Celadon Group, Inc. | NYSE: CGI

Price Target: $0.00

Share Price:
$6.35

Avg Daily Volume:
417k

Market Cap:
$179.7m

Debt:
NA (1)

Enterprice Value:
NA (1)

LTM Revenue:
NA (1)

LTM Adj CFFO:
NA (1)

LTM Adj FCF:
NA (1)

Revolver Availability:
NA (1)

Auditor:
BKD, LLP

(1) *Information not available due to ongoing financial restatements.*

Prescience Point believes that shares of Celadon Group ("CGI", or "the company") are grossly overvalued, failing to reflect the likelihood of an imminent debt restructuring and wipeout of existing shareholders.

In April 2017, Prescience Point issued two research papers (the "Initiation Report" and the "Follow-Up Report") on CGI. In our Initiation Report, we concluded that CGI's profits and TBV were highly overstated in its SEC filings and that the company was at the precipice of bankruptcy. In our Follow-Up Report, we revealed that the company was the subject of an undisclosed investigation by the SEC's Enforcement Division.

In the prevailing 9 months since we released our reports, CGI's auditor BKD withdrew its audits of CGI's financial statements; CGI's top 3 executives were replaced; CGI disclosed an active formal SEC investigation; and, CGI violated its debt covenants and would have already declared bankruptcy if not for the generosity of its lenders who have amended the credit agreement three times since May.

Unbelievably, despite all of the challenges and uncertainties facing CGI, its share price has almost quadrupled over the past few months from a low of $1.55 on May 3rd to the current share price of $6.35. Investors appear to believe that, with new management in place and the recent improvement in the trucking environment, CGI is in the midst of a successful turnaround.

However, we continue to believe that CGI is a Zero, and that bankruptcy is the most plausible outcome, for the following reasons:

- After generously amending the credit agreement several times, CGI's lenders appear to have finally lost patience. In the most recent amendment dated September 29th, a clause was added requiring CGI to refinance its existing credit facility by December 31st. If CGI fails to do so, it appears that its lenders are now prepared to force the company into bankruptcy in order to preserve the value of their collateral.

- CGI's refinancing efforts appear to be on the verge of failing. As of November 30th, the company had yet to receive a satisfactory LOI for its proposed term loan, and had only managed to secure a <u>non-binding</u> LOI for its proposed ABL which is subject to due diligence. Non-binding LOIs are far from firm commitments as evidenced by Bank of America's decision to walk away from its proposed $225m ABL with CGI earlier this year after conducting due diligence. Also, based on the cautious tone of CGI's latest refinancing update, it appears that management is losing confidence in its ability to refinance on acceptable terms for shareholders.

- In addition to the ongoing financial restatements and SEC investigation, we believe that CGI's difficulties in attracting interest from lenders is also attributable to its dire financial condition. Our research indicates that CGI's already poor operating performance has further deteriorated in the 3+ quarters since it last reported earnings. For example, CGI has communicated to investors that it expects to report a net loss of $10.0m in Q3'17, as well as a net losses for FY'17 and Q1'18. Additionally, the minimum LTM EBITDAR covenant in the latest credit agreement amendment – $76.4m, $71.0m and $67.0m for the periods ended 9/30/17, 10/31/17 and 11/30/17, respectively – suggests that CGI's LTM EBITDAR has declined significantly since Q2'17. Lastly, although CGI's rampant asset liquidations have helped keep it afloat in the short term, these dispositions will greatly pressure the company's revenue and profitability going forward. Consider that the recently sold Quality business accounted for $12.8m of annualized operating profit in Q2'17.

- In our Initiation Report, we concluded that CGI's last reported TBV of $10.80 per share as of Q2'17 is mostly fiction. In total, we estimated CGI's accounting shenanigans had inflated its Q2'17 TBV by $219m, and that CGI's actual Q2'17 TBV was no more than $.42 per share. Recent evidence has confirmed that CGI's reported TBV is significantly overstated and is likely worthless, in our view. For example, Element has written down its JV stake by almost 50% over the past 3 quarters, supporting our conclusion that the $100m JV stake on CGI's balance sheet is likely worthless. Additionally, according to CFO Thom Albrecht, BKD is reassessing the accounting for around 11,000 equipment transactions, indicating that significant equipment write-downs are likely. Lastly, CGI's continued operating losses will result in further reductions to its TBV.

