LIQUIDITY SERVICES INC
Form 10-Q
August 09, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2011

OR

o 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.)
1920 L Street, N.W., 6th Floor, Washington, D.C.	**20036**
(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 x No o

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 x No o

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

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The number of shares outstanding of the issuer s common stock, par value $.001 per share, as of August 2, 2011 was 28,298,036.

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PART I FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements.

Liquidity Services, Inc. and Subsidiaries
Consolidated Balance Sheets

(Dollars in Thousands)

	June 30, 2011 (Unaudited)	September 30, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 93,512	$ 43,378
Short-term investments	10,910	33,405
Accounts receivable, net of allowance for doubtful accounts of $446 and $328 at June 30, 2011 and September 30, 2010, respectively	5,258	4,475
Inventory	14,714	17,321
Prepaid expenses, deferred taxes and other current assets	15,253	10,122
Total current assets	139,647	108,701
Property and equipment, net	7,984	6,781
Intangible assets, net	3,368	3,057
Goodwill	40,538	39,831
Other assets	6,361	6,534
Total assets	$ 197,898	$ 164,904
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 6,388	$ 8,605
Accrued expenses and other current liabilities	18,307	23,659
Profit-sharing distributions payable	5,358	5,596
Acquisition earn out payable	7,248	995
Customer payables	13,471	9,783
Total current liabilities	50,772	48,638
Acquisition earn out payable	4,741	1,810
Deferred taxes and other long-term liabilities	2,105	2,082
Total liabilities	57,618	52,530
Stockholders equity:		
Common stock, $0.001 par value; 120,000,000 shares authorized; 30,259,365 shares issued and 28,097,309 shares outstanding at June 30, 2011; 28,827,072 shares issued and 26,894,591 shares outstanding at September 30, 2010	28	27
Additional paid-in capital	107,765	85,517
Treasury stock, at cost	(21,884)	(18,343)
Accumulated other comprehensive loss	(832)	(4,645)
Retained earnings	55,203	49,818
Total stockholders equity	140,280	112,374
Total liabilities and stockholders equity	$ 197,898	$ 164,904

See accompanying notes to the unaudited consolidated financial statements.

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Liquidity Services, Inc. and Subsidiaries
Unaudited Consolidated Statements of Operations

(Dollars in Thousands, Except Per Share Data)

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010
Revenue	$ 86,058	$ 72,751	$ 256,671	$ 213,846
Costs and expenses:				
Cost of goods sold (excluding amortization)	34,572	30,378	108,228	90,686
Profit-sharing distributions	12,340	10,256	34,949	30,315
Technology and operations	13,569	11,982	41,256	36,224
Sales and marketing	5,789	5,221	17,984	14,879
General and administrative	6,912	6,148	20,797	18,562
Amortization of contract intangibles	203	203	610	610
Depreciation and amortization	1,391	1,058	3,932	2,938
Acquisition costs and goodwill impairment	16,894	524	21,589	524
Total costs and expenses	91,670	65,770	249,345	194,738
(Loss) income from operations	(5,612)	6,981	7,326	19,108
Interest income and other (expense), net	5	50	(49)	91
(Loss) income before provision for income taxes	(5,607)	7,031	7,277	19,199
Benefit (provision) for income taxes	4,550	(4,041)	(1,892)	(9,692)
Net (loss) income	$ (1,057)	$ 2,990	$ 5,385	$ 9,507
Basic (loss) earnings per common share	$ (0.04)	$ 0.11	$ 0.20	$ 0.35
Diluted (loss) earnings per common share	$ (0.04)	$ 0.11	$ 0.19	$ 0.35
Basic weighted average shares outstanding	27,928,750	26,959,713	27,478,342	27,181,879
Diluted weighted average shares outstanding	27,928,750	27,371,132	28,096,078	27,424,427

See accompanying notes to the unaudited consolidated financial statements.

