



Mossberg's Investor Digest

Idea Profile

Liquidity Services (Nasdaq: LQDT)

DESCRIPTION:

Liquidity Services runs online auction marketplaces that help corporations and government agencies liquidate surplus goods. LQDT procures product from many top 10 retailers, online retailers, and the U.S. government. After taking possession of the goods at one of its 9 warehouse facilities, the company sorts, barcodes, and palletizes common items. The items are then auctioned on one of its auction sites to EBay power users, thrift shops and back alley liquidators. The company just reached a milestone of 1 million registered users of its websites liquidation.com, govliquidation.com, govdeals.com and liquibiz.com.

KEY INVESTMENT CONSIDERATION:

Effectively, the faster LQDT grows the more cash that it generates – The company generated \$20 million in free cash flow over the past 12 months while growing its revenue base by more than 30%. For most other companies, 30% revenue growth would have required cash to finance receivables and inventory. Instead, LQDT's unique business model can actually generate "negative working capital". This happens because auction winners pay faster than LQDT has to pay for the entire consideration (inventory purchase plus profit sharing distribution) of the product. LQDT has three pricing models.

1. Consignment(38% of revenue) – Under the consignment model, there is no cash outlay for the merchandise sold at auction. Payment is received by LQDT and remits funds to the seller after a few days.

2. Profit Share(42% of revenue) – Under this model, LQDT pays a nominal amount (less than 1% of acquisition value) to the seller, then remits a portion of the profits generated on the sale of the merchandise after selling and other expenses are deducted.

3. Purchase(15% of revenue) – LQDT agrees to a purchase price per item, and sometimes receives terms from the seller that can be as much as 120-180 days. In most cases this is twice as long as it takes LQDT to sell and receive payment for the item.

As a result of this model, LQDT can finance growth without issuing new shares and diluting shareholders. Excess cash can be used to repurchase stock or make acquisitions that further expand the scope and scale. It's also conceivable that LQDT could pay a dividend at some point in the future.

Weak economy could help business – In a trade group survey of more than 200 resale and thrift shops, nearly 2/3 of businesses reported higher sales in 2008...the average increase was 35%. The two largest charitable resellers, The Salvation Army and Goodwill Industries, reported year-to-date increases of 6% and 15% respectively.

Critical mass and infrastructure create strong value proposition and barriers to entry – In the auction business, the larger the efficiencies of scale and scope the more valuable the auction is to sellers and buyers. The company has 500 product categories and over 1.7 million annual auction participants. In addition, the company has built infrastructure to support a \$1B business. Its 9 warehouse facilities with over one million sqft. of usable space, systems, and knowledge base would be significant barriers for any new entrant to duplicate.

VALUATION:

LQDT is currently trading at an enterprise value of 7.6x trailing twelve months EBITDA. This is a bargain for a company that is already generating a ROE of 13% and has multiple recurring revenue streams. Following the DoD surplus contract reset through FY09, profitability should grow faster than the top line as LQDT leverages the investments made in infrastructure, which is currently operating at less than 60% of capacity. Based on a targeted contribution margin of 12% to 14% (up from approximately 9% currently), LQDT could generate 20% to 25% ROE. As these returns are realized, valuation multiples should expand significantly from current levels.

(Nasdaq: LQDT)

Investment Data (as of 10/23/08)

Recent Price	\$7.52
52-Week Range	6.73 - 15.18
Fiscal Year End	September
Shares Outstanding	28 MM
Average Trading Volume (3 mos)	174,000
Market Capitalization	210 MM
Cash	51 MM
Long Term Debt	0
Enterprise Value (EV)	159 MM
LT Debt/ Equity	0%
Tangible BV/ Share	1.85
TTM Revenue	245 MM
P/ Revenue	0.9x
TTM EPS	0.43
P/ EPS	17.5x
TTM EBITDA	21 MM
EV/ TTM EBITDA	7.6x

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