Even if CGI is somehow able to refinance and remain solvent, we believe CGI shareholders will still incur significant losses. In order to effectively run its business, CGI will need to substantially reduce its debt balance which stood at $455.3m as of Q2'17. With access to the equity markets likely cutoff due to a lack of audited financials, we believe that the company will need to exchange more than $250m of its existing debt for equity in order to reduce its debt to a target leverage ratio of 2.0x LTM EBITDAR. Given that current TBV appears to be worthless or close to it, we estimate that such a debt-for-equity swap would be priced at no more than $1.00 per share – diluting existing shareholders by at least 90%! Thus, all roads appear to lead to a disastrous outcome for shareholders.

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.

Developments Over the Past Nine Months Have Validated Our Research

Since we published our initial short recommendation on CGI almost nine months ago, a number of developments have transpired which have either confirmed or reinforced many of our key research conclusions. These developments include the following:

- **BKD withdrew its audit reports:** In our Initiation Report, we concluded that CGI would restate its historical results due to the myriad of accounting improprieties we highlighted. On April 25th, this prediction came true as BKD withdrew its audits for CGI's FY'16, Q1'17 and Q2'17 financial reports. In a subsequent press release on October 2nd, CGI indicated that it did not expect BKD's audit work to be completed until sometime after 12/31/17. In our view, the lengthy amount of time it is taking for BKD to complete its work indicates that CGI's financial reports are likely to be restated significantly.

- **CGI replaced its top 3 executives:** In our Initiation Report, we presented evidence that CGI management had not only fabricated CGI's financials, but had also used a related party (19th Capital) to enrich itself at the expense of shareholders. In the months following our report, CEO Paul Will, COO Eric Meek and CFO Bobby Peavler were all let go and replaced by the company. In our view, this swift cleaning of house by CGI confirms that the concerns we raised about management's conduct have merit.

- **CGI's liquidity issues have intensified:** In our Initiation Report, we concluded that CGI would be insolvent in 1-2 quarters due to its deeply negative and rapidly deteriorating FCF and limited revolver availability. Since we published our report, CGI's liquidity issues have intensified. The company has been firesaling assets and recently raised $22.6m in term loan financing in order to keep itself afloat. CGI also violated its debt covenants, and its credit agreement has been amended three times since May. If not for the generosity of its lenders, CGI would have already declared bankruptcy.

- **CGI revealed that it is the subject of a formal SEC investigation:** In our Follow-Up Report, we revealed FOIA data confirming that CGI was the subject of an ongoing SEC investigation. We concluded that this investigation would result in enforcement actions against CGI and its management team. CGI verified our findings when it disclosed on October 2nd that the SEC had undertaken a formal investigation related to the company. Public companies are only required to disclose SEC investigations that they deem to be "material." The fact that management judged this investigation to be serious in our view indicates that future enforcement actions are likely.

CGI's Refinancing Efforts Appear to be on the Verge of Failing

Since BKD withdrew its audits in April, CGI's lenders have generously amended the credit agreement a total of three times as they have patiently waited for the company to get its financial house in order. However, it appears that their generosity and patience is wearing thin as the sixth and most recent amendment contains a new clause requiring CGI to refinance its current $221m credit facility by December 31st, indicating that they are now willing to let the company fall into bankruptcy in order to preserve the value of their collateral.

> *Section 6.02 of the Credit Agreement is hereby amended by adding the following new clauses (w) and (x) to such section:*
>
> *(x) on or before November 22, 2017, a certificate signed by a Responsible Officer of the Borrower confirming that the Borrower has paid the necessary due diligence or similar upfront fees required under one or more letters of intent executed in connection with a prospective transaction or transactions that would enable the Borrowers to* ***repay in full all Obligations under the Loan Documents on or before December 31, 2017.*** *(Sixth Amendment to Credit Agreement, Pg. 4, 9/29/17)*

Thus, CGI must refinance its existing credit facility in short order, or else it will almost assuredly have to file for Chapter 11. Unfortunately, despite months of effort, the company has made little progress in securing new lenders, and based on the cautious tone of CGI's November 30th press release, it appears that management is losing confidence in the company's ability to do so. These developments have led us to believe that CGI's refinancing efforts are on the verge of failing and bankruptcy is the most plausible scenario.