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Liquidity Services, Inc. and Subsidiaries
Unaudited Consolidated Statement of Changes in Stockholders Equity

(In Thousands Except Share Data)

	Treasury Stock		Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total
	Shares	Amount	Shares	Amount				
Balance at September 30, 2010	(1,932,481)	$ (18,343)	28,827,072	$ 27	$ 85,517	$ (4,645)	$ 49,818	$ 112,374
Common stock repurchased	(229,575)	(3,541)						(3,541)
Exercise of common stock options and restricted stock			1,432,293	1	13,050			13,051
Compensation expense from grants of common stock options and restricted stock					9,198			9,198
Comprehensive income:								
Net income							5,385	5,385
Foreign currency translation and other						3,813		3,813
Balance at June 30, 2011	(2,162,056)	$ (21,884)	30,259,365	$ 28	$ 107,765	$ (832)	$ 55,203	$ 140,280

See accompanying notes to the unaudited consolidated financial statements.

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Liquidity Services, Inc. and Subsidiaries
Unaudited Consolidated Statements of Cash Flows

(In Thousands)

	Nine Months Ended June 30, 2011		Nine Months Ended June 30, 2010	
Operating activities				
Net income	$	5,385	$	9,507
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		4,542		3,548
Stock compensation expense		6,749		6,029
Provision for inventory allowance		51		440
Provision for doubtful accounts		118		(272)
Impairment of goodwill		16,648		
Changes in operating assets and liabilities:				
Accounts receivable		(827)		172
Inventory		2,556		(771)
Prepaid expenses and other assets		(4,783)		(862)
Accounts payable		(2,226)		4,222
Accrued expenses and other		(5,381)		4,570
Profit-sharing distributions payable		(238)		(480)
Customer payables		3,689		(1,460)
Acquisition earn out payables		2,195		
Other liabilities		22		(224)
Net cash provided by operating activities		28,500		24,419
Investing activities				
Purchases of short-term investments		(8,830)		(36,559)
Proceeds from the sale of short-term investments		31,420		49,360
Increase in goodwill and intangibles		(30)		(338)
Cash paid for acquisitions, net of cash acquired		(9,000)		(3,587)
Purchases of property and equipment		(4,399)		(3,136)
Net cash provided by investing activities		9,161		5,740
Financing activities				
Principal repayments of capital lease obligations and debt				(138)
Proceeds from exercise of common stock options (net of tax)		13,051		1,520
Incremental tax benefit from exercise of common stock options		2,449		230
Repurchases of common stock		(3,541)		(12,888)
Net cash provided by (used in) financing activities		11,959		(11,276)
Effect of exchange rate differences on cash and cash equivalents		514		(892)
Net increase in cash and cash equivalents		50,134		17,991
Cash and cash equivalents at beginning of period		43,378		33,538
Cash and cash equivalents at end of period	$	93,512	$	51,529
Supplemental disclosure of cash flow information				
Cash paid for income taxes	$	6,232	$	9,495
Cash paid for interest		47		16
Assets acquired under capital leases				
Contingent purchase price accrued		11,684		2,805

See accompanying notes to the unaudited consolidated financial statements.

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Liquidity Services, Inc. and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements

1. Organization

Liquidity Services, Inc. and subsidiaries (LSI or the Company) is a leading online auction marketplace for surplus, salvage and scrap assets. LSI enables buyers and sellers to transact in an efficient, automated online auction environment offering over 500 product categories. The Company s marketplaces provide professional buyers access to a global, organized supply of surplus and salvage assets presented with digital images and other relevant product information. Additionally, LSI enables its corporate and government sellers to enhance their financial return on excess assets by providing a liquid marketplace and value-added services that integrate sales and marketing, logistics and transaction settlement into a single offering. LSI organizes its products into categories across major industry verticals such as consumer electronics, general merchandise, apparel, scientific equipment, aerospace parts and equipment, technology hardware, energy equipment, industrial capital assets, fleet and transportation equipment and specialty equipment. The Company s online marketplaces are *www.liquidation.com*, *www.govliquidation.com, www.govdeals.com, www.networkintl.com, www.truckcenter.com, www.secondipity.com, www.uk-liquidation.co.uk* and *www.liquibiz.com*. LSI has one reportable segment consisting of operating online marketplaces for sellers and buyers of surplus, salvage and scrap assets.

