LIQUIDITY SERVICES INC
Form 424B4
February 23, 2006

QuickLinks -- Click here to rapidly navigate through this document

Filed Pursuant To Rule 424(b)(4)
Registration No. 333-129656

PROSPECTUS

7,687,362 Shares

Common Stock

We are offering for sale 5,000,000 shares of our common stock. The selling stockholders included in this prospectus are offering an additional 2,687,362 shares of common stock. This is our initial public offering and no public market currently exists for our shares.

The initial public offering price is $10.00 per share. The shares have been approved for quotation on the Nasdaq National Market under the symbol "LQDT."

Investing in our common stock involves risk. See "Risk Factors" beginning on page 11.

	Per Share	Total
Public offering price	$ 10.00	$ 76,873,620
Underwriting discounts and commissions	$ 0.70	$ 5,381,153
Proceeds, before expenses, to Liquidity Services, Inc.	$ 9.30	$ 46,500,000
Proceeds, before expenses, to the selling stockholders	$ 9.30	$ 24,992,467

Certain of the selling stockholders have granted the underwriters the right to purchase up to 1,153,104 additional shares of common stock to cover over-allotments, if any.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the shares on or about February 28, 2006.

FRIEDMAN BILLINGS RAMSEY **RBC CAPITAL MARKETS**

CIBC WORLD MARKETS **PACIFIC CREST SECURITIES**

Prospectus dated February 22, 2006.

TABLE OF CONTENTS

PROSPECTUS SUMMARY

The following is a brief summary of selected contents of this prospectus. It does not contain all the information that may be important to you. You should read the entire prospectus, including our consolidated financial statements and related notes appearing elsewhere in this prospectus. You should carefully consider, among other things, the matters discussed under the caption "Risk Factors" before making an investment decision.

Overview

We are a leading online auction marketplace for wholesale, surplus and salvage assets. Our marketplaces provide professional buyers access to a global supply of wholesale, surplus and salvage assets organized into over 500 categories and presented with product information necessary to make more informed bids, including digital images, detailed descriptions and extensive technical information. We enable our corporate and government sellers to enhance their financial returns from the sale of excess assets by providing a liquid marketplace and integrated value-added services, including sales and marketing, logistics and transaction settlement. Our online auction marketplaces are *www.liquidation.com*, *www.govliquidation.com* and *www.uksurplus.com*. We also operate a wholesale industry portal, *www.goWholesale.com,* that connects advertisers with buyers seeking products for sale and business services.

We believe our ability to create liquid marketplaces for wholesale, surplus and salvage assets generates a continuous flow of goods from our corporate and government sellers and that this flow of goods attracts an increasing number of professional buyers to our marketplaces. During calendar year 2005, the number of our registered buyers grew from approximately 292,000 to approximately 415,000, and during the past three fiscal years, we have conducted over 436,000 online transactions generating approximately $264 million in gross merchandise volume. For the fiscal year ended September 30, 2005 and for the quarter ended December 31, 2005, we generated revenue of $89.4 million and $32.2 million, respectively. Our revenue has grown at a compound annual growth rate of approximately 26% since fiscal year 2002, and we have been profitable and have had positive cash flow from operations since fiscal year 2002.

Industry Overview

We believe many manufacturers, retailers, corporations and government agencies focus on the procurement of new goods for initial use or resale but not on the disposal, liquidation and tracking of goods in the reverse supply chain, such as retail customer returns, overstock products and end-of-life goods. We believe that the volume of goods in this reverse supply chain is continuing to increase, driven by accelerating product innovation, supply chain complexity, government regulations and the return policies of national and online retailers. According to D.F. Blumberg Associates, Inc., a research and consulting firm, the estimated reverse logistics market in North America will grow from approximately $38.5 billion in 2004 to over $63.1 billion in 2008. In an effort to streamline and improve the efficiency of their disposition activities for surplus and end-of-life assets, federal and state governments have made significant progress toward outsourcing these functions. Similarly, we believe corporations continue to realize that their current supply chain infrastructure is not well suited to cost effectively handle the sale of surplus, salvage, returned and overstocked merchandise.

Traditional methods of wholesale, surplus and salvage asset disposition, such as live on-site auctions and negotiated direct sales, are generally highly fragmented and limited in geographic reach. As a result, buyers are often unaware of or unable to participate in these events, which reduces buyer competition and the ultimate value a seller realizes from a sale. We believe the Internet provides professional buyers of wholesale, surplus and salvage assets with a more effective and efficient means to identify and source goods available for immediate purchase.

Our Solution

Our solution is comprised of our online auction marketplaces, value-added services and our wholesale search and advertising portal. Our three online marketplaces serve as a transparent and convenient method for the sale of wholesale, surplus and salvage assets and are designed to address the particular requirements of the sellers and professional buyers we serve. Sellers and buyers come together to transact for goods sold "as-is, where-is," generally without the discretionary right to return the goods. We organize our products into categories across major industry verticals such as consumer electronics, general merchandise, apparel, scientific equipment, aerospace parts and equipment, technology hardware, and specialty equipment and sell these products in lot sizes ranging from full truck loads to pallets, packages and large individual items.

Our comprehensive solution includes value-added services that simplify the sale process for sellers and enhances the utility of our marketplaces for our buyers. Unlike other online auction websites on which sellers post information and deal directly with the buyer to complete a sale, we manage each step of the transaction. We perform all required pre-sale services such as receiving and lotting merchandise and implementing marketing strategies. In a centralized location, our buyers are provided access to detailed product descriptions, digital images, seller transaction histories, shipping weights and dimensions and estimated shipping costs. After a transaction is executed, we also perform all required post-sale services such as payment collection, settlement and reporting. We believe these value-added services significantly contribute to an enhanced selling price while providing buyers with a secure transaction environment and confidence in the goods they purchase.

We believe our marketplaces benefit over time from greater scale and adoption by our constituents. Aggregating buyer demand enables us to generate a continuous flow of goods from corporate and government sellers, which in turn attracts an increasing number of professional buyers. As buyers continue to discover and use our online trading platform as an effective method to source assets, we believe our marketplaces become an increasingly attractive sales channel for corporations and government agencies. We believe this self-reinforcing cycle results in greater transaction volume and enhances the value of our marketplaces.

In addition to our marketplaces, our wholesale industry portal, *www.goWholesale.com*, provides a single online destination for buyers to find wholesale products, suppliers and services. We developed this portal to provide advertisers with the ability to reach our growing network of professional buyers.

Our Benefits to Sellers and Buyers

We offer the following key benefits to sellers and buyers:

Benefits to Sellers	Benefits to Buyers
Access to a broad, aggregated buyer audience enhances value realized on the sale of wholesale, surplus and salvage assets	Marketplaces provide access to a continuous flow of wholesale, surplus and salvage assets
Comprehensive service offerings allow sellers the ability to fully outsource reverse supply chain activities	Complete product search capabilities with search criteria including keyword, category, lot size, condition and location improve information availability
Profit-sharing arrangements align our interests with those of our sellers	Intelligent alerts delivered through email provide buyers with notice of upcoming auctions of interest
Online auction environment and liquid marketplaces allow sellers to sell goods in any condition for cash	Superior product information, including digital images, detailed descriptions with shipping dimensions and extensive technical information, enables more informed bidding
Faster cycle times and greater flexibility than traditional auction methods improve seller recovery on asset sales	Shipping quotes and services assure buyers can both estimate the cost of delivery in advance of a bid and have the goods delivered
Discrete venue to sell surplus and salvage assets preserves brand value and mitigates channel conflict	Secure settlement and dispute resolution assure the delivery of goods and provide a means to resolve problems
Transaction platform provides transparent reporting capabilities	Tracking and reporting tools provide buyers real time transaction information

Our Growth Strategy

Our objective is to build upon our position as a leading online auction marketplace for selling wholesale, surplus and salvage assets. The key elements of our strategy are:

Grow our buyer base and increase the total number of auction participants. We intend to increase the level of bidding activity and competition within each auction by growing our database of professional buyers and implementing an increased variety of both online and traditional marketing programs to increase buyer participation in our online marketplaces.

Increase penetration of existing sellers. We intend to increase our sales by further penetrating our existing seller relationships to manage and sell an increased share of their available supply of wholesale, surplus and salvage assets.

Develop new seller relationships. We intend to increase our number of corporate and government seller relationships by leveraging our demonstrated performance record and expanded sales and marketing initiative.

Develop and enhance features and services. We intend to utilize the insights gained from our completed auctions to develop and enhance features and services that benefit our buyers and sellers.

Expand our wholesale industry portal and advertising network. We intend to further expand our advertising network and develop products that enable wholesale buyers and sellers to more quickly and easily find, create and organize relevant industry information.

Acquire complementary businesses. We intend to continue our disciplined and targeted acquisition strategy to increase our share of the supply of wholesale, surplus and salvage goods sold by selectively acquiring complementary businesses.

Our Government Contracts

We are the exclusive contractor of the Defense Reutilization and Marketing Service, or DRMS, for the sale of surplus and scrap assets of the United States Department of Defense, or DoD, in the United States. In June 2001, we were awarded a competitive-bid exclusive contract under which we acquire, manage and sell all usable surplus property of DoD turned into DRMS. This contract expires in 2008 and accounted for 95.8%, 91.0%, 87.5% and 64.3% of our revenue and for 80.5%, 77.5%, 76.5% and 56.4% of our gross merchandise volume for the fiscal years ended September 30, 2003, 2004 and 2005 and for the quarter ended December 31, 2005, respectively. Total revenue under our DoD surplus property contract has increased at a compound annual growth rate in excess of 21% since fiscal year 2002. In June 2005, we were awarded a competitive-bid exclusive contract under which we acquire, manage and sell substantially all scrap property of DoD turned into DRMS. This contract expires in 2012, subject to DoD's right to extend for three additional one-year terms, and accounted for 0.4% and 21.6% of our revenue and for 0.3% and 19.0% of our gross merchandise volume in fiscal year 2005 and for the quarter ended December 31, 2005, respectively.

Risks Associated with Our Business

We are subject to a number of risks, which you should be aware of before you decide to buy our common stock. These risks are discussed more fully in the "Risk Factors" section of this prospectus beginning on page 11. We depend on contracts with the DoD for a significant portion of our revenue, as described above. If our DoD contracts are terminated or if our relationship with DoD is impaired, we could experience a significant decrease in our revenue and have difficulty generating income. In addition, our ability to increase our revenue and maintain profitability depends on whether we can successfully expand the supply of merchandise available for sale on our online marketplaces and attract and retain active professional buyers to purchase the merchandise. We operate in a highly competitive, rapidly growing online services market for auctioning or liquidating wholesale, surplus and salvage assets. We may not be able to obtain merchandise that meets our buyer's price or selection requirements, which may cause our buyer base to decline or not grow as rapidly as we expect.

Corporate Information

We were incorporated in Delaware in November 1999 as Liquidation.com, Inc. and commenced operations in January 2000. We were renamed Liquidity Services, Inc. in November 2001. Our principal executive offices are located at 1920 L Street, N.W., 6th Floor, Washington D.C. 20036, and our telephone number is (202) 467-6868. Our corporate website is located at *www.liquidityservicesinc.com*. The information contained in, or that can be accessed through, our website is not part of this prospectus.

Unless otherwise indicated, the terms "Liquidity Services, Inc.," "LSI," the "company," "we," "us" and "our" refer to Liquidity Services, Inc. and its subsidiaries.

All references to years in this prospectus, unless otherwise noted, refer to our fiscal years, which end on September 30. For example, a reference to "2005" or "fiscal year 2005" means that 12-month period that ended September 30, 2005.

The Offering

Common stock offered by us	5,000,000 shares
Common stock offered by the selling stockholders	2,687,362 shares
Common stock to be outstanding after the offering	27,329,554 shares
Use of proceeds	Our net proceeds from this offering after deducting estimated expenses will be approximately $44.4 million. We will use these net proceeds for the repayment of $4.4 million of our indebtedness, working capital, general corporate purposes and possible future acquisitions. As of the date of this prospectus, we have no arrangements, agreements or commitments for acquisitions of any businesses, products or technologies, and we can give no assurance that we will be able to consummate any acquisitions or strategic investments or that if consummated such acquisitions or investments would be on terms that are favorable to us. We will not receive any proceeds from the sale of shares by the selling stockholders.
Proposed Nasdaq National Market symbol	"LQDT"

The share information in the table above is based on the number of shares outstanding as of December 31, 2005 and excludes:

- 50,000 shares issuable upon the exercise of outstanding warrants at a weighted average exercise price of $2.50 per share;
- 1,203,845 shares issuable upon the exercise of outstanding stock options at a weighted average exercise price of $3.71 per share; and
- 264,886 shares available for future issuance under our 2005 Stock Option and Incentive Plan.

Except as otherwise noted, all information in this prospectus:

- assumes the underwriters do not exercise their over-allotment option;
- gives effect to the increase in the authorized shares of common stock to 120,000,000, which occurred effective January 10, 2006; and
- gives effect to the conversion of our outstanding shares of our Series C preferred stock into 3,262,643 shares of common stock, which will occur automatically upon the closing of this offering.

Summary Consolidated Financial Data

You should read the following summary consolidated financial data together with our consolidated financial statements and the related notes, and with "Management's Discussion and Analysis of Financial Condition and Results of Operations," included elsewhere in this prospectus. The consolidated statement of operations data for the years ended September 30, 2003, 2004 and 2005 are derived from, and are qualified by reference to, our consolidated financial statements that have been audited by Ernst & Young LLP, an independent registered public accounting firm, and that are included in this prospectus. The consolidated statement of operations data for the three months ended December 31, 2004 and 2005, and the consolidated balance sheet data as of December 31, 2005, are derived from, and are qualified by reference to, our unaudited consolidated financial statements that are included in this prospectus.

