THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

LQDT - Q4 2015 Liquidity Services Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 19, 2015 / 3:30PM GMT

CORPORATE PARTICIPANTS

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

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

Kathy Domino *Liquidity Services, Inc. - CAO*

Jorge Celaya *Liquidity Services, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Colin Sebastian *Robert W. Baird & Company, Inc. - Analyst*

Rohit Kulkarni *RBC Capital Markets - Analyst*

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

Dan Kurnos *The Benchmark Company - Analyst*

Jason Mitchell *BofA Merrill Lynch - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Liquidity Services fourth-quarter and FY15 earnings call.

(Operator Instructions)

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

I would now like to introduce your host for today's program, Julie Davis, Senior Director of Investor Relations. Please go ahead.

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

Thank you, Jonathan. Hello, and welcome to our fourth-quarter and FY15 financial results conference call. Joining us today are Bill Angrick, our Chairman and Chief Executive Officer; Jorge Celaya, our Chief Financial Officer; and Kathy Domino, 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, November 19, 2015, 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. The supplemental operating data includes gross merchandise volume, and should not be considered a substitute for, or superior to, GAAP results.

Additionally, our guidance for the first quarter of FY16 adjusts EBITDA and diluted EPS for: one, acquisition costs, impairment of goodwill and long-lived assets, business realignment expenses, and gains or losses from business dispositions; and, two, for stock-based compensation costs, which we estimate to be approximately $3.5 million to $4 million for the first quarter of FY16. These stock-based compensation costs are consistent with FY15.

At this time, I'd like to turn the presentation over to our CEO, Bill Angrick.

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

Thank you, Julie. Good morning, and welcome to our Q4 earnings call. I'll review our Q4 performance, and provide an update on key strategic initiatives. Next, Kathy Domino will provide more details on the quarter. Finally, Jorge Celaya will provide our outlook for the current quarter.

Liquidity Services reported Q4 results in line with our guidance on both the top and bottom line, led by our state and municipal government marketplace, and our industrial capital assets marketplace, which both experienced double-digit growth this quarter, driven by an increase in the number of sellers and transaction volume in these verticals. We experienced a decline in the availability of supply in our consumer electronics vertical, and unfavorable industry trends in our energy vertical, which impacted pricing and transaction volume during the quarter. In addition, several large capital assets projects were delayed as clients continued to evaluate the business climate and their willingness to transact under current market conditions.

During the quarter, we grew our registered buyer base and number of completed transactions 9% and 4%, respectively, over the prior-year period. During the quarter, we also signed over 40 new commercial accounts, including 11 in the energy vertical, who are taking a more strategic view of investment recovery activities. Our state and local marketplace added over 200 new agency clients, including attractive new metropolitan areas in California, Washington and Canada.

Overall, we continue to do an excellent job in winning new client engagements, and our attention is now focused on converting these clients to transacting customers. Clients continue to rely on us to help them assess the value of their assets, and determine the optimal sales method to maximize recovery, both in the US and throughout the globe.

Q4 capped off a productive year in our Asia Pacific region, which grew over 100% annually, as more international clients and buyers leveraged the superior service, scale and results of our marketplace solution. In fact, during the quarter we completed transactions in every major region of the world, including Australia, Brazil, Canada, China, Germany, Malaysia, Mexico, Philippines, South Africa, United Kingdom and Vietnam. Our GovDeals state and municipal government marketplace also achieved record annual results, with impressive growth in the US, and successful expansion in Canada.

We exited the year in a strong financial position, with $95.5 million in cash and a debt-free balance sheet. Together with the approximately $33.5 million of cash benefit expected from our recent sale of the Jacobs Trading business, we will have $129 million in cash, equivalent to $4 per share, to support our growth strategy.

Our long-term objectives remain as follows: one, invest in new services and capabilities to support customer needs; second, integrate our Business to create scale advantages in our buyer base, operations and service capabilities; and finally, enable our Business to drive further operating leverage as we grow. We are investing aggressively in our multi-year LiquidityOne Transformation program based on the massive growth opportunities we see ahead to leverage our knowledge, platform and capabilities. Macro trends in globalization, the growth of eCommerce, and increased emphasis on sustainability will drive the need for scalable, global solutions to manage reverse supply chain activity. We are the Company that will deliver those solutions.

In response to what our customers want and need to improve their own performance, we are building the next generation of cloud-based marketplace, analytics, and returns management solutions that will transform how the world's largest organizations capture value in their supply chain, and leverage our unique insights from transacting over $6 billion in surplus goods. We recently began sharing a beta version of our product with strategic customers, and they are playing an active role in the development and testing of our new LiquidityOne platform. Thus far, the feedback has been very positive. We expect our first marketplace to go live on the new LiquidityOne platform in the summer of 2016, with staggered releases over the next several quarters thereafter.

