THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

LQDT - Q1 2017 Liquidity Services Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 09, 2017 / 3:30PM GMT

CORPORATE PARTICIPANTS

Julie Davis *Liquidity Services, Inc. - Senior Director of IR*

Bill Angrick *Liquidity Services, Inc. - Chairman and CEO*

Michael Sweeney *Liquidity Services, Inc. - CAO*

Jorge Celaya *Liquidity Services, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Dan Kurnos *The Benchmark Company - Analyst*

Gary Prestopino *Barrington Research Associates, Inc. - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, welcome to Liquidity Services' first-quarter 2017 earnings conference call.

(Operator Instructions)

As a reminder, today's conference is being recorded.

I'd now like to introduce your host for today's conference, Ms. Julie Davis, Senior Director of Investor Relations. Ma'am, please go ahead

---

Julie Davis - *Liquidity Services, Inc. - Senior Director of IR*

Thank you, Liz. Hello, and welcome to our first-quarter FY17 financial results conference call. Joining us today are Bill Angrick, our Chairman and Chief Executive Officer; Jorge Celaya, our Chief Financial Officer; and Michael Sweeney, our Chief Accounting Officer. We will be available for questions after our prepared remarks.

The following discussion or responses to your questions reflect management's views as of today, February 9, 2017, and will include forward-looking statements. Actual results may differ materially. Additional information about factors that could potentially impact our financial results is included in today's press release, and in our filings with the SEC, including our most recent annual report on Form 10-K.

As you listen to today's call, we encourage you to have our press release in front of you, which includes our financial results, as well as metrics and commentary on the quarter. During this call, we will discuss certain non-GAAP financial measures. In our press release and our filings with the SEC, each of which is posted on our website, you will find additional disclosures regarding these non-GAAP measures, including reconciliations of these measures with comparable GAAP measures.

We also use certain supplemental operating data as a measure of certain components of operating performance, which we also believe is useful for management and investors. This supplemental operating data includes gross merchandise volume, and should not be considered a substitute for or superior to GAAP results. At this time, I'd like to turn the presentation to our CEO, Bill Angrick.

Bill Angrick - *Liquidity Services, Inc. - Chairman and CEO*

Thanks, Julie, good morning, and welcome to our Q1 earnings call. I will review our Q1 performance and provide an update on key strategic initiatives. Next, Mike Sweeney will provide more details on the quarter. Finally, Jorge Celaya will provide our outlook for the current quarter.

Liquidity Services reported Q1 results in line with our GMV guidance, and above the guidance range on adjusted EBITDA, driven by our commercial capital assets marketplaces, which experienced higher-than-expected volume and margins related to large projects in our industrial and energy verticals, in addition to higher than expected service running revenues. Our DoD marketplace GMV was down 21% year over year, reflecting lower volumes and a less favorable product mix.

We are pleased with the progress made this quarter, despite the headwinds related to changes in our DoD contracts. The focus of our long-term growth strategy is on our commercial and state and local government business, and we are pleased to report that aggregate GMV in these marketplaces grew 12% year over year, marking a return to top-line organic growth for the first time in eight quarters, and a significant milestone in the advancement of our transformation strategy.

We continue to expand our service offerings to capture more opportunities, and to invest in our sales channels to grow, seller accounts and our buyer network. During the quarter our retail supply chain marketplace achieved double-digit top-line growth and improved margins, as we continued to attract new clients and expand existing relationships, driven by our strong recovery rates and innovative returns management services.

Liquidity Services is well-positioned to assist retailers and manufacturers during the post-holiday return season, and throughout the year. With the growth of e-commerce, the volume of returns in the retail supply chain and the need for our services is growing. Our national distribution center network, returns management services, leading sales channels, and growing buyer base provide clients a one-stop solution to free up space and human resources to quickly recover more capital and reduce their total supply chain costs.

Our commercial capital assets business benefited from strong activity with corporate accounts, particularly in the energy vertical, which is up 68% year over year during the quarter. We added 23 new commercial accounts during the quarter, and have expanded our sales and business development teams to capitalize on our success and reputation for delivering strong results for our clients.

Our state and local government marketplace also outperformed our expectations during the quarter, as more sellers utilized our platform and value-added services. We added over 230 new local accounts, including 22 in Canada and 36 in the western United States, which we believe are both still under underpenetrated for Liquidity Services. This quarter, we also continued to make steady progress with our LiquidityOne transformation program.

We launched our new customer management module, which provides a common process for managing customer and client data, eliminating eight external platforms to manage these processes. We plan to launch our network international energy marketplace on our new LiquidityOne platform in the summer of this year. This deployment will support over 32,000 sellers and buyers, transacting across 37 countries and 247 asset categories.

