

# PRESCIENCE POINT RESEARCH GROUP

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## Celadon Group, Inc. | NYSE: CGI

### ***FOIA Requests Reveal CGI as the Subject of an Active SEC Investigation***

Share Price:  
\$4.40

Avg Daily Volume:  
520k

Market Cap:  
\$124.5m

Debt:  
\$471.9m

Enterprise Value:  
\$590.3m

LTM Revenue:  
\$1055m

LTM Adj CFO:  
-\$28.9m

LTM Adj FCF:  
-\$48.3m

Revolver Availability:  
~\$54.3m (est)

Auditor:  
BKD, LLP

On April 5, 2017, Prescience Point published a research paper (the "[Initiation Report](#)") on Celadon Group ("CGI" or "the company"). The report presented compelling evidence that CGI is fabricating its SEC financial statements and that shareholder value has been unsuspectingly siphoned out of the company. We believe the company's profits and TBV are highly overstated in its SEC filings and that CGI is at the precipice of bankruptcy.

In this report, we present troubling, NEW information, obtained through SEC FOIA requests, which confirms that **CGI is the subject of an active SEC Enforcement Division investigation**. CGI has not disclosed these proceedings.

With CGI, we were already confident in our belief we are bearing witness to the real-time terminal collapse of a troubled company. As discussed in our Initiation Report, CGI's projected cash burn in 2H'17 of \$80.1m far exceeds its borrowing availability of \$54.3m and our estimate of 'true' TBV of ~\$12m; as such, we expect the company to be insolvent within 1-2 quarters.

We now have reason to believe this collapse will be accelerated. The historical record indicates that the disclosure of an SEC investigation when it comes to a company that has previously been accused of vastly overstating its financial position, results in the propulsion of a terminal collapse. For example,

- Enron: Enron's disclosure of an SEC investigation 10/22/2001 propelled its terminal collapse. As demonstrated in this report, within just 1.5 months after disclosing the investigation, Enron's stock price collapsed by -99%, from over \$20 to pennies, and it filed for bankruptcy.
- Wins Finance (WINS): On March 30, 2017, a Seeking Alpha [author](#) reported that data he received (acquired via an SEC FOIA request) confirms that Wins Finance is the subject of an active SEC investigation, propelling a collapse in the stock price. Over the past ~2 weeks since this disclosure, WINS' stock has fallen -79%.

In our view, all paths for CGI end at bankruptcy, with no recoverable value for current shareholders; and the ongoing terminal decline we are witnessing is likely to accelerate in light of our revelation of an SEC investigation.

**We hope that current and future investors and creditors familiarize themselves with the risks we have addressed and take immediate action to preserve the value of their holdings. We have communicated our findings to CGI's auditor BKD LLP, and we hope they consider taking whatever precautions necessary to protect public shareholders.**