Finally, there still remain a number of unresolved operational and contractual details related to phasing in our new DoD surplus contract, and we are working together with our agency partner to prioritize and resolve all open items. We will continue to update shareholders as we conclude this process. As noted in an 8-K release this morning, we will continue to process and receive selected products through the end of calendar-year 2016 under our old surplus contract.

In summary, we are in the midst of a major investment cycle to develop game-changing new products for our customers, and integrate our Business to deliver superior service, scale and results. Our costs during this transition process will be elevated, and we will also face a drag on productivity as we implement new ways of doing business. We will have uneven periods of financial performance as we execute our strategy. However, what will emerge will be a much more diversified, scalable Organization focused entirely on growth and the reverse supply chain.

Now let me turn it over to Kathy for more details on Q4 results.

Kathy Domino - *Liquidity Services, Inc. - CAO*

Thanks, Bill.

We finished the fourth quarter of FY15 at the higher end of our guidance in GMV, adjusted EBITDA, and above in adjusted EPS. We saw strong performance in our state and local government business, as we increased our number of sellers, and continued to expand into the Western United States and Canada.

Our DoD businesses were down year over year due to decreased property flows and lower commodity prices. Decreases in product flows around consumer electronics, and softness in the buyer market, drove retail volumes lower in our consumer goods marketplaces, but margins have improved due to increased efficiencies. Our capital assets business continues to be challenged in the energy sector.

Next I will comment on our fourth-quarter and full-year results. Please note: The comparative financial results reflect the reset of our base business following the loss of our Department of Defense rolling stock program, the removal of our Walmart-Jacobs Trading program, and our LiquidityOne investment program.

Total gross merchandise volume, or GMV, decreased to $170.7 million, down 23.8% for the fourth quarter, and to $799 million, down 14.2%, for the fiscal year. GMV in our GovDeals, or state and local government marketplace, increased to $53.4 million, up 19.6% for the fourth quarter, and to a record $198.7 million, up 15.9% for the fiscal year, as we continue to add new clients, bringing total clients to over 8,100 out of a potential 88,000, and thus, further penetrating the $3 billion state and local government market.

GMV in our DoD scrap marketplace decreased to $11.7 million, or 30.2%, for the fourth quarter, and to $60.8 million, down 14.7%, for the year as a result of decreased property flow from the DoD and lower commodity prices. GMV in our DoD surplus marketplace decreased to $19.6 million, or 34.9%, for the fourth quarter, and to $98.2 million, down 26.2% for the fiscal year, as a result of decreased flow of lower-value property from the DoD.

GMV in our commercial marketplaces decreased to $86 million, or 35% for the fourth quarter, and to $441.1 million, down 20.6% for the fiscal year, as a result of reduced product flows in our retail and energy verticals. Total revenue decreased to $79.3 million, or 33% for the fourth quarter, and decreased to $397.1 million, down 19.9% for the fiscal year, primarily due to the decrease in GMV already discussed.

I will now discuss certain fourth-quarter and FY15 expense line items, and will not provide detailed explanations for changes in the fiscal year when those explanations are similar to the ones previously discussed in my comparison for the fourth quarter.

Technology and operations expenses decreased 13% to $23.3 million for the fourth quarter, primarily due to decreases in staff and temporary wages, including stock-based compensation as a result of our business realignment initiative, performance-based compensation costs, and lower warehouse and temporary storage fees due to the decreases in inventory balances. As a percentage of revenue, these expenses increased to 29.4% from 22.6%, primarily due to the decreases in revenue, as discussed above.

Technology and operations expenses decreased 8.4% to $99.7 million for the fiscal year. As a percentage of revenue, these expenses increased to 25.1% from 22%.

Sales and marketing expenses decreased 8.8% to $10 million for the fourth quarter, primarily due to decreases in staff wages, including stock-based compensation, as a result of our business realignment initiatives. As a percentage of revenue, these expenses increased to 12.6% from 9.2%, primarily due to the decrease in revenue.

Sales and marketing expenses decreased 1.2% to $41.5 million for the fiscal year, which is not significant. As a percentage of revenue, these expenses increased to 10.5% from 8.4%.

General and administrative expenses decreased 22.1% to $10 million for the fourth quarter, due to decreases in: one, performance-based compensation costs; two, staff wages, including stock-based compensation as a result of our business realignment initiative; and three, streamlining our global operations, and lowering our general and administrative expenses. As a percentage of revenue, general and administrative expenses increased to 12.6% from 10.8%, primarily due to the decrease in revenue.