	Year ended September 30,			Three months ended December 31,	
	2003	2004	2005	2004	2005
				(unaudited)	
	(dollars in thousands, except per share data)				
Consolidated Statement of Operations Data:					
Revenue	$ 60,719	$ 75,869	$ 89,415	$ 19,817	$ 32,207
Costs and expenses:					
Cost of goods sold (excluding amortization)	4,481	5,743	6,288	1,296	2,367
Profit-sharing distributions	30,427	39,718	48,952	10,985	18,170
Technology and operations	10,358	12,814	14,696	3,434	4,055
Sales and marketing	3,798	4,586	5,503	1,190	1,816
General and administrative	5,810	6,046	7,397	1,690	2,633
Amortization of contract intangibles	1,862		135		203
Depreciation and amortization	465	531	586	141	153
Total costs and expenses	57,201	69,438	83,557	18,736	29,397
Income from operations	3,518	6,431	5,858	1,081	2,810
Interest expense and other income, net	(391)	(621)	(570)	(110)	(363)
Income before provision for income taxes	3,127	5,810	5,288	971	2,447
Provision for income taxes	(351)	(541)	(1,166)	(353)	(979)
Net income	$ 2,776	$ 5,269	$ 4,122	$ 618	$ 1,468
Basic earnings per common share	$ 0.19	$ 0.31	$ 0.22	$ 0.03	$ 0.08
Basic weighted average shares outstanding	14,428,121	16,865,313	19,038,464	19,029,284	19,034,172
Diluted earnings per common share	$ 0.17	$ 0.29	$ 0.18	$ 0.03	$ 0.06
Diluted weighted average shares outstanding	16,124,927	18,280,366	22,598,519	22,519,522	22,848,367
Non-GAAP Financial Measures:					
EBITDA(1)	$ 5,845	$ 6,962	$ 6,579	$ 1,222	$ 3,166
Adjusted EBITDA(1)	3,750	6,115	6,666	1,288	3,167
Adjusted profit-sharing distributions(2)	32,522	40,650	48,952	10,985	18,170
Adjusted net income(2)	$ 681	$ 4,337	$ 4,122	$ 618	$ 1,468
Supplemental Operating Data:					
Gross merchandise volume(3)	$ 72,305	$ 89,104	$ 102,210	$ 22,346	$ 36,710
Completed transactions(4)	123,000	141,000	173,000	38,000	47,000
Total registered buyers(5)	150,000	264,000	386,000	292,000	415,000
Total auction participants(6)	552,000	671,000	848,000	197,000	225,000

The pro forma consolidated balance sheet data gives effect to the conversion of our outstanding Series C preferred stock into common stock upon the closing of this offering as if such conversion had taken place on December 31, 2005. The pro forma as adjusted consolidated balance sheet data gives effect to (1) our sale of shares of common stock in this offering at the initial public price of $10.00 per share, after deducting the underwriting discounts and commissions and estimated offering expenses payable by us, (2) the repayment of $4.4 million of our indebtedness and (3) the termination of a redemption feature related to our redeemable common stock upon the closing of this offering.

	As of December 31, 2005		
	Actual	**Pro forma**	**Pro forma as adjusted**
	(unaudited, in thousands)		
Consolidated Balance Sheet Data:			
Cash, cash equivalents and short-term investments	$ 15,196	$ 15,196	$ 55,196
Working capital(7)	5,613	5,613	46,253
Total assets	31,854	31,854	71,854
Total liabilities	18,740	18,740	14,439
Redeemable common stock(8)	708	708	
Series C preferred stock	3		
Common stock	19	22	27
Total stockholders' equity	12,406	12,406	57,415

(1) EBITDA and adjusted EBITDA are supplemental non-GAAP financial measures. GAAP means generally accepted accounting principles in the United States. EBITDA is equal to net income (loss) plus (a) interest expense and other income; (b) provision for income taxes; (c) amortization of contract intangibles; and (d) depreciation and amortization. Our definition of adjusted EBITDA is different from EBITDA because we further adjust EBITDA for: (a) stock based compensation expense; and (b) a portion of the SurplusBid.com acquisition payments, as described below under footnote 2. For a description of our use of EBITDA and adjusted EBITDA and a reconciliation of these non-GAAP financial measures to net income (loss), see the discussion and related table below.

(2) In June 2001, we acquired certain assets and assumed certain liabilities of SurplusBid.com, Inc. and its affiliates for $7.5 million, including SurplusBid.com's surplus contract with the DoD. The SurplusBid.com acquisition price was paid over 33 months in accordance with the terms of the purchase agreement. At the same time, we were awarded our current surplus contract with the DoD. Our surplus contract required monthly profit-sharing distributions under the contract to be reduced by the amount of the monthly SurplusBid.com acquisition payments. This resulted in a temporary non-recurring reduction in our profit-sharing distributions and a significant increase in our net income during the 33 month period from June 2001 to March 2004. The total amount of the SurplusBid.com acquisition payment was recorded as a note payable in our consolidated balance sheet in fiscal 2001, discounted to a present value of approximately $6.5 million. The discount of approximately $1 million was accreted as interest expense over the term of the acquisition payments.

As a result, we present two supplemental non-GAAP financial measures, adjusted profit-sharing distributions and adjusted net income, to eliminate the impact of the SurplusBid.com acquisition payments. These measures are prepared by increasing the profit-sharing distributions line item in our statements of operations by DoD's portion of the principal payments on the SurplusBid.com note payable made during each period (*i.e.*, approximately 80% of the principal payments). We do not add back the accreted interest portion of the SurplusBid.com acquisition payments when adjusting distributions and net income because the accreted interest is already included in interest expense and other income in our consolidated statements of operations. We believe adjusted profit-sharing distributions and adjusted net income are useful to investors because they eliminate an item that we do not consider indicative of our core operating performance due to its temporary, non-recurring nature. We also believe it is important to provide investors with the same metrics used by management to measure core operating performance.

The table below reconciles profit-sharing distributions and net income to such item's adjusted presentation for the periods presented.

	Year ended September 30,			Three months ended December 31,	
	2003	2004	2005(a)	2004(a)	2005(a)
				(unaudited)	
			(in thousands)		
Profit-sharing distributions	$ 30,427	$ 39,718	$ 48,952	$ 10,985	18,170
Adjustment	2,095	932			
Adjusted profit-sharing distributions	$ 32,522	$ 40,650	$ 48,952	$ 10,985	18,170
Net income	$ 2,776	$ 5,269	$ 4,122	$ 618	$ 1,468
Adjustment	(2,095)	(932)			
Adjusted net income	$ 681	$ 4,337	$ 4,122	$ 618	$ 1,468

(a) The final SurplusBid.com acquisition payment was made in March 2004 and therefore no adjustments were made in fiscal 2005 or the three months ended December 31, 2004 and 2005.

(3) Gross merchandise volume is the total sales value of all merchandise sold through our marketplaces during a given period.

(4) Completed transactions represents the number of auctions in a given period from which we have recorded revenue.

(5) Total registered buyers as of a given date represents the aggregate number of persons or entities who have registered on one of our marketplaces.

(6) For each auction we manage, the number of auction participants represents the total number of registered buyers who have bid one or more times on that auction, and total auction participants for a given period is the sum of the auction participants in each auction conducted during that period.

(7) Working capital is defined as current assets minus current liabilities.

(8) Upon the consummation of this offering and the resulting repayment of our $2.0 million subordinated note, the redemption feature related to these shares of common stock will terminate. The pro forma as adjusted consolidated balance sheet takes into account the

termination of this redemption feature, reflecting the decrease in the value recorded by us for redeemable common stock.

We believe EBITDA and adjusted EBITDA are useful to an investor in evaluating our performance for the following reasons:

The amortization of contract intangibles relate to the amortization of SurplusBid.com's surplus contract with the DoD during fiscal years 2001 to 2003, and amortization of the scrap contract beginning in June 2005. Depreciation and amortization expense primarily relates to property and equipment. Both of these expenses are non-cash charges that have significantly fluctuated over the past five years. As a result, we believe that adding back these non-cash charges to net income (loss) is useful in evaluating the operating performance of our business on a consistent basis from year-to-year.

As a result of substantial federal net operating loss carryforwards, or NOLs, we did not incur significant income tax expense until fiscal 2005. With the exhaustion of our remaining federal NOLs during fiscal 2005, we recorded federal income tax expense for the first time, thus significantly decreasing our fiscal 2005 net income relative to prior years. Consequently, we believe that presenting a financial measure that adjusts net income (loss) for provision for income taxes is useful to investors when evaluating the operating performance of our business.

During July 2001, we modified the exercise price of 3,402,794 stock options issued to employees. As a result, we are accounting for the modified stock options from the date of modification to the date the stock options are exercised, forfeited or expire unexercised using variable accounting. Under variable accounting, we revalue compensation costs for the stock options at each reporting period based on changes in the intrinsic value of the stock options. We recorded approximately $85,000, $87,000 and $1,000, respectively, in stock compensation expenses based on vesting of the fair value of the options for the years ended September 30, 2004 and 2005 and the quarter ended December 31, 2005. We will continue to revalue compensation costs for the options based on changes in the fair value of our common stock in future periods. As a result, we present a financial measure that adjusts net income (loss) and EBITDA for the stock compensation expense that results solely from the July 2001 modification of these stock options. We believe that it is useful to exclude this expense because it results from a one-time event that requires us to record expense that we are not otherwise required to record in connection with new stock options granted during the same time period.

As discussed above, the requirement under our surplus contract with the DoD for monthly profit-sharing distributions to be reduced by the monthly SurplusBid.com acquisition payments resulted in a temporary non-recurring reduction in our profit-sharing distributions and a significant increase in our net income and EBITDA during the 33 month period from July 2001 to March 2004. As a result, we believe that it is useful to exclude a portion of these profit-sharing distributions from adjusted EBITDA because the payments will not recur in future periods and were unrelated to our core operations.

We believe these measures are important indicators of our operational strength and the performance of our business because they provide a link between profitability and operating cash flow.

We also believe that analysts and investors use EBITDA and adjusted EBITDA as supplemental measures to evaluate the overall operating performance of companies in our industry.

Our management uses EBITDA and adjusted EBITDA:

as measurements of operating performance because they assist us in comparing our operating performance on a consistent basis as they remove the impact of items not directly resulting from our core operations;

for planning purposes, including the preparation of our internal annual operating budget;

to allocate resources to enhance the financial performance of our business;

to evaluate the effectiveness of our operational strategies; and

to evaluate our capacity to fund capital expenditures and expand our business.

EBITDA and adjusted EBITDA as calculated by us are not necessarily comparable to similarly titled measures used by other companies. In addition, EBITDA and adjusted EBITDA: (a) do not represent net income or cash flows from operating activities as defined by GAAP; (b) are not necessarily indicative of cash available to fund our cash flow needs; and (c) should not be considered as alternatives to net income, income from operations, cash provided by operating activities or our other financial information as determined under GAAP.

We prepare adjusted EBITDA by adjusting EBITDA to eliminate the impact of items that we do not consider indicative of our core operating performance. You are encouraged to evaluate these adjustments and the reasons we consider them appropriate for supplemental analysis. As an analytical tool, adjusted EBITDA is subject to all of the limitations applicable to EBITDA. Our presentation of adjusted EBITDA should not be construed as an implication that our future results will be unaffected by unusual or non-recurring items.

The table below reconciles net income (loss) to EBITDA and adjusted EBITDA for the periods presented.

	Year ended September 30,			**Three months ended December 31,**	
	2003	**2004**	**2005**	**2004**	**2005**
				(unaudited)	
			(in thousands)		
Net income	$ 2,776	$ 5,269	$ 4,122	$ 618	$ 1,468
Interest expense and other income, net	391	621	570	110	363
Provision for income taxes	351	541	1,166	353	979
Amortization of contract intangibles	1,862		135		203
Depreciation and amortization	465	531	586	141	153
EBITDA	5,845	6,962	6,579	1,222	3,166
Stock compensation expense		85	87	66	1
Adjustment(1)	(2,095)	(932)			
Adjusted EBITDA	$ 3,750	$ 6,115	$ 6,666	$ 1,288	$ 3,167

(1) The adjustment amount for each period equals approximately 80% of the principal payments on the SurplusBid.com note payable made during each period, as described above in footnote 2. No payments were made in fiscal 2005 or the three months ended December 31, 2004 and 2005.

RISK FACTORS

This offering involves a high degree of risk. You should carefully consider the risks described below, together with all of the other information in this prospectus, including the consolidated financial statements and related notes, before making a decision to invest in our common stock. If any of the following risks actually occurs, our business, financial condition or operating results could suffer. As a result, the trading price of our common stock could decline and you may lose all or part of your investment in our common stock.

Risks Related to Our Business

We depend on contracts with the U.S. Department of Defense for a significant portion of our revenue, and if our relationship with this customer is disrupted, we would experience a significant decrease in revenue and have difficulty generating income.