All property management, customer management, transaction management, and financial settlement will occur in our integrated LiquidityOne platform, and will replace numerous legacy systems, and in some cases, manual processes. Our new mobile first marketplace experience is built on best practices and customer experiences, refined over millions of transactions, to provide a marketplace for sellers to safely and efficiently sell inventory and equipment, and for buyers to purchase an unmatched selection of business assets from the most recognizable sellers across the globe.

We exited the quarter in a strong financial position to pursue our growth initiatives with $127 million in cash and zero debt. Our near-term outlook remains cautious due to the increase in costs and soft asset pricing in our DoD scrap contract, variability in the timing of large client projects in our capital assets business, and ongoing investments in our LiquidityOne transformation program.

Looking ahead at FY17, we continue to expect solid organic revenue growth in our commercial and local marketplaces. Our near-term outlook reflects significant current investment on our part, but does not yet reflect the benefit of new products, capabilities, and business expansion opportunities we are building at Liquidity Services.

In closing, as we begin to harvest the investments we are making in our people, processes, and new platform over the next few years, we are excited about the tremendous potential to grow our business. Macro trends in globalization to growth of e-commerce and sustainability will drive the need for our platform and services.

Liquidity Services is committed to driving innovation and significant value creation for our customers and our shareholders, as we execute our long-term growth strategy. Now, let me turn it over to Mike for more details on Q1 results.

Michael Sweeney - *Liquidity Services, Inc. - CAO*

Thanks, Bill. So as Bill noted, we finished the first quarter of FY17 within our guidance range for GMV, and above our guidance range for GAAP net loss, non-GAAP adjusted EBITDA, GAAP EPS and non-GAAP adjusted EPS.

So I'll comment on our first-quarter results with comparison to the prior-year period. The amount of GMV increased 6% or $8.3 million to $159.7 million, due to increases of 15% or $10.5 million in our commercial marketplaces, and 8% or $3.9 million in our state and local government or GovDeals marketplace, partially offset by a 21% decrease or $6.1 million in our DoD businesses.

The commercial GMV increase was primarily due to growth of corporate accounts in our retail marketplace, and an increase in the energy vertical. The GovDeals GMV increase was driven by an increase in the number of new sellers, as well as additional sales volume from existing clients. The GMV decline in our DoD businesses was due to lower volume related to our surplus contracts, and lower pricing related to our scrap contract.

Total revenue increased $4.9 million or 7% to $70.8 million, and was the result of increases in our commercial and GovDeals marketplaces, partially offset by net decreases in our DoD business. Revenue from the commercial marketplaces was up 17% or $5.3 million, due to growth of core accounts in the retail marketplace, as well as stronger capital assets deal flow in the energy vertical.

GovDeals revenue increased 8% or $0.4 million, due to an increase in a number of new sellers, and additional sales volume from existing clients. Revenue from our DoD contracts declined 3% or $0.8 million due to lower volume related to our surplus contract, and lower pricing related to our scrap contracts, partly offset by higher service revenue.

Cost of goods sold increased $5.4 million or 20% to $32.3 million, increasing from 40.8% to 45.6% of revenue. This increase is primarily due to one, that the price we paid for inventory under the surplus contract, and two, growth in core accounts in our retail business.

Client distribution increased $2.2 million or 93% to $4.5 million, driven by the increase in the amount of the distribution we now pay to the DOA under the new scrap contract. As a percentage of revenue, distributions increased to 6.4% from 3.6%. There were slight changes in technology and operations, sales and marketing, general and administrative, and depreciation and amortization expenses. Technology and operations expenses decreased $0.9 million or 4%, while sales and marketing expenses increased $0.5 million or 6%. G&A expenses decreased $0.2 million or 2%, and depreciation and amortization decreased $0.2 million.

We also had $0.9 million in other operating income in FY17, which was from the principal business transaction with a partner, where there was an increase in the expected net cash proceeds to be received, of which about a third were subsequently received in the quarter. Provision for income taxes increased $2.3 million to a provision of $0.1 million for the quarter, up from a benefit in the prior year of $2.2 million, driven by a valuation allowance charge and the impact of foreign state and local taxes and permanent tax adjustments.

Net loss increased 62% to negative $8.4 million. Adjusted net loss increased 96% to negative $6.8 million. Adjusted EBITDA loss increased 32% to a negative $4.3 million, mostly due to the year-over-year decreases in revenue in our DoD business, related to the wind down of our old surplus contract and higher costs of our new surplus contract.