**We think CGI stock is fundamentally worth \$0.00/share and should be de-listed from the New York Stock Exchange.**



PRESCIENCE  
INVESTMENT GROUP

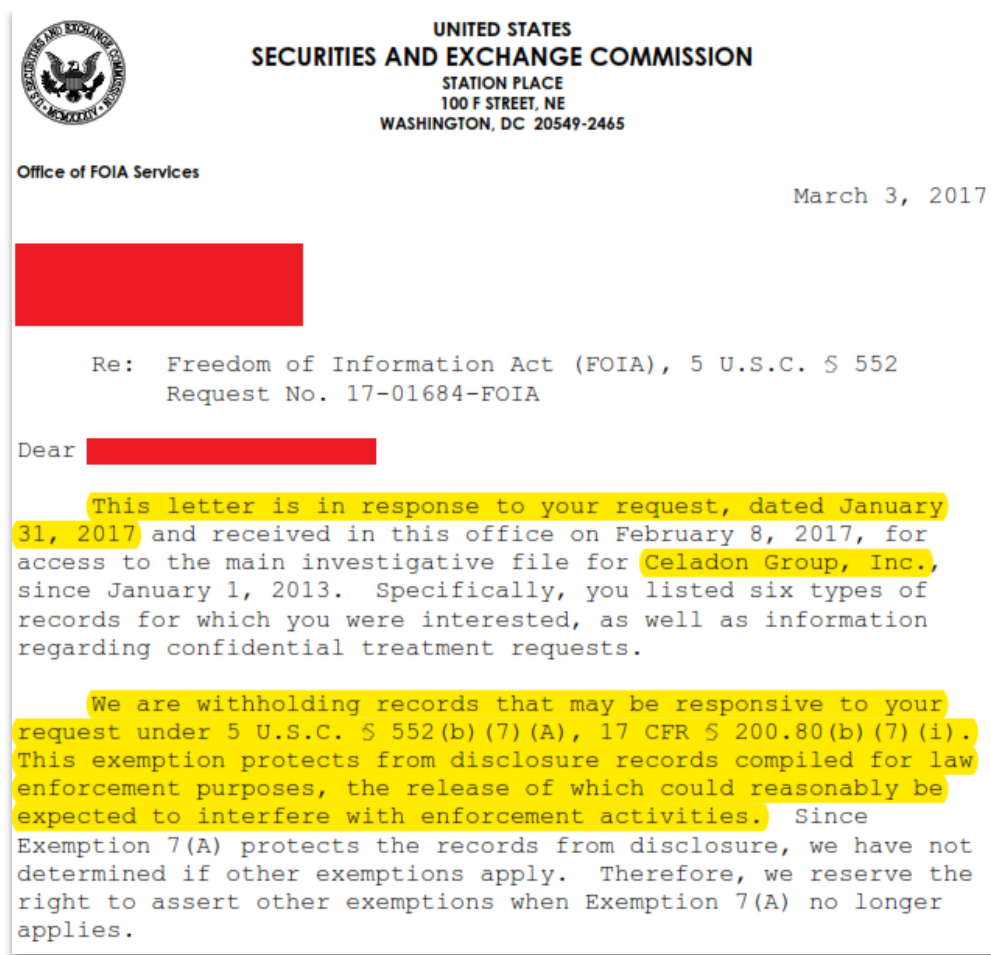
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## CGI is Being Investigated by the SEC Enforcement Division

We received data in response to our Freedom of Information Act ("FOIA") requests that confirms CGI is the subject of an active SEC investigation. CGI has failed to disclose these proceedings.

In a letter dated March 3, 2017, the FOIA office denied our request for access to CGI's investigative records by invoking Exemption (b)(7)(A) of the FOIA. Citation of the (b)(7)(A) exemption means that the SEC deems the release of information it has collected on CGI could be expected to interfere with law enforcement proceedings.