We have two material contracts with the Defense Reutilization and Marketing Service, or DRMS, under which we acquire, manage and sell surplus property of the U.S. Department of Defense, or DoD. The largest contract was awarded in June 2001 and relates to usable surplus property of the DoD turned into the DRMS and located in the United States, Puerto Rico and Guam, such as computers, electronics, office supplies, scientific and medical equipment, aircraft parts, clothing and textiles. The second contract was awarded in June 2005 and relates to substantially all scrap property of the DoD turned into the DRMS and located in the United States, such as metals, alloys and building materials. Our surplus contract accounted for approximately 95.8%, 91.0%, 87.5% and 64.3% of our revenue and 80.5%, 77.5%, 76.5% and 56.4% of our gross merchandise volume for the fiscal years ended September 30, 2003, 2004 and 2005 and for the quarter ended December 31, 2005, respectively. Our recently awarded scrap contract represented 0.4% and 21.6% of our revenue and 0.3% and 19.0% of our gross merchandise volume for the fiscal year ended September 30, 2005 and for the quarter ended December 31, 2005, respectively. We believe that these contracts will continue to be the source of a significant portion of our revenue and gross merchandise volume during their terms. The surplus contract expires in June 2008. The scrap contract became operational in August 2005 and has a seven-year base term that expires in August 2012, subject to DoD's right to extend for three additional one-year terms. The contracts were awarded by DoD through a competitive bidding process, and we may be required to go through a new competitive bidding process when our existing contracts expire.

Although our contracts with DoD do not allow DoD to terminate for convenience, each contract requires us to meet specified performance benchmarks. The contracts may be terminated by DoD if rate of return performance ratios do not exceed specified benchmark ratios for two consecutive quarterly periods and the preceding twelve months. We have never failed to meet the required benchmark ratio with respect to our surplus contract during any of the testing periods. The first testing period for the scrap contract will be the twelve month period ending on June 30, 2006. We cannot assure you that we will meet the performance benchmarks in the future. DoD also has the right, after giving us notice and a 30 day opportunity to cure, to terminate the contracts and seek other contract remedies in the event of material breaches.

If our relationship with DoD is impaired, we are not awarded new DoD contracts when our current contracts expire, any of our DoD contracts are terminated or the supply of assets under the contracts significantly decreased, we would experience a significant decrease in revenue and have difficulty generating income.

The success of our business depends on our ability to successfully obtain a supply of merchandise for our buyers and to attract and retain active professional buyers to create sufficient demand for our sellers.

Our ability to increase our revenue and maintain profitability depends on whether we can successfully expand the supply of merchandise available for sale on our online marketplaces and attract and retain active professional buyers to purchase the merchandise. Our ability to attract sufficient quantities of suitable merchandise and new buyers will depend on various factors, some of which are out of our control. These factors include our ability to:

- offer sellers liquid marketplaces for their wholesale, surplus and salvage assets;
- offer buyers a sufficient supply of merchandise;
- develop and implement effective sales and marketing strategies;
- comply with regulatory or corporate seller requirements affecting marketing and disposition of certain categories of merchandise;
- efficiently catalogue, handle, store, ship and track merchandise; and
- achieve high levels of seller and buyer satisfaction with the trading experience.

We may not be able to compete successfully against existing or future competitors.

The online services market for auctioning or liquidating wholesale, surplus and salvage assets is competitive and growing rapidly. We currently compete with:

- other e-commerce providers, such as Amazon.com, GSI Commerce and Overstock.com;
- auction websites such as eBay, Yahoo! Auctions and uBid;
- government agencies that have created websites to sell wholesale, surplus and salvage assets; and
- traditional liquidators and fixed-site auctioneers.

We expect our market to become even more competitive as traditional and online liquidators and auctioneers continue to develop online and offline services for disposition, redeployment and remarketing of wholesale, surplus and salvage assets. In addition, manufacturers, retailers and additional government agencies may decide to create their own websites to sell their own wholesale, surplus and salvage assets and those of third parties. Competitive pressures could affect our ability to attract and retain customers, which could decrease our revenue and negatively affect our operating results.

Some of our other current and potential competitors have longer operating histories, larger client bases, greater brand recognition and significantly greater financial, marketing and other resources than we do. In addition, some of these competitors may be able to devote greater financial resources to marketing and promotional campaigns, secure merchandise from sellers on more favorable terms, adopt more aggressive pricing or inventory availability policies and devote substantially more resources to website and systems development than we are able to do. Increased competition may result in reduced operating margins and loss of market share. We may not be able to compete successfully against current and future competitors.

12

If we fail to manage our growth effectively, our operating results could be adversely affected.

We have expanded our operations rapidly since our inception in 1999. In fiscal year 2005, we processed over 173,000 completed transactions, as compared to approximately 92,000 completed transactions in fiscal year 2002.

Although we currently do not have specific plans for any expansion that would require significant capital investment, in the future we plan to expand our operations further by developing new or complementary services, products, or trading formats and enhancing the breadth and depth of our value-added services. We also plan to continue to expand our sales and marketing, technology and client support organizations. In addition, we will likely need to continue to improve our financial and management controls and our reporting systems and procedures. If we are unable to effectively implement these plans and to otherwise manage our expanding operations, we may not be able to execute our business strategy and our operating results could significantly decrease.

Our business depends on the continued growth of the Internet and e-commerce.

The business of selling merchandise over the Internet, particularly through online trading, is dynamic and relatively new. Growth in the use of the Internet as a medium for consumer commerce may not continue. Concerns about fraud and privacy, increased costs of Internet service, Internet service disruptions and other problems may discourage consumers from engaging in e-commerce. In particular, many traditional buyers and sellers of wholesale, surplus and salvage goods still conduct much of their business in traditional live auctions that do not occur on the Internet, and those buyers and sellers may be hesitant to engage in e-commerce. If the e-commerce industry fails to grow or traditional buyers and sellers of wholesale, surplus and salvage assets are unwilling to conduct business on the Internet, we may be unable to attract customers, which could cause our revenue and operating results to decline.

Because we have a limited operating history, it is difficult to evaluate our business and future operating results.

We commenced operations in early 2000 and, as a result, have only a limited operating history upon which you can evaluate our business and prospects. Although we have experienced significant revenue growth in recent periods, we may not be able to sustain this growth. If we are not able to sustain this revenue growth, the value of your investment in our common stock may decline.

Our quarterly operating results have fluctuated in the past and may do so in the future, which could cause volatility in our stock price.

Our prior operating results have fluctuated due to changes in our business and the e-commerce industry. Similarly, our future operating results may vary significantly from quarter to quarter due to a variety of factors, many of which are beyond our control. You should not rely on period-to-period comparisons of our operating results as an indication of our future performance. Factors that may affect our quarterly operating results include the following:

- the addition of new buyers and sellers or the loss of existing buyers and sellers;

- the volume, size, timing and completion rate of transactions in our marketplaces;

- changes in the supply and demand for and the volume, price, mix and quality of our supply of wholesale, surplus and salvage assets;

- introduction of new or enhanced websites, services or product offerings by us or our competitors;

- implementation of significant new contracts;
- changes in our pricing policies or the pricing policies of our competitors;
- changes in the conditions and economic prospects of the e-commerce industry or the economy generally, which could alter current or prospective buyers' and sellers' priorities;
- technical difficulties, including telecommunication system or Internet failures;
- changes in government regulation of the Internet and e-commerce industry;
- event-driven disruptions such as war, terrorism, disease and natural disasters;
- seasonal patterns in selling and purchasing activity; and
- costs related to acquisitions of technology or equipment.

Our operating results may fall below the expectations of market analysts and investors in some future periods. If this occurs, even temporarily, it could cause volatility in our stock price.

Our operating results depend on our websites, network infrastructure and transaction processing systems. Service interruptions or system failures could negatively affect the demand for our services and our ability to grow our revenue.

Any system interruptions that affect our websites or our transaction systems could impair the services that we provide to our sellers and buyers. In addition, our systems may be vulnerable to damage from a variety of other sources, including telecommunications failures, power outages, malicious human acts and natural disasters. Improving the reliability and redundancy of our systems may be expensive, reduce our margins and may not be successful in preventing system failures. Our services are also substantially dependent on systems provided by third parties, over whom we have little control. We have occasionally experienced interruptions to our services due to system failures unrelated to our own systems. Any interruptions or failures of our current systems or our ability to communicate with third party systems could negatively affect the demand for our services and our ability to grow our revenue.

If we do not respond to rapid technological changes or upgrade our systems, we could fail to grow our business and our revenue could decrease.

To remain competitive, we must continue to enhance and improve the functionality and features of our e-commerce business. Although we currently do not have specific plans for any upgrades that would require significant capital investment, in the future we will need to improve and upgrade our technology, transaction processing systems and network infrastructure in order to allow our operations to grow in both size and scope. Without such improvements, our operations might suffer from unanticipated system disruptions, slow transaction processing, unreliable service levels, or impaired quality or delays in reporting accurate financial information, any of which could negatively affect our reputation and ability to attract and retain sellers and buyers. We may also face material delays in introducing new services, products and enhancements. The Internet and the e-commerce industry are rapidly changing. If competitors introduce new products and services using new technologies or if new industry standards and practices emerge, our existing websites and our proprietary technology and systems may become obsolete. In addition, the expansion and improvement of our systems and infrastructure may require us to commit substantial financial, operational and technical resources, with no assurance our business will increase. If we fail to respond to technological change or to adequately maintain, expand, upgrade and develop our systems and infrastructure in a timely fashion our ability to grow could be limited and our revenue could decrease.

Shipment of merchandise sold in our marketplaces could be delayed or disrupted by factors beyond our control and we could lose buyers and sellers as a result.

We rely upon third party carriers such as United Parcel Services, or UPS, for timely delivery of our merchandise shipments. As a result, we are subject to carrier disruptions and increased costs due to factors that are beyond our control, including labor difficulties, inclement weather, terrorist activity and increased fuel costs. In addition, we do not have a long-term agreement with UPS or any other third party carriers, and we cannot be sure that our relationship with UPS will continue on terms favorable to us, if at all. If our relationship with UPS is terminated or impaired or if UPS is unable to deliver merchandise for us, we would be required to use alternative carriers for the shipment of products to our buyers. We may be unable to engage alternative carriers on a timely basis or on terms favorable to us, if at all. Potential adverse consequences include:

- reduced visibility of order status and package tracking;
- delays in merchandise receipt and delivery;
- increased cost of shipment; and
- reduced shipment quality, which may result in damaged merchandise.

Any failure to receive merchandise at our distribution centers or deliver products to our buyers in a timely and accurate manner could lead to client dissatisfaction and cause us to lose sellers and buyers.

A significant interruption in the operations of our customer service system or our distribution centers could harm our business and operating results.

Our business depends, to a large degree, on effective customer service and distribution center operations. We currently manage DoD warehouse distribution space, for which we do not incur leasing costs as well as leased commercial warehouse distribution space. These operations could be harmed by several factors, including any material disruption or slowdown at our distribution centers resulting from labor disputes, changes in the terms of our underlying lease agreements or occupancy arrangements in the case of government provided facilities, telecommunications failures, power or service outages, human error, terrorist attacks, natural disasters or other events. In addition, space provided to us by DoD could be re-configured or reduced as a result of DoD's Base Relocation and Closure initiative or other infrastructure reduction initiatives. A disruption in our customer service and distribution operations could cause us to lose sellers and buyers, decrease our revenue and harm our operating results.

If our transaction models are not accepted by our clients or alternative transaction models are developed, we could lose clients and our revenue and our profitability could decline.

Our services are offered to sellers using the following two primary transaction models:

- consignment (in which we charge the seller a commission); and
- profit-sharing (in which we purchase merchandise from sellers and share profits).

We also collect a buyer's premium on substantially all completed transactions and may engage in outright purchases of client inventory. It is possible that new transaction models that are not compatible with our business model or our marketplaces may be developed and gain widespread acceptance. Alternative transaction models could cause our revenue and margins to decline. In addition, if current and potential customers do not recognize the benefits of our transaction models, activity in our marketplaces may decline or develop more slowly than we expect, which may limit our ability to grow our revenue or cause our revenue to decline.

If we fail to accurately predict our ability to sell merchandise in which we take inventory risk and credit risk, our margins may decline as a result of lower sale prices from such merchandise.

Under our profit-sharing model, we purchase merchandise and assume the risk that the merchandise may sell for less than we paid for it. In addition, we occasionally engage in transactions with sellers in which we purchase merchandise without a profit-sharing component. In each case, we assume general and physical inventory and credit risk. These risks are especially significant because some of the goods we sell on our websites are characterized by rapid technological change, obsolescence and price erosion, and because we sometimes make large purchases of particular types of inventory. In addition, we do not receive warranties on the goods we purchase and, as a result, we have to resell or dispose of any returned goods. Historically, the number of disposed goods (which includes returned goods that we have not resold) has been less than 2% of the goods we have purchased.

To manage our inventory successfully, we need to maintain sufficient buyer demand and sell merchandise for a reasonable financial return. We may miscalculate buyer demand and overpay for the acquired merchandise. In the event that merchandise is not attractive to our buyer base, we may be required to take significant losses resulting from lower sale prices, which could reduce our revenue and margins. For example, under our DoD surplus contract, we are obligated to purchase all DoD surplus property at set prices representing a percentage of the original acquisition cost, which varies depending on the type of surplus property being purchased. When we resell property under the contract, we are entitled to approximately 20% of the profits of sale (defined as gross proceeds of sale less allowable operating expenses) and DoD is entitled to approximately 80% of the profits. Historically, the cost of inventory has been approximately 5% of the gross merchandise volume under our profit-sharing model. Occasionally, we are not able to sell our inventory for amounts above its cost and we may incur a loss. As we grow our business, we may choose to increase the amount of merchandise we purchase directly from sellers, thus resulting in increased inventory levels and related risk. Any such increase would require the use of additional working capital and subject us to the additional risk of incurring losses on the sale of that inventory.

We may be unable to adequately protect or enforce our intellectual property rights, which could harm our reputation and negatively impact the growth of our business.

