

AVALON HOLDINGS CORP  
Form 10-Q  
November 10, 2016  
**2016**

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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**FORM 10-Q**

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

**For the quarterly period ended September 30, 2016**

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 1-14105

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**AVALON HOLDINGS CORPORATION**

(Exact name of registrant as specified in its charter)

<b>Ohio</b> (State or other jurisdiction of incorporation or organization)	<b>34-1863889</b> (I.R.S. Employer Identification No.)
<b>One American Way, Warren, Ohio</b> (Address of principal executive offices)	<b>44484-5555</b> (Zip Code)

Registrant's telephone number, including area code: **(330) 856-8800**

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Indicate by a check mark whether the registrant (1) has filed all reports required to be filed 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 and posted on its Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes  No

Indicate by a 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” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

The registrant had 3,191,100 shares of its Class A Common Stock and 612,231 shares of its Class B Common Stock outstanding as of November 7, 2016.

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**AVALON HOLDINGS CORPORATION AND SUBSIDIARIES**

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****AVALON HOLDINGS CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statements of Operations (Unaudited)***(in thousands, except per share amounts)*

	<b>Three Months Ended September 30, 2016</b>		<b>Nine Months Ended September 30, 2015</b>	
Net operating revenues	\$19,133	\$14,577	\$45,774	\$39,232
Costs and expenses:				
Costs of operations	15,496	11,766	37,607	32,738
Depreciation and amortization expense	714	603	2,093	1,836
Selling, general and administrative expenses	2,108	1,782	5,865	5,725
Operating income (loss)	815	426	209	(1,067)
Other income (expense):				
Interest expense	(94 )	(55 )	(273 )	(67 )
Other income, net	57	64	218	237
Income (loss) before income taxes	778	435	154	(897 )
Provision for income taxes	43	18	79	42
Net income (loss)	735	417	75	(939 )
Less net loss attributable to non-controlling interest in subsidiary	(71 )	(112 )	(244 )	(423 )
Net income (loss) attributable to Avalon Holdings Corporation common shareholders	\$806	\$529	\$319	\$(516 )
Income (loss) per share attributable to Avalon Holdings Corporation common shareholders:				
Basic net income (loss) per share	\$0.21	\$0.14	\$0.08	\$(0.14 )
Diluted net income (loss) per share	\$0.21	\$0.14	\$0.08	\$(0.14 )

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Weighted average shares outstanding - basic	3,803	3,803	3,803	3,803
Weighted average shares outstanding - diluted	3,893	3,803	3,836	3,803

*See accompanying notes to unaudited condensed consolidated financial statements.*

**AVALON HOLDINGS CORPORATION AND SUBSIDIARIES****Condensed Consolidated Balance Sheets (Unaudited)***(in thousands, except per share amounts)*

	<b>September 30, 2016</b>	<b>December 31, 2015</b>
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 1,604	\$ 1,814
Accounts receivable, less allowance for doubtful accounts of \$247 in 2016 and \$235 in 2015	13,737	9,579
Inventories	863	830
Prepaid expenses	578	487
Refundable income taxes	-	33
Other current assets	39	45
Total current assets	16,821	12,788
Property and equipment, net	44,009	43,386
Leased property under capital leases, net	5,901	6,042
Noncurrent deferred tax asset	8	8
Other assets, net	69	78
Total assets	\$ 66,808	\$ 62,302
<b>Liabilities and Equity</b>		
Current liabilities:		
Current portion of obligations under capital leases	\$ 73	\$ 59
Revolving line of credit	9,000	-
Accounts payable	10,208	8,022
Accrued payroll and other compensation	745	618
Accrued income taxes	21	-
Other accrued taxes	376	380
Deferred revenues	3,273	2,401
Other liabilities and accrued expenses	879	667
Total current liabilities	24,575	12,147
Revolving line of credit	-	7,975
Obligations under capital leases, net of current portion	280	274
Asset retirement obligation	100	100
Deferred rental income	-	50
Equity:		
Avalon Holdings Corporation Shareholders' Equity:		
Class A Common Stock, \$.01 par value	32	32
Class B Common Stock, \$.01 par value	6	6

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Paid-in capital	58,946	58,924
Accumulated deficit	(19,862 )	(20,181 )
Total Avalon Holdings Corporation Shareholders' Equity	39,122	38,781
Non-controlling interest in subsidiary	2,731	2,975
Total equity	41,853	41,756
Total liabilities and equity	\$ 66,808	\$ 62,302

*See accompanying notes to unaudited condensed consolidated financial statements.*



**AVALON HOLDINGS CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statement of Shareholders' Equity (Unaudited)***(in thousands)***For the Nine Months Ended September 30, 2016**

	<b>Shares</b>		<b>Common Stock</b>		<b>Paid-in</b>	<b>Accumulated</b>	<b>Total</b>	<b>Non-controlling</b>	
	<b>Class</b>	<b>Class</b>	<b>Class</b>	<b>Class</b>	<b>Capital</b>	<b>Deficit</b>	<b>Shareholders'</b>	<b>Interest</b>	<b>Total</b>
	<b>A</b>	<b>B</b>	<b>A</b>	<b>B</b>			<b>Equity</b>	<b>in</b>	
								<b>Subsidiary</b>	
Balance at January 1, 2016	3,191	612	\$32	\$6	\$58,924	\$(20,181)	\$38,781	\$2,975	\$41,756
Stock options - compensation costs	-	-	-	-	22	-	22	-	22
Net income (loss)	-	-	-	-	-	319	319	(244)	75
Balance at September 30, 2016	3,191	612	\$32	\$6	\$58,946	\$(19,862)	\$39,122	\$2,731	\$41,853

*See accompanying notes to unaudited condensed consolidated financial statements.*

**AVALON HOLDINGS CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows (Unaudited)***(in thousands)*

	<b>Nine Months Ended September 30, 2016</b>	<b>2015</b>
Operating activities:		
Net income (loss)	\$ 75	\$ (939 )
Reconciliation of net income (loss) to net cash provided by operating activities:		
Depreciation and amortization expense	2,093	1,836
Compensation costs - stock options	22	43
Deferred rental income	(66 )	(66 )
Provision for losses on accounts receivable	30	10
Change in operating assets and liabilities, net of effect of acquisition:		
Accounts receivable	(4,188 )	(502 )
Inventories	(33 )	(37 )
Prepaid expenses	(91 )	(98 )
Refundable income taxes	33	(21 )
Other assets	11	8
Accounts payable	2,091	(329 )
Accrued payroll and other compensation	127	215
Accrued income taxes	21	(8 )
Other accrued taxes	(4 )	(47 )
Deferred revenues	872	492
Other liabilities and accrued expenses	228	11
Net cash provided by operating activities	1,221	568
Investing activities:		