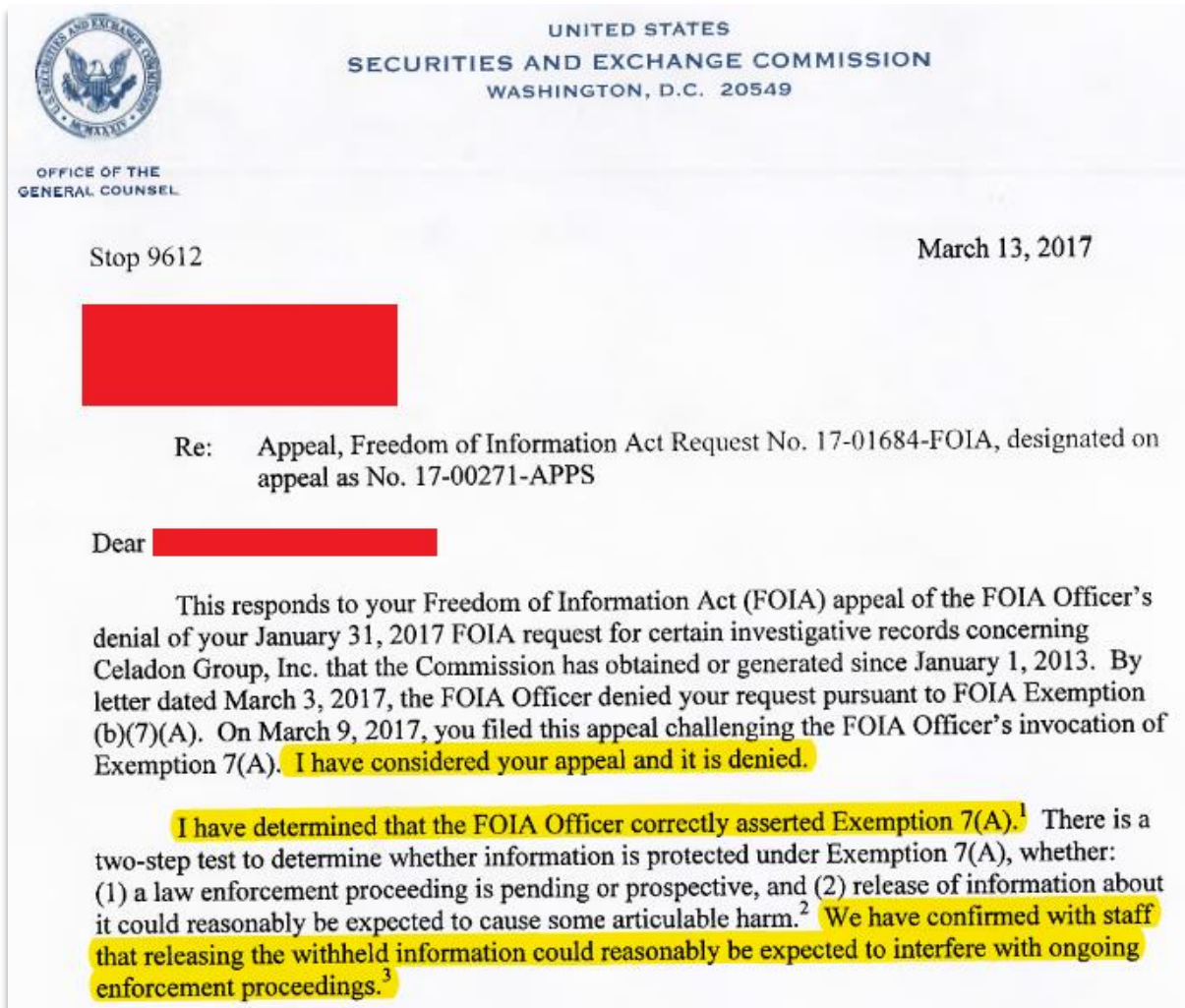
- An excerpt from the first page of the FOIA office's response letter is provided below:



- Again, by invoking Exemption (b)(7)(A), the SEC has acknowledged that CGI is the subject of an ongoing SEC investigation. Per the [Department of Justice](#),

*The first subpart of Exemption 7 of the Freedom of Information Act, Exemption 7, authorizes the withholding of 'records or information compiled for law enforcement purposes, but only to the extent that production of such law enforcement records or information . . . could reasonably be expected to interfere with enforcement proceedings.'*

- For further confirmation of the existence of an investigation, we sent an administrative appeal to the General Counsel's office. In its response, the General Counsel's office denied our access to CGI's records by once again invoking Exemption (b)(7)(A), stating that releasing investigative records on CGI could "interfere with ongoing enforcement proceedings." By doing so, the General Counsel's office has confirmed that CGI is the subject of an active SEC investigation. An excerpt from the first page of the General Counsel's response letter is provided below:



## Overwhelming Evidence of Wrongdoing Means that Future Enforcement Actions Are Likely Inevitable

Based on our analysis, CGI has left a paper trail of wrongdoing: Its most recent SEC filings contain an overwhelming amount of evidence that indicates it grossly fabricated its financial reports. For example, as detailed in our Initiation Report, the JV subscription agreement filed on February 10<sup>th</sup> contains what, in our view, amounts to incontrovertible proof that CGI lied about collecting a \$31.8m receivable from Element. Given how thorough its investigations generally are, we believe the SEC is almost certain to take notice of such seemingly definitive evidence of misconduct during its review of CGI's filings. Therefore, we fully expect the SEC's investigation to result in severe enforcements actions against the company and its senior management team.