We regard our intellectual property, particularly domain names, copyrights and trade secrets, as critical to our success. We rely on a combination of contractual restrictions and copyright and trade secret laws to protect our proprietary rights, know-how, information and technology. Despite these protections, it may be possible for a third party to copy or otherwise obtain and use our intellectual property without authorization or independently develop similar intellectual property.

We currently are the registered owners of several Internet domain names, including *www.liquidation.com*, *www.govliquidation.com*, *www.uksurplus.com* and *www.goWholesale.com*. We pursue the registration of our domain names in the U.S. and internationally. We currently do not have any patents or registered copyrights, trademarks or service marks, but we may pursue patents or registration of such intellectual property in the future. Effective patent, copyright, trademark, service mark, trade secret and domain name protection is expensive to maintain and may require litigation. We seek to protect our domain names in an increasing number of jurisdictions and may not be successful in certain jurisdictions. Our competitors may adopt trade names or domain names similar to ours, thereby impeding our ability to promote our marketplaces and possibly leading to client confusion. In addition, there could be potential trade name or trademark or service mark infringement claims brought by owners of other registered or unregistered trademarks or service marks, including trademarks or service marks that may incorporate variations of our marketplace names. Any claims related to our intellectual property or client confusion related to our marketplaces could damage our reputation and negatively impact the growth of our business.

Our inability to use software licensed from third parties or our use of open source software under license terms that interfere with our proprietary rights could disrupt our business.

We use software licensed from third parties, including some software, known as open source software, that we use without charge. We currently use the following open source software: Linux (an operating system), MySql (database software), PERL (an interpreter) and Apache (a web server), and we may in the future use additional open source software. In the future, these licenses to third party software may not be available on terms that are acceptable to us, or at all. Our inability to use third-party software could result in disruptions to our business, or delays in the development of future services or enhancements of existing services, which could impair our business. In addition, the terms of certain open source software licenses may require us to provide modified versions of the open source software, which we develop, if any, or any proprietary software that incorporates all or a portion of the open source software, if any, to others on unfavorable license terms that are consistent with the open source license term. If we are required to license our proprietary software in accordance with the foregoing, our competitors and other third parties could obtain access to our intellectual property, which could harm our business.

Assertions that we infringe on intellectual property rights of others could result in significant costs and substantially harm our business and operating results.

Other parties may assert that we have infringed their technology or other intellectual property rights. We use internally developed systems and licensed technology to operate our online auction platform and related websites. Third parties could assert intellectual property infringement claims against us based on our internally developed systems or use of licensed third party technology. Third parties also could assert intellectual property infringement claims against parties from whom we license technology. If we are forced to defend against any infringement claims, whether they are with or without merit or are determined in our favor, we may face costly litigation, diversion of technical and management personnel and/or delays in completion of sales. Furthermore, the outcome of a dispute may be that we would need to change technology, develop non-infringing technology or enter into royalty or licensing agreements. A switch to different technology could cause interruptions in our business. Internal development of a non-infringing technology may be expensive and time-consuming, if we are able to successfully develop such technology at all. Royalty or licensing agreements, if required, may be unavailable on terms acceptable to us, or at all.

If we do not retain our senior management, we may not be able to achieve our business objectives.

Our future success is substantially dependent on the continued service of our senior management, particularly William P. Angrick, III, our chief executive officer, Jaime Mateus-Tique, our chief operating officer, and Benjamin Brown, chairman of our LSI Technology Advisory Committee and chief technology officer of our Government Liquidation subsidiary. We do not have key-person insurance on any of our officers or employees. The loss of any member of our existing senior management team could damage key seller relationships, result in the loss of key information, expertise or know-how, lead to unanticipated recruitment and training costs and make it more difficult to successfully operate our business and achieve our business goals.

If we are unable to attract and retain skilled employees, we might not be able to sustain our growth.

Our future success depends on our ability to continue to attract, retain and motivate highly skilled employees, particularly employees with sales, marketing, operations and technology expertise. Competition for employees in our industry is intense. We have experienced difficulty from time to time in attracting the personnel necessary to support the growth of our business, and we may experience similar difficulties in the future. If we are unable to attract, assimilate and retain employees with the necessary skills, we may not be able to grow our business and revenue.

Unfavorable government audit results could force us to adjust previously reported operating results and could subject us to a variety of penalties and sanctions.

The U.S. federal government has the right to audit and review our performance on our government contracts, as well as our compliance with applicable laws and regulations. Although we have not had any unfavorable government audit results, any adverse findings from future audits or reviews could result in a significant adjustment to our previously reported operating results. For example, our DoD contracts provide that we share sales profits with the government. The federal government may disagree with our calculation of the profits realized from the sales of government surplus assets and may require us to increase profit-sharing payments to the government. If this occurs, our operating margins may be reduced.

If a government audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines, and suspension or debarment from doing business with U.S. federal government agencies. In addition, we could suffer serious harm to our reputation if allegations of impropriety are made against us, whether or not true. If we are suspended or debarred from contracting with the federal government generally, or any specific agency, if our reputation or relationship with government agencies is impaired, or if the government otherwise ceases doing business with us or significantly decreases the amount of business it does with us, our revenue and profitability would substantially decrease.

Our international operations subject us to additional risks and challenges that could harm our business and our profitability.

We have begun expanding internationally, and in the future we may do so more aggressively. For both the fiscal year 2005 and the quarter ended December 31, 2005, international operations accounted for less than 4% of our revenue. International operations subject us to additional risks and challenges, including:

- the need to develop new seller and buyer relationships;
- difficulties and costs of staffing and managing foreign operations;
- changes in and differences between domestic and foreign regulatory requirements;
- price controls and foreign currency exchange rate fluctuations;
- difficulties in complying with export restrictions and import permits;
- reduced protection for intellectual property rights in some countries;
- potentially adverse tax consequences;
- lower per capita Internet usage and lack of appropriate infrastructure to support widespread Internet usage;
- political and economic instability; and
- tariffs and other trade barriers.

We cannot assure you that we will be successful in our efforts in foreign countries. Some of these factors may cause our international costs to exceed our domestic costs of doing business. Failure to adequately address these risks could decrease our profitability and operating results.

We may make acquisitions that require significant resources and could be unsuccessful.

In the future, we may acquire other businesses, products and technologies to complement our current business. We may not be able to identify, negotiate, finance, complete or integrate any future acquisition successfully. Acquisitions involve a number of risks, including possible adverse effects on our operating results, diversion of management's attention, inability to retain key employees of the acquired business and risks associated with unanticipated events or liabilities, some or all of which could disrupt our business and reduce the likelihood that we will receive the anticipated benefits of the acquisition in the amount or the time frame that we expect.

Should we be unable successfully to integrate a new business, we could be required either to dispose of the operation or restructure the operation. In either event, our business could be disrupted and we would not achieve the anticipated benefits of the acquisition. In addition, future transactions could result in potentially dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities or amortization of expenses, or write-offs of goodwill, any of which could harm our financial condition and operating results. Future transactions may also require us to obtain additional financing, which may not be available on favorable terms or at all.

We may need additional financing in the future, which may not be available on favorable terms, if at all.

We may need additional funds to finance our operations, as well as to enhance our services, fund our expansion, respond to competitive pressures or acquire complementary businesses or technologies. However, our business may not generate the cash needed to finance such requirements. If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our existing stockholders would be reduced, and these securities may have rights, preferences or privileges senior to those of our common stock. If adequate funds are not available or are not available on acceptable terms, our ability to enhance our services, fund our expansion, respond to competitive pressures or take advantage of business opportunities would be significantly limited, and we might need to significantly restrict our operations.

We face legal uncertainties relating to the Internet in general and to the e-commerce industry in particular and may become subject to costly government regulation.

The laws and regulations related to the Internet and e-commerce are evolving. These laws and regulations relate to issues such as user privacy, freedom of expression, pricing, fraud, quality of products and services, taxation, advertising, intellectual property rights and information security. Laws governing issues such as property ownership, copyrights and other intellectual property issues, taxation, libel and defamation, obscenity and personal privacy could also affect our business. Laws adopted prior to the advent of the Internet may not contemplate or address the unique issues of the Internet and related technologies and it is not clear how they will apply. Current and future laws and regulations could increase our cost of doing business and/or decrease the demand for our services.

Our auction business may be subject to a variety of additional costly government regulations.

Many states and other jurisdictions have regulations governing the conduct of traditional "auctions" and the liability of traditional "auctioneers" in conducting auctions, which may apply to online auction services. In addition, certain states have laws or regulations that expressly apply to online auction services. We expect to incur costs in complying with these laws and could be subject to fines or other penalties for any failure to comply with these laws. We may be required to make changes in our business to comply with these laws, which could increase our costs, reduce our revenue, cause us to prohibit the listing of certain items, or otherwise adversely affect our financial condition or operating results.

In addition, the law regarding the potential liability of an online auction service for the activities of its users is not clear. We cannot assure you that users of our websites will comply with our terms and conditions or with laws and regulations applicable to them and their transactions. It is possible that we may be subject to allegations of civil or criminal liability for any unlawful activities conducted by sellers or buyers. Any costs we incur as a result of any such allegations, or as a result of actual or alleged unlawful transactions using our marketplaces, or in our efforts to prevent any such transactions, may harm our opportunities for future revenue growth. In addition, any negative publicity we receive regarding any such transactions or allegations may damage our reputation, our ability to attract new sellers and buyers and our business.

Certain categories of merchandise sold on our marketplaces are subject to government restrictions.

We sell merchandise, such as scientific instruments, information technology equipment and aircraft parts, that is subject to export control and economic sanctions laws, among other laws, imposed by the United States and other governments. Such restrictions include the U.S. Export Administration Regulations, the International Traffic in Arms Regulations, and economic sanctions and embargo laws administered by the Office of the Foreign Assets Control Regulations. These restrictions prohibit us from, among other things, selling property to (1) persons or entities that appear on lists of restricted or prohibited parties maintained by the United States or other governments or (2) countries, regimes, or nationals that are the target of applicable economic sanctions or other embargoes. In addition, for specified categories of property sold under our contracts with the DoD, we are required to (1) obtain an end-use certificate from the prospective buyer describing the nature of the buyer's business, describing the expected disposition and specific end-use of the property, and acknowledging the applicability of pertinent export control and economic sanctions laws and (2) confirm that each buyer has been cleared to purchase export-controlled items.

We may incur significant costs or be required to modify our business to comply with these requirements. If we are alleged to have violated any of these laws or regulations we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines, and suspension or debarment from doing business with U.S. federal government agencies. In addition, we could suffer serious harm to our reputation if allegations of impropriety are made against us, whether or not true.

Our business may be harmed if third parties misappropriate our clients' confidential information.

We retain highly confidential information on behalf of our clients in our systems and databases. Although we maintain security features in our systems, our operations may be susceptible to hacker interception, break-ins and other disruptions. These disruptions may jeopardize the security of information stored in and transmitted through our systems. We may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches. These issues are likely to become more difficult as we expand our operations. If any compromise of our security were to occur, we may lose clients and our reputation, business, financial condition and operating results could be harmed by the misappropriation of confidential client information. In addition, if there is any perception that we cannot protect our clients' confidential information, we may lose the ability to attract new clients and our revenue could decline.

If we fail to comply with increasing levels of regulation relating to privacy, our business could suffer harm.

We are subject to increasing regulation at the federal, state and international levels relating to privacy and the use of personal user information. In addition, several states have proposed or enacted legislation to limit uses of personal information gathered online or require online services to establish privacy policies. Data protection regulations and enforcement efforts may restrict our ability to collect demographic and personal information from users, which could be costly or harm our marketing efforts. Such regulations, along with increased government or private enforcement, may increase the cost of growing our business and require us to expend significant capital and other resources. Our failure to comply with these federal, state and international laws and regulations could subject us to lawsuits, fines, criminal penalties, statutory damages, adverse publicity and other costs could decrease our profitability.

If one or more states successfully assert that we should collect sales or other taxes on the sale of our merchandise or the merchandise of third parties that we offer for sale on our websites, our business could be harmed.

We are currently required to pay sales taxes in all states for shipment of goods from our DoD contracts. We also pay sales or other similar taxes in respect of shipments of other goods into states in which we have a substantial presence. In addition, as we grow our business, any new operation in states in which we currently do not pay sales taxes could subject shipments into such states to state sales taxes under current or future laws.

In November 2004, the federal government passed legislation placing a three-year ban on state and local governments' imposition of new taxes on Internet access or electronic commerce transactions. This ban does not prohibit federal, state or local authorities from collecting taxes on our income or from collecting taxes that are due under existing tax rules. Unless the ban is extended, state and local governments may begin to levy additional taxes on Internet access and electronic commerce transactions upon the legislation's expiration in November 2007. An increase in taxes may make electronic commerce transactions less attractive for merchants and businesses, which could result in a decrease in the level of demand for our services.

Currently, decisions of the U.S. Supreme Court restrict the imposition of obligations to collect state and local sales and use taxes with respect to sales made over the Internet. However, a number of states, as well as the U.S. Congress, have been considering various initiatives that could limit or supersede the Supreme Court's position regarding sales and use taxes on Internet sales. If any of these initiatives resulted in a reversal of the Supreme Court's current position, we could be required to collect sales and use taxes in states other than states in which we currently pay such taxes. A successful assertion by one or more local, state or foreign jurisdictions that the sale of merchandise by us is subject to sales or other taxes, could subject us to material liabilities and increase our costs of doing business. To the extent that we pass such costs on to our clients, could harm our business and decrease our revenue.

Fraudulent activities involving our websites and disputes relating to transactions on our websites may cause us to lose clients and affect our ability to grow our business.