General and administrative expenses decreased 16.2% to $41.4 million for the fiscal year. As a percentage of revenue, these expenses increased to 10.4% from 10%.

Adjusted EBITDA decreased 79.2% for the fourth quarter to $1.9 million, mostly due to the decreases in our commercial marketplaces and DoD businesses discussed above. Adjusted EBITDA decreased 47.5% for the fiscal year to $33.1 million. Adjusted net income decreased 50.4% to $2 million for the fourth quarter, and decreased 38.4% to $20 million for the fiscal year.

Adjusted diluted earnings per share decreased 46.2% to $0.07 for the fourth quarter, based on approximately 30 million diluted weighted average shares outstanding. Adjusted diluted earnings per share decreased 41.7% to $0.60 for the fiscal year, based on approximately 30 million diluted weighted average shares outstanding.

During the fourth quarter, Liquidity Services generated $3.9 million of operating cash flow, a decrease of 41.6% from the prior year. During the fiscal year, we generated $43.5 million of operating cash flow, an increase of 266.8% from prior year.

We continue to have a strong debt-free balance sheet. At September 30, 2015, we had a cash balance of $95.5 million, which included current assets of $188.4 million, total assets of $288.5 million, and $119.2 million in working capital.

Capital expenditures during the quarter were $1.9 million, and $7.3 million for the fiscal year. Our budget for capital expenditures for the fiscal year was $8 million to $9 million.

I will now turn it over to Jorge for the outlook on the next quarter.

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

Thank you, Kathy. Good morning, everyone.

We expect 2016 to be a year marked by a reset, indicative of our fourth-quarter and our expected first-quarter financial performance, while we focus on building our new service offerings and marketplace platform to meet the needs of our clients globally, and be in a better position to serve how organizations manage and sell surplus assets. Of particular importance is our ability to leverage this investment to offer both full-service and self-service capabilities to both large- and mid-sized organizations throughout the supply chain.

As we look to the first quarter, our focus remains on strategic investments in our LiquidityOne initiative, and enhancing the capabilities of our platform for our clients. We expect to incur increased costs during this phase throughout 2016 and 2017.

Our comparative results are also expected to continue to be impacted by lower ASPs and volume in our consumer electronics vertical, continued adverse macroeconomic conditions in our energy marketplace, lower commodity prices, and variability in the timing of large asset sales in our commercial capital assets marketplaces related to both underwritten and consignment programs. As our Business undergoes transformation, we are excited about the long-term value we are creating, even as our results in the short term may be less indicative of that progress.

Management guidance for the next fiscal quarter is as follows. We expect GMV for the first quarter of FY16 to range from $140 million to $160 million. We expect adjusted EBITDA to range from a negative $2 million to a positive $2 million, and adjusted earnings per diluted share to range from minus $0.09 to breakeven. This guidance assumes that we have an average fully diluted number of shares outstanding for the quarter of $30.1 million, and that we will not repurchase shares of the approximately $5.1 million yet to be expended under the share repurchase program.

We will now take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Colin Sebastian, Robert Baird.

Colin Sebastian - *Robert W. Baird & Company, Inc. - Analyst*

First off, how much spending was there in aggregate on the LiquidityOne platform in FY15? And what would you expect that to be in FY16 as a whole?

And then, secondly, looking beyond the first quarter's guidance, factoring in the efficiency gains that you've talked about through the next fiscal year, should we expect EBITDA to ramp sequentially as you move through FY16 off of the flat base in Q1?

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

First, let me describe the context of FY15 with regard to LiquidityOne. A lot of the effort there, Colin, relates to people and internal resources to design and effectively begin to build process of LiquidityOne. That has a couple impacts -- one, the actual cost of those FTEs dedicated to LiquidityOne; and, second, the opportunity cost, both for IT-specific resources and then the rest of our operations and management team not dedicating that time to growth initiatives in the normal business context.

That begins to elevate as we move into FY16 where we start to add resources that include third-party consultative resources for project management and actual rollout of new software that we're using in areas like HRIS, inventory management, ERP systems, and the further build of the LiquidityOne modules that support customer management, transaction management, property management and financial settlement.

So, there is an elevated spend as we move into Q1 from where we've been in the recent past. The numbers, I believe, are in the $1 million to $2 million range per quarter. That is up from the prior year run rate and that will remain elevated during FY16.

Relative to EBITDA and how that rolls out sequentially through the fiscal year, look, we have multiple headwinds that have conspired, really, at the same time to make the current environment very, what I would call, tempered for our business. Certainly the macro weakness in energy is profound. I think if you look at the oil price in October, November of last year versus this year, it's down over 50%. And that similarly is the type of year-over-year decline we've experienced in energy.