CGI Has Made Little Progress in Securing Lenders for Its New Credit Facility

Over the past few months, CGI has been scrambling to raise money for a newly proposed credit facility consisting of an ABL and a term loan. According to management, the ABL will be smaller than the current credit facility, meaning that the company will need to close both the ABL and term loan in order to successfully complete the refinancing. The bad news for CGI shareholders is that, with the year-end deadline just days away, the company does not appear to be close to closing either:

- **Although CGI recently signed a letter of intent ("LOI") for its proposed ABL, the LOI is non-binding and subject to completion of due diligence:** In its November 30th press release, CGI disclosed that it had signed an LOI for a proposed ABL with two of its existing lenders.

  > *In particular, we have entered into a nonbinding letter of intent which contemplates an asset based revolving credit facility with two of our existing revolving lenders. (CGI Press Release, 11/30/17)*

  However, in the same press release, the company noted that the LOI it received was non-binding, and that the closing of the ABL was subject to further diligence, internal lender approvals and negotiation of definitive documents. Therefore, although signing an LOI represents some incremental progress, CGI appears to be a long way away from closing on the ABL as many hurdles still need to be cleared.

  > *The proposals are non-binding and the completion of the refinancing is subject to, among other things, the prospective lenders' satisfactory completion of due diligence, internal lender approvals, and negotiation of definitive documentation. (CGI Press Release, 11/30/17)*

  Also, as disclosed in its May 1st press release, one of CGI's current lenders – Bank of America – provided CGI with a term sheet for a proposed $225m ABL back in May. At the time, the company disclosed that it expected the facility to close by the end of June. However, the ABL never closed as Bank of America apparently walked after further diligence. We believe there is a good chance that the lenders who signed the current LOI will also do the same after digging deeper into the company.

- **CGI has not received any satisfactory LOIs for its proposed term loan:** Prior to its November 30th press release, CGI had last updated investors on its refinancing process in a press release on October 16th. In this update, the company disclosed that it had received indications of interest ("IOIs") for both its proposed ABL and term loan:

  > *The Company has received the required indications of interest…In particular, two members of our current bank group proposed asset-based revolving credit or similar facilities consistent with our requested terms…**In addition, we received indications from multiple term lenders to accompany the revolving facility**, with terms being consistent with our range of expectations. Based on these indications of interest, which are non-binding, we continue to expect to refinance our existing facility with a more appropriate long term capital structure. (CGI Press Release, 10/16/17)*

  Over one month later, in its latest refinancing update on November 30th, CGI disclosed that it had signed an LOI with two of its existing lenders for its proposed ABL. However, no mention was made of signing an LOI for its proposed term loan, indicating that the company had yet to receive a satisfactory LOI from potential lenders. The fact that CGI had yet to receive a satisfactory LOI as of November 30th was further confirmed in a conversation with CFO Thom Albrecht.

> *In particular, we have entered into a nonbinding letter of intent which contemplates an asset based revolving credit facility with two of our existing revolving lenders. This continued support from our current lenders is much appreciated as we continue to work towards accomplishing the refinancing. (CGI Press Release, 11/30/17)*

So why has CGI failed to attract a satisfactory LOI for its term loan? Some of the lenders who submitted IOIs may have dropped out after further diligence. Others may have submitted LOIs that CGI rejected due to unsatisfactory terms. Regardless of what happened, the simple fact is that CGI's attempts to attract serious interest for its term loan have largely failed.

Has Management Lost Confidence in CGI's Ability to Successfully Refinance?

In a press release on November 30th, CGI provided investors with an update on its refinancing efforts. As detailed below, this latest refinancing update struck a much more cautious tone in comparison to the company's previous update on October 16th. In our view, this significant change in tone is an indication that, after putting in months of effort with little progress, management has lost confidence in CGI's ability to successfully complete the refinancing.

- **The refinancing update on October 16th struck a very confident tone:** In CGI's October 16th press release, CEO Paul Svindland expressed a great deal of confidence when commenting on the company's ongoing refinancing efforts. More specifically, Mr. Svindland thanked current lenders for their "strong support." He also noted that the terms CGI had received from prospective lenders were "consistent with our range of expectations." Finally, he noted that management continued to "expect to refinance our existing facility."