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Capital expenditures	(2,408 )	(6,814 )
Net cash used in investing activities	(2,408 )	(6,814 )
Financing activities:		
Borrowings under line of credit facilities	1,025	8,800
Repayment under line of credit facilities	-	(5,000 )
Principal payments on capital lease obligations	(48 )	(42 )
Net cash provided by financing activities	977	3,758
Decrease in cash and cash equivalents	(210 )	(2,488 )
Cash and cash equivalents at beginning of period	1,814	4,329
Cash and cash equivalents at end of period	\$ 1,604	\$ 1,841
Supplemental disclosure of cash flow information:		
Significant non-cash operating and investing activities:		
Capital expenditures included in accounts payable	\$ 95	\$ 166
Significant non-cash investing and financing activities:		
Capital lease obligation incurred	\$ 68	\$ -
Cash paid during the period for interest	\$ 273	\$ 164
Cash paid during the period for income taxes	\$ 25	\$ 65

*See accompanying notes to unaudited condensed consolidated financial statements.*



## **AVALON HOLDINGS CORPORATION AND SUBSIDIARIES**

### **Notes to Unaudited Condensed Consolidated Financial Statements**

**September 30, 2016**

#### **Note 1. Description of Business**

Avalon Holdings Corporation (“Avalon” or the “Company”) was formed on April 30, 1998 as a subsidiary of American Waste Services, Inc. (“AWS”). On June 17, 1998, AWS distributed, as a special dividend, all of the outstanding shares of capital stock of Avalon to the holders of AWS common stock on a pro rata and corresponding basis.

Avalon provides waste management services to industrial, commercial, municipal and governmental customers in selected northeastern and midwestern U.S. markets, captive landfill management services and salt water injection well operations. In addition, Avalon owns Avalon Clubs and Resorts, Inc. (“ACRI”), which includes the operation and management of three golf courses and associated clubhouses, fitness centers, tennis courts, spa services, dining and banquet facilities and a travel agency. ACRI also owns and operates a hotel and related amenities including dining, banquet and conference facilities, fitness center, indoor junior Olympic size swimming pool and tennis courts.

In July 2016, the Company formed ACRI, a wholly owned subsidiary of Avalon, the purpose of which is to hold the corporate activity of Avalon Clubs, Inc. and Avalon Resorts, Inc., both formed concurrently with ACRI. Avalon Clubs, Inc. was formed to hold the wholly owned subsidiaries of the Avalon Golf and Country Club, and Avalon Resorts, Inc. holds the operations of The Avalon Inn.

#### **Note 2. Basis of Presentation**

The unaudited condensed consolidated financial statements of Avalon and related notes included herein have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted consistent with such rules and regulations. The accompanying unaudited condensed consolidated financial statements and related notes should be read in conjunction with the consolidated financial statements and related notes included in Avalon’s 2015 Annual Report to Shareholders.

The unaudited condensed consolidated financial statements include the accounts of Avalon, its wholly owned subsidiaries and those companies in which Avalon has managerial control. All significant intercompany accounts and transactions have been eliminated in consolidation.

In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the financial position of Avalon as of September 30, 2016, and the results of its operations and cash flows for the interim periods presented.

The operating results for the interim periods are not necessarily indicative of the results to be expected for the full year.

### **Note 3. Recent Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, *Revenue from Contracts with Customers* (“ASU 2014-09”), to clarify the principles used to recognize revenue for all entities. Under ASU 2014-09, a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The new guidance establishes a five-step approach for the recognition of revenue. ASU 2014-09 is effective for annual periods beginning after December 15, 2017. Avalon is currently evaluating the impact the adoption of this guidance will have on its financial position, results of operations, cash flows and related disclosures and does not anticipate that the new guidance will fundamentally change our revenue recognition policies, practices or systems.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties About an Entity’s Ability to Continue as a Going Concern* (“ASU 2014-15”). The new standard provides guidance on determining when and how to disclose going-concern uncertainties in the financial statements. Under ASU 2014-15, management will be required to perform interim and annual assessments of the Company’s ability to continue as a going concern within one year of the date the financial statements are issued. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter, with early adoption permitted. The adoption of this standard is not expected to have an impact on Avalon’s financial statement disclosures.

In February 2015, the FASB issued ASU 2015-02, *Amendments to the Consolidation Analysis* (“ASU 2015-02”). The new standard makes changes to the variable interest model. ASU 2015-02 requires all reporting entities involved with limited partnerships to re-evaluate whether these entities qualify for consolidation and revise documentation accordingly. During the first quarter of 2016, the Company adopted ASU 2015-02. The adoption of this standard did not have an impact on Avalon’s financial position, results of operations or financial statement disclosures.

In November 2015, the FASB issued ASU 2015-17, *Balance Sheet Classification of Deferred Taxes* (“ASU 2015-17”), which simplifies the presentation of deferred income taxes by eliminating the need for entities to separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position. This amendment is effective for annual periods beginning after December 15, 2016. The Company is currently evaluating the potential impact that ASU 2015-17 may have on its financial position and results of operations. The adoption of this standard is not expected to have an impact on Avalon’s financial position, results of operations or financial statement disclosures.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. The new standard establishes a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. Avalon is currently evaluating the impact the adoption of this guidance will have on its financial position, results of operations, cash flows and related disclosures.

In March 2016, the FASB issued ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*(“ASU 2016-08”), which clarifies how to apply revenue recognition guidance related to whether an entity is a principal or an agent. ASU 2016-08 is effective for annual periods beginning after December 15, 2017. Avalon is currently evaluating the impact the adoption of this guidance will have on its financial position, results of operations, cash flows and related disclosures.

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*, which simplifies several aspects of the accounting for employee share-based payment transactions including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification of related amounts within the statement of cash flows. The new standard will become effective beginning with the first quarter of 2017, with early adoption permitted. Avalon is currently evaluating the impact the adoption of this guidance will have on its financial position, results of operations, cash flows and related disclosures.

The Company reviews new accounting standards as issued. The Company has considered all other recently issued accounting pronouncements and does not believe that adoption of such pronouncement will have a material impact on its financial statements.



**Note 4. Property and Equipment**

Property and equipment is stated at cost and depreciated using the straight-line method over the estimated useful life of the asset which varies from 10 to 30 years for land improvements; 5 to 50 years in the case of buildings and improvements; and from 3 to 10 years for machinery and equipment, vehicles and office furniture and equipment.