Lower commodity prices for things like stainless steel, aluminum and copper have affected the scrap business profoundly, as well. There's also a reset in the material that's flowing through that legacy DoD business and the follow-on contract, which is down year over year. And we indicated that softness in the consumer electronics vertical, which is an industry-wide issue. Unit volumes and average sales prices are down. Those are all headwinds that affect the current business.

We have huge operating leverage in the business presently. We have the infrastructure and capacity to more than double or triple the business without incurring incremental fixed costs, independent of allotted investment. So, we're in identifying opportunities to position ourselves as a service provider that manages not only the evaluation and sale of inventory but returns management, return to vendor. Some of that is fee-for-service business that doesn't show on GMV.

In our view, if we have even modest recovery in any of these headwinds, that we will have sequential growth in EBITDA as we go through the quarter. The difficulty for us is to give precise guidance in light of these various macro factors that affect our business and, frankly, affect everyone in the supply chain.

Colin Sebastian - *Robert W. Baird & Company, Inc. - Analyst*

Okay. That's helpful, Bill. Thanks. And maybe as a follow-up to your comments on the capital asset segment and the delayed projects, what's specifically holding these partners back? Are they awaiting more of the services layer or the LiquidityOne rollout? Or are they just more specific to each of those potential partners? If you could add some detail.

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

A couple points. One is that we've invited strategic customers to partner with us and provide feedback on the requirements that they have to drive efficiencies in their business. And we've begun that beta testing exercise. These clients are very enthusiastic about how we can play a more strategic role in managing the flow of assets, the valuation analysis of assets, and ultimately saving them costs by bundling returns management with the disposition activity. Certain business will naturally flow to us as we complete various service layers of the LiquidityOne program.

We also have multiple ways that LiquidityOne capabilities will be monetized in the future. Whether that is extending our technology as a service, whether it's self-service capabilities where we unbundle components of what we do for our clients and they do it on their own, the ability to concentrate buyer activity in one platform versus currently in separate brands and technology stacks, that there's monetization on the buyer side. All those things we're very much looking forward to.

In terms of industry-specific delays and projects, we have had a lot of success in signing fortune 500 companies to become customers. Now, these customers individually must determine when is it appropriate for them to transact. And in the energy vertical, there has been some reluctance there to determine, are we in the new normal in terms of pricing, and does that new normal stick, the price range, trading range stick for a few a months and then a few quarters. Then people are likely to begin to transact in the new normal business environment.

We have done well, actually, to earn engagements and drive consignments. And, yet, the transaction activity has been very lethargic in the current business climate. We believe, as that market realizes that the climate is more the new normal, that that ultimately at some point snaps back. So, we're positioned to provide the marketplace and the services to advise and transact when the clients are ready. And that's specifically in energy and some other industrial verticals.

We also see similar behavior -- the manufacturing vertical was a bright spot in the September quarter. That was up double digits year over year. I mentioned tremendous activity occurring outside the United States in Asia. There's a lot of acceptance of the model cross-border with what we're doing, so that was a bright spot, a lot of volume activity there. We've been very active in mainland China and Australia and Pacific Rim activity.

We would like to see some improvement in driving retail manufacturers into the marketplace. Those manufacturers are a target for us and we're layering in service to make the value proposition more compelling for them. So, at some point the worm turns on some of these macro headwinds as we move through the year.

Colin Sebastian - *Robert W. Baird & Company, Inc. - Analyst*

Okay. Very helpful. Good. Thanks, Bill.

Operator

Rohit Kulkarni, RBC Capital Markets.

Rohit Kulkarni - *RBC Capital Markets - Analyst*

Bill, a question for you. You mentioned the first marketplace on the LiquidityOne will go live in summer of 2016. Any additional color you can provide in terms of milestones that you're tracking over the next six months or so? And beyond summer, would it be fair to assume that you would then be able to launch more of those integrated marketplaces work in 2.0 at a somewhat accelerated clip? And, then, can you remind us, what was the Jacobs contribution during FY15? Thanks.

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

Sure. In terms of the milestones, we will manifest LiquidityOne marketplace functionality in the first release in the summer of 2016. We are doing that for a variety of reasons. One, we believe we have customers that are excited to have that functionality, both on the buyer side and the seller side. And we're doing the release in a controlled way so that we can obtain feedback, maintain this agile development philosophy of taking that feedback and improve the product for the subsequent releases.

This marketplace will be providing the full feature-rich My Account Management, search, discovery, reporting, allowing us to leverage a lot of the marketing automation. So, we'll take that as a learning opportunity and invest feedback for the next subsequent releases.

The other functionality that we will see in FY16 or subsequent milestones is the ability to test and manage a self-service platform in the middle market. We have a number of clients who have desired to take ownership of how assets are loaded into our system and those assets are sold in place. We've observed in the government arena, with over 8,000 state and local government clients, high adoption of self-service platform.