  Provided below are Mr. Svindland's comments in their entirety from the October 16th press release:

  > *We were pleased to receive multiple indications of interest from both asset-based revolving lenders and term lenders to provide the required financing. In particular, two members of our current bank group proposed asset-based revolving credit or similar facilities consistent with our requested terms. **This strong support from our current lenders is much appreciated** and will be instrumental to our refinancing process. In addition, we received indications from multiple term lenders to accompany the revolving facility, **with terms being consistent with our range of expectations**. Based on these indications of interest, which are non-binding, **we continue to expect to refinance our existing facility** with a more appropriate long term capital structure.*

- **The refinancing update on November 30th was notably more cautious:** Fast forwarding over one month later, in CGI's November 30th press release, Mr. Svindland was much more cautious when commenting on the company's ongoing refinancing efforts. For example, he thanked current lenders for their "continued support" rather than their "strong support." He also stated that CGI was continuing to "work towards accomplishing the refinancing," which was much more subdued compared to his prior statement that CGI continued to "expect to refinance our existing facility." Finally, he made no mention of the terms CGI had received from prospective lenders, while in his prior comments he noted that terms were "consistent with our range of expectations."

  Provided below are Mr. Svindland's comments in their entirety from the November 30th press release:

  > *We were pleased to receive proposals for both an asset based revolving credit facility and term loan financing. In particular, we have entered into a nonbinding letter of intent which contemplates an asset based revolving credit facility*

with two of our existing revolving lenders. ***This continued support from our current lenders is much appreciated as we continue to work towards accomplishing the refinancing****.*

- **This significant change in tone indicates that management has lost confidence:** Some investors do not pay attention to changes in language in public disclosures. We believe this is a mistake. For legal reasons, companies and their management teams are typically very careful that the information presented in official filings and press releases cannot be construed as being misleading. Therefore, changes in how disclosures are worded can often provide important clues for investors.

  If CGI management was still optimistic about its chances of successfully refinancing, we believe it would have used similarly confident language in its latest refinancing update as it did in its prior one. Therefore, in our view, the cautious tone that management has adopted indicates that it has lost confidence in CGI's ability to refinance on acceptable terms for shareholders.

CGI's Financial Condition Remains Dire

So why is CGI struggling so much to raise money for its new credit facility? Well, to begin with, CGI is missing audited financials for almost two fiscal years and is currently under a formal investigation by the SEC. Lenders are generally more risk averse than equity investors, and we believe this cloud of uncertainty surrounding CGI has likely scared off many of them.

In addition to the ongoing financial restatements and SEC investigation, we believe that CGI's dire financial condition has compounded its difficulties in attracting interest from lenders. As detailed below, recent evidence indicates that CGI's already poor operating performance has further deteriorated in the 3+ quarters since it last reported earnings. As also detailed below, recent evidence in our view confirms that CGI's reported TBV is significantly overstated and is likely worthless. Therefore, we believe it is doubtful that CGI generates enough profit or has enough collateral to support its proposed credit facility.

Despite the Recent Trucking Turnaround, CGI's Operating Performance Appears to Have Further Deteriorated

Despite recent increases in shipping volumes and rates across the trucking sector, CGI's recent disclosures indicate that its operating performance continues to remain challenged. Even worse, our research indicates that CGI's operating performance has actually deteriorated significantly over the past few quarters, and will likely continue to deteriorate over the coming quarters. We arrived at these conclusions based on the following:

- **CGI has reported estimated net losses since Q2'17:** Despite a more favorable trucking environment, CGI has yet to return to profitability. Although the company has not reported quarterly financial results since Q2'17, CGI has communicated to investors that it expects to report a net loss of $10.0m in Q3'17, as well as a net losses for FY'17 and Q1'18. Provided below is an excerpt from CGI's most recent NT 10-Q filing:

  The Company presently expects to report a net loss for the fiscal quarter ended September 30, 2017. *Because of the Company's continued evaluation of the matters noted in Part III above, it is not in a position to give more detailed estimated results for the period. (NT Q1'18 10-Q, 9/14/17)*