We are aware that other companies operating online auction or liquidation services have periodically received complaints of fraudulent activities of buyers or sellers on their websites, including disputes over the quality of goods and services, unauthorized use of credit card and bank account information and identity theft, potential breaches of system security, and infringement of third-party copyrights, trademarks and trade names or other intellectual property rights. We may receive similar complaints if sellers or buyers trading in our marketplaces are alleged to have engaged in fraudulent or unlawful activity. In addition, we may suffer losses as a result of purchases paid for with fraudulent credit card data even though the associated financial institution approved payment. In the case of disputed transactions, we may not be able to require users of our services to fulfill their obligations to make payments or to deliver goods. We also may receive complaints from buyers about the quality of purchased goods, requests for reimbursement, or communications threatening or commencing legal actions against us. Negative publicity generated as a result of fraudulent conduct by third parties or the failure to satisfactorily settle disputes related to transactions on our websites could damage our reputation, cause us to lose clients and affect our ability to grow our business.

False or defamatory statements transmitted through our services could harm our reputation and affect our ability to attract clients.

The law relating to the liability of online services companies for information carried on or disseminated through their services is currently unsettled. Claims could be made against online services companies under both the U.S. and foreign law for defamation, libel, invasion of privacy, negligence, copyright or trademark infringement, or other theories based on the nature and content of the materials disseminated through their services. Our goWholesale.com website allows users to make comments regarding the online auction industry in general and other users and their merchandise in particular. Although all such comments are generated by users and not by us, we are aware that claims of defamation or other injury have been made against other companies operating auction services in the past and could be made in the future against us for comments made by users. If we are held liable for information provided by our users and carried on our service, we could be directly harmed and may be forced to implement measures to reduce our liability. This may require us to expend substantial resources or discontinue certain service offerings, which could negatively affect our operating results. In addition, the increased attention focused upon liability issues as a result of these lawsuits and legislative proposals could harm our reputation and affect our ability to attract clients.

Risks Related to This Offering

We cannot assure you that a market will develop for our common stock or what the market price of our common stock will be.

Before this offering, there was no public trading market for our common stock, and we cannot assure you that one will develop or be sustained after this offering. The initial public offering price is determined by negotiations between the underwriters and us, and may bear no relationship to the price at which the common stock will trade upon completion of the offering. You may not be able to resell your shares above the initial public offering price and may suffer a loss on your investment.

Our stock price may be volatile and your investment in our common stock could suffer a decline in value.

The market prices of the securities of e-commerce companies and for initial public offerings have been extremely volatile and have overall declined significantly since early 2000. Broad market and industry factors may adversely affect the market price of our common stock, regardless of our actual operating performance. Factors that could cause fluctuation in the stock price may include, among other things:

- actual or anticipated variations in quarterly operating results;
- changes in financial estimates by us or by a securities analyst who covers our stock;
- publication of research reports about our company or industry;
- conditions or trends in our industry;
- stock market price and volume fluctuations of other publicly traded companies and, in particular, those whose business involves the Internet and e-commerce;
- announcements by us or our competitors of significant contracts, acquisitions, commercial relationships, strategic partnerships or divestitures;
- announcements by us or our competitors of technological innovations, new services or service enhancements;

- announcements of investigations or regulatory scrutiny of our operations or lawsuits filed against us;
- the passage of legislation or other regulatory developments that adversely affect us, our clients or our industry;
- additions or departures of key personnel;
- sales of our common stock, including sales of our common stock by our directors and officers or specific stockholders; and
- general economic conditions and slow or negative growth of related markets.

Volatility in the market price of shares may prevent investors from being able to sell their shares of common stock at or above our initial public offering price. In the past, securities class action litigation has often been instituted against companies following periods of volatility in their stock price. This type of litigation could result in substantial costs and divert our management's attention and resources.

Future sales of our common stock could cause our stock price to decline.

Upon completion of this offering, our existing stockholders will beneficially own approximately 19.6 million shares of our common stock, which will be approximately 72% of our outstanding common stock. We and our officers, directors and our existing stockholders representing substantially all of our shares are subject to the lock-up agreements described in the "Underwriting" section and a lock-up period of 180 days after the date of this prospectus. After the expiration of this 180-day period, approximately 19.3 million of the shares of common stock subject to the lock-up agreements will be eligible for sale in the public market pursuant to Rule 144 under the Securities Act of 1933, or the Securities Act. Friedman, Billings, Ramsey & Co., Inc. and RBC Capital Markets Corporation, on behalf of the underwriters, may release our directors, officers and stockholders from their lock-up agreements with the underwriters at any time and without notice, which would allow for earlier sale of shares in the public market. If our stockholders sell, or the market perceives that our stockholders intend to sell, substantial amounts of our common stock in the public market following this offering, the market price of our common stock could decline. These sales, or the perception that these sales could occur, might also make it more difficult for you to sell your shares at a time and price that you deem appropriate and for us to sell additional equity securities at a time and price that we deem appropriate.

In addition to the foregoing, we had options and warrants to purchase approximately 245,000 shares of common stock outstanding and exercisable as of December 31, 2005. We intend to register the shares of common stock issuable or reserved for issuance under our equity plans within 180 days after the date of this prospectus.

Purchasers in this offering will experience immediate and substantial dilution in the book value of their investment.

Prior investors have paid substantially less per share than the price in this offering. The initial public offering price is substantially higher than the pro forma net tangible book value per share of the outstanding common stock immediately after this offering. As a result, investors purchasing our common stock in this offering will incur immediate dilution of $8.23 per share. To the extent that all of our options and warrants outstanding as of December 31, 2005 were exercised, investors purchasing common stock in this offering would incur immediate dilution of $8.15 per share. Future equity issuances at prices below the initial public offering price would result in further dilution to purchasers in this offering. For a further description of the dilution that investors purchasing common stock in this offering will experience, please see "Dilution."

Insiders will continue to have substantial control over us after this offering, which could limit your ability to influence the outcome of key transactions, including a change in control.

Our principal stockholders, directors and executive officers and entities affiliated with them will own approximately 68% of the outstanding shares of our common stock after this offering. As a result, these stockholders, acting together, would be able to influence or control matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other extraordinary transactions. These stockholders may have interests that differ from yours and may vote in a way with which you disagree and which may be adverse to your interest. The concentration of ownership could have the effect of delaying, preventing or deterring a change in control of our company, could deprive our stockholders of an opportunity to receive a premium for their common stock as part of a sale of our company and could ultimately affect the market price of our common stock.

Our costs will increase significantly as a result of operating as a public company, and our management will be required to devote substantial time to comply with public company regulations.

We have never operated as a public company. As a public company, we will incur significant legal, accounting and other expenses that we did not incur as a private company. These expenses are associated with our public company reporting requirements and recently adopted corporate governance requirements, including requirements under the Sarbanes-Oxley Act of 2002, as well as new rules implemented by the SEC, the Public Company Accounting Oversight Board and the Nasdaq National Market, or Nasdaq. We expect these rules and regulations to increase our legal and financial compliance costs and to make some activities more time-consuming and costly. We also expect these rules and regulations may make it more difficult and more expensive for us to obtain director and officer liability insurance. As a result, it may be more difficult for us to attract and retain qualified individuals to serve on our board of directors or as executive officers. We cannot predict or estimate the amount of additional costs we may incur as a public company or the timing of such costs.

Our disclosure controls and procedures may not prevent or detect all errors or acts of fraud.

Upon completion of this offering, we will become subject to the periodic reporting requirements of the Securities Exchange Act of 1934, or the Exchange Act. Our disclosure controls and procedures are designed to reasonably assure that information required to be disclosed by us in reports we file or submit under the Exchange Act is accumulated and communicated to management, recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. We believe that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by an unauthorized override of the controls. Accordingly, because of the inherent limitations in our control system, misstatements due to error or fraud may occur and not be detected.

Because we have operated as a private company, we have limited experience attempting to comply with public company obligations, including Section 404 of the Sarbanes-Oxley Act of 2002.

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the SEC has adopted rules requiring public companies to include a report of management on the company's internal controls over financial reporting in their annual reports on Form 10-K. In addition, the public accounting firm auditing a public company's financial statements must attest to and report on management's assessment of the effectiveness of the company's internal controls over financial reporting. These requirements will first apply to our annual report on Form 10-K for our fiscal year ending on September 30, 2007.

We currently do not have an internal audit group, and we will need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge. Also, we may in the future discover areas of our internal controls that need improvement. We cannot be certain that any remedial measures we take will ensure that we implement and maintain adequate controls over our financial processes and reporting in the future. Any failure to implement required new or improved controls, or difficulties encountered in their implementation could harm our operating results or cause us to fail to meet our reporting obligations. If we are unable to conclude that we have effective internal controls over financial reporting, or if our independent auditors are unable to provide us with an unqualified report as to the effectiveness of our internal controls over financial reporting as of September 30, 2007 and future year ends as required by Section 404, investors could lose confidence in the reliability of our financial statements, which could result in a decrease in the value of our common stock. Failure to comply with Section 404 could potentially subject us to sanctions or investigations by the SEC, Nasdaq or other regulatory authorities.

We will have broad discretion over the use of proceeds from this offering, and we may not use these proceeds effectively, which could affect our operating results and cause our stock price to decline.

We will have broad discretion to use the net proceeds to us from this offering, and you will be relying on the judgment of our board of directors and management regarding the application of these proceeds. Although we expect to use a portion of the net proceeds from this offering for working capital, general corporate purposes, and possible future acquisitions, we have not allocated these net proceeds for specific purposes or acquisitions. It is possible that the net proceeds will be invested in a way that does not yield a favorable, or any, return for our company and that we will not be able to find suitable acquisition candidates at attractive prices.

Some provisions of our charter, bylaws and Delaware law inhibit potential acquisition bids that you may consider favorable.

Our corporate documents and Delaware law contain provisions that may enable our board of directors to resist a change in control of our company even if a change in control were to be considered favorable by you and other stockholders. These provisions include:

- a staggered board of directors;
- a prohibition on actions by our stockholders by written consent;
- limitations on persons authorized to call a special meeting of stockholders;
- the authorization of undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval;
- advance notice procedures required for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders; and
- the requirement that board vacancies be filled by a majority of our directors then in office.

These provisions could discourage, delay or prevent a transaction involving a change in control of our company. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors of your choosing and cause us to take other corporate actions you desire.

FORWARD-LOOKING STATEMENTS

This prospectus 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 those listed under "Risk Factors" and elsewhere in this prospectus. 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 are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this prospectus. Important factors that could cause our actual results to differ materially from those expressed as forward-looking statements are set forth in this prospectus, including but not limited to those under the heading "Risk Factors." 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 prospectus and are expressly qualified in their entirety by the cautionary statements included in this prospectus. 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 prospectus or to reflect the occurrence of unanticipated events.

USE OF PROCEEDS

The net proceeds from our sale of 5,000,000 shares of common stock in this offering will be approximately $44.4 million, after deducting underwriting discounts and commissions and estimated offering expenses, payable by us. We will not receive any proceeds from the sale of shares by selling stockholders. We intend to use approximately $2.4 million and $2.0 million of the net proceeds from this offering to repay amounts outstanding under our senior credit facility and our subordinated note, respectively.

The senior credit facility bears an annual interest rate of LIBOR plus 2.25% and terminates in July 2007. In June 2005, we borrowed approximately $2.0 million under the credit facility. We used this amount, together with available cash, to acquire a wholesale industry portal, Wholesale411.com, and to fund the costs incurred by us in procuring our DoD scrap contract.

In May 2003, we issued our subordinated note in exchange for $2.0 million in cash. The subordinated note is due in May 2008 and bears an annual interest rate of 12%.

We intend to use the remaining net proceeds from this offering for working capital, general corporate purposes and possible future acquisitions.

The amounts that we actually expend for working capital and other general corporate purposes will vary significantly depending on a number of factors, including future revenue growth, if any, and the amount of cash that we generate from operations. As a result, we will retain broad discretion over the allocation of the net proceeds of this offering. We also may use a portion of the net proceeds for the acquisition of businesses, products or technologies that we could utilize in expanding our online auction business or our wholesale industry portal. We periodically review acquisitions and strategic investment opportunities that are related to our business, and we believe that it is desirable to have funds on hand so that we have the ability to make acquisitions and strategic investments promptly. As of the date of this prospectus, we have no arrangements, agreements or commitments for acquisitions of any businesses, products or technologies, and we can give no assurance that we will be able to consummate any acquisitions or strategic investments or that if consummated such acquisitions or investments would be on terms that are favorable to us.

Pending these uses, we will invest the net proceeds of this offering in short-term interest bearing investment grade securities.

DIVIDEND POLICY

We currently anticipate that we will retain any future earnings for use in our business. As a result, we do not anticipate paying any cash dividends in the foreseeable future. Any determination to pay dividends in the future will be at the discretion of our board of directors and will depend upon, among other factors, our results of operations, financial condition, capital requirements and restrictions contained in future financing instruments.

In connection with our Series C preferred stock financing in September 2004, we declared and paid a special dividend in the aggregate amount of approximately $20 million to all holders of our common stock and our Series A and Series B preferred stock. Each holder of common stock was paid a dividend of $1.05 per share.

CASH AND CAPITALIZATION

The following table sets forth our cash and cash equivalents and our capitalization as of December 31, 2005:

- on an actual basis;
- on a pro forma basis to give effect to the conversion of our outstanding Series C preferred stock into common stock upon the closing of this offering; and
- on a pro forma as adjusted basis to give effect to (1) our sale of shares of common stock in this offering at the initial public offering price of $10.00 per share, after deducting the underwriting discounts and commissions and estimated offering expenses payable by us, (2) the repayment of $4.4 million of our indebtedness and (3) the termination of a redemption feature related to our redeemable common stock upon the closing of this offering.