2. Summary of Significant Accounting Policies

Unaudited Interim Financial Information

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles (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 months ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending September 30, 2011 or any future period.

Short-Term Investments

Available-for-sale securities, which approximate par value, are stated at fair value, with the unrealized gains and losses reported in accumulated other comprehensive income. For the three and nine months ended June 30, 2011 and 2010, the amount of unrealized gains (losses) reported in accumulated other comprehensive loss was approximately $51,000 and $96,000, and ($45,000) and ($133,000), respectively. Realized gains and losses and declines in fair value that are determined to be other-than-temporary on available-for-sale securities are included in interest income and other income, net. The cost of securities sold is based on the specific identification method and the securities have a duration of three to twelve months. Interest and dividends on securities classified as available-for-sale are included in interest income and other income, net. Realized losses for sales of investments for the three and nine months ended June 30, 2011 and 2010 were $77,000 and $1,000, and $11,000 and $40,000 respectively.

Stock-Based Compensation

The Company recognizes compensation cost for all share-based payments based on the grant-date fair value. As a result, the Company s income before provision for income taxes and net income for the three and nine months ended June 30, 2011 and 2010 was approximately $2,221,000 and $2,730,000, and $6,749,000 and $4,994,000; and $1,785,000 and $758,000, and $6,029,000 and $2,985,000 lower, respectively, than if it had continued to account for share-based compensation under the previous authoritative guidance. The total compensation cost related to nonvested awards not yet recognized at June 30, 2011 was approximately $20,707,000, which will be recognized over the weighted average vesting period of 25 months. The Company utilizes the Black-Scholes option pricing model to determine its shared-based compensation expense. Inputs into the Black-Scholes model include volatility rates that range from 40% to 72%, a dividend rate of 0%, and risk-free interest rates that range from 0.31% to 5.05% since October 1, 2005. The Company anticipates a forfeiture rate of 18.4% based on its historical forfeiture rate. As a result of adopting the new authoritative guidance on October 1, 2005, the Company s basic and diluted earnings per share for the three and nine months ended June 30, 2011 and 2010 were approximately $0.10 and $0.10, and $0.18 and $0.18; and $0.03 and $0.03, and $0.11 and $0.11, lower, respectively, than if it had continued to account for share-based compensation under the previous authoritative guidance.

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

Comprehensive Income

Comprehensive income includes net income adjusted for foreign currency translation and unrealized gains and losses on available-for-sale securities, and is reflected as a separate component of stockholders equity. For the three and nine months ended June 30, 2011 and 2010 comprehensive income was approximately $2,016,000 and $9,198,000; and $2,537,000 and $7,490,000, respectively.

(Loss) Earnings per Share

Basic net income attributable to common stockholders per share is computed by dividing net income attributable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted net income attributable to common stockholders per share includes the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The Company had 1,360,979 unvested restricted shares outstanding at June 30, 2011, which were issued at prices ranging from $7.48 to $18.72 during the years ended September 30, 2010 and 2009 and the nine months ended June 30, 2011, of which only 0 and 617,736, and 395,288 and 242,548 shares have been included in the calculation of diluted income per share for the three and nine months ended June 30, 2011 and 2010, respectively, due to the difference between the issuance price and the average market price for the period in which they have been outstanding or because there was a net loss for the quarter. The Company has also excluded the following stock options in its calculation of diluted income per share because the option exercise prices were greater than the average market prices for the applicable period or because there was a net loss for the quarter:

(a) for the three months ended June 30, 2011, 3,847,651 options;

(b) for the nine months ended June 30, 2011, 264,552 options;

(c) for the three months ended June 30, 2010, 2,029,955 options; and

(d) for the nine months ended June 30, 2010, 2,029,955 options.