- **Revised covenants suggest that CGI's operating performance has deteriorated significantly since Q2'17:** Although CGI has not filed financials since Q2'17, clues to the company's operating performance can be found in the sixth and most recent amendment to the credit agreement. Under this amendment, CGI is required to maintain a minimum LTM EBITDAR of $76.4m, $71.0m and $67.0m for the periods ended 9/30/17, 10/30/17 and 11/30/17, respectively:

Maintain Adjusted EBITDAR, on a trailing twelve month basis, not less than (i) $76,400,000 for the twelve-month period ending September 30, 2017, (ii) $71,000,000 for the twelve-month period ending October 31, 2017 and (ii) $67,000,000 for the twelve-month period ending November 30, 2017. (Sixth Amendment to Credit Agreement, Pg. 5, 9/29/17)

In our experience, lenders typically give a cushion ranging between 20% - 25% on this type of covenant. After adding a 25% cushion to the minimum LTM EBITDAR thresholds, we estimate CGI's LTM EBITDAR was $101.9m, $94.7m and $89.3m for the periods ended 9/30/17, 10/30/17 and 11/30/17, respectively. These estimates represent a significant decline from the $127.4m of LTM EBITDAR that CGI last reported in Q2'17 (quarter ended 6/30/17).

Based on the above analysis, we believe it is likely that CGI's financial performance has deteriorated significantly over the past 3+ quarters. While it is possible that our EBITDAR estimates are too low, we do not believe this is likely. A cushion far in excess of 25% for this type of covenant is something we cannot recall seeing before.

- **CGI's operating performance is likely to deteriorate even further:** We believe that a return to profitability for CGI is unlikely to happen anytime soon. In fact, we believe that CGI's operating performance is likely to get worse before it gets better. Consider that, over the past few months, the company has been selling off divisions to fund its significant cash burn. In September, CGI sold its flatbed division to PS Logistics for an undisclosed amount. Additionally, based on a call with CFO Thom Albrecht on December 5th, CGI also recently sold its Quality division, a transaction which was puzzlingly not disclosed to investors in a formal press release.

Mr. Albrecht: That leasing company is gone.

Research Consultant: To clarify, Quality is the leasing business, right? Is that still a part of Celadon?

Mr. Albrecht: Yeah, that's gone. The employees are gone.

Selling off divisions have helped CGI to stay afloat in the short term. However, on the flipside, these dispositions will greatly pressure the company's revenue and profitability going forward. For example, as disclosed on pg. 9 of CGI's Q2'17 10-Q, the Quality division generated $16.2m of revenue in Q2'17. More importantly, this division generated $3.2m of operating income in Q2'17 which amounts to $12.8m on an annualized basis. CGI will be hard-pressed to replace the loss of such a large amount of operating income. *(Note: Quality is also referred to as "Equipment leasing and services" in CGI's 10-Q and 10-K filings)*

Revenue:

	Three Months Ended December 31, 2016	2015
Asset-based	$ 218,617	$ 236,324
Asset-light based	30,954	32,943
Equipment leasing and services	16,154	6,132
Total	$ 265,725	$ 275,399

Operating Income:

	Three Months Ended December 31, 2016	2015
Asset-based	$ (6,790)	$ 11,471
Asset-light based	1,876	3,280
Equipment leasing and services	3,180	(672
Total	$ (1,734)	$ 14,079

Further pressuring CGI's profitability will be its aging tractor fleet. As per the company's FY'16 10-K, the average age of the company's tractor fleet was 1.9 years as of 6/30/16:

> ***The average age of our owned and leased tractors** and trailers **was approximately 1.9 years** and 3.7 years, respectively, **at June 30, 2016.** (FY'16 10-K, Pg. 7, 9/13/16)*

Given CGI's challenged liquidity position, we believe it is unlikely that the company has been able to refresh much, if any, of its existing tractor fleet. Thus, at the end of this year (12/31/17), we estimate that the average age of CGI's tractor fleet will be ~3.4 yrs (1.9 yrs + 1.5 yrs).

Now, consider that in CGI's FY'16 10-K, the company stated that maintenance costs begin to increase substantially once tractors reach 4 years of age. Given this fact, it appears that CGI's maintenance expenses will begin to increase significantly in 2018.