Diluted loss per share increased 59% to negative $0.27, and adjusted diluted loss per share increased 100% to negative $0.22, based on approximately 31.3 million diluted weighted average shares outstanding. During the first quarter, Liquidity Services used $5 million of net cash for operating activities, a reduction of 40% from $8.3 million used in the prior year first quarter. The improvement in operating cash flows is primarily due to an increase from changes in working capital of approximately $8.1 million, partially offset by the higher losses this year versus last year.

We continue to have a strong debt free balance sheet. At December 31, 2016, we had a cash balance of $127 million, current assets of $177 million, total assets of $253 million, and $91 million in working capital.

Capital expenditures during the quarter were $2.3 million. We expect capital expenditures for FY17 to be between $8 million and $13 million. I'll now turn it over to Jorge for the outlook on the next quarter.

Jorge Celaya - *Liquidity Services, Inc. - CFO*

Good morning, everyone. As our first-quarter results reflect, we are gaining momentum in fulfilling our goal to deliver the most trusted and integrated e-commerce marketplace solutions to manage, value, and sell inventory and equipment for business and government clients.

In Q1, we returned to organic growth in our commercial businesses, as we continued to build more depth in our client base and grow our network of relationships within our core verticals, including energy, industrial, retail, and state and local government. We expect the growth in our commercial relationships, combined with the ongoing strength of our state and local government business, to drive GMV growth in FY17.

We anticipate long-term benefits as we continue to move forward with our LiquidityOne platform rollout from our legacy marketplace. Our platform is designed and being developed as a scalable and elegant solution that addresses the complexity of a two-sided marketplace focused on multiple verticals, and a wide range of asset categories, creating an integrated database and unified buyer experience.

The migration of our next marketplace onto the platform will drive a better user experience and a more efficient operation to grow our sales channels in the US and internationally. Additionally, the scope of functionality, integrated into each step of our rollout will include the majority of the functionality needed for each subsequent go-live, with the aim to make the process faster and easier with each marketplace we migrate.

Over the long term, this platform serves as a foundation for new capabilities, including self-service and white label solutions. Looking ahead, our second-quarter items anticipate year-over-year comparative GMV growth in our commercial capital assets, retail, and state and local government businesses, offset by lower volumes in DoD surplus.

Our bottom-line results will be comparatively down year over year, as our gains across our commercial businesses are still more than offset by the effect of the new DoD contract for both surplus and scrap. Additionally, we anticipate continued investment in sales and marketing in our IronDirect business as we build demand for its products onto the platform.

Management's guidance for the next fiscal quarter does not include any one-time impact from the wind down of our truck center, live auction and retail business. Our guidance is as follows: we expect GMV for Q2 of 2017 to range from $150 million to $170 million.

A GAAP net loss is expected for Q2 of 2017 in the range of negative $12 million to negative $9 million, and the corresponding GAAP loss per share for Q2 of 2017 ranging from negative $0.38 to negative $0.29. We estimate non-GAAP adjusted EBITDA for Q2 of 2017 to range from a negative $7.5 million to negative $4.5 million.

A non-GAAP adjusted loss per share is estimated for Q2 of 2017 in the range of negative $0.30 to a negative $0.21. This guidance also assumes that we have diluted weighted average shares outstanding for the quarter of approximately 31.4 million.

We will now take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Dan Kurnos, The Benchmark Company

Dan Kurnos - *The Benchmark Company - Analyst*

Just let's start with a quick housekeeping, can you remind us on truck center, the impact on the top and the bottom line you expect from the wind down, how that's -- excluding any charges, just what's are going to mean to GMV, and how that's either impairing or impacting the growth rate on the expense side?

Jorge Celaya - *Liquidity Services, Inc. - CFO*

On a GMV it's going to be minimal. On the bottom line, will be -- the plan, as we indicated in the 8-K, is that were going to be winding down here this quarter, and likely a little bit into next quarter, meaning the April. So if you look at an annualized basis, we're looking at bottom line savings $2.5 million to $3 billion. The quarter that will have full impact of that will be obviously the June quarter.

Bill Angrick - *Liquidity Services, Inc. - Chairman and CEO*

From a strategic point of view, let me confirm that Liquidity Services has a very active and growing online marketplace for the sale of a variety of transportation assets for national fleet customers, leasing companies, government agencies, and corporate clients. We did over $150 million of transportation and fleet asset sales through our online channel in the last 12 months. The legacy truck center live auction business from permanent land-based sites is what is being wound down. And that's what Jorge is referring to.