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

	Three Months Ended June 30,				Nine Months Ended June 30,			
	2011		2010		2011		2010	
	(unaudited) (dollars in thousands, except per share amounts)							
Weighted average shares calculation:								
Basic weighted average shares outstanding		27,928,750		26,959,713		27,478,342		27,181,879
Treasury stock effect of options and restricted stock				411,419		617,736		242,548
Diluted weighted average common shares outstanding		27,928,750		27,371,132		28,096,078		27,424,427
Net (loss) income	$	(1,057)	$	2,990	$	5,385	$	9,507
Net (loss) income per common share:								
Basic (loss) earnings per common share	$	(0.04)	$	0.11	$	0.20	$	0.35
Diluted (loss) earnings per common share	$	(0.04)	$	0.11	$	0.19	$	0.35

3. Defense Logistics Agency (DLA) Disposition Services Contracts

The Company s original Surplus Contract with the DLA Disposition Services expired on December 17, 2008. Under the terms of the original Surplus Contract, the Company distributed to the DLA Disposition Services a fixed percentage of the profits realized from the ultimate sale of the inventory, after deduction for allowable expenses, as provided for under the terms of the original Surplus Contract. Profit-sharing distributions to the DLA Disposition Services for the three and nine months ended June 30, 2011 and 2010 were $0 and $0; and $0 and $445,000, respectively, including accrued amounts, as of June 30, 2011 and 2010, of $169,000 and $413,000, respectively.

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

The Company responded to a RFP and was awarded the new Surplus Contract. Significant operations began under the new Surplus Contract during February 2009. The new Surplus Contract has a base term expiring in February 2012 with two one year renewal options, exercisable by the DLA Disposition Services. Under the new Surplus Contract, the Company is required to purchase all usable surplus property offered to the Company by the Department of Defense (DOD) at a fixed percentage equal to 1.8% of the DoD s original acquisition value. The Company retains 100% of the profits from the resale of the property and bears all of the costs for the merchandising and sale of the property. The new Surplus Contract contains a provision providing for a mutual termination of the contract for convenience.

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

The Company has a Scrap Contract with the DLA Disposition Services, in which the base term expires in June 2012 with three one year renewal options, exercisable by the DLA Disposition Services. Under the terms of the Scrap Contract, the Company is required to purchase all scrap government property referred to it by DLA Disposition Services. The Company distributes to the DLA Disposition Services a fixed percentage of the profits realized from the ultimate sale of the inventory, after deduction for allowable expenses, as provided for under the terms of the Contract. Effective June 1, 2007, the profit-sharing distribution for the Scrap Contract was decreased from 80% to 77% in exchange for the Company s agreement to implement additional inventory assurance processes and procedures with respect to the mutilation of demilitarized scrap property sold by the Company. The Scrap Contract also has a performance incentive that allows the Company to receive up to an additional 2% of the profit sharing distribution if sales are made to certain target levels of small-business buyers. This incentive is measured annually on June 30th, and is applied to the prior 12 months. The Company earned a performance incentive for the 12 months ended June 30, 2011, of approximately $1,601,000, in the quarter ended June 30, 2011. The performance incentive is recorded in Profit-sharing distributions in the Consolidated Statements of Operations. For the three and nine months ended June 30, 2011 and 2010, profit-sharing distributions to the DLA Disposition Services under the Scrap Contract were $12,324,000 and $34,529,000; and $9,927,000 and $28,701,000, respectively, including accrued amounts, as of June 30, 2011 and 2010, of $5,126,000 and $3,719,000, respectively. The Scrap Contract may be terminated by either the Company or DLA Disposition Services if the rate of return performance ratio does not exceed specified benchmark ratios for two consecutive quarterly periods and the preceding twelve months. The Company has performed in excess of the benchmark ratios throughout the contract period through June 30, 2011.