> *Our replacement cycle for our tractors is approximately three to four years. This equipment renewal policy has allowed us to recognize significant benefits associated with reduced maintenance and tire expenses, as such **expenses increase significantly for tractors beyond the fourth year of operation**, as wear and tear increases and some warranties expire. (FY'16 10-K, Pg. 5, 9/13/16)*

Recent Evidence Strongly Supports Our Conclusion that CGI's TBV is Close to Worthless

We believe that CGI's last reported TBV of $10.80 per share as of Q2'17 is mostly fiction. In our Initiation Report, we concluded that CGI had used improper and manipulative accounting practices to significantly inflate the value of its assets, including the value of its equipment and JV stake. In total, we estimated CGI's accounting shenanigans had inflated its Q2'17 TBV by $219m, and that CGI's actual Q2'17 TBV was no more than $.42 per share.

Recent evidence which has emerged over the past nine months has validated much of our analysis:

- **Element has written down the value of its JV stake by almost 50% over the span of just 3 quarters:** In our Initiation Report, we estimated that CGI had overstated the value of its JV stake by $100m. CGI marked its JV stake at $100m on its Q2'17 balance sheet. However, our analysis indicated that this stake was actually worthless.

  As disclosed on pg. 12 of its 9/30/17 earnings report, Element has written down its JV stake by 49.2% from CAD $135.8m to CAD $69.0m over the past 3 quarters. In our view, this confirms that the JV value of $100m as reported on CGIs balance sheet is inflated and must also be written down. We reiterate our belief that the JV is worthless.

  Element Fleet Management - 9/30/17 Balance Sheet:

(in $000's for stated values)	September 30, 2017 $	June 30, 2017 $	December 31, 2016 $
Assets			
Fleet Management finance assets			
Finance receivables	12,002,525	12,780,472	12,555,776
Equipment under operating leases	1,524,674	1,523,396	1,421,637
Fleet Management finance assets	13,527,199	14,303,868	13,977,413
Non-Core finance receivables	883,148	1,100,318	898,235
Total finance assets	14,410,347	15,404,186	14,875,648
Non-Core other earning assets	122,346	161,623	170,889
Non-Core investment in joint venture	69,045	81,425	135,846

- **BKD is re-assessing the accounting involving an extensive amount of equipment currently and previously owned by CGI:** In our Initiation Report, we estimated that CGI had overstated the value of the equipment (PP&E + equipment held for sale) on its Q2'17 balance sheet by $78.8m through improper accounting methods. Additionally, we estimated that CGI had failed to record a $36m loss from the sale of Quality equipment in its Q2'17 financial statements.

  As we highlighted earlier, on April 25th, BKD withdrew its audit opinions for CGI's FY'16, Q1'17 and Q2'17 financial reports. In a press release on May 1st, CGI disclosed that BKD was reassessing the carrying values and accounting of transactions involving the company's equipment:

  > *The insufficient appropriate audit evidence relates to the carrying values and accounting (and related structure, substance, and disclosure) of transactions involving dispositions and acquisitions of revenue equipment between June and December of 2016. Additional information concerning the transactions and the fair values of the revenue equipment disposed of and acquired is required to determine the appropriateness of the accounting for these transactions. (CGI Press Release, 5/1/17)*

  From the same conversation with Mr. Albrecht referenced earlier in this report, it was revealed that BKD is in the process of analyzing the accounting for around 11,000 "pieces of equipment" that the company currently owns or had previously owned. The fact that BKD is reassessing the accounting for such an extensive amount of equipment strongly indicates that the accounting red flags we identified involving CGI's equipment have merit.

  > *Mr. Albrecht: There were a lot of transactions with Quality, and again that portfolio at one point had gotten up to 11,000 pieces of equipment. So, there's a lot of transactions in there that are being studied (by BKD).*

- **Bank of America explored providing an asset-backed loan ("ABL") to CGI but walked upon further diligence, indicating that collateral was insufficient:** As already discussed earlier, back in May, CGI signed a term sheet with Bank of America for a proposed $225m ABL facility. As highlighted below, availability under the proposed ABL was to be based on the value of certain assets which included its AR, equipment, inventory, and real estate. In our view, Bank of America's apparent decision to walk after further diligence indicates that the company did not have the necessary assets / collateral needed to close the facility – Further evidence that CGI's last reported TBV is mostly fiction.