That's been an attractive arena for us, so we're going to begin testing that in the middle markets. And I believe that ultimately that creates another vector of growth and opportunity for us, and one that's much more of a technology-enabled service than one dependent upon providing fixed storage locations or people on the ground to physically manifest in lots of property.

So those are two important milestones. And then eventually this radiates outward to more of a global platform, multi-currency, multi-lingual. We have buyers and sellers transacting with us today in industry-specific marketplaces. We will radiate outward from US-centric to these international markets on the LOne platform as we move into FY17.

Then we really have something unique, we believe, in that clients can manage on a full-service or self-service basis anywhere in the globe using our system. And, in some cases, we've built in multi-tenancy applications so that if clients want to, in effect, run their own eCommerce marketplace system, we'll be able to support that in parallel with our, let's say, big marketplace where we are handling all the transactions.

So, there's lots of layers of additional growth and market opportunities that follow this first release in the summer and we're very excited about it. It's a long-term investment and one that we're doing with quality and lots of customer input.

In terms of the Jacobs business, the Jacobs business had both variable and fixed costs allocated to the business in the past. And that business, because of the cessation of the Walmart general merchandise program, was a negative contribution margin in the nine months prior to our disposition of the assets. That business would have had a negative margin in the $5 million-plus range, and one that also has opportunity costs for us.

I would add that with Walmart and others, those are still clients of ours. We've seen clients bring us ideas on how we can help manage a variety of their pain points, including the addition of value-added services -- pre- and post-sale value-added services -- to what we provide in our standard offering, and we are doing that. And we'll continue to work with Walmart and other such clients today and in the future.

Rohit Kulkarni - *RBC Capital Markets - Analyst*

Okay. And if I could just ask one more on the state and municipal side of things. That seems to be, I'm sorry to say, the only bright spot here. Can you explain what is going on there? It seems to be sustaining a somewhat accelerated growth strategy, if I look out over the last maybe 9 to 12 months. Are you fundamentally doing something different in there? Or is there some sort of a tipping point in terms of scale or scope efficiencies that you have reached that is leading to this traction recently?

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

I think there's always this reinforcing dynamic of sellers want to be where the buyers and the highest returns are. And as we've gotten some more scale now, over $200 million of GMV, in that channel, many agency clients are asking themselves why reinvent the wheel, and moving away from fixed site live auctions to sell-in-place solutions that do at least three things -- one, allow them quicker conversion of assets into cash; two, outsource all the buyer-facing customer service and financial settlements so they don't have to ask buyers to visit locations, mail in checks; three, it allows these agencies to free up space and people, and that aligns with budget-conscious municipal decisions.

I think, also, we're accessing what I would call the next frontier of growth in West of the Mississippi, major metro areas, in California, Washington, Colorado, even in some of the large cities like Chicago, who are seeing the value proposition and embracing that value proposition, and finally getting to a point where they're not afraid of using a technology-based marketplace. Most of this marketplace historically has been served by people physically touching and seeing the assets, physically going to government-sponsored events. And I think that there's a turning point in terms of you can sell high-value equipment even if you don't see the asset.

Lastly, we've expanded north of the border to Canada and it's been well-received. It's a good case study for us that the service and the tech platform travels well outside the United States. We'll continue to see opportunities to expand into Canada.

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

And, Rohit, this is Jorge. Just to add, from a business model perspective, the municipal and state government business is one that is a self-service business. And as we mentioned in our earlier comments, the self-service business is part of what we're trying to expand in our LiquidityOne eCommerce platform to enable across our different marketplaces, to more effectively and efficiently expand that type of offering in addition to our full-service capability offerings that we have.

One of the advantages that we have in the Liquidity One Transformation is that our process and proven business model that we have embedded in that particular vertical is one that we are comfortable with and we now just have to put it in place to facilitate that opportunity for the rest of our verticals. So that is part of the initiatives that you see over time -- us looking at the areas that our clients have shown good demand and they've requested certain capabilities. And we are now trying to facilitate those for them.

Rohit Kulkarni - *RBC Capital Markets - Analyst*

Okay, great. One last question. As you look ahead, I know you're not giving guidance for this year or beyond, can you highlight, is there anything structurally that is going to change as you mix shift the business away from the Department of Defense and obviously Jacobs? And if I look back, you had margins in mid to high teens for several years. Is there anything structurally different with the business that would prohibit you from going back to those margins three years from now?

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

I think the blend of services and GMV will evolve depending upon the rate of adoption of either full-service or self-service offerings. So, no structural change. Really, just a function of what the level of penetration is by each service offering and how that blends.