You should read this table together with the information under the headings "Selected Consolidated Financial Data" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" as well as the audited consolidated financial statements and related notes contained elsewhere in this prospectus.

	As of December 31, 2005		
	Actual	**Pro forma**	**Pro forma as adjusted**
	(unaudited, in thousands)		
Cash and cash equivalents	$ 15,196	$ 15,196	$ 55,196
Total debt and capital lease obligations, including current portion	4,476	4,476	175
Redeemable common stock(1)	708	708	
Stockholders' equity:			
Series C preferred stock with a $20,000,000 liquidation preference, $.001 par value; 3,262,643 shares authorized; 3,262,643 shares issued and outstanding, actual; none issued and outstanding, pro forma and pro forma as adjusted	3		
Common stock, $0.001 value; 26,737,357 shares authorized; 19,066,911 shares issued and outstanding, actual; 22,329,554 shares issued and outstanding, pro forma; and 27,329,554 shares issued and outstanding, pro forma as adjusted	19	22	27
Additional paid-in capital	9,450	9,450	53,845
Accumulated other comprehensive loss	(67)	(67)	(67)
Retained earnings	3,001	3,001	3,610
Total stockholders' equity	12,406	12,406	57,415
Total capitalization	$ 17,590	$ 17,590	$ 57,590

(1) Upon the closing of this offering and the resulting repayment of our $2.0 million subordinated note, the redemption feature related to these shares of common stock will terminate. The pro forma as adjusted consolidated balance sheet takes into account the termination of this redemption feature, reflecting the decrease in the value recorded by us for redeemable common stock.

The table above excludes the following shares of common stock:

- 50,000 shares issuable upon the exercise of outstanding warrants at a weighted average exercise price of $2.50 per share;

- 1,203,845 shares issuable upon the exercise of outstanding stock options at a weighted average exercise price of $3.71 per share; and

- 264,886 shares available for future issuance under our 2005 Stock Option and Incentive Plan.

DILUTION

Dilution is the amount by which the initial offering price paid by the purchasers of common stock in this offering exceeds the net tangible book value per share of common stock following this offering. Our pro forma net tangible book value per share represents our pro forma tangible assets, or total assets less intangible assets, less our total liabilities, divided by the number of shares of our common stock outstanding as of December 31, 2005 after giving effect to the conversion of our outstanding Series C preferred stock into common stock. As of December 31, 2005 our pro forma net tangible book value was approximately $4.0 million or $0.18 per share of common stock.

After giving effect to (1) the sale of 5,000,000 shares of common stock by us at the initial public offering price of $10.00 per share, after deducting the underwriting discounts, commissions and estimated offering expenses payable by us, and (2) the repayment of $4.4 million of our indebtedness, our pro forma as adjusted net tangible book value at December 31, 2005 would have been approximately $48.5 million or $1.77 per share of common stock. After giving effect to the offering, our pro forma as adjusted net tangible book value represents an immediate increase in the pro forma net tangible book value of $1.59 per share to existing stockholders and an immediate dilution in the pro forma as adjusted net tangible book value of $8.23 per share to the investors who purchase our common stock in this offering.

The following table illustrates this per share dilution:

Initial public offering price per share		$ 10.00
Pro forma net tangible book value per share as of December 31, 2005	$ 0.18	
Increase in pro forma net tangible book value per share attributable to this offering	1.59	
Pro forma net tangible book value per share as adjusted after this offering		1.77
Dilution per share to new investors		$ 8.23

The following table summarizes, on a pro forma as adjusted basis as of December 31, 2005, the difference between existing stockholders and new investors with respect to the number of shares of common stock purchased from us, the total consideration paid to us and the average price per share paid by our existing stockholders and by the investors purchasing shares of common stock in this offering. The calculation below is based on the initial public offering price of $10.00 per share before deducting underwriting discounts and commissions and estimated offering expenses payable by us.

	Shares purchased		Total consideration		Average price per share
	Number	Percent	Number	Percent	
Existing stockholders	22,329,554	82%	$ 20,833,079	29%	$ 0.93
New investors	5,000,000	18	50,000,000	71	10.00
Total	27,329,554	100%	$ 70,833,079	100%	$ 2.59

The share amounts in this table exclude:

50,000 shares issuable upon the exercise of outstanding warrants at a weighted average exercise price of $2.50 per share;

1,203,845 shares issuable upon the exercise of outstanding stock options at a weighted average exercise price of $3.71 per share; and

264,886 shares available for future issuance under our 2005 Stock Option and Incentive Plan.

If all of our outstanding options and warrants as of December 31, 2005 had been exercised, the pro forma as adjusted net tangible book value per share after this offering would be $1.85 per share, representing an immediate increase in net tangible book value of $1.67 per share to our existing stockholders and an immediate dilution in the net tangible book value to our new investors of $8.15.

If the underwriters exercise their over-allotment option in full, the number of shares held by new investors will increase to 8,840,466, or 32% of the total number of shares of common stock outstanding after this offering.

SELECTED CONSOLIDATED FINANCIAL DATA

You should read the following selected consolidated financial data together with our consolidated financial statements and the related notes, and with "Management's Discussion and Analysis of Financial Condition and Results of Operations," included elsewhere in this prospectus. The consolidated statement of operations data for the years ended September 30, 2003, 2004 and 2005 are derived from, and are qualified by reference to, our consolidated financial statements that have been audited by Ernst & Young LLP, an independent registered public accounting firm, and that are included in this prospectus. The consolidated statement of operations data for the three months ended December 31, 2004 and 2005, and the consolidated balance sheet data as of December 31, 2005, are derived from, and are qualified by reference to, our unaudited consolidated financial statements that are included in this prospectus. The consolidated statement of operations data for the nine months ended September 30, 2001 and for the year ended September 30, 2002, and the consolidated balance sheet data as of September 30, 2001, 2002 and 2003 are derived from our audited consolidated financial statements that are not included in this prospectus.

	Nine months ended September 30,	Year ended September 30,				Three months ended December 31,	
	2001	2002	2003	2004	2005	2004	2005
						(unaudited)	
	(dollars in thousands, except per share data)						
Consolidated Statement of Operations Data:							
Revenue	$ 7,050	$ 44,463	$ 60,719	$ 75,869	$ 89,415	$ 19,817	$ 32,207
Costs and expenses:							
Cost of goods sold (excluding amortization)	628	4,876	4,481	5,743	6,288	1,296	2,367
Profit-sharing distributions	2,000	17,717	30,427	39,718	48,952	10,985	18,170
Technology and operations	2,865	9,849	10,358	12,814	14,696	3,434	4,055
Sales and marketing	2,329	1,964	3,798	4,586	5,503	1,190	1,816
General and administrative	3,058	5,673	5,810	6,046	7,397	1,690	2,633
Amortization of contract intangibles	670	2,483	1,862		135		203
Depreciation and amortization	265	408	465	531	586	141	153
Total costs and expenses	11,815	42,970	57,201	69,438	83,557	18,736	29,397
Income (loss) from operations	(4,765)	1,493	3,518	6,431	5,858	1,081	2,810
Interest expense and other income, net	(92)	(169)	(391)	(621)	(570)	(110)	(363)
Income before provision for income taxes	(4,857)	1,324	3,127	5,810	5,288	971	2,447
Provision for income taxes			(351)	(541)	(1,166)	(353)	(979)
Net income (loss)	$ (4,857)	$ 1,324	$ 2,776	$ 5,269	$ 4,122	$ 618	$ 1,468
Basic earnings per common share	$ (0.25)	$ 0.10	$ 0.19	$ 0.31	$ 0.22	$ 0.03	$ 0.08
Basic weighted average shares outstanding	19,310,208	13,561,073	14,428,121	16,865,313	19,038,464	19,029,284	19,034,172

						Three months ended December 31,	
Diluted earnings per common share	$ (0.14)	$ 0.07	$ 0.17	$ 0.29	$ 0.18	$ 0.03	$ 0.06
Diluted weighted average shares outstanding	34,528,638	18,107,552	16,124,927	18,280,366	22,598,519	22,519,522	22,848,367
Non-GAAP Financial Measures:							
EBITDA(1)	$ (3,830)	$ 4,384	$ 5,845	$ 6,962	$ 6,579	$ 1,222	$ 3,166
Adjusted EBITDA(1)	(4,126)	2,485	3,750	6,115	6,666	1,288	3,167
Adjusted profit-sharing distributions(2)	2,296	19,616	32,522	40,650	48,952	10,985	18,170
Adjusted net income (loss)(2)	$ (5,153)	$ (575)	$ 681	$ 4,337	$ 4,122	$ 618	$ 1,468
Supplemental Operating Data:							
Gross merchandise volume(3)	$ 7,997	$ 49,209	$ 72,305	$ 89,104	$ 102,210	$ 22,346	$ 36,710
Completed transactions(4)	N/A	92,000	123,000	141,000	173,000	38,000	47,000
Total registered buyers(5)	N/A	69,000	150,000	264,000	386,000	292,000	415,000
Total auction participants(6)	N/A	404,000	552,000	671,000	848,000	197,000	225,000

N/A Not available

	As of September 30, 2001	2002	2003	2004	2005	As of December 31, 2005
						(unaudited)
			(in thousands)			
Consolidated Balance Sheet Data:						
Cash, cash equivalents and short-term investments	$ 2,901	$ 5,654	$ 10,450	$ 12,178	$ 10,378	$ 15,196
Working capital(7)	(1,586)	(1,683)	3,780	7,021	4,154	5,613
Total assets	10,661	11,113	13,715	17,711	26,013	31,854
Total liabilities	10,148	10,362	9,984	10,333	14,596	18,740
Redeemable common stock(8)				324	474	708
Series C preferred stock				3	3	3
Common stock	18	12	16	19	19	19
Total stockholders' equity	513	751	3,731	7,054	10,943	12,406

(1) EBITDA and adjusted EBITDA are supplemental non-GAAP financial measures. GAAP means generally accepted accounting principles in the United States. EBITDA is equal to net income (loss) plus (a) interest expense and other income; (b) provision for income taxes; (c) amortization of contract intangibles; and (d) depreciation and amortization. Our definition of adjusted EBITDA is different from EBITDA because we further adjust EBITDA for: (a) stock based compensation expense; and (b) a portion of the SurplusBid.com acquisition payments, as described below under footnote 2. For a description of our use of EBITDA and adjusted EBITDA and a reconciliation of these non-GAAP financial measures to net income (loss), see the discussion and related table below.

(2) In June 2001, we acquired certain assets and assumed certain liabilities of SurplusBid.com, Inc. and its affiliates for $7.5 million, including SurplusBid.com's surplus contract with the DoD. The SurplusBid.com acquisition price was paid over 33 months in accordance with the terms of the purchase agreement. At the same time, we were awarded our current surplus contract with the DoD. Our surplus contract required monthly profit-sharing distributions under the contract to be reduced by the amount of the monthly SurplusBid.com acquisition payments. This resulted in a temporary non-recurring reduction in our profit-sharing distributions and a significant increase in our net income during the 33 month period from June 2001 to March 2004. The total amount of the SurplusBid.com acquisition payment was recorded as a note payable in our consolidated balance sheet in fiscal 2001, discounted to a present value of approximately $6.5 million. The discount of approximately $1 million was accreted as interest expense over the term of the acquisition payments.

As a result, we present two supplemental non-GAAP financial measures, adjusted profit-sharing distributions and adjusted net income, to eliminate the impact of the SurplusBid.com acquisition payments. These measures are prepared by increasing the profit-sharing distributions line item in our statements of operations by DoD's portion of the principal payments on the SurplusBid.com note payable made during each period *(i.e.*, approximately 80% of the principal payments). We do not add back the accreted interest portion of the SurplusBid.com acquisition payments when adjusting distributions and net income because the accreted interest is already included in interest expense and other income in our consolidated statements of operations. We believe adjusted profit-sharing distributions and adjusted net income are useful to investors because they eliminate an item that we do not consider indicative of our core operating performance due to its temporary, non-recurring nature. We also believe it is important to provide investors with the same metrics used by management to measure core operating performance.

The table below reconciles profit-sharing distributions and net income to such item's adjusted presentation for the periods presented.

Nine months ended September 30, 2001	Year ended September 30, 2002	2003	2004	2005(a)	Three months ended December 31, 2004(a)	2005(a)
					(unaudited)	

				(in thousands)		Three months ended December 31,	
Profit-sharing distributions	$ 2,000	$ 17,717	$ 30,427	$ 39,718	$ 48,952	10,985	$ 18,170
Adjustment	296	1,899	2,095	932		$	
Adjusted profit-sharing distributions	$ 2,296	$ 19,616	$ 32,522	$ 40,650	$ 48,952	$ 10,985	$ 18,170
Net income (loss)	$ (4,857)	$ 1,324	$ 2,776	$ 5,269	$ 4,122	$ 618	$ 1,468
Adjustment	(296)	(1,899)	(2,095)	(932)			
Adjusted net income (loss)	$ (5,153)	$ (575)	$ 681	$ 4,337	$ 4,122	$ 618	$ 1,468

(a) The final SurplusBid.com acquisition payment was made in March 2004 and therefore no adjustments were made in fiscal 2005 or the three months ended December 31, 2004 and 2005.

(3) Gross merchandise volume is the total sales value of all merchandise sold through our marketplaces during a given period.

(4) Completed transactions represents the number of auctions in a given period from which we have recorded revenue.

(5) Total registered buyers as of a given date represents the aggregate number of persons or entities who have registered on one of our marketplaces.

(6) For each auction we manage, the number of auction participants represents the total number of registered buyers who have bid one or more times on that auction, and total auction participants for a given period is the sum of the auction participants in each auction conducted during that period.