> *The Company has reached an agreement in principle with Bank of America…for a new $225 million senior secured revolving credit facility ("Proposed ABL Facility"). The Proposed ABL Facility will be used to refinance the Company's existing credit facility…**Availability under the facility will be based on a borrowing base including accounts receivable, equipment, inventory, and real estate** at customary advance rates. The expected closing date is on or about June 30, 2017, subject to customary closing conditions including negotiation and execution of definitive agreements, due diligence, and requisite approvals. (CGI Press Release, 5/1/17)*

Recent evidence also indicates that CGI's TBV has further deteriorated over the 3+ quarters since Q2'17. As already mentioned above, after correcting for CGI's improper accounting, we estimate that the company's actual Q2'17 TBV was just $.42 per share. We believe that CGI's current TBV is less than $.42 per share and may even be negative based on the following:

- **Recent asset sales were likely completed at firesale prices:** CGI has been selling off various assets in order to fund its ongoing cash burn and keep itself afloat. Assets which have recently been sold off include its flatbed division, its driver academy and Quality Companies. As disclosed in its October 2nd press release, CGI also plans on selling two more small divisions (excludes Quality which has already been sold), as well as excess trailers and real estate over the coming quarters:

  > *In terms of non-core assets, we exited the flatbed business and our driver-training academy in September, and we plan to exit three additional small businesses, including our Quality Companies lease servicing business, in coming quarters. In addition, excess trailers and real estate have been identified for sale. (CGI Press Release, 10/2/17)*

  Given CGI's weak negotiating position, we believe that the company will likely incur significant write-downs from its asset sales. Supporting our conclusion is the fact that CGI 1) did not disclose the amount of proceeds it received from the sale of its flatbed division and driver academy, and 2) did not bother to inform investors that its Quality division had been sold. If the sale of these divisions had fetched substantive proceeds, we believe CGI would have been eager to inform investors just how much it had received. This lack of transparency by CGI indicates to us that these divisions were likely sold at firesale prices.

- **Persistent softness in used tractor prices will likely lead additional equipment write-downs:** Given that 1) the book value of CGI's tractors appears to be significantly inflated relative to market value and 2) used tractor prices are not expected to recover for quite some time, we believe CGI will need to write-down the value of its equipment to reflect current market prices.

  While the trucking environment has improved over the past few months, used tractor prices remain deeply depressed and actually declined during the first 9 months of 2017:

  > *In the larger overall wholesale environment…Average pricing in the first 9 months of 2017 is running 2.4% lower than the same period of 2016. (Source: JD Power Report, Pg. 3, November 2017)*

  According to an analyst from Stifel, used tractor prices are likely to remain soft for a while as a surplus of used tractors are continuously flushed into the market:

  > *There is little hope for much improvement in used truck prices over the short- to medium term…a surplus of 3-, 4-, and 5-year-old tractors continues to be flushed [into] a used truck market that continues to be plagued by mediocre demand… (Transport Topics Article, 8/28/17)*

CGI depreciates its tractors to a salvage value of 40% over 4 years. This means that CGI would depreciate a tractor that is purchased for $135K to a salvage value of $54K after 4 years. By comparison, the average price of a 4 year-old sleeper at wholesale was more than $21K or 39% lower at just $32.9K in September 2017:

Average pricing by age was as follows…4-year-old trucks: $32,914 (Source: JD Power Report, Pg. 3, November 2017)

- **Continued operating losses:** CGI has disclosed that it expects to report a net loss for Q3'17, FY'17 and Q1'18, and we expect it will report continued losses for the foreseeable future. These continued operating losses will result in further reductions to CGI's TBV.

Given the totality of the evidence presented above, we believe that BKD will force CGI to drastically write-down the value of its assets once the ongoing audit is complete. Following these write-downs, we expect that CGI's restated TBV will either be worthless or close to it.

All Roads Appear to Lead to a Disastrous Outcome for Shareholders

At the moment, the signs overwhelmingly indicate that CGI will be unable to secure the necessary lenders for its new credit facility. Thus, we believe that CGI's refinancing efforts will ultimately fail, and that the company will subsequently file for bankruptcy.

However, even if CGI is somehow able to refinance, the outcome is still likely to be disastrous for shareholders. As shown in the table below, at the end of Q2'17, CGI's last reported debt balance including capital and operating leases was $455.3m. Given our assessment that CGI has continued to burn cash since Q2'17, we believe that the company's current debt balance has not declined and has likely increased.