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

4. Acquisition Costs and Goodwill Impairment

Network International Acquisition

On June 15, 2010, the Company acquired the stock of Network International, Inc. for approximately $10,305,000. The acquisition price included an upfront cash payment of $7,500,000 and an earn-out payment. Under the terms of the agreement, the earn-out is based on the earnings before interest, taxes, depreciation and amortization (EBITDA) earned by Network International, Inc. during each of the three six month periods after the closing date of the acquisition through December 31, 2011. The Company estimated the fair value of the earn-out at the time of the acquisition to be $2,805,000 out of a possible total earn-out payment of $7,500,000. Upon review of the estimate as of December 31, 2010, the Company determined that the operating results of Network International exceed original estimates significantly, and estimated that the full $7,500,000 earn-out payment is likely based on the operating history, since the acquisition date, and estimates for the remainder of the earn-out period. Therefore, the Company recorded an additional liability of $4,695,000 as of December 31, 2010 and reflected this increase in its statement of operations for the three months ended December 31, 2010 in accordance with new authoritative guidance related to business combinations issued by the FASB in December 2007, which the Company adopted for fiscal year 2010. During the three months ended March 31, 2011, the Company paid $2,500,000 of the earn-out. As of June 30, 2011, $5,000,000 remained as the earn-out liability, which is the Company s estimate of the fair value of the earn-out liability as of that date.

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

Truck Center Acquisition

On June 1, 2011, the Company acquired the assets of Truckcenter.com, LLC. (TC) for approximately $15,989,000. The acquisition price includes an upfront cash payment of $9,000,000 and an earn-out payment. Under the terms of the agreement, the earn-out is based on EBITDA earned by TC during the trailing 12 months ending August 31, 2012, and the revenue earned by TC during each of the two 12 month periods after the closing date of the acquisition through May 31, 2013. The Company s estimate of the fair value of the earn-out as of June 30, 2011 is $6,989,000 out of a possible total earn out payment of $9,000,000. TC is a leading marketplace for the sale of idle, surplus and used fleet and transportation equipment. TC conducts sales of client assets on a consignment basis using its marketplace, an extensive global buyer base and product domain expertise. The Company incurred $246,000 of acquisition costs which were expensed as incurred. The operating results of TC have been included in the consolidated financial statements from the date of acquisition, which were not material for the period ended June 30, 2011.

Goodwill was created as part of the acquisition as the Company acquired an experienced and knowledgeable workforce. The purchase consideration was preliminarily allocated, as the Company is evaluating certain liabilities and assets assumed, to acquired tangible assets, identifiable intangible assets ,and liabilities assumed at fair value and goodwill as follows:

	Consideration Amount (in thousands)
Current assets	$ 250
Goodwill	14,156
Brand assets	623
Intangible technology assets	250
Covenants not to compete	700
Property and equipment	48
Current liabilities	(38)
Total consideration	$ 15,989

Goodwill Impairment Geneva Acquisition

On May 1, 2008, the Company acquired the stock of the United Kingdom (UK) based companies in the Geneva Group (Geneva), including Geneva Industries Ltd., Willen Trading Ltd., and Geneva Auctions Ltd., for approximately $16,238,000 million in cash net of acquired cash, of $925,000. Goodwill of $16,648,000 was created as part of the acquisition as the Company acquired an experienced and knowledgeable workforce, along with customer lists and non-contractual customer relationships. Following the acquisition of Geneva, the economic downturn and a low buyer adoption rate in Europe of online inventory sourcing have created ongoing losses that are not sustainable by the Company. The Company expects to have its UK operations substantially closed down by September 30, 2011, resulting in the impairment of the goodwill, as of June 30, 2011, including the reversal of currency translation adjustments of $3.1 million previously recorded in Other Comprehensive Income since the time of acquisition. The impairment charge of $16.6 million is recorded in Acquisition costs and goodwill impairment in the Consolidated Statements of Operations.