A quick recap of our findings about the \$31.8m receivable is provided below:

- CGI claimed in its January 6<sup>th</sup> 8-K and Q2'17 10-Q that it collected on a \$31.8m receivable from Element prior to the JV closing.
- The truth, as later disclosed in the JV subscription agreement, is that CGI received a \$31.8m sham 'daylight loan' from Element which was then immediately paid off at the JV closing. Thus, it appears CGI was not reimbursed by Element and should have written off this receivable in its Q2'17 financial statements; in not doing so, CGI inflated its asset values.
- This, in our view, amounts to incontrovertible proof that CGI inflated its Q2'17 TBV and profits by at least \$31.8m.

Topic	What CGI Disclosed in its 1/6/17 8-K & Q2'17 Earnings Release	What Was Disclosed in the JV Subscription Agreement														
Collection of Lease Shortfall Advances	<p><u>Source: CGI 8-K Filed on 1/6/17 –</u></p> <table><tr><th>Source / (Use) (in millions)</th><th>Description</th></tr><tr><td>\$ 4,600</td><td>Cash received – redemption</td></tr><tr><td>6,700</td><td>Cash received – receipt of deferred purchase price cash</td></tr><tr><td>50,000</td><td>Cash received – sale of Quality equipment</td></tr><tr><td>31,800</td><td>Cash received – reimbursement of Other Assets</td></tr><tr><td>(35,300)</td><td>Cash invested in 19<sup>th</sup> Capital at closing</td></tr><tr><td>\$ 57,800</td><td>Net cash received at closing</td></tr></table> <p><u>Source: CGI Q2'2017 Earnings Release –</u></p> <ul style="list-style-type: none"><li>• Successful consummation of our non-controlled joint venture, 19<sup>th</sup> Capital Group.</li><li>• Contributed the asset intensive Quality revenue equipment sales and leasing business to 19<sup>th</sup> Capital Group, to complete the conversion of Quality to a recurring revenue asset light business with little ongoing capital investment.</li><li>• Sold equipment recorded under assets held for sale, leasing assets held for sale, and leasing assets.</li><li>• Reduced net debt by approximately \$64 million during the December quarter.</li><li>• Collected the \$31.8 million amount previously recorded under "Other assets".</li><li>• Reallocated approximately 45 tractors from our less profitable irregular route truckload business into more profitable operations.</li></ul>	Source / (Use) (in millions)	Description	\$ 4,600	Cash received – redemption	6,700	Cash received – receipt of deferred purchase price cash	50,000	Cash received – sale of Quality equipment	31,800	Cash received – reimbursement of Other Assets	(35,300)	Cash invested in 19 <sup>th</sup> Capital at closing	\$ 57,800	Net cash received at closing	<p><u>Source: JV Subscription Agreement Filed on 2/10/17 –</u></p> <p>At the closing of the Element Investment,</p> <p>(i) Element shall transfer, convey, and assign to the Company the Element Assets;</p> <p>(ii) Element shall make a loan to the Company in the principal amount of \$31,800,000 (the "Element Daylight Loan"), which shall be evidenced by this Agreement, and the Company shall pay \$31,800,000 to Celadon in respect of the Payment;</p> <p>At the closing of the Celadon Investment,</p> <p>(i) Celadon shall transfer, sell, and assign all of its interests in the Quality Assets to the Company;</p> <p>(ii) Celadon shall transfer \$31,800,000 in cash to an account designated by the Company, and the Company shall repay the Element Daylight Loan in full;</p> <p><i>*Note: The JV is referred to as "the Company" in the above disclosures.</i></p>
	Source / (Use) (in millions)	Description														
\$ 4,600	Cash received – redemption															
6,700	Cash received – receipt of deferred purchase price cash															
50,000	Cash received – sale of Quality equipment															
31,800	Cash received – reimbursement of Other Assets															
(35,300)	Cash invested in 19 <sup>th</sup> Capital at closing															
\$ 57,800	Net cash received at closing															

## Like CGI, Like... Enron?

We always index the companies we expose against accounting frauds past; in doing so, we develop better understandings of our subjects. Further, we have found no better predictor for how things will unfold than tracking against a what we deem to be a historical parallel.

