

Why We Invested in Liquidity Services

This article by Jim Roumell is excerpted from a letter of [Roumell Asset Management](#).

We [wrote about LQDT](#) in our second quarter letter of this year. LQDT's stock dropped during the second quarter and we added to our position. We find LQDT's shares to be very attractive given that we believe the value of one of its business lines — GovDeals — currently exceeds the company's valuation.

Here's a simple way to think about LQDT. GovDeals is an online surplus goods marketplace exclusively serving North American municipalities. It has been growing at about a 17% CAGR since FY09. Management estimates the total addressable market for state and local government is close to \$3 billion. Even if they're overestimating by a factor of 3x, GovDeals can still comfortably triple its revenue from here. Let's assume it grows at only 13% over the next five years (a 20% plus drop in its growth rate) off of today's \$30 million revenue run rate. In five years GovDeals would have \$55 million in revenue. With 90% gross margins and a double-digit growth rate, let's assume a value of 4x revenue, which equates to \$220 million, or \$6.90/share. Assume even 3x revenue and the value goes to \$165 million, or \$5.15/share.

Let's assume LQDT's retail supply chain business has a value of \$50 million (2022 value), a fraction of retail competitor Opro's last capital raise valuation. Retail's gross margin is 30% (with 5% GMV growth in the last quarter), but it should benefit from growing online purchases, and the 3x return rate of goods purchased online compared to brick and mortar store purchases. We assume the company's commercial assets business is worth \$32 million, or \$1/share, since we can't see a clear picture of profitability. IronPlanet's purchase by Ritchie Bros suggests our valuation for this company business line is conservative. Finally, we give LQDT's DoD and IronDirect business lines each zero value. Additionally, let's take total net cash down to \$100 million from currently \$124 million.

The above analysis sums to \$402 million, or \$12.50/share; that's a 15% CAGR on one's investment (and we're holding retail and commercial assets verticals at today's washed-out values). Thus, LQDT provides multiple shots on goal anchored by the GovDeals gem, which is buried in the haystack and receiving no respect...today. Our strong belief is that the value will be unlocked as GovDeals continues to execute with both high margins and growth in revenue. The GovDeals vertical is effectively a monopoly for online municipal liquidation and benefits from a two-sided network effect. It appears GovDeals is the "go to" municipal liquidator as the community members talk amongst each other and increasingly move away from weekend onsite auctions (which they all seem to hate). There are now over 9,000 municipal customers and the number grows quarterly.

During the summer, we sat down with Bill Angrick, CEO, for a two-hour one-on-one and walked away with our confidence fully intact that Bill understands the opportunities and challenges of LQDT's various business lines. Moreover, we gained comfort that he well understands the importance of capital allocation decisions. Bill remains the company's largest shareholder, owning roughly 17% of the company. We also spoke to more LQDT GovDeal clients and have thus far been unable to find even one unsatisfied customer. In fact, the additional customers we've spoken with are quite effusive in their praise of the

company's value proposition to their liquidation efforts. Customers we spoke with rated their level of satisfaction from 8 to 9.75 (on a scale from 1 to 10 with 10 being highest). One state we spoke with indicated that selling online through GovDeals reduced its operational costs by \$1 million per year.

Pessimism is high regarding LQDT's turnaround efforts — a great environment for a buyer. The investment thesis is not complicated. The company is exceptionally well-capitalized with over \$100 million in cash and no debt. It possesses the important and necessary RAM ingredient of having time on its side while it segues to returning to a cash-generative business.