# Exela Technologies Annual Report 2020

## Form 10-K (NASDAQ:XELA)

Published: June 9th, 2020

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**WASHINGTON, D.C. 20549**

# FORM 10-K

**(Mark One)**

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2019**

**or**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from to**

**Commission File Number: 001-36788**

# EXELA TECHNOLOGIES, INC.
(Exact Name of Registrant as Specified in its Charter)

| | |
|---|---|
| **Delaware**<br>(State of or other Jurisdiction Incorporation or Organization) | **47-1347291**<br>(I.R.S. Employer Identification No.) |
| **2701 E. Grauwyler Rd.**<br>**Irving, TX**<br>(Address of Principal Executive Offices) | **75061**<br>(Zip Code) |

Registrant's Telephone Number, Including Area Code: **(844) 935-2832**

Securities Registered Pursuant to Section 12(b) of the Act:

| Title of Each Class | Trading Symbol | Name of Each Exchange On Which Registered |
|---|---|---|
| Common Stock, Par Value $0.0001 per share | XELA | The Nasdaq Stock Market LLC |

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ Yes ☒ No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ☐ Yes ☒ No

Indicate by check mark whether the Registrant (1) has filed all reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☐ Yes ☒ No

Indicate by check mark whether the Registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit such files). ☐ Yes ☒ No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer”, “accelerated filer”, “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer ☐ | Accelerated filer ☒ | Non-accelerated filer ☐ | Smaller reporting company ☒<br>Emerging growth company ☐ |

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). ☐ Yes ☒ No

The aggregate market value of the Registrant’s voting common equity held by non-affiliates of the Registrant, computed by reference to the price at which such voting common equity was last sold as of June 30, 2019, was approximately $92,130,068 (based on a closing price of $2.18).

As of June 5, 2020, the Registrant had 147,511,430 shares of common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

The information required by Part III of this Report, to the extent not set forth herein, is incorporated herein by reference from the registrant’s definitive proxy statement relating to the Annual Meeting of Shareholders to be held in 2020, which definitive proxy statement shall be filed with the Securities and Exchange Commission no later than June 12, 2020.

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## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements included in this Annual Report on Form 10-K ("Annual Report") are not historical facts but are forward-looking statements for purposes of the safe harbor provisions under The Private Securities Litigation Reform Act of 1995. Forward-looking statements generally are accompanied by words such as "may", "should", "would", "plan", "intend", "anticipate", "believe", "estimate", "predict", "potential", "seem", "seek", "continue", "future", "will", "expect", "outlook" or other similar words, phrases or expressions. These forward-looking statements include statements regarding our industry, future events, the estimated or anticipated future results and benefits of the Novitex Business Combination, future opportunities for the combined company, and other statements that are not historical facts. These statements are based on the current expectations of Exela management and are not predictions of actual performance. These statements are subject to a number of risks and uncertainties regarding Exela's businesses, and actual results may differ materially. The factors that may affect our results include, among others: the impact of political and economic conditions on the demand for our services; the impact of the COVID-19 pandemic; the impact of a data or security breach; the impact of competition or alternatives to our services on our business pricing and other actions by competitors; our ability to address technological development and change in order to keep pace with our industry and the industries of our customers; the impact of terrorism, natural disasters or similar events on our business; the effect of legislative and regulatory actions in the United States and internationally; the impact of operational failure due to the unavailability or failure of third-party services on which we rely; the effect of intellectual property infringement; and other factors discussed in this report under the headings "Risk Factors", "Legal Proceedings", "Management's Discussion and Analysis of Financial Condition and Results of Operations" and otherwise identified or discussed in this Annual Report. You should consider these factors carefully in evaluating forward-looking statements and are cautioned not to place undue reliance on such statements, which speak only as of the date of this report. It is impossible for us to predict new events or circumstances that may arise in the future or how they may affect us. We undertake no obligation to update forward-looking statements to reflect events or circumstances occurring after the date of this report. We are not including the information provided on the websites referenced herein as part of, or incorporating such information by reference into, this Annual Report. In addition, forward-looking statements provide Exela's expectations, plans or forecasts of future events and views as of the date of this report. Exela anticipates that subsequent events and developments will cause Exela's assessments to change. These forward-looking statements should not be relied upon as representing Exela's assessments as of any date subsequent to the date of this report.