We initially decided to compare CGI against Enron because Enron was notorious for using off-balance sheet entities and related party transactions to fabricate its SEC financial statements and siphon shareholder value out of the company. CGI has used these same structures and methods, in our opinion, to achieve the same results. Beyond these factors, we found the similarities ran much deeper. We are confident that the CGI of today is similar to the Enron of 2001, and that the company will meet a similar fate.

The table below demonstrates some of the most troubling similarities:

### Celadon Bears a Striking Resemblance to the Enron Fraud \*\*

	Celadon Group	Enron	Comments **
Use of opaque off-balance entities & related party transactions	✓	✓	<ul style="list-style-type: none"> <li>Enron used off b/s special purpose entities (SPEs) to inflate its assets &amp; profits, hide liabilities and siphon money to mgmt as the company collapsed</li> <li>CGI has used off-balance sheet JVs to inflate its assets &amp; profits and siphon money to mgmt as the company is collapsing</li> </ul>
Inflation of assets and profits via improper accounting	✓	✓	<ul style="list-style-type: none"> <li>Enron used improper revenue recognition, mark-to-market accounting and SPEs to fabricate its financials</li> <li>CGI has used off-balance sheet transactions, PP&amp;E inflation and other improper accounting tactics to fabricate its financials</li> </ul>
Dismal earnings quality & FCF burn	✓	✓	<ul style="list-style-type: none"> <li>From 1998 to 2000, Enron reported a cumulative net profit of \$2.6Bn while its FCF was a LOSS of \$4.1Bn</li> <li>CGI's reported LTM Q2'17 net profit was \$2.5m while its FCF was a LOSS of more than \$48m</li> </ul>
Insolvent financial condition	✓	✓	<ul style="list-style-type: none"> <li>Enron's fabrications masked its insolvent condition (&gt;\$13Bn of debt, deeply negative FCF) and prevented a covenant default</li> <li>CGI's fabrications have masked its insolvent condition (\$471.9m of debt, deeply negative FCF) and have prevented a covenant default</li> </ul>
High audit fees signal elevated financial risk	✓	✓	<ul style="list-style-type: none"> <li>In 2000, Enron was Arthur Andersen's 2nd largest account</li> <li>CGI is by far BKD-Indiana's largest public company client. CGI's fees to BKD have increased ~180% in just two years</li> </ul>
Overly bullish / clueless Wall Street analysts	✓	✓	<ul style="list-style-type: none"> <li>13 of Enron's 18 analysts rated the stock as a Buy just months prior to its collapse</li> <li>4 of 6 CGI analysts have rated the stock as a Buy, with an average price target of ~\$11</li> </ul>