Some of these services we provide only are recording fee-for-service on the GAAP revenue line and do not show up in things like GMV. So, we would counsel over time, the way to measure the business would be margins as a percentage of GAAP revenue as the level of commission and fee-for-service business rises over time.

Rohit Kulkarni - *RBC Capital Markets - Analyst*

Okay. I got it. Thanks a lot, guys. Good luck.

Operator

Gary Prestopino, Barrington Research.

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

Kathy, did you give a CapEx guidance number for the year? I know you gave something on CapEx but was that historical or for FY16?

Kathy Domino - *Liquidity Services, Inc. - CAO*

That was historical.

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

Okay. Can you share with us what you think your CapEx will be this year?

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

I think what it will be is something similar or slightly higher than last year.

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

Okay. Slightly higher to similar? Okay. All right. Just to make sure that I'm clear on when you're giving your guidance for this year, the guidance includes the new pricing on the remaining surplus contract. Obviously Jacobs is out and rolling stock is out. Is that, that's correct?

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

Yes. That's correct.

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

Okay. So if you look at within the guidance, what should we be using for a recorded tax rate percentage?

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

Looking forward and what's in our first-quarter guidance is a tax rate in the low 30%s. And I would expect it to be in the 30%s. As our expenditure levels are where they are and our expected net income performance, the variability in the tax rate will vary more than it has in the past. It's a bit hard to give a single number so I would keep a number that's in the 30s more in mind as you model out.

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

Okay. But because of the sale of Jacobs, on a GAAP basis will you be paying any taxes at all if you show profits?

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

Sorry. Was that a retrospective question or prospective?

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

Prospective. What I'm trying to get at, didn't the Jacobs generate some tax loss NOLs?

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

No. Prospectively, from a tax point of view, the Jacobs transaction is really behind us from a tax point of view. So, no, I would not count on that.

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

Okay. And then, Bill, you mentioned that -- and I was writing this down -- you mentioned you had something out in beta, one of the beta versions of one of the products, and the feedback has been positive. Maybe I didn't write this down or listen well enough, but what is that beta version? And what has been some of the positive feedback that you've been getting from the clients with the new product?

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

I think we've commented over the course of the last year that we feel there's a lot of value in this two-way relationship between manufacturers and retailers. Retailers and their vendor base are looking to reduce the complexity of managing returns. And one area that we've taken a lot of feedback on is what's the level of reporting and management of that process that creates value for both parties?

So, we have architected the returns management component of LiquidityOne, seeking to simplify and reduce handling and transportation costs around that return to vendor problem. And we've gotten feedback from selected parties in that space on the need for enhancements, and lots of aspects related to realtime reporting, the ability to make decisions on further investment and refurbishing of items versus the opportunity to capture value through the disposition of the item, should the item be transported back into stock versus held and liquidated, or even other disposition decisions including destruction and donation.

Bringing all that together involves our data warehouse, it involves our client reporting portal and tools and then the layering of services on top of our eCommerce marketplace to dispose of items. Those are all things we're very excited about.

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

Okay. Then, lastly, you talked about the electronic supply is down for your end market. Energy is weak, but that's more or less symptomatic of just what's going on in the market itself. I would assume there's a lot of equipment out there that needs to be regenerated back into the market.

Are you getting any sense from some of these energy companies that, what would be the flashpoint where they would really start having a higher level of interest and an appetite for some of this? Obviously probably a lot of having to do with where energy prices end up.

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

Yes. I think as you have some steady-state planning around current levels, and the market locks in to the current trading range of where oil is and therefore investment activity, people are going to need to make decisions on how do you recover some value in idle assets, idle equipment. I mentioned we signed 11 energy clients in the last quarter. There's a reason for that because they are starting to take aim at how do I recover some value for things that aren't likely to go into production in the next several years.

It would be one think if we had a quick bounce back, but all the industry activities that I'm seeing is that people are hunkering down and expect multiple years of lower energy prices. I think there's probably some reference point as we get to the end of the tax year, as we get through the December cycle, people will take a very hard look at disposition as a strategy. And I believe you're talking a couple, three quarters and it will be apparent that people have adopted the new normal around energy prices.

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

Okay. Thank you.

Operator

Dan Kurnos, The Benchmark.

Dan Kurnos - *The Benchmark Company - Analyst*

Not to be beat this one to death but maybe if you could give us directionally some color -- and I think I know the answer -- but if you strip out Walmart/Jacobs for the December quarter going forward for retail, how is retail pacing in general? And as a follow-up to that, Bill, you've talked about it obviously ad nauseum in the energy vertical and capital assets, and you touched on it in your prepared remarks, but maybe if you could give us some color on the impact of deflationary pricing, particularly in the eCommerce market that we're seeing and the rise of a lot of very price-sensitive competitors and what that's doing to the secondary marketplace.