Dan Kurnos - *The Benchmark Company - Analyst*

Okay. That's helpful. So let me jump into the higher level questions. Just starting, still a little bit of housekeeping, but would you characterize the upside in the quarter in industrial and energy as related to one-time projects that you called out before? Or is this more of a general increase in volume where you took market share around larger projects?

Bill Angrick - *Liquidity Services, Inc. - Chairman and CEO*

We are seeing market share expansion. We have had great success in converting available business and prospects and retail supply chain, state and local government, energy, and what I call multinational industrial clients. Our pipeline continues to grow, our capabilities are unique in the marketplace. We believe our competitive advantage is strengthening, in some cases you have consolidation in the marketplace, which is benefiting Liquidity Services, and we expect that to be a longer-term trend.

Dan Kurnos - *The Benchmark Company - Analyst*

On the service revenue front, Bill, how much of incremental business sales force would you attribute to driving that line specifically? I know you're going after the high end direct. But understanding that obviously the packaged products sale in general, if you could also just talk about expanding your service capabilities and what investments you're making on that front to expand the TAM in that segment?

Bill Angrick - *Liquidity Services, Inc. - Chairman and CEO*

Sure. Well, it's top of mind, coming out of the holiday season the growth of omnichannel and online retail. Our Company is positioned to be the turnkey service and solution for large retailers and manufacturers. We're dealing with a crushing volume of returns, return rates in the online channel that have gone from 15% to 20% up to 30% or 40% in certain categories, in areas like consumer electronics, apparel, housewares, that dynamic as online sales is the largest share of the pie of overall retail.

It's driving greater demand for our services, and those services include the ability to take returns back directly from consumers, to validate condition of items and in some cases, making level I, and level II, repair and value enhancements. And then, giving retailers and manufacturers the option to re-commerce those items and sell them back through their own channels, or to use our channels and liquidate and recover value.

In most cases these large companies, and increasing midsize companies, they don't want to dedicate warehouse space, people, time, material handling equipment, to managing open box returns, it's a non-core function, something that is our core focus. We have a lot of economies of scale through our national distribution center hubs, through our software and services to process, reconcile, and then recover value from these returns.

In our locations the ability to do quite impressive value-added services to certify items as like-new refurbished items, and allow them to be sold directly to end consumers for the maximum recovery for our clients. So that's a flavor of the types of services that we're offering, and we expect that to be very well linked to macro trends in the evolution of retail supply chain.

Dan Kurnos - *The Benchmark Company - Analyst*

Maybe just ask my question just a little bit differently, then. Do you feel like you're at the point where you need to invest aggressively to expand your capabilities, or is it more just about penetrating client mind share as you get them to utilize your services and have plenty of capacity on that front?

Bill Angrick - *Liquidity Services, Inc. - Chairman and CEO*

I think as part of our Liquidity One investment, we're not only consolidating and integrating our existing marketplaces, we're funding the development of new capabilities, and that will include further enhancements in our returns management solutions, reporting capabilities, client portals for data analytics, to understand what's happening with their inventories. So we are investing in product.

We're investing in process. We're investing in the sales and marketing outreach. We think we have a great product to offer, and we will continue to invest in sharing our story, directly and indirectly, to the industry.

Dan Kurnos - *The Benchmark Company - Analyst*

Perfect. That's what I was getting at. And as a good segue there on the data front, on the customer management module, could you just talk about the difference on the back end in terms of data that you expect to see. It is more of an aggregation tool, or will you be able to get significantly enhanced analytics out of this?

Bill Angrick - *Liquidity Services, Inc. - Chairman and CEO*

Both. We have removed the tools from disparate systems, and brought them into a single platform that aligns with the transactional marketplaces, and gives buyers and sellers unified account management and visibility over all of their in-process and complete transactions with us.

So from the outside perspective, they are getting better -- using convenience to access information, which can include information about values, about different channels that they can tap within our Company to sell goods. From the inside perspective, it's just much of our productive for our team to have a single system to use, and it has lots of apps and features internally to capture new client cases.

A case could travel from Australia to Europe in North America, back to China, seamlessly through our platform, with different account managers involving themselves at the right time. And given the nature of our global client base, that's very valuable to us. So you've got productivity gains for the internal team, and new features I'm reporting for clients, better integration with our transactional platforms, all being housed within the customer management module.

Dan Kurnos - *The Benchmark Company - Analyst*

Great and then lastly, I guess maybe this is a little bit unfair and a bit of a curveball. Any thoughts of the potential impact of a border tax or trade tariffs? Everybody's asking about it on all the other calls, I figured I might as well throw it at you, having the global business, and I know nothing's set in stone, it's probably too early to speculate. But any color?