5. Intangible Assets

Intangible assets at June 30, 2011 consisted of the following:

	Useful Life (in years)	Gross Carrying Amount	Accumulated Amortization & Foreign Currency Translation Adjustment	Net Carrying Amount
		(dollars in thousands)		
Contract intangible	7	$ 5,694	$ (4,813)	$ 881
Brand and technology	5	1,448	(417)	1,031
Covenants not to compete	5 - 7	2,500	(1,194)	1,306
Patent and trademarks	3 - 10	237	(87)	150
Total intangible assets, net				$ 3,368

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

Future expected amortization of intangible assets at June 30, 2011 was as follows:

Years ending September 30,		**(in thousands)**
2011 (remaining three months)	$	424
2012		1,449
2013		465
2014		293
2015 and after		737
Total	$	3,368

6. Debt

Senior Credit Facility

In December 2002, and as subsequently amended, the Company entered into a senior credit facility with a bank, which provided for borrowings up to $30.0 million. This senior credit facility expired on April 30, 2010. The Company had no outstanding borrowings under this facility as of April 30, 2010.

On April 30, 2010, the Company entered into a new senior credit facility (the Agreement) with a bank, which provides for borrowings up to $30.0 million with a maturity date of April 30, 2013. Borrowings under the Agreement bear interest at an annual rate equal to the 30 day LIBOR rate plus 1.25% (1.437% at June 30, 2011) due monthly. As of September 30, 2010 and June 30, 2011, the Company had no outstanding borrowings under the Agreement.

Borrowings under the Agreement are secured by substantially all of the assets of the Company. The Agreement contains certain financial and non-financial restrictive covenants including, among others, the requirements to maintain a minimum level of EBITDA and a minimum debt coverage ratio. As of June 30, 2011, the Company was in compliance with these covenants.

7. Income Taxes

The Company s interim effective income tax rate is based on management s best current estimate of the expected annual effective income tax rate. The Company estimates that its fiscal year 2011 tax rate will be approximately 26%, which is a decrease from the 50% effective tax rate estimated in the prior two quarters. The decrease in the estimate is a result of the estimated tax benefit from the closing of the Company s UK operations. The Company estimates that its effective income tax rate beyond fiscal year 2011 will be approximately 44%, which is comprised of (1) approximately 35% for federal taxes, (2) approximately 6% for state taxes, and (3) approximately 3% for book and tax differences including stock based compensation expenses, primarily related to employee stock options, which are currently expensed in the financial statements but are not deductable for tax purposes until they are exercised.

The Company applies the guidance related to uncertainty in income taxes. The Company has concluded that there were no uncertain tax positions identified during its analysis. The Company s policy is to recognize interest and penalties in the period in which they occur in the income tax provision. The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, various state and local jurisdictions and in foreign jurisdictions, primarily the U.K. Currently, the Company is not subject to any income tax examinations. The statute of limitations for years prior to fiscal 2007 is now closed. However, certain tax attribute carryforwards that were generated prior to fiscal 2007 may be adjusted upon examination by tax authorities if they are utilized.

8. Stockholders Equity

Common Stock

On February 23, 2006, the Company issued 5,000,000 shares of common stock for net proceeds of $43,977,000 in conjunction with its initial public offering. On March 13, 2007, the Company issued 100,000 shares of common stock for net proceeds of $1,070,000 in conjunction with its follow-on offering.