Major additions and improvements are charged to the property and equipment accounts while replacements, maintenance and repairs, which do not improve or extend the life of the respective asset, are expensed as incurred. The cost of assets retired or otherwise disposed of and the related accumulated depreciation is eliminated from the accounts in the year of disposal. Gains or losses resulting from disposals of property and equipment are credited or charged to operations. Interest costs are capitalized on significant construction projects.

Property and equipment at September 30, 2016 and December 31, 2015 consists of the following (in thousands):

	<b>September 30, 2016</b>	<b>December 31, 2015</b>
Land and land improvements	\$ 14,038	\$ 13,931
Buildings and improvements	33,440	30,556
Machinery and equipment	8,940	8,865
Vehicles	445	445
Office furniture and fixtures	5,922	5,571
Construction in progress	196	1,251
	62,981	60,619
Less accumulated depreciation and amortization	(18,972 )	(17,233 )
Property and equipment, net	\$ 44,009	\$ 43,386

**Note 5. Capital Leased Assets**

In November 2003, Avalon entered into a long-term agreement with Squaw Creek Country Club to lease and operate its golf course and related facilities. The lease has an initial term of ten (10) years with four (4) consecutive ten (10) year renewal term options unilaterally exercisable by Avalon. Under the lease, Avalon is obligated to pay \$15,000 in annual rent and make leasehold improvements of \$150,000 per year. Amounts expended by Avalon for leasehold improvements during a given year in excess of \$150,000 will be carried forward and applied to future leasehold improvement obligations. Based upon the amount of leasehold improvements already made and leasehold improvements anticipated to be made in the future, Avalon expects to exercise all its remaining renewal options.

In addition, the captive landfill operations lease a piece of equipment that was determined to be a capital lease. During 2016, the golf and related operations entered into a lease agreement for a vehicle that was determined to be a capital lease. The amounts capitalized in the Condensed Consolidated Balance Sheets under the caption “Leased property under capital leases, net” relating to these assets were approximately \$0.1 million at September 30, 2016 and December 31, 2015, respectively.

Leased property under capital leases at September 30, 2016 and December 31, 2015 consists of the following (in thousands):

	<b>September 30, 2016</b>	<b>December 31, 2015</b>
Leased property under capital leases	\$ 10,538	\$ 10,352
Less accumulated amortization	(4,637 )	(4,310 )
Leased property under capital leases, net	\$ 5,901	\$ 6,042

**Note 6. Basic and Diluted Net Income (Loss) per Share**

Basic net income (loss) per share attributable to Avalon Holdings Corporation common shareholders is computed by dividing the net income (loss) by the weighted average number of common shares outstanding, which were 3,803,331 for each period.

Diluted net income (loss) per share attributable to Avalon Holdings Corporation common shareholders is computed by dividing net income (loss) by the weighted average number of common shares outstanding plus any weighted common equivalent shares determined to be outstanding during the period using the treasury method. The weighted common equivalent shares included in the calculation are related to stock options granted by Avalon where the weighted average market price of Avalon's common stock for the period presented is greater than the option exercise price of the stock option.

For the three months ended September 30, 2016, the diluted weighted average number of shares outstanding was 3,892,799. For the three months ended September 30, 2015, the diluted per share amount reported is equal to the basic per share amount because the average market price of Avalon's common shares during the period was less than the exercise price of the stock options outstanding.

For the nine months ended September 30, 2016, the diluted weighted average number of common shares outstanding was 3,836,048. For the nine months ended September 30, 2015, the diluted per share amount reported is equal to basic per share amounts because Avalon was in a net loss position and as a result, such dilution would be considered anti-dilutive. Assuming dilution, the weighted average number of common shares outstanding for the nine months ended September 30, 2015 was 3,863,055.

**Note 7. Credit Facility**

On May 21, 2015, Avalon and certain wholly owned subsidiaries entered into a line of credit agreement (the "Agreement") with The Home Savings and Loan Company of Youngstown, Ohio providing for a line of credit of up to \$9 million. On December 30, 2015, the Agreement was modified (the "Modification") to extend the original maturity date of June 30, 2016 to March 31, 2017. The Modification also has the option to extend the maturity date one 90 day period upon written notice to the Lender at least 30 days before the maturity date subject to certain terms and conditions.

Borrowings under the line of credit agreement are secured by all business assets of the Company including accounts receivable, inventory, equipment and certain real property as defined in the Agreement. Interest on outstanding borrowings accrue at Prime Rate plus .25%. The line of credit agreement contains certain financial and other covenants, customary representations, warranties and events of defaults. Avalon was in compliance with the debt covenants at September 30, 2016.

Initial borrowings of \$5.0 million under the Agreement were utilized to repay the total amount outstanding under the previous line of credit agreement with Huntington National Bank. The line of credit agreement with Huntington National Bank was terminated in conjunction with the repayment. Borrowings under the line of credit agreement with Huntington National Bank were utilized to fund the acquisition and renovation of The Avalon Inn.

At September 30, 2016, the outstanding borrowings under the Agreement were \$9.0 million. As of September 30, 2016, the line of credit was fully utilized. During the three months ended September 30, 2016 and 2015, the weighted average interest rate on outstanding borrowings was 3.75% and 3.50%, respectively. During the nine months ended September 30, 2016 and 2015, the weighted average interest rate on outstanding borrowings was 3.75% and 3.16%, respectively. At September 30, 2016, the interest rate was 3.75%. Total unamortized debt issuance costs incurred in connection with the Agreement were approximately \$6,000 at September 30, 2016 and \$11,000 at December 31, 2015.

Amounts outstanding under the line of credit agreement with The Home Savings and Loan Company of Youngstown, Ohio are classified as a current liability in the Condensed Consolidated Balance Sheet at September 30, 2016 due to the Agreement expiring on March 31, 2017. The Company is currently discussing refinancing options with various financial institutions. The Company anticipates refinancing the Agreement before the expiration date. Although the Company is in discussions to refinance the line of credit, there can be no assurance that a refinancing would occur and the Company cannot guarantee success in doing so.

In accordance with FASB Accounting Standards Codification (“ASC”) 835-20, *Capitalization of Interest*, during the three and nine month periods ended September 30, 2015, Avalon capitalized approximately \$20,000 and \$97,000, respectively, of interest costs on borrowings incurred related to construction on The Avalon Inn. No amounts were capitalized during the three and nine month periods ended September 30, 2016.