## DEFINED TERMS

In this Annual Report, we use the terms "Company", "we", "us", or "our" to refer to Exela Technologies, Inc. and its consolidated subsidiaries, and where applicable, our predecessors SourceHOV and Novitex prior to the closing of the Novitex Business Combination. "Following is a glossary of other abbreviations and acronyms that are found in this Annual Report."

*"Appraisal Action"* means the petition for appraisal pursuant to 8 Del. C. § 262 in the Delaware Court of Chancery, captioned Manichaean Capital, LLC, et al. v. SourceHOV Holdings, Inc., C.A. No. 2017 0673 JRS.

"*BPA"* means business process automation.

"*BPO"* means business process outsourcing

"*Code*" means the Internal Revenue Code of 1986, as amended.

"*Common Stock*" means the common stock of the Company, par value $0.0001.

"*Consent, Waiver and Amendment*" means the Consent, Waiver and Amendment dated June 15, 2017, by and among the Company, Quinpario Merger Sub I, Inc., Quinpario Merger Sub II, Inc., SourceHOV, Novitex, Novitex Parent, L.P., Ex Sigma LLC, HOVS LLC and HandsOn Fund 4 I, LLC, amending the Novitex Business Combination Agreement.

"*EIM*" means enterprise information management.

"*ERP*" means enterprise resource planning system.

"*Exchange Act*" means the Securities Exchange Act of 1934, as amended.

"Ex-Sigma 2" means Ex-Sigma 2 LLC, our principal stockholder at the Closing of the Novitex Business Combination.

"*Ex-Sigma*" means Ex-Sigma LLC, the sole equity holder of Ex-Sigma 2.

"*GAAP*" means generally accepted accounting principles in the United States.

"*HGM Group*" means, collectively, HOVS LLC and HandsOn Fund 4 I, LLC and certain of their respective affiliates.

"*HITECH Act of 2009*" means the Health Information Technology for Economic and Clinical Health Act, enacted under Title XIII of the American Recovery and Reinvestment Act of 2009.

*"HIPAA"* means the Health Insurance Portability and Accountability Act of 1996.

*"IT"* mean information technology.

"*JOBS Act"* means the Jumpstart our Business Startups Act.

"*Margin Loan*" means the additional PIPE financing in the form of a $55.8 million loan obtained by Ex-Sigma 2 as borrower (and secured by shares of the Company held by Ex-Sigma 2) that was used by Ex-Sigma 2 to purchase additional common and preferred shares from the Company to help meet the minimum cash requirements needed to close the Novitex Business Combination.

"*MegaCenter"* means the Company's Tier-III document processing and outsourcing centers in Windsor, Connecticut, and Austin, Texas.

"*Nasdaq*" means The Nasdaq Stock Market.

"*Novitex*" means Novitex Holdings, Inc., a Delaware corporation.

"*Novitex Business Combination*" means the transactions contemplated by the Novitex Business Combination Agreement, which closed on July 12, 2017 and resulted in SourceHOV and Novitex becoming our wholly-owned subsidiaries and the financing transactions entered into in connection therewith.

"*Novitex Business Combination Agreement*" means the Business Combination Agreement, dated February 21, 2017, among the Company, Quinpario Merger Sub I, Inc., Quinpario Merger Sub II, Inc., SourceHOV, Novitex, HOVS LLC, HandsOn Fund 4 I, LLC and Novitex Parent, L.P., as amended by the Consent, Waiver and Amendment.

"*PCIDSS*" means the Payment Card Industry Data Security Standard.

"*Quinpario*" means Quinpario Acquisition Corp. 2, a Delaware corporation, the former name of Exela Technologies, Inc.

"*SEC*" means the United States Securities and Exchange Commission.

"*Securities Act*" means the Securities Act of 1933, as amended.

"*SourceHOV*" means SourceHOV Holdings, Inc., a Delaware corporation.

"*TCJA*" means the Tax Cut and Jobs Act.

"*TPS*" means transaction processing solutions.

