



Case Study: A Post-Acquisition Autopsy Mistakes Made; Lessons Learned

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Transaction

- ❖ \$100M equity purchase, 10X multiple
- ❖ Seller note -\$5M; equity rollover -\$5M
- ❖ Reps & warranties insurance - \$10M

Buyers

- ❖ Independent sponsor
- ❖ Two multi-billion private equity firms

Post-Transaction Concerns

- ❖ Significantly underperforming EBITDA
- ❖ Multiple issues to investigate
- ❖ Client selected Avant due to capabilities in
 - M&A, particularly Q of Es
 - Distressed/turnarounds
 - Fraud investigations & forensic accounting
 - Litigation support – consulting & testifying experts

Engaged under legal privilege, to review, analyze & opine on multiple issues, primarily focused on:

- ➡ Appropriate technical accounting & impact of each issue on 2015 financial statements
- ➡ Effects on 2015 audited financials & TTM 2016 EBITDA
- ➡ Adjustment to net working capital, if any, at Transaction Date
- ➡ Potentially inaccurate or inadequate Seller disclosures

Interviewed

- ❖ Multiple accounting, financial & operational personnel
- ❖ Members of the board of directors & management
- ❖ Outside experts
 - Company's auditors
 - Legal counsel
 - Big 4 CPA Firm – Q of E
 - Investment banker

Read thousands of pages

- ❖ CPA audited financial statements
- ❖ Big 4 firm Quality of Earnings diligence report
- ❖ SPA & related acquisition documents

Performed

- ❖ Financial / forensic analyses
- ❖ Technical accounting application
- ❖ Industry research

Impact of Multiple Issues?

- ➡ 2015 audited financial statements **materially misstated**
- ➡ Normalized / pro forma TTM May 2016 EBITDA **grossly overstated**
- ➡ Working capital **target significantly understated**
- ➡ Missed debt-like items **inflated purchase price by \$10M**
- ➡ **Deferred CAPEX** (plus, deferred R&M) required additional **millions in cash** post-transaction
- ➡ Multiple inaccurate, inadequate, and undisclosed items in the SPA

Severely Defective Q of E

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	ISSUE	GAAP/ AFS	NWC	Normalized EBITDA	Other	Claim Number
1	Non-GAAP Capitalization of Equipment Maintenance and Repairs	X		X		A1
2	Non-GAAP Accounting Treatment for Long-Term Obligations	X	X	X	X	A2
3	Treatment of Prepaid Items		X	X		N/A
4	City Memphis Relationship and Operations Issues		X	X		A4, 5, and B2
5	Germantown Terminated Contract			X		N/A
6	Non-Ordinary Course Delaware Operations/Financial Shortfall			X		A6
7	Deferred Truck Expense			X	X	A7
8	NW Arkansas Rebranding				X	A8
9	Memphis CNG Code Violations	X	X	X		A9
10	Trade Payables Delay				X	N/A
11	Unpaid Title and Survey Costs		X		X	B4

Audited Financials Materially Misstated

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Pro Forma adjusted 2015 audited financial statements after Avant proposed adjustments under generally accepted accounting principles ("GAAP") for a single item alone (contract indebtedness)

Pro Forma Effect of CNG (in \$000s) As of the year ending December 31, 2015	Per Audit	Avant Adjusted
Total current assets	\$ 8,240	\$ 9,041
Property and equipment, net	26,831	25,834
Total assets	<u>41,063</u>	<u>45,551</u>
Total current liabilities	8,576	10,178
Long term Liabilities	30,715	36,061
Total liabilities	39,291	46,239
Members' equity	1,772	(688)
Total liabilities & equity	<u>41,063</u>	<u>45,551</u>
Revenues	36,834	36,033
Gross profit	32,966	32,352
Income from operations	<u>2,444</u>	<u>1,830</u>
Net income	<u>\$ 1,144</u>	<u>\$ 256</u>
Impact on EBITDA		(614.0)
Working Capital	(336.0)	(1,137.2)
Current Ratio	0.96	0.89
Debt/Equity	22.17	(67.19)

Note: Analysis ignores potential effects of fuel purchase commitments on members' equity and debt that could further negatively impact debt to equity ratios and debt covenants.

- ➡ Poor quality of earnings as suggested by number and size of Avant adjustments
- ➡ Several questionable items, e.g., deficient audit; aggressive accounting, including increasing capitalization levels preceding acquisition, physical inventory not observed, changed pricing methodology, understated E&O reserves, etc.
- ➡ Materially misstated historical financial statements attributable to:
 - Inappropriate capitalization of expense items
 - Incomplete booking of deferred expenses, omission of contract indebtedness, inadequate disclosure of a \$10M contract – debt-like item
- ➡ Multiple red flags (fraud indicia) in overstating EBITDA and other financial data
- ➡ Too complex for prosecutors to pursue criminally, especially for sophisticated investors.

- ➡ Careful of emotional investment bias, i.e., urgency to deploy capital.
- ➡ Big 4 / large CPA firms use of lower level, inexperienced audit staff.
- ➡ Trust the professionals but verify and don't be afraid to question!
- ➡ Question if too good to be true.
- ➡ Consider failure of professionals to collaborate, i.e., working in silos.
- ➡ Don't count on justice and full recovery regardless of strength of the case.



SECURING VALUE

Questions?

Los Angeles

Newport Beach

Sacramento

Miami

New York City