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

Share Repurchase Program

On December 2, 2008, the Company s Board of Directors approved a $10.0 million share repurchase program. Under the program, the Company is authorized to repurchase the issued and outstanding shares of common stock. Share repurchases may be made through open market purchases, privately negotiated transactions or otherwise, at times and in such amounts as management deems appropriate. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements and other market conditions. The repurchase program may be discontinued or suspended at any time, and will be funded using available cash. On February 2, 2010, the Company s Board of Directors approved an additional $10.0 million for the share repurchase program. On November 30, 2010, the Company s Board of Directors approved an additional $10.0 million for the share repurchase program. During the year ended September 30, 2009, 707,462 shares were purchased under the program for approximately $3,874,000. During the year ended September 30, 2010, 1,225,019 shares were purchased under the program for approximately $14,471,000. During the three months ended December 31, 2010, 229,575 shares were purchased under the program for approximately $3,541,000. During the three months ended March 31 and June 30, 2011, no shares were purchased under the program. On May 3, 2011, the Company s Board of Directors approved an additional $10.0 million for the share repurchase program. The Company s Board of Directors reviews the share repurchase program periodically, the last such review having occurred in May 2011. As of June 30, 2011, approximately $18,114,000 may yet be expended under the program.

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

Under the 2006 Plan, 5,000,000 shares of common stock were initially reserved for issuance. In February 2009, at the Company s annual meeting of stockholders, the stockholders approved an increase of 5,000,000 shares of the Company s common stock to the shares available for issuance under the 2006 Plan. At September 30, 2009, there were 5,189,996 shares remaining reserved for issuance in connection with awards under the 2006 Plan. During fiscal year 2010, the Company granted options to purchase 624,566 shares to employees and directors with exercise prices between $9.05 and $13.96, and options to purchase 75,467 shares were forfeited. During fiscal year 2010, the Company granted 699,410 restricted shares to employees and directors at prices ranging from $9.05 to $13.96, and 45,026 restricted shares were forfeited. At September 30, 2010, there were 3,986,513 shares remaining reserved for issuance in connection with awards under the 2006 Plan. During the nine months ended June 30, 2011, the Company issued options to purchase 321,072 shares to employees and directors with exercise prices between $13.48 and $17.02, and options to purchase 22,780 shares were forfeited. During the nine months ended June 30, 2011, the Company issued 676,890 restricted shares to employees and directors at prices ranging from $12.88 to $18.72, and 54,715 restricted shares were forfeited. At June 30, 2011, there were 3,066,046 shares remaining reserved for issuance in connection with awards under the 2006 Plan. The maximum number of shares subject to options or stock appreciation rights that can be awarded under the 2006 Plan to any person is 1,000,000 per year. The maximum number of shares that can be awarded under the 2006 Plan to any person, other than pursuant to an option or stock appreciation right, is 700,000 per year.

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

Stock Option Activity

A summary of the Company s stock option activity for the year ended September 30, 2010 and the three months ended December 31, 2010, March 31, 2011and June 30, 2011 is as follows:

	Options	Weighted-Average Exercise Price
Options outstanding at September 30, 2009	4,609,226	$ 10.95
Options granted	624,566	10.92
Options exercised	(411,036)	7.88
Options canceled	(75,467)	12.24
Options outstanding at September 30, 2010	4,747,289	11.20
Options granted	231,000	15.56
Options exercised	(261,442)	9.17
Options canceled	(9,345)	11.80
Options outstanding at December 31, 2010	4,707,502	11.52
Options granted	90,072	14.30
Options exercised	(399,668)	11.85
Options canceled	(12,538)	14.70
Options outstanding at March 31, 2011	4,385,368	11.54
Options granted		
Options exercised	(536,820)	11.03
Options canceled	(897)	13.48
Options outstanding at June 30, 2011	3,847,651	11.61
Options exercisable at June 30, 2011	2,190,090	11.99

The intrinsic value of outstanding and exercisable options at June 30, 2011 is approximately $46,164,000 and $25,438,000, respectively, based on a stock price of $23.61 on June 30, 2011.