#### **Note 8. Income Taxes**

During the three month periods ended September 30, 2016 and 2015, net income attributable to Avalon Holdings Corporation shareholders was \$0.8 million and \$0.5 million, respectively. During the nine month period ended September 30, 2016, net income attributable to Avalon Holdings Corporation shareholders was \$0.3 million compared with a net loss attributable to Avalon Holdings Corporation shareholders of \$0.5 million during the nine month period ended September 30, 2015. Avalon recorded a state income tax provision in both the three and nine month periods ended September 30, 2016 and 2015, which was related entirely to the waste management and brokerage operations. Excluding the effect of this state tax provision, Avalon’s overall effective tax rate was 0% in both the three and nine month periods ended September 30, 2016 and 2015. The overall effective tax rate is different than statutory rates primarily due to a change in the valuation allowance. Avalon’s income tax on the income (loss) before taxes was offset by a change in the valuation allowance. A valuation allowance is provided when it is more likely than not that deferred tax assets relating to certain federal and state loss carryforwards will not be realized. Avalon continues to maintain a valuation allowance against the majority of its deferred tax amounts until it is evident that the deferred tax asset will be utilized in the future.

#### **Note 9. Long-Term Incentive Plan**

The purpose of the Avalon Holdings Corporation 2009 Long-term Incentive Plan (the “Plan”) is (a) to improve individual employee performance by providing long-term incentives and rewards to employees of Avalon, (b) to assist Avalon in attracting, retaining and motivating employees and non-employee directors with experience and ability, and (c) to associate the interests of such employees and directors with those of the Avalon shareholders. Under the Plan, 1,300,000 shares have been reserved for the issuance of stock options of which 760,000 options were outstanding at September 30, 2016. In January 2016, 90,000 options granted under the Plan were forfeited and in March 2016, 90,000 options were granted. The stock options, vest ratably over a five year period and have a contractual term of ten years from the date of grant. At the end of each contractual vesting period, the share price of the Avalon common stock, traded on a public stock exchange (NYSE Amex), must reach a predetermined price within three years following such contractual vesting period before the stock options are exercisable (See table below). If the Avalon common stock price does not reach the predetermined price, the stock options will either be cancelled or the period will be extended at the discretion of the Board of Directors.

The 90,000 options to purchase common stock that were granted in March 2016 have a weighted average grant date fair value of \$0.43 per option. The grant-date fair values of these stock option awards were estimated using the Monte

Carlo Simulation. The Monte Carlo Simulation was selected to determine the fair value because it incorporates six minimum considerations; 1) the exercise price of the option, 2) the expected term of the option, taking into account both the contractual term of the option, the effects of employees' expected exercise and post-vesting employment termination behavior, as well as the possibility of change in control events during the contractual term of the option agreements, 3) the current fair value of the underlying equity, 4) the expected volatility of the value of the underlying share for the expected term of the option, 5) the expected dividends on the underlying share for the expected term of the option and 6) the risk-free interest rate(s) for the expected term of the option.

The grant-date fair values of the stock option awards granted in March 2016 using the Monte Carlo Simulation model were determined with the assumptions set forth in the following table:

Exercise price	\$1.83
Expected volatility	52.40 %
Expected dividend yield	0.00 %
Risk-free rate over the estimated expected life	1.74 %
Expected term (in years)	7.25

The expected term, or time until the option is exercised, is typically based on historical exercising behavior of previous option holders of a company's stock. Due to the fact that the Company has had no historical exercising activity, the simplified method was applied for each option block to adjust the holding period for which the optionee would hold the options to 6.2, 6.7, 7.2, 7.7 and 8.2 years, respectively for option blocks 1 through 5, respectively.

The grant date fair value of the underlying equity was determined to be equal to Avalon's publicly traded stock price as of the grant dates times the sum of the Class A and Class B common shares outstanding.

The expected volatility of 52.40% was based on the observed historical volatility of Avalon common stock for a 7.25 year period prior to the grant date. There were no expected dividends and the risk-free interest rate of 1.74% was based on yield data for U. S. Treasury securities over a period consistent with the expected term.

The following information is a summary of the stock option activity:

	<b>Number of Options Granted</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Fair Value at Grant Date</b>
Outstanding at January 1, 2016	760,000	2.63	1.09
Options granted	90,000	1.83	0.43
Options exercised	-	-	-
Options cancelled or forfeited	(90,000 )	2.89	1.20
Outstanding at September 30, 2016	760,000	\$ 2.51	\$ 1.00
Options Vested	632,000		
Exercisable at September 30, 2016	268,000		

The stock options vest and become exercisable based upon achieving two critical metrics as follows:

- 1) Contract Vesting Term: The stock options vest ratably over a five year period.
- 2) The Avalon common stock price traded on a public stock exchange (NYSE Amex) must reach the predetermined vesting price within three years after the options become vested under the contractual vesting term.

The table below represents the period and predetermined stock price needed for vesting.

	<b>Begins Vesting</b>	<b>Ends Vesting</b>	<b>Predetermined Vesting Price</b>
Block 1	12 months after Grant Dates	48 months after Grant Dates	\$ 3.43
Block 2	24 months after Grant Dates	60 months after Grant Dates	\$ 4.69
Block 3	36 months after Grant Dates	72 months after Grant Dates	\$ 6.43
Block 4	48 months after Grant Dates	84 months after Grant Dates	\$ 8.81
Block 5	60 months after Grant Dates	96 months after Grant Dates	\$ 12.07

Compensation costs were approximately \$6,000 and \$13,000 for the three months ended September 30, 2016 and 2015, respectively, and \$22,000 and \$43,000 for the nine months ended September 30, 2016 and 2015, respectively, based upon the estimated grant date fair value calculations. As of September 30, 2016, there was approximately \$48,000 of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of 2.63 years.

#### **Note 10. Legal Matters**

In the ordinary course of conducting its business, Avalon becomes involved in lawsuits, administrative proceedings and governmental investigations, including those related to environmental matters. Some of these proceedings may result in fines, penalties or judgments being assessed against Avalon which, from time to time, may have an impact on its business and financial condition. Although the outcome of such lawsuits or other proceedings cannot be predicted with certainty, Avalon does not believe that any uninsured ultimate liabilities, fines or penalties resulting from such pending proceedings, individually or in the aggregate, will have a material adverse effect on its liquidity, financial position or results of operations.



### Note 11. Business Segment Information

Avalon's reportable segments include waste management services and golf and related operations. In determining the segment information, Avalon considered its operating and management structure and the types of information subject to regular review by its "chief operating decision maker." Using the criteria of ASC 280 *Segment Reporting*, Avalon's reportable segments include waste management services and golf and related operations. Avalon accounts for intersegment net operating revenues as if the transactions were to third parties. The segment disclosures are presented on this basis for all periods presented.

