	47.7	55.5	48.0	46.5
Profit sharing dists	12.5	11.4	11.9	13.2	12.1	11.0	11.3	12.6
GM/GMV	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Technology & Ops	15.8	15.8	16.0	16.1	16.6	16.2	16.6	16.9
S&M	6.5	6.9	7.0	7.1	7.0	7.0	7.1	7.3
G&A	7.8	8.2	8.3	8.4	8.6	8.4	8.6	8.8
Amort of contract intang	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
D&A	1.5	1.5	1.6	1.7	1.8	1.9	2.0	2.1
Acquisition costs & impairment	0.3	(7.0)	-	-	-	-	-	-
Total cost and expenses	89.8	93.9	94.5	92.5	96.0	102.2	95.8	96.4
Operating income	16.3	31.9	24.8	21.6	17.5	21.1	21.6	20.5
Interest expense and other	(0.5)	(0.6)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Pre-tax income	15.7	31.3	24.3	21.1	17.0	20.6	21.1	20.0
Income taxes	6.6	12.5	9.7	8.4	6.8	8.2	8.4	8.0
Net income	9.1	18.8	14.6	12.6	10.2	12.4	12.6	12.0
Shares	32.4	32.8	33.1	33.4	33.7	34.0	34.3	34.6
GAAP EPS	0.28	0.57	0.44	0.38	0.30	0.36	0.37	0.35

Y/Y change %

Y/Y change %	F1Q12a	F2Q12a	F3Q12	F4Q12	F1Q13	F2Q13	F3Q13	F4Q13
Revenue	40%	35%	23%	27%	4%	-2%	-3%	2%
Fee revenue	43%	115%	na	na	33%	1%	6%	8%
Total revenue	41%	41%	39%	44%	7%	-2%	-2%	2%
COGS, excluding amort	40%	44%	37%	72%	10%	1%	1%	6%
Profit sharing dists	21%	-4%	-4%	-10%	-3%	-4%	-5%	-5%
GM/GMV	4%	-5%	0%	-2%	-12%	-8%	-9%	-7%
Technology & Ops	26%	16%	18%	22%	5%	3%	4%	5%
S&M	13%	16%	21%	19%	7%	1%	2%	3%
G&A	24%	21%	20%	23%	10%	3%	3%	4%
Amort of contract intang	895%	890%	885%	885%	-1%	-1%	0%	0%
D&A	46%	26%	15%	27%	18%	26%	25%	24%
Acquisition costs & impairment	-93%	na	-100%	-100%	-100%	-100%	na	na
Total cost and expenses	25%	20%	3%	33%	7%	9%	1%	4%
Operating income	331%	177%	-541%	124%	7%	-34%	-13%	-5%
Interest expense and other	116%	116%	-10100%	25%	-5%	-14%	0%	0%
Pre-tax income	346%	179%	-533%	129%	8%	-34%	-13%	-5%
Income taxes	378%	147%	-313%	233%	3%	-34%	-13%	-5%
Net income	325%	205%	-1477%	89%	12%	-34%	-13%	-5%
Shares	14%	17%	18%	9%	4%	4%	4%	4%
GAAP EPS	271%	161%	-1263%	73%	7%	-36%	-16%	-8%

As a % of revenue:

	F1Q12a	F2Q12a	F3Q12	F4Q12	F1Q13	F2Q13	F3Q13	F4Q13
Revenue	91%	89%	89%	89%	88%	89%	88%	88%
Fee revenue	9%	11%	11%	11%	12%	11%	12%	12%
Total revenue	100%	100%	100%	100%	100%	100%	100%	100%
COGS, excluding amort	41%	44%	40%	38%	42%	45%	41%	40%
Profit sharing dists	12%	9%	10%	12%	11%	9%	10%	11%
GM/GMV	0%	0%	0%	0%	0%	0%	0%	0%
Technology & Ops	15%	13%	13%	14%	15%	13%	14%	14%
S&M	6%	5%	6%	6%	6%	6%	6%	6%
G&A	7%	7%	7%	7%	8%	7%	7%	8%
Amort of contract intang	2%	2%	2%	2%	2%	2%	2%	2%
D&A	1%	1%	1%	1%	2%	2%	2%	2%
Acquisition costs & impairment	0%	-6%	0%	0%	0%	0%	0%	0%
Total cost and expenses	85%	75%	79%	81%	85%	83%	82%	82%
Operating income	15%	25%	21%	19%	15%	17%	18%	18%
Interest expense and other	0%	0%	0%	0%	0%	0%	0%	0%
Pre-tax income	15%	25%	20%	18%	15%	17%	18%	17%
Income taxes	6%	10%	8%	7%	6%	7%	7%	7%
Net income	9%	15%	12%	11%	9%	10%	11%	10%

14. Additional Tables based on OWS estimates:

Table 9: Estimated GMV, excluding discontinued operations:

GMV	FY 10	FY11a	FY12e	FY13e
DoD Scrap	71.7	86.2	82.2	78.1
DoD Surplus	82.8	103.5	124.3	107.1
Commercial purchase	91.2	109.5	205.2	218.4
Commercial consignment	82.1	137.8	288.6	342.9
Govdeals- consignment	85.5	111.6	142.0	177.5
Total GMV	413.3	548.5	842.2	924.0

Table 10: Estimated quarterly GMV

GMV	Q3 12e	Q4 12e	Q1 13e	Q2 13e	Q3 13e	Q4 13e
DoD Scrap	19.8	22.1	20.1	18.3	18.8	21.0
DoD Surplus	31.7	29.4	25.0	28.8	26.9	26.5
Commercial purchase	52.1	46.8	52.1	61.0	53.8	51.5
Commercial consignment	79.3	83.4	89.7	74.6	86.8	91.8
Govdeals- consignment	43.3	36.9	31.1	46.1	54.1	46.1
Total GMV	226.1	218.5	218.0	228.7	240.4	236.9

Table 11: Reconciliation from GAAP to non-GAAP

	1Q12a	2Q12a	3Q12e	4Q12e	1Q13e	2Q13e	3Q13e	4Q13e
GAAP net income	9.1	18.8	14.6	12.6	10.2	12.4	12.6	12.0
Adjustments, net of tax:	-	-	-	-	-	-	-	-
Stock comp net of tax	1.5	1.5	1.6	1.6	1.7	1.8	1.8	1.9
Amortization of contract intangibles	1.1	1.1	1.2	1.2	1.2	1.2	1.2	1.2
Acquisition costs	0.2	(4.2)	-	-	-	-	-	-
Adjusted net income	11.9	17.2	17.3	15.5	13.1	15.3	15.7	15.1
Adjusted EPS	0.37	0.52	0.52	0.46	0.39	0.45	0.46	0.44

Table 12: Normalized free cash flow:

	FY09a	FY10a	FY11a	FY12e	FY13e
Normalized FCF					
Net income	8.40	15.11	20.68	55.61	48.17
Amortization of contract intangibles	0.81	0.81	0.81	8.04	8.00
D&A	2.66	3.61	4.88	6.33	7.80
Acquisition costs and impairments	-	0.52	6.70	(6.67)	-
Normalized FCF	11.87	20.06	33.08	63.31	63.97
Capex	(3.30)	(3.60)	(4.80)	(6.00)	(6.80)
Normalized FCF	8.57	16.46	28.28	57.31	57.17
FCF based on current market cap	0.5%	1.0%	1.7%	3.5%	3.5%