

## Independent Investment Research Focused on Public Company Interactions with the SEC.

### [Barely] Disclosed SEC Investigation

## The SEC Investigation Carvana Really Does Not Want to Talk About

**Troubled Company. Run fast, run far. We see images of rats fleeing a sinking ship.** In our opinion, Carvana has been playing Disclosure Games® with investors through its choice to first mislead, and then to stay silent on an SEC inquiry that investors would surely consider material. We know what it's about. The market would too, had the inquiry not been so well disguised when first tucked into an unrelated 2020 SEC filing. There have been no updates since, but our own work suggests the problem remains ongoing. Insiders have been recent and heavy sellers of the stock. Today's report parses the initial disclosure, lays out the timeline since, and adds fresh data to make our negative case on Carvana.

– John P. Gavin, CFA

### Facts of Interest or Concern

Early in the Covid pandemic, [on 30-Mar-2020](#), Carvana filed an 8-K, ostensibly to give investors a “Business Update” on the impact the company was seeing from it.

Tucked within this same 8-K, Carvana said this –

*In addition, [we have received a voluntary request from the SEC](#) requesting information about our related party disclosure and accounting policies and procedures for historical loan sales and refinancings. We are providing relevant documentation in response to this request.*

Carvana 8-K, 30-Mar-2020

- Nowhere in the above disclosure excerpt are words one would expect such as inquiry, investigation, probe, informal, formal, or subpoena.
- **Quick Take:** A “voluntary request from the SEC” you say? Sounds routine, harmless even. It's not. This represents the stealth disclosure of an SEC investigation, in this case, an informal SEC inquiry.

The market surely would have reacted differently had Carvana not disguised and buried its SEC inquiry in an unrelated 8-K. To us, it appears a deliberate effort to mislead investors about a material risk.

- [Also on 30-Mar-2020](#), Carvana issued a press release announcing a stock offering that gave insiders company shares at a distressed market price.

The following is from the press release, [Carvana Co. Announces Registered Direct Offering of \\$600 Million](#)

*“... a registered direct offering of 13.3 million shares of Class A Common Stock (“Common Stock”) to certain existing investors. Each share of Common Stock is being sold for a purchase price of \$45.00, resulting in gross proceeds of \$600 million. The offering included investments of \$25 million each from Ernest Garcia III, the Company's founder and CEO, and Ernest Garcia II, the Company's controlling shareholder.”*

- This stock sale took place after the shares had lost over 50% of their value due to Covid fears.
- Many criticized this as self-dealing on the part of company insiders. **Quick Take:** We agree.
- [The related press release was silent on the SEC activity](#) announced in the 8-K, filed that same day.
- [The prospectus supplement was also silent on the SEC activity](#) announced in the 8-K, just the day prior (this was Form 424B2).

- Our work then found SEC investigative activity at Carvana on **22-Oct-2020**. This represented our first time researching this company. We later confirmed it as ongoing, as of **15-Dec-2020**.
- On **12-Aug-2021**, Carvana again went to market, this time with a debt offering of \$750 mm of Senior Notes. Again, there was no mention of SEC investigative activity in the related SEC filings.
- Days later, on **15-Aug-2021**, the *Wall Street Journal* ran an [article highlighting Carvana’s unusual loan practices](#).



- Remember, it was March 2020 when we learned the SEC had already made that “voluntary request from Carvana” into the company’s, “historical loan sales and refinancings”.
- The *Journal* article, [Carvana’s Success Rides on Used-Car Loans](#), did not reference SEC investigative activity, and the company continued to say nothing about it.
- **Quick Take:** Like we argue is the case with most investors, this suggests the *Journal* reporters were also not aware of Carvana’s March 2020 stealth disclosure of an informal SEC inquiry into matters that included the company’s loan practices.
- On **02-Sep-2021**, the SEC again confirmed an investigation of Carvana was “still active and ongoing.” This is the second confirmation since December 2020.

- **Quick Take:** At this stage, we cannot know if this is a continuation of the matter the company disclosed in March 2020, or if Carvana has an unrelated, undisclosed SEC investigation. We think the former.

If it’s a continuation that makes this a protracted SEC probe. That’s not good. That would raise the risk of a negative impact on investors. It would also likely have become a formal investigation by now. That means subpoenas and significant distraction for a company.

- At its peak in Aug-2021, Carvana’s stock was up well over 700% since the time of the Mar-2020 offering.
- It’s now September 2021. There have been no updates from Carvana on that “voluntary request from the SEC” since that first disclosure in March 2020. **That’s 18 months now.**
- Insiders have been heavy sellers of the stock during this period. Recent reports speak of recent sales well in excess of \$3 billion.

**Quick Take:** In over 20 years of doing this kind of research, we cannot recall another instance like this.

We are used to companies using clever wording and leaving things out when they disclose their SEC investigations. We also used to them providing cut-and-paste repeats of earlier disclosures in place of substantive updates on SEC investigations. We see it all the time.

But we cannot recall another instance where we saw a company make a stealth disclosure of SEC investigative activity; say nothing further about it for the next 18 months; and, then engage in massive insider selling during much of that period.

We see images of rats fleeing a sinking ship.

*Continued, next page*

## How to Proceed from Here

**You really need to know what became of that “voluntary request from the SEC” disclosed in Mar-2020.**

Keep in mind that public companies can provide investors with far more substantive detail and updates on SEC investigative activity than most do.

Further, there is nothing to prohibit Carvana management from disclosing greater detail on such things as –

- First contact with the SEC – super helpful to know.
- Is the investigation now formal or informal?
- If formal, when did it become formal?
- Whether the investigation has expanded.
- Records / testimony requested beyond what was already disclosed.
- Time period [now] covered by the investigation.
- Areas it is [now] focused on.
- Involvement by other agencies.
- Company personnel asked to give testimony.
- Subpoenas (there can be many over time).
- To whom were subpoenas sent, how many, when, and what did they seek?
- Last contact with the SEC on the investigation(s).
- A public company can be involved in more than one SEC investigation at a time.
- Is the matter disclosed in the 8-K the only matter the SEC was investigating at that time? Have there been others?

**What Carvana did here is highly unusual – and dangerous to investors.**

Even though it's been 18 months since we first/last heard about this, we caution investors to remember that there is a reason Carvana started disclosing what we recognize as SEC investigative activity:

**Management believed that SEC “voluntary request from Carvana” into the company’s, “historical loan sales and refinancings” posed a material risk.**

We suggest you trust them on this.

If you cannot independently understand why they reached that conclusion, or if they give no further updates as is the case here, you are effectively left with a company that has a known material risk that you cannot properly analyze and discount. We generally recommend investors avoid such scenarios.

*Disclosure Games® is a trademarked term we use to highlight those public companies engaging in disclosure practices that in our opinion may be misleading, confusing, evasive, or otherwise lacking the transparency needed for investors to make well-informed investment decisions regarding a potentially material exposure.*

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**Notes:** The SEC reminds us that its assertion of the law enforcement exemption should not be construed as an indication by the Commission or its staff that any violations of law have occurred with respect to any person, entity, or security.

New SEC investigative activity could theoretically begin or end after the date covered by the latest information in this report, which would not be reflected here. The SEC did not disclose the details on investigations referenced herein. All we know is that they somehow pertain to the conduct, transactions, and/or disclosures of the companies referenced above. Companies with undisclosed SEC investigations are maintained on our Watch List of companies with undisclosed SEC investigations.

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