(7) Working capital is defined as current assets minus current liabilities.

(8) Upon the closing of this offering and the resulting repayment of our $2.0 million subordinated note, the redemption feature related to these shares of common stock will terminate. The pro forma as adjusted consolidated balance sheet takes into account the termination of this redemption feature, reflecting the decrease in the value recorded by us for redeemable common stock.

We believe EBITDA and adjusted EBITDA are useful to an investor in evaluating our performance for the following reasons:

The amortization of contract intangibles relate to the amortization of SurplusBid.com's surplus contract with the DoD during fiscal years 2001 to 2003, and amortization of the scrap contract beginning in June 2005. Depreciation and amortization expense primarily relates to property and equipment. Both of these expenses are non-cash charges that have significantly fluctuated over the past five years. As a result, we believe that adding back these non-cash charges to net income (loss) is useful in evaluating the operating performance of our business on a consistent basis from year-to-year.

As a result of substantial federal net operating loss carryforwards, or NOLs, we did not incur significant income tax expense until fiscal 2005. With the exhaustion of our remaining federal NOLs during fiscal 2005, we recorded federal income tax expense for the first time, thus significantly decreasing our fiscal 2005 net income relative to prior years. Consequently, we believe that presenting a financial measure that adjusts net income (loss) for provision for income taxes is useful to investors when evaluating the operating performance of our business.

During July 2001, we modified the exercise price of 3,402,794 stock options issued to employees. As a result, we are accounting for the modified stock options from the date of modification to the date the stock options are exercised, forfeited or expire unexercised using variable accounting. Under variable accounting, we revalue compensation costs for the stock options at each reporting period based on changes in the intrinsic value of the stock options. We recorded approximately $85,000, $87,000 and $1,000, respectively, in stock compensation expenses based on vesting of the fair value of the options for the years ended September 30, 2004 and 2005 and for the quarter ended December 31, 2005. We will continue to revalue compensation costs for the options based on changes in the fair value of our common stock in future periods. As a result, we present a financial measure that adjusts net income (loss) and EBITDA for the stock compensation expense that results solely from the July 2001 modification of these stock options. We believe that it is useful to exclude this expense because it results from a one-time event that requires us to record expense that we are not otherwise required to record in connection with new stock options granted during the same time period.

As discussed above, the requirement under our surplus contract with the DoD for monthly profit-sharing distributions to be reduced by the monthly SurplusBid.com acquisition payments resulted in a temporary non-recurring reduction in our profit-sharing distributions and a significant increase in our net income and EBITDA during the 33 month period from July 2001 to March 2004. As a result, we believe that it is useful to exclude a portion of these profit-sharing distributions from adjusted EBITDA because the payments will not recur in future periods and were unrelated to our core operations.

We believe these measures are important indicators of our operational strength and the performance of our business because they provide a link between profitability and operating cash flow.

We also believe that analysts and investors use EBITDA and adjusted EBITDA as supplemental measures to evaluate the overall operating performance of companies in our industry.

Our management uses EBITDA and adjusted EBITDA:

as measurements of operating performance because they assist us in comparing our operating performance on a consistent basis as they remove the impact of items not directly resulting from our core operations;

for planning purposes, including the preparation of our internal annual operating budget;

to allocate resources to enhance the financial performance of our business;

to evaluate the effectiveness of our operational strategies; and

to evaluate our capacity to fund capital expenditures and expand our business.

EBITDA and adjusted EBITDA as calculated by us are not necessarily comparable to similarly titled measures used by other companies. In addition, EBITDA and adjusted EBITDA: (a) do not represent net income or cash flows from operating activities as defined by GAAP; (b) are not necessarily indicative of cash available to fund our cash flow needs; and (c) should not be considered as alternatives to net income, income from operations, cash provided by operating activities or our other financial information as determined under GAAP.

We prepare adjusted EBITDA by adjusting EBITDA to eliminate the impact of items that we do not consider indicative of our core operating performance. You are encouraged to evaluate these adjustments and the reasons we consider them appropriate for supplemental analysis. As an analytical tool, adjusted EBITDA is subject to all of the limitations applicable to EBITDA. Our presentation of adjusted EBITDA should not be construed as an implication that our future results will be unaffected by unusual or non-recurring items.

The table below reconciles net income (loss) to EBITDA and adjusted EBITDA for the periods presented.

	Nine months ended September 30,	Year ended September 30,				Three months ended December 31,	
	2001	2002	2003	2004	2005	2004	2005
						(unaudited)	
	(in thousands)						
Net income (loss)	$ (4,857)	$ 1,324	$ 2,776	$ 5,269	$ 4,122	$ 618	$ 1,468
Interest expense and other income, net	92	169	391	621	570	110	363
Provision for income taxes			351	541	1,166	353	979
Amortization of contract intangibles	670	2,483	1,862		135		203
Depreciation and amortization	265	408	465	531	586	141	153
EBITDA	(3,830)	4,384	5,845	6,962	6,579	1,222	3,166
Stock compensation expense				85	87	66	1
Adjustment(1)	(296)	(1,899)	(2,095)	(932)			

						Three months ended December 31,	
Adjusted EBITDA	$ (4,126)	$ 2,485	$ 3,750	$ 6,115	$ 6,666	$ 1,288	$ 3,167

(1) The adjustment amount for each period equals approximately 80% of the principal payments on the SurplusBid.com note payable made during each period, as described above in footnote 2. No payments were made in fiscal 2005 or the three months ended December 31, 2004 and 2005.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our consolidated financial statements and related notes and the information contained under the caption "Selected Consolidated Financial Data" contained elsewhere in this prospectus. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could vary materially from those indicated, implied, or suggested by these forward-looking statements as a result of many factors, including those discussed under "Risk Factors" and elsewhere in this prospectus.

Overview

About us. We are a leading online auction marketplace for wholesale, surplus and salvage assets. We enable buyers and sellers to transact in an efficient, automated online auction environment offering over 500 product categories. Our marketplaces provide professional buyers access to a global, organized supply of wholesale, surplus and salvage assets presented with digital images and other relevant product information. Additionally, we enable our 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. We organize our products into categories across major industry verticals such as consumer electronics, general merchandise, apparel, scientific equipment, aerospace parts and equipment, technology hardware, and specialty equipment. Our online auction marketplaces are *www.liquidation.com*, *www.govliquidation.com* and *www.uksurplus.com*. We also operate a wholesale industry portal, *www.goWholesale.com,* that connects advertisers with buyers seeking products for resale and related business services.

We believe our ability to create liquid marketplaces for wholesale, surplus and salvage assets generates a continuous flow of goods from our corporate and government sellers. This flow of goods in turn attracts an increasing number of professional buyers to our marketplaces. During calendar year 2005, the number of registered buyers grew from approximately 292,000 to approximately 415,000, and the number of monthly searches on our websites grew from approximately 1.6 million to 4.5 million. During the past three fiscal years, we have conducted over 436,000 online transactions representing approximately $264 million in gross merchandise volume. Approximately 90% of our initial listings have resulted in a completed cash sale during the past three fiscal years.

Our history. We were incorporated in Delaware in November 1999 as Liquidation.com, Inc. and commenced operations in early 2000. During 2000, we developed our online auction marketplace platform and began auctioning merchandise primarily for small commercial sellers and government agencies. In 2001, we changed our name to Liquidity Services, Inc. In June 2001, we were awarded our first major DoD contract, the Commercial Venture Two or CV2 contract. Under this agreement, we became the exclusive contractor with the Defense Reutilization and Marketing Service, or DRMS, for the sale of usable DoD surplus assets in the United States. In June 2005, we were awarded an additional exclusive contract with the DRMS to manage and sell substantially all DoD scrap property. During 2004, we launched our wholesale industry portal, *www.goWholesale.com*.

Recent initiatives. We have recently made several new investments to enhance the value of our business. During calendar year 2005, we hired additional key employees, including our Chief Financial Officer and Treasurer, our General Counsel and our Vice President of Operations, as well as additional sales and marketing and technology and operations personnel. We incurred start-up administrative and legal costs during fiscal 2005 associated with the award of our new scrap contract. We also incurred start-up costs associated with *www.goWholesale.com* throughout fiscal 2005. During May 2005, we completed the acquisition of Wholesale411.com, a wholesale industry search engine and portal, and completed the integration of this business with goWholesale.com in October 2005. Throughout fiscal

2005, we continued to make investments in our U.S. distribution center operations as well as in our uksurplus.com marketplace, which was started at the end of fiscal 2003. In anticipation of becoming a public company, we have also invested in our administrative infrastructure, including a new accounting system and the hiring of a consultant to assist us with our efforts to meet the requirements of becoming a public company. In addition, on January 24, 2006, we were awarded a contract to purchase DoD surplus property in Germany. This contract award is subject to the expiration of the applicable ten-day government-mandated protest period. This contract will expire in January 2009.

Our revenue. We generate substantially all of our revenue by retaining a percentage of the proceeds from the sales we manage for our sellers. We offer our sellers two primary transaction models: a profit-sharing model and a consignment model.

Profit-sharing model. Under our profit-sharing model, we purchase inventory from our suppliers and share with them a portion of the profits received from a completed sale in the form of a distribution. Distributions are calculated based on the value received from sale after deducting direct costs, such as sales and marketing, technology and operations and other general and administrative costs. Because we are the primary obligor, and take general and physical inventory risks and credit risk under this transaction model, we recognize as revenue the sale price paid by the buyer upon completion of a transaction. Revenue from our profit-sharing model accounted for approximately 95.8%, 91.0%, 87.9% and 85.9% of our total revenue for the fiscal years ended September 30, 2003, 2004 and 2005 and for the quarter ended December 31, 2005, respectively. The merchandise sold under our profit-sharing model accounted for approximately 80.5%, 77.5%, 76.8% and 75.4% of our gross merchandise volume, or GMV, for the fiscal years ended September 30, 2003, 2004 and 2005 and for the quarter ended December 31, 2005, respectively.

Consignment model. Under our consignment model, we recognize commission revenue from sales of merchandise in our marketplaces that is owned by others. These commissions, which we refer to as seller commissions, represent a percentage of the sale price the buyer pays upon completion of a transaction. We vary the percentage amount of the seller commission depending on the various value-added services we provide to the seller to facilitate the transaction. For example, we generally increase the percentage amount of the commission if we take possession, handle, ship or provide enhanced product information for the merchandise. We collect the seller commission by deducting the appropriate amount from the sales proceeds prior to their distribution to the seller after completion of the transaction. Revenue from our consignment model accounted for approximately 4.2%, 5.7%, 5.2% and 5.7% of our total revenue for the fiscal years ended September 30, 2003, 2004 and 2005 and for the quarter ended December 31, 2005, respectively. The merchandise sold under our consignment model accounted for approximately 19.5%, 19.7%, 18.5% and 19.3% of our GMV for the fiscal years ended September 30, 2003, 2004 and 2005 and for the quarter ended December 31, 2005, respectively.

We collect a buyer premium on substantially all of our transactions under both of our transaction models. Buyer premiums are calculated as a percentage of the sale price of the merchandise sold and are paid to us by the buyer. Buyer premiums are in addition to the price of the merchandise. Under our profit sharing model, we typically share in the proceeds of any buyer premiums with our sellers.

In addition, we occasionally engage in transactions with our sellers in which we purchase merchandise without a profit-sharing component. Under this model, we do not share any profits with the sellers. These transactions generated approximately 2% of our revenue in both fiscal year 2005 and the quarter ended December 31, 2005.

In both fiscal year 2005 and the quarter ended December 31, 2005, we generated approximately 2% of our revenue from advertisements on our wholesale industry portals.

Industry trends. We believe there are several industry trends impacting the growth of our business including: (1) the increase in the adoption of the Internet by businesses to conduct e-commerce both in the United States and abroad; (2) product innovation in the retail supply chain that has increased the pace of product obsolescence and, therefore, the supply of surplus assets; (3) the increase in the volume of returned merchandise handled by both online and offline retailers; (4) the increase in government regulations necessitating verifiable recycling and remarketing of surplus assets; and (5) the increase in outsourcing by corporate and government organizations of disposition activities for surplus and end-of-life assets.

Our Seller Agreements

Our DoD agreements. We have two contracts with the DoD pursuant to which we acquire, manage and sell excess property:

Surplus contract. In June 2001, we were awarded the CV2 contract, a competitive-bid exclusive contract under which we acquire, manage and sell all usable DoD surplus personal property turned into the DRMS. Surplus property generally consists of items determined by the DoD to be no longer needed, and not claimed for reuse by any federal agency, such as computers, electronics, office supplies, scientific and medical equipment, aircraft parts, clothing and textiles. In connection with the award of this surplus contract, we agreed to acquire SurplusBid.com, Inc. and its wholly owned subsidiary Levy Latham Global, LLC, the holder of the predecessor DoD surplus agreement, the Commercial Venture One or CV1 contract. Revenue from our surplus contract (including buyer premiums) accounted for approximately 95.8%, 91.0%, 87.5% and 64.3% of our total revenue for the fiscal year ended September 30, 2003, 2004 and 2005 and for the quarter ended December 31, 2005, respectively. The property sold under our surplus contract accounted for approximately 80.5%, 77.5%, 76.5% and 56.4% of our GMV for the fiscal years ended September 30, 2003, 2004 and 2005 and for the quarter ended December 31, 2005, respectively. The surplus contract expires in July 2008.