## EXPLANATORY NOTE

**Overview of Restatement**

In this Annual Report on Form 10-K, the Company:

(a) restates its Consolidated Balance Sheets as of December 31, 2018 and the related Consolidated Statements of Operations, Consolidated Statements of Comprehensive Loss, Consolidated Statements of Stockholders' Deficit, and Consolidated Statements of Cash Flows for the fiscal years ended December 31, 2018 and 2017;

(b) amends its Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") as it relates to the fiscal years ended December 31, 2018 and 2017;

(c) restates its "Selected Financial Data" in Item 6 for fiscal years 2018 and 2017; and

(d) restates its Unaudited Quarterly Financial Data for the first three fiscal quarters in the fiscal year ended December 31, 2019 and each fiscal quarter in the fiscal year ended December 31, 2018.

**Background on the Restatement**

As previously disclosed in the Company's Current Report on Form 8-K filed with the SEC on March 17, 2020, the board of directors of the Company, based on the recommendation of the audit committee and in consultation with management, concluded that, because of errors identified in the Company's previously issued financial statements for the fiscal years ended December 31, 2018 and 2017 and the first three quarters of fiscal 2019, the Company would restate its previously issued financial statements, including the quarterly data for fiscal years 2019 and 2018 and its selected financial data for the relevant periods.

These errors were discovered during the course of preparing this Annual Report and the audit of the financial results for fiscal 2019. We have determined that these errors were the result of material weaknesses in internal control over financial reporting that are reported in management's report on internal control over financial reporting as of December 31, 2019 in Part II—Item 9A – Controls and Procedures of this Annual Report.

The restated financial statements correct the following errors:

*Appraisal Action Liability Adjustments*:

· $43.1 million, $40.6 million and $37.8 million understatement of accrued liabilities and total stockholders' deficit, as at September 30, 2019, December 31, 2018 and 2017, respectively, due to applying an incorrect accounting treatment for the obligation to pay the fair market value of the former stockholders' shares under the Appraisal Action.

· $2.4 million, $2.9 million and $1.2 million understatement of loss for the nine months ended September 30, 2019 and for the years ended December 31, 2018 and 2017, respectively, due to the unrecorded interest expense accrual associated with the Company's obligation related to the Appraisal Action. Interest should have been accrued in the relevant periods at the rate set by the Delaware Court of Chancery.

*Outsourced Contract Cost Adjustments*:

· A $5.3 million understatement of loss for the nine months ended September 30, 2019 and a $3.2 million overstatement of loss for the year ended December 31, 2018, due to the incorrect capitalization of employee training related costs during the set-up phase as costs of fulfilling contracts which should have been expensed under ASC 340-40. Additionally, an adjustment of $15.4 million was recorded to increase accumulated deficit as of January 1, 2018 to correct the previously-recorded transition adjustment for costs of fulfilling contracts upon the adoption of ASC 606 and ASC 340-40. These errors resulted in $17.3 million and $12.0 million overstatement of intangible assets, net as of September 30, 2019 and December 31, 2018, respectively.

*Expense Reimbursement Adjustments*:

- A $2.1 million understatement of loss and related party payables for the nine months ended September 30, 2019, due to non-accrual of the obligation to reimburse Ex-Sigma 2 for the discount to the market price on shares sold by Ex-Sigma 2 in a secondary offering in June 2019 and required to be reimbursed pursuant to the terms of the Consent, Waiver and Amendment.

- A $2.4 million understatement of loss and related party payables for the year ended December 31, 2018, due to non-accrual of the obligation to reimburse Ex-Sigma 2 for the underwriting discount and commission expenses of $2.1 million and an advisory fee of $0.3 million incurred by Ex-Sigma 2 in a secondary offering in April 2018 and required to be reimbursed pursuant to the terms of the Consent, Waiver and Amendment.

- A $1.5 million overstatement of loss for the nine months ended September 30, 2019, due to an amount paid to Ex-Sigma 2 in July 2019 for the fees incurred in connection with the secondary offering, out of a total reimbursable amount of $4.5 million as discussed in the two bullet points above, was erroneously recorded as selling, general and administrative expenses.