Avalon's primary business segment, the waste management services segment, provides hazardous and nonhazardous brokerage and management services to industrial, commercial, municipal and governmental customers, captive landfill management for an industrial customer, construction mats and salt water injection well operations.

Avalon's golf and related operations segment consists of three golf courses and associated clubhouses which provide dining and banquet facilities, a hotel which provides lodging, dining, banquet and conference facilities and a travel agency. Revenue for the golf and related operations segment consists primarily of membership dues, greens fees, cart rentals, room rentals, merchandise sales, tennis and fitness activities, spa services and food and beverage sales. Revenue related to annual membership dues are recognized proportionately over twelve months. The unrecognized or deferred revenues relating to membership dues at September 30, 2016 and December 31, 2015 were \$3.3 million and \$2.4 million, respectively.

Avalon does not have significant operations located outside the United States and, accordingly, geographical segment information is not presented.

For the nine months ended September 30, 2016, no one customer accounted for 10% of Avalon's consolidated or reportable segment net operating revenues. For the nine months ended September 30, 2015, one customer accounted for approximately 7.6% of Avalon's consolidated net operating revenues and 10.7% of the waste management service segment's net operating revenues.

The accounting policies of the segments are consistent with those described for the consolidated financial statements in the summary of significant accounting policies included in Avalon's 2015 Annual Report to Shareholders. Avalon measures segment profit for internal reporting purposes as income (loss) before taxes.

Business segment information including the reconciliation of segment income before taxes to income (loss) before taxes is as follows (in thousands):

	<b>Three Months Ended September 30, 2016</b>		<b>Nine Months Ended September 30, 2016</b>	
	<b>2015</b>		<b>2015</b>	
<b>Net operating revenues from:</b>				
Waste management services:				
External customer revenues	\$13,593	\$9,679	\$32,625	\$27,821
Intersegment revenues	-	-	-	-
Total waste management services	13,593	9,679	32,625	27,821
Golf and related operations:				
External customer revenues	5,540	4,898	13,149	11,411
Intersegment revenues	23	27	50	64
Total golf and related operations	5,563	4,925	13,199	11,475
Segment operating revenues	19,156	14,604	45,824	39,296
Intersegment eliminations	(23 )	(27 )	(50 )	(64 )
Total net operating revenues	\$19,133	\$14,577	\$45,774	\$39,232

	<b>Three Months Ended September 30, 2016</b>		<b>Nine Months Ended September 30, 2015</b>	
<b>Income (loss) before income taxes:</b>				
Waste management services	\$950	\$560	\$2,035	\$1,171
Golf and related operations	608	509	468	55
Segment income before income taxes	1,558	1,069	2,503	1,226
Corporate interest expense	(89 )	(51 )	(260 )	(54 )
Corporate other income, net	2	3	7	20
General corporate expenses	(693 )	(586 )	(2,096)	(2,089)
Income (loss) before income taxes	\$778	\$435	\$154	\$(897 )

	<b>September 30, 2016</b>	<b>December 31, 2015</b>
<b>Identifiable assets:</b>		
Waste management services	\$ 26,599	\$ 22,575
Golf and related operations	45,088	43,390
Corporate	47,947	47,800
Subtotal	119,634	113,765
Elimination of intersegment receivables	(52,826 )	(51,463 )
Total	\$ 66,808	\$ 62,302

In comparing the total assets at September 30, 2016 with those at December 31, 2015, the increase in total assets of the waste management services segment of \$4.0 million is primarily due to an increase in accounts receivable and to a lesser extent an increase in intersegment transactions, which are eliminated in consolidation, partially offset by a lower net book value of property and equipment as a result of current year depreciation on the salt water injection wells. The increase in total assets of the golf and related operations segment of \$1.7 million is primarily due to capital expenditures related to the renovation and expansion of The Avalon Inn and an increase in accounts receivable partially offset by current year depreciation on property and equipment. The increase in corporate total assets is primarily due to an increase in intersegment transactions partially offset by current year depreciation on property and equipment.

## **Note 12. Certain Relationships and Related Transactions**

In August 2013, Avalon created a new Ohio limited liability company, AWMS Holdings, LLC, to act as a holding company to form and own a series of wholly owned subsidiaries that will own and operate Class II salt water injection wells and facilities (together the “facilities”). AWMS Holdings, LLC, offers investment opportunities to accredited investors by selling membership units of AWMS Holdings, LLC through private placement offerings. The monies

received from these offerings, along with internally contributed capital, are used to construct the facilities necessary for the operation of salt water injection wells. AWMS Water Solutions, LLC (formerly American Water Management Services, LLC), a wholly owned subsidiary of Avalon, manages all the salt water injection well operations, including the marketing and sales function and all decisions regarding the well operations for a percentage of the gross revenues.

In 2014 and 2013, Avalon, through a wholly owned subsidiary made capital contributions totaling approximately \$3.4 million, which included cash and certain well assets, including the permits, in exchange for membership units of AWMS Holdings, LLC. Through a private placement offering for the purchase of membership units, AWMS Holdings, LLC raised approximately \$3.8 million from accredited investors in 2014 and 2013. Management and outside directors of Avalon, who qualified as accredited investors, invested approximately \$1.0 million in AWMS Holdings, LLC.

As a result of a private placement offering, Avalon is not the majority owner of AWMS Holdings, LLC. At September 30, 2016 and December 31, 2015, respectively, Avalon owns approximately 47% of AWMS Holdings, LLC. In accordance with ASC 810-10, *Consolidations-Overall* (“ASC 810-10”) due to the managerial control of AWMS Water Solutions, LLC, AWMS Holdings, LLC is a variable interest entity, and the financial statements of AWMS Holdings, LLC and subsidiaries are included in Avalon’s condensed consolidated financial statements. ASC 810-10 requires noncontrolling interests to be reported as a separate component of equity. The amount of net loss attributable to the noncontrolling interest is recorded in “net loss attributable to noncontrolling interest” in our Condensed Consolidated Statements of Operations.

### **Note 13. Injection Wells Suspension**

As a result of a seismic event with a magnitude of 2.1 occurring on August 31, 2014, the Chief of the Division of Oil and Gas Resources Management (“Chief” or “Division”) issued Orders on September 3, 2014, to immediately suspend all operations of both of Avalon’s saltwater injection wells. The Orders were based on the findings that the two saltwater injection wells were located in close proximity to an area of known seismic activity and also that the saltwater injection wells pose a risk of increasing or creating seismic activity. The two saltwater injection wells are located approximately 112 feet apart. Based on these findings, the Chief ordered the immediate suspension of all operations of the two saltwater injection wells, until the Division could further evaluate the wells.