Restricted Share Activity

A summary of the Company s restricted share activity for the year ended September 30, 2010 and the three months ended December 31, 2010, March 31, 2011 and June 30, 2011 is as follows:

	Restricted Shares	Weighted-Average Fair Value

Unvested restricted shares at September 30, 2009	462,836	$	8.88
Restricted shares granted	699,410		10.00
Restricted shares vested	(144,053)		8.47
Restricted shares canceled	(45,026)		9.30
Unvested restricted shares at September 30, 2010	973,167		9.73
Restricted shares granted	635,092		15.44
Restricted shares vested	(176,060)		8.79
Restricted shares canceled	(15,313)		10.17
Unvested restricted shares at December 31, 2010	1,416,886		12.40
Restricted shares granted	31,798		13.74
Restricted shares vested	(33,803)		10.71
Restricted shares canceled	(9,292)		13.94
Unvested restricted shares at March 31, 2011	1,405,589		12.46
Restricted shares granted	10,000		18.72
Restricted shares vested	(24,500)		11.86
Restricted shares canceled	(30,110)		11.86
Unvested restricted shares at June 30, 2011	1,360,979		12.53

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

9. 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, 2011 and September 30, 2010, the Company s Level 1 short-term investments of $10,910,000 and $33,405,000, respectively, were the only financial assets measured at fair value. As of June 30, 2011 and September 30, 2010, the Company s $11,989,000 and $2,805,000 liability for the earn-out related to the Network International and Truckcenter.com acquisitions is the only liability measured at fair value on a recurring basis and is classified as Level 3 within the fair value hierarchy. The changes in liabilities measured at fair value for which the Company has used Level 3 inputs to determine fair value for the year ended September 30, 2010 and the nine months ended June 30, 2011 are as follows ($ in thousands):

		Level 3 Liabilities
Balance at September 30, 2009		
Acquisition contingent consideration	$	2,805
Purchases and issuances		
Settlements		
Unrealized gains (losses), net		
Balance at September 30, 2010		2,805
Acquisition contingent consideration		11,684
Purchases and issuances		
Settlements		(2,500)
Unrealized gains (losses), net		
Balance at June 30, 2011	$	11,989

The Company did not have any Level 3 assets or liabilities prior to fiscal year 2010.

When valuing its Level 3 liability, the Company gives consideration to operating results, financial condition, economic and/or market events, and other pertinent information that would impact its estimate of the expected earn-out payment. The valuation procedures are primarily based on management s projection of EBITDA for Network International, and EBITDA and Revenue for Truckcenter.com and applying a discount to the expected proceeds to estimate fair value. Because of the inherent uncertainty, this estimated value may differ significantly from the value that would have been used had a ready market for the liability existed, and it is reasonably possible that the difference could be material.

10. Contingencies

In January 2008, Kormendi/Gardener Partners (KGP) commenced litigation against Government Liquidation.com (GL) and Surplus Acquisition Venture, LLC (SAV), two of the Company s subsidiaries, seeking $2.8 million in damages. KGP claims it is entitled to these damages because of actions GL and SAV took at the direction of DLA Disposition Services pursuant to an amendment to the original Surplus Contract entered into in August 2006. GL and SAV believe they have meritorious defenses in this litigation. In addition, SAV and GL believe they likely would be able to recover their costs and damages arising out of this litigation from DLA Disposition Services under the terms of the original Surplus Contract.

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

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements. These statements are only predictions. The outcome of the events described in these forward-looking statements is subject to known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. These risks and other factors include but are not limited to the factors set forth in our Annual Report on Form 10-K for the year ended September 30, 2010 and subsequent filings with the Securities and Exchange Commission. You can identify forward-looking statements by terminology such as may, will, should, could, would, expects, intends, plans, anticipates, believes, estimates, predicts, potential, continues or the negative of these terms or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. There may be other factors of which we are currently unaware or deem immaterial that may cause our actual results to differ materially from the forward-looking statements.

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

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

Overview

About us. We are a leading online auction marketplace for surplus and salvage assets. We enable buyers and sellers to transact in an efficient, online auction environment offering over 500 product categories. Our marketplaces provide professional buyers access to a global, organized supply of surplus and salvage assets presented with customer focused information including digital images and other relevant product information along with services to efficiently complete the transaction. Additionally, we enable our corporate and government sellers to enhance their financial return on excess assets by providing liquid marketpl