CGI Debt Balance as of Q2'17

($ in millions)	
Debt	$114.5
Capital Lease Obligations	$266.0
PV of Operating Leases (1)	$74.8
Lease-Adjusted Debt	**$455.3**

Source: CGI's filings with the SEC, PP estimates.
(1) Discounted to PV at a 10% rate.

CGI's current debt burden is much too high, and refinancing its existing credit facility does not address this problem. So, what is an appropriate amount of leverage for the company? In FY'13 and FY'14, CGI maintained a leverage ratio of around 3x LTM EBITDAR. However, as CFO Tom Albrecht acknowledged during the same conversation we referenced earlier, the company will need to begin refreshing its tractor fleet a year or so from now in order to keep its maintenance costs under control. Based on this, we estimate that CGI will need to reduce its leverage to 2.0x LTM EBITDAR in order to give itself the necessary dry powder to finance its future tractor purchases.

Research Consultant: Turning to your fleet…I know that maintenance costs increase quite a bit after about 3 (or 4) years…Do you have a plan to refresh your fleet?

Mr. Albrecht: We do…It won't be for probably another year.

To estimate CGI's current LTM EBITDAR, we can once again refer to the minimum LTM EBITDAR covenant in the latest amendment to the credit agreement:

> *Maintain Adjusted EBITDAR, on a trailing twelve month basis, not less than (i) $76,400,000 for the twelve-month period ending September 30, 2017… (Sixth Amendment to Credit Agreement, Pg. 5, 9/29/17)*

CGI's minimum LTM EBITDAR covenant for the period ending 9/30/2017 is $76.4m. Assuming a 25% covenant cushion, we estimate that CGI's LTM EBITDAR as of 9/30/2017 was $101.9m. 2.0x our estimated LTM EBITDAR of $101.9m equates to a target debt balance of $203.7m. Assuming a current debt balance of $455.3m, we estimate that the company will have to reduce its debt by $251.6m to achieve a target leverage of 2.0x:

Target Debt Balance Assuming 2.0x Debt-to-EBITDAR

($ in millions)	2.0x Lvg
Estimated LTM EBITDAR [(1)]	$101.9
Target Debt-to-EBITDAR	2.0x
Target Debt Balance	**$203.7**
Reported Q2'17 Debt Balance [(2)]	$455.3
Less: Target Debt Balance	($203.7)
Debt Reduction Required to Achieve Target	***$251.6***

** Prescience Point estimates.*
(1) PP estimate. Based on a 25% covenant cushion applied to CGI's minimum EBITDAR covenant of $71.6m for the LTM period ended 9/30/2017.
(2) Includes $114.5m of debt, $266.0m of capital lease obligations and $74.8m of operating leases discounted to PV at a 10% rate.

For the time being, issuing additional equity does not appear to be a viable option for CGI due to its lack of audited financials. With access to the equity markets cutoff, we believe that the company will need to exchange some of its existing debt (most likely its capital leases and operating leases) for equity in order to reduce its debt balance.

As of December 20th, CGI's share price is $6.35. However, given that CGI's reported TBV appears to be worthless or close to it, we believe that lenders will pay no more than $1.00 per share for any equity received in a swap. This will result in an enormous amount of dilution for current shareholders.

For example, if CGI's equity is priced at $1.00 per share in a debt-for-equity swap, the company would have to issue 251.6m shares in order reduce its leverage to 2.0x LTM EBITDAR. As shown in the table below, this would reduce the ownership of existing shareholders by 89.9%, resulting in a near wipe-out of existing shareholder value.

Estimated Shareholder Dilution From a Debt-for-Equity Swap

($ in millions)	**2.0x Lvg**
Estimated Equity Issued in Swap	$251.6
Price Per Share	$1.00
# of New Shares Issued	**251.6**
# of Existing Shares Outstanding [1]	28.3
# of New Shares Issued	251.6
Pro Forma Shares Outstanding	**279.9**
Existing Shareholders:	
Pre-Swap Ownership	*100.0%*
Post-Swap Ownership	*10.1%*
Reduction in Ownership of Existing Shareholders	***89.9%***

** Prescience Point estimates.*
(1) As per CGI's Q2'17 10-Q.