On September 5, 2014, Avalon submitted the information required by the Chief’s Order in regards to its AWMS #1 injection well. The Division reviewed all the information submitted by Avalon and additional data. Based upon this review, the Division concluded that with reasonable scientific certainty, the injection operations of AWMS #1 were not related to the deep seismic event that occurred on August 31, 2014. As a result, the Order suspending all operations of AWMS #1 was terminated effective September 18, 2014. As such, Avalon resumed injection operations of AWMS #1 consistent with all terms and conditions of the permit issued on July 18, 2013.

On September 19, 2014, Avalon submitted the information and a written plan required by the Chief’s Order proposing the establishment of certain operations and management controls on injections at the AWMS #2 injection well. The plan called for injection to resume at AWMS #2 at lower levels and monitored for seismicity. Under the plan, Avalon would gradually increase injection volumes over time based upon data obtained through monitoring.

On October 2, 2014, Avalon filed an appeal with the Ohio Oil and Gas Commission disputing the basis for suspending operations of AWMS #2 and also the authority of the Chief to immediately suspend such operations. On November 19, 2014, Avalon filed a Motion to Stay the execution of the suspension order.

On March 11, 2015, an appeal hearing was held and post hearing briefs were filed thereafter. The Chief stated during the hearing that the suspension is only temporary, and that he expects that AWMS #2 will be allowed to inject once the state’s final policymaking is complete.

On August 12, 2015, the Oil and Gas Commission upheld the temporary suspension of injection operations of AWMS #2 stating that the temporary suspension will allow the Chief to more fully evaluate the facts in anticipation of the Division’s implementation of a comprehensive regulatory plan that will specifically address injection-induced seismicity. In October 2015, the Division informed the Company that they were currently drafting the hydraulic fracturing induced seismicity policy and will start the Class II injection well policy once that was complete. In conjunction with the August 12, 2015 decision, Avalon temporarily suspended operations of AWMS #1 and will

resume operations when a favorable ruling on AWMS #2 is received.

On September 8, 2015, Avalon filed an appeal with the Franklin County Court of Common Pleas. Avalon also filed a notice of appeal addressed to the Division. On October 16, 2015, the Division filed a motion to dismiss stating that although Avalon filed its notice of appeal with the Franklin County Court of Common Pleas, it did not file the notice of appeal with the Oil and Gas Commission as mandated by the Ohio Revised Code. On October 20, 2015, Avalon filed its notice of appeal with the Oil and Gas Commission. On December 18, 2015, the Franklin County Court of Common Pleas concluded that Avalon untimely filed its notice of appeal with the Oil and Gas Commission and thus did not comply with the Ohio Revised Code and that the Division's motion to dismiss was granted. On January 4, 2016, Avalon filed an appeal with the Franklin County, Ohio 10<sup>th</sup> District Court of Appeals regarding the motion to dismiss ruling on the September 8, 2015 appeal. On April 6, 2016, an appeal hearing was held. During the hearing it was noted that Commission did not comply with the proper procedural requirements for providing Avalon with its August 12, 2015 decision. On May 5, 2016, Avalon's assignment of error was rendered moot by the Ohio 10<sup>th</sup> District Court of Appeals and the judgment of the Franklin County Court of Common Pleas was reversed and subsequently the Commission re-notified the parties of the decision. Avalon thereby filed an appeal in the Franklin County Court of Common Pleas. On November 1, 2016 an appeal hearing was held in that court. The Company is currently awaiting judgment from the court. Operations of Avalon's AWMS #2 injection well is still suspended under the Chief's order but Avalon will continue to fight the suspension until a favorable ruling lifting the temporary suspension is received.

Avalon was not in violation of any law, Ohio Regulation governing its operations or any of the terms and conditions of its injection permit, as acknowledged by the Division. The observed seismic events the Division used to justify the suspension order were of such magnitudes that occur every day in the State of Ohio. There were no documented complaints from the public concerning the observed seismic events. Avalon does not believe that there is substantial risk that the operations of AWMS #2 present an imminent danger to public health, safety or damage to the environment. The argument is further evidenced by the publication “Potential Injection-Induced Seismicity Associated with Oil & Gas Development: The Primer on Technical and Regulatory Considerations Informing Risk Management and Mitigation” released in 2015 stating that seismic events below 3.0 (approximately 22 times stronger than the August 31, 2014 event) are generally not felt by humans. This report was developed by the StatesFirst Induced Seismicity by Injection Work Group (“ISWG”) members (the State agencies) with input from the ISWG technical advisors (subject matter experts from academia, industry, federal agencies, and environmental organizations) to help better inform the public on technical and regulatory considerations associated with evaluation and response, seismic monitoring systems, information sharing, and the use of ground motion metrics. In addition, the Company also contends that other Class II injection wells within Ohio have produced seismic events with similar and/or higher magnitudes and have been allowed to continue operations.

On August 26, 2016, Avalon filed a complaint in the 11<sup>th</sup> Appellate District Court in Trumbull County, Ohio for a Peremptory Writ of Mandamus to compel the Director of the Ohio Department of Natural Resources (“ODNR”) to initiate appropriations procedures to determine damages from the illegal regulatory taking of the Company’s property, or issue an alternative remedy at law. There is currently no implemented state-wide policy on induced seismicity and The ODNR has refused to communicate with the Company regarding the status and requirements of any policymaking. The Company believes that the actions, and lack of responsible actions, by ODNR, which were triggered by a seismic event that presented no hazard or risk to any individual or to the environment, is a clear violation of the Company’s property rights and a violation of the Fifth and Fourteenth Amendments to the U.S. Constitution; Article I, Section 19 of the Ohio Constitution; and Ohio Revised Code Chapter 163. On September 26, 2016, the ODNR filed a motion to dismiss Avalon’s Writ of Mandamus complaint. The Company intends to vigorously pursue the Complaint and obtain due process and fair compensation.

At December 31, 2015, in accordance with FASB ASC 360-10-35, *Property, Plant and Equipment – Overall – Subsequent Measurement* (“ASC 360-10-35”), Avalon assessed the recoverability of the carrying values of the salt water injection wells based on the Chief of the Division of Oil and Gas Resources Management’s decision to temporarily suspend operations of the wells. Avalon estimated future cash flows directly associated with and which are expected to arise as a direct result of the wells once the temporary suspension is lifted. The assumptions used by management in developing the estimates of future cash flows were based on current market conditions and comparable prior periods while in operation. Based on the estimated undiscounted sum of the future cash flows, the net book value of the property, plant and equipment relating to the wells of approximately \$4.8 million at December 31, 2015 was recoverable in less than the estimated remaining useful life of those assets. There were no changes to this assessment at September 30, 2016.