- $1.7 million and $5.2 million understatement of loss for the nine months ended September 30, 2019 and for the year ended December 31, 2018, respectively, due to the unrecorded related party expense accrual associated with the Company's obligation to reimburse Ex-Sigma 2 in connection with premium payments made by Ex-Sigma 2 under the Margin Loan and required to be reimbursed pursuant to the terms of the Consent, Waiver and Amendment. This error resulted in $6.9 million and $5.2 million understatement of related party payables as of September 30, 2019 and December 31, 2018, respectively.

- $0.5 million and $0.4 million overstatement of selling, general and administrative expenses and understatement of related party expense by the same amount for the nine months ended September 30, 2019 and year ended December 31, 2018, respectively, due to incorrect classification of related party expense as selling, general and administrative expenses. This error had no impact on net loss.

*Revenue Recognition Adjustments*:

- A $4.8 million understatement of loss, for the year ended December 31, 2017, due to incorrect recognition of revenue of $6.4 million and related cost of revenue of $1.6 million in 2017 related to a multiple element arrangement that included a software license where vendor specific objective evidence (VSOE) of fair value was not established for the undelivered elements of the arrangement under the previous revenue recognition guidance in ASC 985-605. This error resulted in a $6.4 million understatement of deferred revenue and a $1.6 million understatement of prepaid expenses and other current assets as at December 31, 2017.

- A $1.9 million understatement of revenues and understatement of cost of revenue by the same amount for the nine months ended September 30, 2019, due to incorrect application of the gross vs. net presentation guidance under ASC 606. The Company incorrectly netted the costs of rendering service from the revenue under a contract with one customer. This error had no impact on net loss.

*Cash Flows Classification Adjustments*:

- $0.1 million and $34.5 million understatement of operating cash flows and overstatement of financing cash flows, for the years ended December 31, 2018 and 2017, respectively, due to the incorrect interpretation of ASU 2016-15 (*Classification of Certain Receipts and Cash Payments*) and application on a retrospective basis upon adoption of ASU 2016-15 in 2018.

- $14.3 million, $7.5 million and $11.0 million overstatement of operating cash flows and understatement of investing cash flows, for the nine months ended September 30, 2019 and for the years ended December 31, 2018 and 2017, respectively, due to misclassification of cash flows associated with outsourced contract costs.

*Other Adjustments*:

- In addition to the errors described above, the restated financial statements also include adjustments to correct certain other immaterial errors, including previously unrecorded immaterial adjustments identified in audits of prior years' financial statements.

Cumulatively through September 30, 2019, the restatement had the following effects on net loss (in thousands):

| | Appraisal Action Liability Adjustments | Outsourced Contract Cost Adjustments | Expense Reimbursement Adjustments | Revenue Recognition Adjustment | Other Adjustment | Tax Effect of Adjustments | Total Increase in Net Loss |
|---|---|---|---|---|---|---|---|
| Year Ended December 31, 2017 | $ 1,187 | $ — | $ — | $ 4,834 | $ — | $ (822) | $ 5,199 |
| Year Ended December 31, 2018 | 2,896 | (3,196) | 7,628 | — | 15 | (54) | 7,289 |
| Nine Months Ended September 30, 2019 | 2,457 | 5,330 | 2,304 | (1,910) | (628) | — | 7,553 |
| | $ 6,540 | $ 2,134 | $ 9,932 | $ 2,924 | $ (613) | $ (876) | $ 20,041 |

**Effects of Restatement**

The following table sets forth the effects of the restatement on affected items within our previously reported Consolidated Statements of Operations.