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

Let me address the first question. The retail business is a business that's, A, running more efficiently, and it's focused on a multi-channel sales strategy, one that has been developed with the input from clients. We handle a range of large volume or large-sized transactions. We handle that both domestically and overseas. We handle pallet to truckload activity on B2B sales through our liquidation marketplace and we also handle sales on B2C channels, and now over 15 B2C channels, including some of our clients' channels. So, we have a range of disposition strategies that we bring to each of the clients.

I think the emphasis of the retail business just continue to expand in multiple categories. The consumer electronics vertical has been a more difficult vertical and it's a function of this rotation in the world away from hardware to various very limited application hardware devices and lower pricing in that vertical. So, some of the traditional PC manufacturers and laptop manufacturers, I think, have some tough sledding in the environment that we're in. So, we've rotated to a lot of areas that we see more growth and prospects, and we have a lot of volume and activity.

The home improvement and building tools category, general merchandise, apparel, soft goods, those are categories where there's a lot of omnichannel activity, a lot of opportunity to bundle returns management refurbishing activity. The rise of eCommerce clearly means that you've got to provide the customer the ability to return the item the way they want to return it. Not everyone wants to go back to the stores so a lot of these products are packed with shipping return labels.

So, there's a lot of stress placed on the traditional retailer and manufacturer to manage volumes and returns. We're well-positioned in the retail vertical to provide both facilities, transportation management, ability to test and refurbish items, and ultimately sell those items. And that's where we see macro opportunity and growth.

In terms of the secondary marketplace for capital assets, there are lots of different solutions that a client might have depending on the vertical and the regional offering. Most of the competition in the capital asset space would consist of the traditional auctioneers, which have aggregated product in live events.

There are emerging players that offer purely software that would allow people to run their own auction. That has been around for many years. I think what it comes down to is what is the level of service that a client desires to protect their brand, manage the logistics aspects, manage the reporting aspects.

Our experience, Dan, has been that the larger companies, particularly Fortune 500, publicly traded, multinational, they're really interested in a full-service offering to manage compliance reporting, manage the service offering around their supply chain in a consistent way, and need the arms and legs and data to manifest and sell the equipment. And those are high-value sales. We're talking about million dollar items being sold in the marketplace.

The way that that equipment is presented to buyers is very important to them. They want to have confidence that we know the buying customer, that the buying customer is a qualified and safe-to-sell counterparty to an transaction. I think we're one of the very few companies that sells compliance as a service almost, as it relates to the various overlapping checks and reviews we do, both on the assets and the buyer side. That's a very important to our clients. The local auctioneer is still a factor more on a regional basis, and that's really who we encounter as the alternative.

Dan Kurnos - *The Benchmark Company - Analyst*

I was really more asking, Bill -- and that's good color and it's also interesting to hear how you think about the evolving returns market, which is maybe a topic of discussion for another time -- but I was really getting more at the retail-oriented marketplace. I know you guys have done some intentional churn to get out of the consumer electronics and re-shift your focus on some other verticals where there might be more growth opportunities.

But we're seeing a broad-brush general merchandise entry, within eComm particularly, that's been very price sensitive. And obviously you've seen the news from Walmart in terms of getting more price aggressive. And I was just wondering if the deflationary pricing was expected to depress the secondary marketplace in retail on an extended basis, or if you really see it as just more of a holiday type of impact and then maybe it normalizes over the coming 6 to 18 months?

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

Sure. The promotional environment that we're in certainly will depress average sale prices and people are being very aggressive. That's to be expected. We counteract that by bulking up the product that we sell. We handle pallets and truckload quantities which provide efficient handling and transportation for the buying customer.

We also see the offset from eCommerce being a source of steady returns flow into the marketplace. And that provides an opportunity to bundle services and create value. Sometimes just the reduction in transportation costs can be a win for the client. So, those are things that would counteract a price-sensitive promotional environment during the holidays.

Dan Kurnos - *The Benchmark Company - Analyst*

Got it. That's helpful. And then just one last one for me from a high level, Bill. Maybe not a fair question since it's still early in the transformation, but if you were to step back and look at the process and your goals and expectations before you underwent the transformation and now where you're at, maybe you could talk about some of the key learnings you've had thus far. You've talked about a few things in response to others, but maybe any differences in strategy or how things have played out versus you initial expectations would be helpful. Thanks.

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

First, you have to have the sustenance to build the winning products and services and aim at a large market opportunity. We have been bold in thinking about the business as having an international global market opportunity. And the front-end investment to be a player not just in the United States but around the world is non trivial. There's a significant amount of investment there, both from a process perspective, from a legal compliance, finance perspective, and a staffing perspective.