Management continues to consider whether indicators of impairment are present and tests for recoverability, as necessary, in accordance with ASC 360-10-15. There can be no guarantee that the salt water injection wells will resume operations. If management concludes that the suspension is other than temporary and the carrying amount of

the salt water injection wells are not recoverable, Avalon may record an impairment charge up to \$4.4 million, the carrying value of the salt water injection wells.



## **Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion provides information which management believes is relevant to an assessment and understanding of the operations and financial condition of Avalon Holdings Corporation and its subsidiaries. As used in this report, the term “Avalon” or the “Company” means Avalon Holdings Corporation, its wholly owned subsidiaries and variable interest entities when it has been determined that Avalon is the primary beneficiary of those company’s operations, taken as a whole, unless the context indicates otherwise.*

*Statements included in Management’s Discussion and Analysis of Financial Condition and Results of Operations which are not historical in nature are intended to be, and are hereby identified as, “forward looking statements”. Avalon cautions readers that forward looking statements, including, without limitation, those relating to Avalon’s future business prospects, revenues, working capital, liquidity, capital needs, interest costs, and income, are subject to certain risks and uncertainties that could cause actual results to differ materially from those indicated in the forward looking statements, due to risks and factors identified herein and from time to time in Avalon’s reports filed with the Securities and Exchange Commission.*

### **Liquidity and Capital Resources**

For the nine months ended September 30, 2016, Avalon utilized existing cash, cash provided by operations and borrowings under the line of credit facility to meet operating needs, fund capital expenditures and fund the renovation and expansion of The Avalon Inn as described below.

In July 2016, the Company formed Avalon Clubs and Resorts, Inc. (“ACRI”), a wholly owned subsidiary of Avalon, the purpose of which is to hold the corporate activity of Avalon Clubs, Inc. and Avalon Resorts, Inc., both formed concurrently with ACRI. Avalon Clubs, Inc. was formed to hold the wholly owned subsidiaries of the Avalon Golf and Country Club, and Avalon Resorts, Inc. holds the operations of The Avalon Inn.

During the nine months ended September 30, 2016, Avalon incurred capital expenditures of \$2.5 million and paid vendors \$2.4 million for such expenditures. During the nine months ended September 30, 2015, Avalon incurred capital expenditures of \$7.0 million and paid vendors \$6.8 million for such expenditures. Such expenditures related principally to the renovation and expansion of The Avalon Inn. In 2015 and during the nine months ended September 30, 2016, The Avalon Inn, which was acquired on August 1, 2014, was in operation and in the process of being renovated and expanded. The renovations and expansion include a complete renovation of the existing facility and indoor junior Olympic sized swimming pool, new restaurants, bars, extensive conference facilities and complete fitness center. Avalon’s aggregate capital expenditures in 2016 are expected to be in the range of \$2.8 million to \$3.0 million, which will principally relate to the continued renovation and expansion of The Avalon Inn, building

improvements and equipment purchases.

On May 21, 2015, Avalon and certain wholly owned subsidiaries entered into a line of credit agreement (the "Agreement") with The Home Savings and Loan Company of Youngstown, Ohio providing for a line of credit of up to \$9 million. On December 30, 2015, the Agreement was modified (the "Modification") to extend the original maturity date of June 30, 2016 to March 31, 2017. The Modification also has the option to extend the maturity date one 90 day period upon written notice to the Lender at least 30 days before the maturity date subject to certain terms and conditions.

Borrowings under the line of credit agreement are secured by all business assets of the Company including accounts receivable, inventory, equipment and certain real property as defined in the Agreement. Interest on outstanding borrowings accrue at Prime Rate plus .25%. The line of credit agreement contains certain financial and other covenants, customary representations, warranties and events of defaults. Avalon was in compliance with the debt covenants at September 30, 2016.

Initial borrowings of \$5.0 million under the Agreement were utilized to repay the total amount outstanding under the previous line of credit agreement with Huntington National Bank. The line of credit agreement with Huntington National Bank was terminated in conjunction with the repayment. Borrowings under the line of credit agreement with Huntington National Bank were utilized to fund the acquisition and renovation of The Avalon Inn.

At September 30, 2016, the outstanding borrowings under the Agreement were \$9.0 million. As of September 30, 2016, the line of credit was fully utilized. During the three months ended September 30, 2016 and 2015, the weighted average interest rate on outstanding borrowings was 3.75% and 3.50%, respectively. During the nine months ended September 30, 2016 and 2015, the weighted average interest rate on outstanding borrowings was 3.75% and 3.16%, respectively. At September 30, 2016, the interest rate was 3.75%.

Amounts outstanding under the line of credit agreement with The Home Savings and Loan Company of Youngstown, Ohio are classified as a current liability in the Condensed Consolidated Balance Sheet at September 30, 2016 due to the Agreement expiring on March 31, 2017. The Company is currently discussing refinancing options with various financial institutions. The Company anticipates refinancing the Agreement before the expiration date. Although the Company is in discussions to refinance the line of credit, there can be no assurance that a refinancing would occur and the Company cannot guarantee success in doing so.

In November 2003, Avalon entered into a long-term agreement with Squaw Creek Country Club to lease and operate its golf course and related facilities. The lease has an initial term of ten (10) years with four (4) consecutive ten (10) year renewal term options unilaterally exercisable by Avalon. Under the lease, Avalon is obligated to pay \$15,000 in annual rent and make leasehold improvements of \$150,000 per year. Amounts expended by Avalon for leasehold improvements during a given year in excess of \$150,000 will be carried forward and applied to future leasehold improvement obligations. Based upon the amount of leasehold improvements already made, Avalon expects to exercise all of its remaining renewal options.

Management believes that anticipated cash provided from future operating activities, will be, for the foreseeable future, sufficient to meet operating requirements. When business conditions warrant, Avalon will take actions such as incurring additional indebtedness, issuance of common stock or issuance of a security with characteristics of both debt and equity. In the event Avalon is unable to refinance its line of credit facility, the Company will take the actions noted above, including seeking alternative financing options, although the Company cannot guarantee success in doing so.

At September 30, 2016, there was a working capital deficit of approximately \$7.8 million compared to working capital of \$0.6 million at December 31, 2015. Working capital was negatively impacted by the current liability classification of the total amount outstanding under our line of credit facility of \$9.0 million and to a lesser extent an increase in accounts payable and deferred revenues relating to membership dues. This decrease in working capital was partially offset by a higher accounts receivable balance. During the nine months ended September 30, 2016, additional borrowings under our line of credit facility and cash on hand were utilized to fund the renovation and expansion of The Avalon Inn. As previously described above, Avalon anticipates refinancing the line of credit facility before the expiration date.