Scrap contract. In June 2005, we were awarded a competitive-bid exclusive contract under which we acquire, manage and sell substantially all scrap property of the DoD turned into the DRMS. Scrap property generally consists of items determined by DoD to have no use beyond their base material content, such as metals, alloys, and building materials. The contract accounted for 0.4% and 21.6% of our revenue and 0.3% and 19.0% of our GMV for the fiscal year ended September 30, 2005 and for the quarter ended December 31, 2005, respectively. We were required to pay $5.7 million for the right to manage the operations and remarket scrap material in connection with the scrap contract. The contract expires in June 2012, subject to DoD's right to extend it for three additional one-year terms.

The surplus contract and the scrap contract are structured as profit-sharing arrangements in which we purchase and take possession of all goods we receive from the DoD at a contractual percentage of the original acquisition cost of those goods. After deducting allowable operating expenses, we disburse to the DoD approximately 80% of the profits from the sale. We retain the remaining 20% of these profits. We refer to these disbursement payments to DoD as profit-sharing distributions. As a result of this arrangement, we recognize as revenue the gross proceeds from these sales.

In January 2005, we were awarded a contract to purchase DoD surplus property located in the United Kingdom. This contract is in its initial start-up phase and generated less than 1% of our revenue in both fiscal 2005 and the quarter ended December 31, 2005. This contract expires in January 2007.

Our UK MoD agreement. In July 2003, we were awarded a contract to manage and sell surplus property from the United Kingdom Ministry of Defence. This contract generated less than 4% of our revenue in both fiscal year 2005 and the quarter ended December 31, 2005. This contract expires in July 2008, subject to the Ministry's right to extend the contract for two additional one-year terms.

Our commercial agreements. During fiscal year 2005, we had over 280 corporate clients who each sold in excess of $10,000 of wholesale, surplus and salvage assets in our marketplaces. Our agreements with these clients are generally terminable at will by either party.

Key Business Metrics

Our management periodically reviews certain key business metrics for operational planning purposes and to evaluate the effectiveness of our operational strategies, allocation of resources and our capacity to fund capital expenditures and expand our business. These key business metrics include:

Gross merchandise volume. Gross merchandise volume, or GMV, is the total sales value of all merchandise sold through our marketplaces during a given period. We review GMV because it provides a measure of the volume of goods being sold in our marketplaces and thus the activity of those marketplaces. GMV also provides a means to evaluate the effectiveness of investments that we have made and continue to make, including in the areas of customer support, value-added services, product development, sales and marketing, and operations. The gross merchandise volume of goods sold in our marketplace during fiscal 2005 and the quarter ended December 31, 2005 was $102.2 million and $36.7 million, respectively.

Completed transactions. Completed transactions represents the number of auctions in a given period from which we have recorded revenue. Similar to GMV, we believe that completed transactions is a key business metric because it provides an additional measurement of the volume of activity flowing through our marketplaces. During the year ended September 30, 2005 and the quarter ended December 31, 2005, we completed approximately 173,000 and 47,000 transactions, respectively.

Total registered buyers. We grow our buyer base through a combination of marketing and promotional efforts. A person becomes a registered buyer by completing an online registration process on one of our marketplaces. As part of this process, we collect business and personal information, including name, title, company name, business address and contact information, and information on how the person intends to use our marketplaces. Each prospective buyer must also accept our terms and conditions of use. Following the completion of the online registration process, we verify each prospective buyer's e-mail address and confirm that the person is not listed on any banned persons list maintained internally or by the U.S. federal government. After the verification process, which is completed generally within 24 hours, the registration is approved and activated and the prospective buyer is added to our registered buyer list.

Total registered buyers as of a given date represents the aggregate number of persons or entities who have registered on one of our marketplaces. We use this metric to evaluate how well our marketing and promotional efforts are performing. Total registered buyers excludes duplicate registrations, buyers who are suspended from utilizing our marketplaces and those buyers who have voluntarily removed themselves from our registration database. In addition, if we become aware of registered buyers that are no longer in business, we remove them from our database. As of September 30, 2005 and December 31, 2005, we had approximately 386,000 and 415,000 registered buyers, respectively.

Total auction participants. For each auction we manage, the number of auction participants represents the total number of registered buyers who have bid one or more times in that auction. As a result, a registered buyer who bids, or participates, in more than one auction is counted as an auction participant in each auction in which he or she participates. Thus, total auction participants for a given period is the sum of the auction participants in each auction conducted during that period. We use this metric to allow us to compare our online auction marketplaces to our competitors, including other online auction sites and traditional on-site auctioneers. In addition, we measure total auction participants on a periodic basis to evaluate the activity level of our base of registered buyers and to measure the performance of our marketing and promotional efforts. For the year ended September 30, 2005 and for the quarter ended December 31, 2005, approximately 848,000 and 225,000 total auction participants, respectively, participated in auctions on our marketplaces.

Non-GAAP Financial Measures

Adjusted profit-sharing distributions and adjusted net income. In June 2001, we acquired certain assets and assumed certain liabilities of SurplusBid.com, Inc. and its affiliates for $7.5 million, including SurplusBid.com's surplus contract with the DoD. The SurplusBid.com acquisition price was paid over 33 months in accordance with the terms of the purchase agreement. At the same time, we were awarded our current surplus contract with the DoD. Our surplus contract required monthly profit-sharing distributions under the contract to be reduced by the amount of the monthly SurplusBid.com acquisition payments. This resulted in a temporary non-recurring reduction in our profit-sharing distributions and a significant increase in our net income during the 33 month period from June 2001 to March 2004. The total amount of the SurplusBid.com acquisition payment was recorded as a note payable in our consolidated balance sheet in fiscal 2001, discounted to a present value of approximately $6.5 million. The discount of approximately $1 million was accreted as interest expense over the term of the acquisition payments.

As a result, we present two supplemental non-GAAP financial measures, adjusted profit-sharing distributions and adjusted net income, to eliminate the impact of the SurplusBid.com acquisition payments. These measures are prepared by increasing the profit-sharing distributions line item in our statements of operations by DoD's portion of the principal payments on the SurplusBid.com note payable made during each period (*i.e.*, approximately 80% of the principal payments). We do not add back the accreted interest portion of the SurplusBid.com acquisition payments when adjusting distributions and net income because the accreted interest is already included in interest expense and other income in our consolidated statements of operations. We believe adjusted profit-sharing distributions and adjusted net income are useful to investors because they eliminate an item that we do not consider indicative of our core operating performance due to its temporary, non-recurring nature. We also believe it is important to provide investors with the same metrics used by management to measure core operating performance.

The table below reconciles profit-sharing distributions and net income to such item's adjusted presentation for the periods presented.

	Nine months ended September 30, 2001	Year ended September 30, 2002	2003	2004	2005(1)	Three months ended December 31, 2004(1)	2005(1)
						(unaudited)	
			(in thousands)				
Profit-sharing distributions	$ 2,000	$ 17,717	$ 30,427	$ 39,718	$ 48,952	$ 10,985	$ 18,170
Adjustment	296	1,899	2,095	932			
Adjusted profit-sharing distributions	$ 2,296	$ 19,616	$ 32,522	$ 40,650	$ 48,952	$ 10,985	$ 18,170
Net income (loss)	$ (4,857)	$ 1,324	$ 2,776	$ 5,269	$ 4,122	$ 618	$ 1,468
Adjustment	(296)	(1,899)	(2,095)	(932)			
Adjusted net income (loss)	$ (5,153)	$ (575)	$ 681	$ 4,337	$ 4,122	$ 618	$ 1,468

(1) The final SurplusBid.com acquisition payment was made in March 2004 and therefore no adjustments were made in fiscal 2005 or the three months ended December 31, 2004 and 2005.

EBITDA and adjusted EBITDA. EBITDA is a supplemental non-GAAP financial measure and is equal to net income (loss) plus (a) interest expense and other income; (b) provision for income taxes; (c) amortization of contract intangibles; and (d) depreciation and amortization. Our definition of adjusted EBITDA is different from EBITDA because we further adjust EBITDA for: (a) stock based compensation expense; and (b) a portion of the SurplusBid.com acquisition payments, as described above under "Adjusted profit-sharing distributions and adjusted net income."

We believe EBITDA and adjusted EBITDA are useful to an investor in evaluating our performance for the following reasons:

The amortization of contract intangibles relate to the amortization of the CV1 contract during fiscal years 2001 to 2003, and amortization of the scrap contract beginning in June 2005. Depreciation and amortization expense primarily relates to property and equipment. Both of these expenses are non-cash charges that have significantly fluctuated over the past five years. As a result, we believe that adding back these non-cash charges to net income (loss) is useful in evaluating the operating performance of our business on a consistent basis from year-to-year.

As a result of substantial federal net operating loss carryforwards, or NOLs, we did not incur significant income tax expense until fiscal 2005. With the exhaustion of our remaining federal NOLs during fiscal 2005, we recorded federal income tax expense for the first time, thus significantly decreasing our fiscal 2005 net income relative to prior years. Consequently, we believe that presenting a financial measure that adjusts net income (loss) for provision for income taxes is useful to investors when evaluating the operating performance of our business.

During July 2001, we modified the exercise price of 3,402,794 stock options issued to employees. As a result, we are accounting for the modified stock options from the date of modification to the date the stock options are exercised, forfeited or expire unexercised using variable accounting. Under variable accounting, we revalue compensation costs for the stock options at each reporting period based on changes in the intrinsic value of the stock options. We recorded approximately $85,000, $87,000 and $1,000, respectively, in stock compensation expenses based on vesting of the fair value of the options for the years ended September 30, 2004 and 2005 and for the quarter ended December 31, 2005. We will continue to revalue compensation costs for the options based on changes in the fair value of our common stock in future periods. As a result, we present a financial measure that adjusts net income (loss) and EBITDA for the stock compensation expense that results solely from the July 2001 modification of these stock options.

We believe that it is useful to exclude this expense because it results from a one-time event that requires us to record expense that we are not otherwise required to record in connection with new stock options granted during the same time period.

As discussed above, the requirement under our surplus contract with the DoD for monthly profit-sharing distributions to be reduced by the monthly SurplusBid.com acquisition payments resulted in a temporary non-recurring reduction in our profit-sharing distributions and a significant increase in our net income and EBITDA during the 33 month period from July 2001 to March 2004. As a result, we believe that it is useful to exclude a portion of these profit-sharing distributions from adjusted EBITDA because the payments will not recur in future periods and were unrelated to our core operations.

We believe these measures are important indicators of our operational strength and the performance of our business because they provide a link between profitability and operating cash flow.

We also believe that analysts and investors use EBITDA and adjusted EBITDA as supplemental measures to evaluate the overall operating performance of companies in our industry.

Our management uses EBITDA and adjusted EBITDA:

- as measurements of operating performance because they assist us in comparing our operating performance on a consistent basis as they remove the impact of items not directly resulting from our core operations;
- for planning purposes, including the preparation of our internal annual operating budget;
- to allocate resources to enhance the financial performance of our business;
- to evaluate the effectiveness of our operational strategies; and
- to evaluate our capacity to fund capital expenditures and expand our business.

EBITDA and adjusted EBITDA as calculated by us are not necessarily comparable to similarly titled measures used by other companies. In addition, EBITDA and adjusted EBITDA: (a) do not represent net income or cash flows from operating activities as defined by GAAP; (b) are not necessarily indicative of cash available to fund our cash flow needs; and (c) should not be considered as alternatives to net income, income from operations, cash provided by operating activities or our other financial information as determined under GAAP.

We prepare adjusted EBITDA by adjusting EBITDA to eliminate the impact of items that we do not consider indicative of our core operating performance. You are encouraged to evaluate these adjustments and the reasons we consider them appropriate for supplemental analysis. As an analytical tool, adjusted EBITDA is subject to all of the limitations applicable to EBITDA. Our presentation of adjusted EBITDA should not be construed as an implication that our future results will be unaffected by unusual or non-recurring items.

The table below reconciles net income (loss) to EBITDA and adjusted EBITDA for the periods presented.

	Nine months ended September 30, 2001	Year ended September 30, 2002	2003	2004	2005	Three months ended December 31, 2004	2005
						(unaudited)	
	(in thousands)						
Net income (loss)	$ (4,857)	$ 1,324	$ 2,776	$ 5,269	$ 4,122	$ 618	$ 1,468
Interest expense and other income, net	92	169	391	621	570	110	363
Provision for income taxes			351	541	1,166	353	979
Amortization of contract intangibles	670	2,483	1,862		135		203
Depreciation and amortization	265	408	465	531	586	141	153
EBITDA	(3,830)	4,384	5,845	6,962	6,579	1,222	3,166
Stock compensation expense				85	87	66	1
Adjustment (1)	(296)	(1,899)	(2,095)	(932)			
Adjusted EBITDA	$ (4,126)	$ 2,485	$ 3,750	$ 6,115	$ 6,666	$ 1,288	$ 3,167

(1) The adjustment amount for each period equals approximately 80% of the principal payments on the SurplusBid.com note payable made during each period, as described above under "Adjusted profit-sharing distributions and adjusted net income." No payments were made in fiscal 2005 and the three months ended December 31, 2004 and 2005.

Critical Accounting Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. A "critical accounting estimate" is one which is both important to the portrayal of our financial condition and results and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. We continuously evaluate our critical accounting estimates. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Revenue recognition. We recognize revenue in accordance with the provisions of Staff Accounting Bulletin 101, *Revenue Recognition*. For transactions in our online marketplaces, which generate substantially all of our revenue, we recognize revenue when all of the following criteria are met:

- a buyer submits the winning bid in an auction and, as a result, evidence of an arrangement exists and the sale price has been determined;
- title has passed to a buyer and the buyer has assumed risks and rewards of ownership;
- for arrangements with an inspection period, the buyer has received the merchandise and has not notified us within that period that it is dissatisfied with the merchandise; and