\*\* Reflects Prescience Point Research Opinions



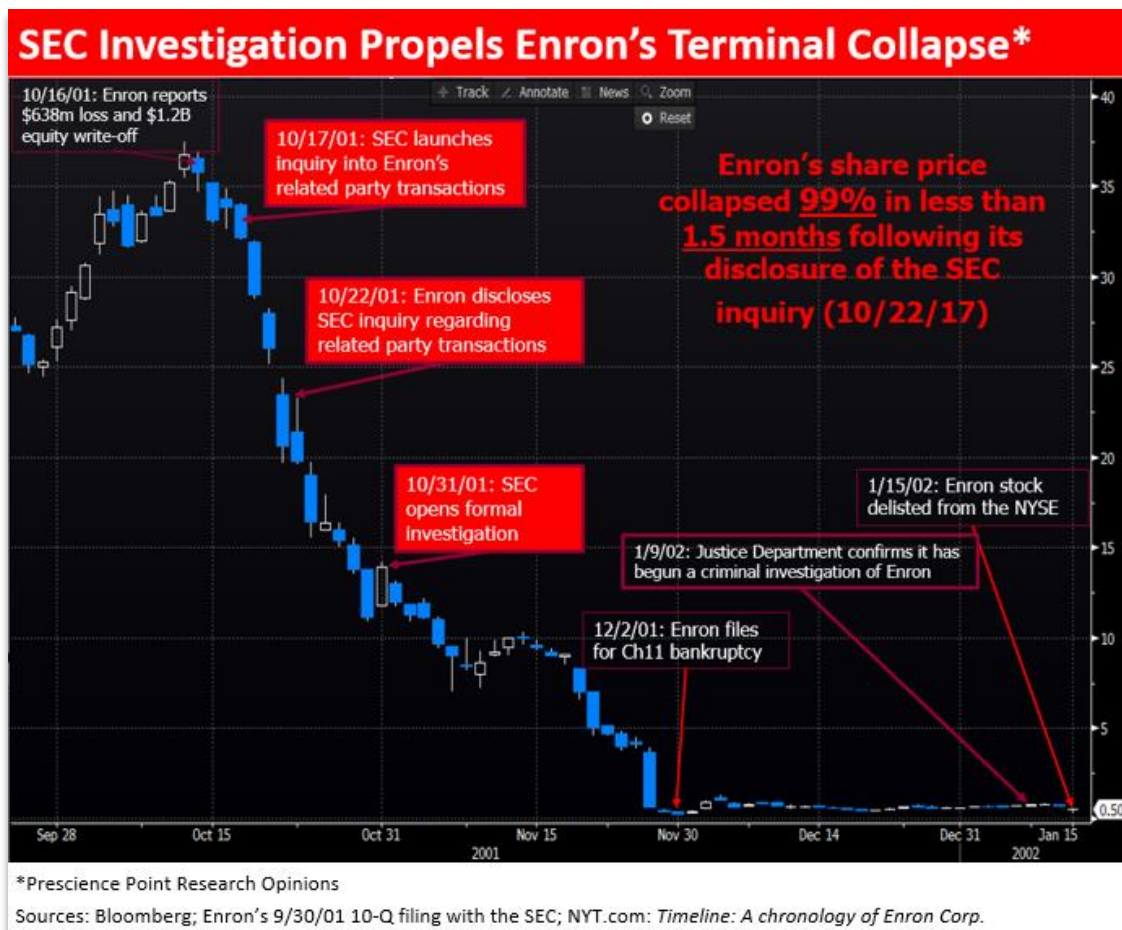
## Effect of Disclosure of an SEC Investigation on the Stock of Troubled Cos.

The historical record indicates that the disclosure of an SEC Investigation when it comes to a company that has previously been accused of fabricating its financials and vastly overstating its TBV, results in the propulsion of a terminal collapse. We believe we are currently witnessing CGI's terminal collapse in real time.

**Enron stock collapsed 99% and it declared Ch 11 bankruptcy in only 1.5 months after it disclosed an SEC investigation.**

One of the most shocking aspects of the Enron story was just how quickly the situation unraveled: Enron's disclosure of an SEC investigation in 2001 propelled its terminal collapse. Within just a month and a half after making this disclosure, Enron's stock price collapsed by -99%, from over \$20 to pennies, and it filed for bankruptcy.

Based on our discovery and confirmation of an active SEC investigation, and our assessment that CGI has grossly fabricated its SEC financials to mask a dire financial condition, we believe CGI faces an unwind of similar speed and consequence.