Bill Angrick - *Liquidity Services, Inc. - Chairman and CEO*

Sure. First of all, we are very global in terms of client base where the assets are located. Our business benefits from the inexorable march of technology obsolescence and the rebalancing of supply chains where companies that reposition plants and equipment over the many years and decades, we've worked with them; they're typically looking for help. They're looking for people to help manage redeployment. It's one of the services we offer. Add to value and sell equipment rather than ship it somewhere.

So we think we are actually pretty resilient and well-positioned for any changes or disruptions from policy changes or renegotiation of tariffs. The reality is, it's a very fluid and dynamic global marketplace that we operate. On the domestic market, I think everyone is in a wait and see mode, as to actually how policy is coming out, and we don't really have any way to forecast that better than you.

Dan Kurnos - *The Benchmark Company - Analyst*

All right. I guess not so much of a curveball then. Thanks for all you detailed answers, Bill.

Operator

(Operator Instructions)

Gary Prestopino, Barrington Research.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

Couple of questions here. Are you still on track with Liquidity One to have this all completed by the end of calendar 2017, all your markets on that new system?

Bill Angrick - *Liquidity Services, Inc. - Chairman and CEO*

We talked about our goals regarding development of the underpinnings for the entire system, which is well underway. The customer management module is a good example of that, and then a series of cascading releases. Gary, we're focused on the customer experience, the quality and reliability of the platform, and migrating these customers.

We have not published a schedule in a more detailed fashion on calendar 2017. We continue to update both our internal teams and investors, when we have tangible evidence of the deployment of functionality in the marketplace. And I think from the outside in, you really aren't going to see the level of progress that we've actually made in things like a global ERP implementation.

You have to do all of the infrastructure work well in advance of deploying an eCommerce market place. So the percentage of progress made or completion is greater than the number of users, the number of market places deployed. I think in Jorge's remarks on the preambles of the call, we have done a lot of work in order to not only prepare for the initial roll out, but to be able to accelerate subsequent market places following the release of network international, which is targeted for the summer.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

Okay.

Bill Angrick - *Liquidity Services, Inc. - Chairman and CEO*

Just to be clear. We're not providing a specific time scale on the release of every marketplace. We're providing a very clear look ahead to what's next.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

Okay. And maybe I was incorrect in saying, in thinking that it was going to be done by 2017. But would then, could we categorize it saying with the bulk of incremental expenses that you've been incurring related to Liquidity One be done by the end of calendar 2017, or does that go into calendar 2018, as well?

Jorge Celaya - *Liquidity Services, Inc. - CFO*

No. There is going to be more expense as we go into calendar 2018. A good amount of this $1 million to $2 million range that I've given, that's going to be pretty consistent this year, is what we said in the past. Might it be a similar amount growing into 2018?

Yes, it might be. But I think at some point that's going to taper down simply by the step function that we're talking about. In terms of timing, at this point, we're not giving timing of exactly when that will happen. Again, because we're deploying and as we build the functionality, and as we build the marketplaces, we assess every significant, what we call internally every wave of implementation, we assess how much more we want to put into that wave versus delaying into another wave, simply as we look to prioritize the quality versus the needs both from a customer and client deployment perspective.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

Okay. That's fine, thank you. And then if you look at your income statement, it looks like the cost of goods sold has gone up year over year, profit sharing has gone up. A lot of that relates to the two new contracts, and it's public knowledge that you have to pay more for the goods. What can you do to increase your yields on those contracts? I understand scrap, that is going to move with the market, but in particular, with the DOD surplus, what's your thought process there as your cost of goods sold has increased under the new contract?

Jorge Celaya - *Liquidity Services, Inc. - CFO*

Well, we recognize that competitive situation. We've increased the revenue yield to the government. The business is like any of our businesses, a beneficiary of growing the recovery rate on the goods that we sell, finding sales channels and marketing methods to expand the buyer base. And as we grow rate of return or recovery rate on the revenue realized on the sale of assets, that falls directly to our bottom line. So the idea that our platform investment is going to improve across the pollination of buyers, provide more competition for offered assets, that will benefit all of our customers including the product that we sell to the DoD, which helps drive margin expansion.

Gary Prestopino - *Barrington Research Associates, Inc. - Analyst*

Okay. Thank you.

Operator

I'm showing no further questions in queue at this time. I'd like to turn the call back to Ms. Davis for any closing remarks.

Julie Davis - *Liquidity Services, Inc. - Senior Director of IR*

Thank you for joining our call today. That concludes our time. We're happy to take follow-up calls afterwards. Thank you.

Operator

Ladies and gentlemen, thank you for participation in today's conference. This concludes the program. You may now disconnect. Everyone, have a great day.