We set up our business, Dan, to be able to execute for clients anywhere in the world, across all the major industry sectors that are going to drive the economy. That is a strategy that ultimately we believe will bear fruit for us.

It's an expensive venture to be able to manage business on six continents, which we did in the last quarter. We sold in every major continent around the world. We ultimately think there is a brand awareness opportunity, the ability to further penetrate clients who work in these various supply chains, which are clearly globalizing.

If nothing else, the market clearly takes and receives more value if you can handle cross-border buying and selling, so we've set ourselves up to do that. And we have the courage and conviction to integrate multiple brands and technology stacks to support this global network effect.

In for a penny in for a pound -- if you're going to do it, you do it the right way and it's going to be necessitating serious multi-year investment and planning to arrive at your future destination. We think the rise of globalization, the rise of technology, product innovation, eCommerce growth, and a renewed focus on sustainability as a strategy positions us to intelligently capture the value of all that material and equipment in the supply chain to benefit our clients, to benefit our buyers, and ultimately drive that sustainability goal for the planet. So that's the big vision around making these investments.

And over to the side, things are going up and down in macro environments, up and down related to a legacy relationship, which we value. It really has less to do with where we're taking the business and creating this future growth opportunity.

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

Dan, to go back to tie this in a little bit to what I mentioned on the municipal and state government, where we were leveraging that capability that we have proven there on the self-service, and where we have the full service on one end, self-service on the other, if you take that to retail, from a self-service and full-service it's the same thing, the capabilities we built.

Although we are able to do both today with clients, and we have clients that we're doing these things with, expanding the capabilities so it's scalable, and we are working with several clients to design the capability within the eCommerce LiquidityOne Transformation project, to allow us to then offer clients what they want, for them to be able to do the scalable transactions that they want on a global basis.

Part of the long-term view in that business is, yes, to some degree you're going to have, let's call it, more commoditized sensitive side of things, but if you then continue to do that and have a very efficient scalable business that can do that, that's one model. While at the same time, you can go to the other side on clients, whether it's retailers or manufacturers of consumer goods, that want full-service capabilities such as return to vendor, that we can leverage the clients and the know-how that we have today to really expand it to different verticals and on a larger scale in the long run.

So, sorry to tie it back into LiquidityOne but that is part of the vision of the investment and the transformation. It's not just the transformation of a technology platform, it's a transformation of how we go to market and how we meet the demands that we're already seeing from our clients.

Dan Kurnos - *The Benchmark Company - Analyst*

All right. Thanks, guys.

Operator

(Operator Instructions)

Jason Mitchell, Bank of America.

Jason Mitchell - *BofA Merrill Lynch - Analyst*

This is Jason here for Nat Schindler. First of all, are there any updates on the scrap contract? Has the government put out an RFP yet or anything like that?

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

We executed an extension of the SV contract. Our expectation would be that there would be an RFP announcement at some point in FY16, though we have not seen that yet.

Jason Mitchell - *BofA Merrill Lynch - Analyst*

Okay. And then just on the surplus business, can you give any commentary or color around what the GMV growth was in 2015 ex rolling stock on a pro forma basis?

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

The business is in a period of year-over-year decline relative to material the volume and then the pricing/mix of that business. And, again, you have maybe 90 days of visibility on the material that will be referred ultimately from sale. So, the lagging indicator would indicate lower volume and a mix of lower value property.

Jason Mitchell - *BofA Merrill Lynch - Analyst*

Okay. And then in your press release, you mentioned you're still in negotiations with the DoD under the new contract terms. Is there any opportunity there for you to maybe get better pricing on the newer contract through value-added services or things like that?

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

The process is really no different than -- when you're performing an engineering project, you build your solution to the specs and the scope of the contract, and if the contract requirements change, then you change the solution to meet the requirements. So, we're in an iterative way understanding what the DLA wants in terms of executing the business and then modifying our solution to meet the new scope.

Of course we would wish to create value for the client and engineer value for Liquidity Services as part of that process. But that's an ongoing exercise. We don't have it definitively resolved. There's really no hard guidance I can give you at this point.

Jason Mitchell - *BofA Merrill Lynch - Analyst*

Is part of your increased investment right now, part of that going into setting up that contract over the course of the next six months?

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

Yes, it is.

Jason Mitchell - *BofA Merrill Lynch - Analyst*

Okay. That's all the questions I had. Thank you.

Operator

This does conclude the question-and-answer session of today's program. I'd like to hand the program back to Julie Davis for any further remarks.

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

Thank you. That concludes our time for today's call. We appreciate your participation. And we will be available for any a follow-up questions you have now. Thank you.

Operator

Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.