## Management Goes Radio Silent on Shareholders: A Tacit Admission of Guilt?

CGI appears to be navigating the most perilous time in its history; based on our analysis, it is running dry of liquidity and faces critical questions about its accounting and business practices. CGI's stock has collapsed by >30% in just the past 2 weeks. Yet, as opposed to fairly representing CGI's shareholders with efforts to re-instill market confidence, management has gone radio silent. In effect, CGI management has turned its back on shareholders, most likely in the interest of self-preservation. The signaling effect of this choice of response should be deeply concerning and interpreted as a tacit admission of guilt.

If we are right in our assessment of this company (refer to our Initial Report), CGI may be on the hook for serious legal infractions. Essentially, we believe investors and creditors were lied to as shareholder value was unsuspectingly sucked out of the company, and that CGI now sits at the precipice of bankruptcy.

- We now know the company is being actively investigated by law enforcement. CGI faces great legal risk.
- Any competent legal team would advise its at-risk client to maintain complete silence to avoid further implication, as the walls are already caving in.

**In our view, management's silence is likely at the advice of legal counsel, and it should be interpreted as a glaring red flag.**

### CGI is not even responding to private email requests for contact

Equally as concerning, management has appeared to be completely unreachable for a period of ~4 weeks now. We have attempted email contact of CGI management and investor relations on several occasions, both before and after we published our Initiation Report. We have yet to receive a single response.

#### Email Directed to CGI IR and CFO, 2 Days Post-Publication of Our Initiation Report

##### request for call

Prescience Point <research@presciencepoint.com>  
To: jweigel@celadongroup.com  
Cc: bpeavler@celadongroup.com, rpeavler@celadongroup.com  
Bcc: research@presciencepoint.com

Mon, Apr 10, 2017 at 8:24 PM

Joe,

Our firm published a short biased research report on Celadon Group last week, which revolved around accounting irregularities we identified in Celadon's SEC filings and other public disclosures.

We would like to discuss our findings with you and Celadon CFO Bobby Peavler to better understand the causes of these irregularities, which suggest Celadon has overstated its assets, and hence its financial position, by at least \$219m. In turn, this means that Celadon's tangible book value has been eroded to no more than \$.42/share, while your balance sheet reports a TBV of \$10.80/share. In other words, our analysis indicates Celadon's reported tangible book value is overstated by at least 25x.

We attempted to open a dialogue with you several times prior to the publication of our report, to give you the opportunity to set the record straight. Obviously, you never responded to any of our requests. We are reaching out to you again, in hopes that you will answer to the allegations (which are supported by the analysis of an independent forensic accounting firm) and provide the basis for the accounting irregularities identified in our report.

Can you and Bobby make yourself available tomorrow, early afternoon?

Your prompt response is greatly appreciated.

#### Multiple Emails Pre-Publication – NOT A SINGLE RESPONSE

##### request for call

5 messages

Prescience Point <research@presciencepoint.com>  
To: jweigel@celadongroup.com  
Bcc: Prescience Point <research@presciencepoint.com>

Thu, Mar 23, 2017 at 11:58 PM

Joe,

We've been assessing the merits of Celadon as an investment opportunity for several months now. We have some questions pertaining to the business, transactions and potential transactions, and some accounting related inquiries.

Are you available for an introductory call tomorrow afternoon? If so, please let me know of a time that works. If not, please let me know if you have availability on Monday.

Your time is greatly appreciated.

Prescience Point <research@presciencepoint.com>  
To: jweigel@celadongroup.com  
Bcc: research@presciencepoint.com

Fri, Mar 24, 2017 at 1:39 PM

Joe,

Checking back in. Can you make yourself available this afternoon or on Monday morning?

Thanks  
[Quoted text hidden]

Prescience Point <research@presciencepoint.com>  
To: jweigel@celadongroup.com  
Bcc: research@presciencepoint.com

Sun, Mar 26, 2017 at 4:15 PM

Joe,

We have now reached out to you multiple times. Your response would be greatly appreciated. We would like to schedule a call with you for tomorrow morning, if your schedule permits.

Can you make yourself available for an hours time? If not tomorrow morning, are you available tomorrow afternoon?

Please let us know, and thank you for your consideration.

**Legal Disclaimer:**

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