| (in thousands, except per share data) | | Nine Months Ended September 30, 2019 | Year Ended December 31, 2018 | Year Ended December 31, 2017 |
|---|---|---|---|---|
| **Revenue** | As Originally Reported | $ 1,166,841 | $ 1,586,222 | $ 1,152,324 |
| | Adjustments | 1,910 | — | (6,433) |
| | As Restated | $ 1,168,751 | $ 1,586,222 | $ 1,145,891 |
| **Operating loss** | As Originally Reported | $ (66,615) | $ (6,249) | $ (99,532) |
| | Adjustments | (5,096) | (4,447) | (4,834) |
| | As Restated | $ (71,711) | $ (10,696) | $ (104,366) |
| **Net loss** | As Originally Reported | $ (197,479) | $ (162,517) | $ (204,285) |
| | Adjustments | (7,553) | (7,289) | (5,199) |
| | As Restated | $ (205,032) | $ (169,806) | $ (209,484) |
| **Basic and diluted loss per share** | As Originally Reported | $ (1.33) | $ (1.09) | $ (2.08) |
| | Adjustments | (0.10) | (0.08) | (0.10) |
| | As Restated | $ (1.43) | $ (1.17) | $ (2.18) |

The following table sets forth the effects of the restatement on affected items within our previously reported Consolidated Statements of Cash Flows.

| (in thousands) | | Nine Months Ended September 30, 2019 | Year Ended December 31, 2018 | Year Ended December 31, 2017 |
|---|---|---|---|---|
| **Net cash provided by (used in) operating activities** | As Originally Reported | $ (33,639) | $ 30,457 | $ 23,455 |
| | Adjustments | (13,718) | (6,857) | 28,322 |
| | As Restated | $ (47,357) | $ 23,600 | $ 51,777 |
| **Net cash provided by (used in) investing activities** | As Originally Reported | $ (34,815) | $ (66,304) | $ (452,374) |
| | Adjustments | 14,304 | 7,552 | 10,992 |
| | As Restated | $ (20,511) | $ (58,752) | $ (441,382) |
| **Net cash provided by (used in) financing activities** | As Originally Reported | $ 39,854 | $ (1,910) | 475,727 |
| | Adjustments | (586) | (695) | (39,314) |
| | As Restated | $ 39,268 | $ (2,605) | $ 436,413 |

The adjustments made as a result of the restatement are more fully discussed in Note 3, *Restatement of Previously Issued Financial Statements*, of the Notes to Consolidated Financial Statements included in this Annual Report. To further review the effects of the accounting errors identified and the restatement adjustments, see Part II—Item 6—Selected

Financial Data and Part II—Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Annual Report. For a description of the control deficiencies identified by management as a result of the investigation and our internal reviews, and management's plan to remediate those deficiencies, see Part II—Item 9A—Controls and Procedures.

Previously filed annual reports on Form 10-K and quarterly reports on Form 10-Q for the periods affected by the restatement have not been amended. Accordingly, investors should no longer rely upon the Company's previously released financial statements for these periods and any earnings releases or other communications relating to these periods, and, for these periods, investors should rely solely on the financial statements and other financial data for the relevant periods included in this Annual Report. See Note 20, Unaudited Quarterly Financial Data, of the Notes to the Consolidated Financial Statements in this Annual Report for the impact of these adjustments on each of the quarterly periods in fiscal 2018 and for the first three quarters of fiscal 2019. Quarterly reports for fiscal 2020 will include restated results for the corresponding interim periods of fiscal 2019. All amounts in this Annual Report on Form10-K affected by the restatement adjustments reflect such amounts as restated.

## PART I

### ITEM 1. BUSINESS

Exela is a business process automation leader leveraging a global footprint and proprietary technology to help turn the complex into the simple through user friendly software platforms and solutions that enable our customers' digital transformation. We have decades of expertise earned from serving many of the world's largest enterprises, including over 60% of the Fortune® 100 and in many mission critical environments across multiple industries, including banking, healthcare, insurance and manufacturing. For the fiscal year ended December 31, 2019, we generated $1.56 billion of revenue from over 4,000 customers throughout the world.

Our solutions and services touch multiple elements within a customer's organization. We use a global delivery model and primarily host solutions in our data centers, on the cloud or directly from our customers' premises. Our approximately 22,700 employees as of December 31, 2019 operate from business facilities in 23 countries, with some of our employees co-located at our customers' facilities. Our solutions are location agnostic, and we believe the combination of our hybrid hosted solutions and global work force in the Americas, EMEA and Asia offers a meaningful differentiation in the industries we serve and services we provide.

Picture 4

*Exela's portals provide on-demand multi industry and departmental solutions and services alongside industry specific solutions.*