Accounts receivable increased to \$13.7 million at September 30, 2016 compared with \$9.6 million at December 31, 2015. Accounts receivable primarily increased as a result of the increased sales related to the waste management services segment in the third quarter of 2016 when compared to the fourth quarter of 2015. Net operating revenues related to the waste management services segment were \$13.6 million in the third quarter of 2016 compared with \$10.5 million in the fourth quarter of 2015. Accounts receivable also increased due to higher membership dues receivable related to the Avalon Golf and Country Club between periods attributable to the increase in the average number of members during the period and an increase in membership dues rates. Accounts receivable related to membership dues were \$1.9 million at September 30, 2016 compared with \$1.3 million at December 31, 2015.

Accounts payable increased to \$10.2 million at September 30, 2016 compared with \$8.0 million at December 31, 2015 primarily as a result of the higher net operating revenues of the waste brokerage and management services business in the third quarter of 2016 compared with the fourth quarter of 2015 and the associated increase in amounts due to disposal facilities and transportation carriers and the timing of payments to vendors in the ordinary course of business. Accounts payable also increased as a result of the increased net operating revenues of the golf and related operations segment in the third quarter of 2016 compared to the fourth quarter of 2015 and the associated amounts due to vendors during the golf season.

The increase in deferred revenues at September 30, 2016 compared with December 31, 2015 is a result of an increase in the average number of members of the Avalon Golf and Country Club. Revenues related to annual membership dues are recognized proportionately over twelve months based upon the anniversary date of each membership. The average number of members during the first nine months of 2016 was 4,588 compared with 3,926 in the same period in the prior year. Deferred revenues related to membership dues increased to \$3.3 million at September 30, 2016 compared with \$2.4 million at December 31, 2015.

## **Growth Strategy**

### ***Waste Management Segment***

Our growth strategy for the waste management services segment focuses on increasing revenue, gaining market share and enhancing shareholder value through internal growth. Although we are a waste management services company, we do not own any landfills or provide waste collection services. However, because of our many relationships with various disposal facilities and transporters, we are able to be more flexible and provide alternative solutions to a customer's waste disposal or recycling needs. We intend to capitalize on our management and sales staff which has extensive experience in all aspects of the waste business. As such, we intend to manage our internal growth as follows:

- ***Sales and Marketing Activities.*** We will focus on retaining existing customers and obtaining new business through our well-managed sales and marketing activities. We seek to manage our sales and marketing activities to enable us to capitalize on our position in many of the markets in which we operate. We provide a tailored program to all of our customers in response to their particular needs. We accomplish this by centralizing services to effectively manage their needs, such as minimizing their procurement costs.

We currently have a number of professional sales and marketing employees in the field who are compensated using a commission structure that is focused on generating high levels of quality revenue. For the most part, these employees directly solicit business from existing and prospective customers. We emphasize our rate and cost structures when we train new and existing sales personnel. We intend to hire additional qualified professional sales personnel to expand into different geographical areas.

- ***Development Activities.*** We will seek to identify opportunities to further position us as an integrated service provider in markets where we provide services. In addition, we will continue to utilize the extensive experience of our management and sales staff to bid on significant one-time projects and those that require special expertise. Where appropriate, we may seek to obtain permits that would provide vertically integrated waste services or expand the service offerings or leverage our existing volumes with current vendors to provide for long term, cost competitive strategic positioning within our existing markets.

### ***Golf and Related Operations Segment***

On August 1, 2014, the Company acquired The Avalon Inn which was subsequently integrated into the golf and related operations segment. The acquisition is consistent with the Company's business strategy in that The Avalon Inn provides guests with a self-contained vacation experience, offering hotel guests golf packages to all of the golf courses of the Avalon Golf and Country Club and allows its guests to utilize the facilities at each of the clubhouses. Members of the Avalon Golf and Country Club also have access to all of the amenities offered by The Avalon Inn. The Avalon Inn earns revenues through room rentals, food and beverage sales, merchandise sales, tennis and fitness activities. The Avalon Inn is open year-round and provides a consistent, comfortable environment where our guests can enjoy our various amenities and activities. Avalon believes that the combination of its three golf facilities and the addition of The Avalon Inn will result in additional memberships in the Avalon Golf and Country Club.

In addition, several private country clubs in the northeast Ohio area are experiencing economic difficulties. Avalon believes some of these clubs may represent an attractive investment opportunity. While Avalon has not entered into any pending agreements for acquisitions, it may do so at any time and will continue to consider acquisitions that make economic sense.

### **Results of Operations**

Avalon's primary business segment, the waste management services segment, provides hazardous and nonhazardous waste brokerage and management services, captive landfill management services and salt water injection well operations. The golf and related operations segment includes the operation of golf courses, country clubs and related facilities, a hotel and travel agency.

## **Performance in the third quarter of 2016 compared with the third quarter of 2015**

### ***Overall Performance***

Net operating revenues increased to \$19.1 million in the third quarter of 2016 compared with \$14.6 million in the third quarter of 2015. This increase was due to an increase of approximately \$3.9 million, or a 40% increase, in net operating revenues of the waste management services segment and an increase of \$0.6 million, or a 13% increase, in net operating revenues of the golf and related operations segment when compared to the same period in the prior year. Costs of operations increased to \$15.5 million in the third quarter of 2016 compared with \$11.8 million in the third quarter of 2015. The increase in the cost of operations between periods is due to the increased net operating revenues between periods as these costs vary directly with the associated net operating revenues. Depreciation and amortization expense was approximately \$0.7 million in the third quarter of 2016 compared to \$0.6 million in the third quarter of 2015. The increase is primarily the result of depreciation expense associated with The Avalon Inn. Consolidated selling, general and administrative expenses were \$2.1 million in the third quarter of 2016 compared to \$1.8 million in the third quarter of 2015. The increase between periods is primarily due to higher employee related costs and to a lesser extent an increase in various administrative expenses. Net income attributable to Avalon Holdings Corporation common shareholders was \$0.8 million, or \$0.21 per share in the third quarter of 2016 compared with net income attributable to Avalon Holdings Corporation common shareholders of \$0.5 million, or \$0.14 per share in the third quarter of 2015.

### ***Segment Performance***

Segment performance should be read in conjunction with Note 11 to the Condensed Consolidated Financial Statements.

#### ***Waste Management Services Segment***

The net operating revenues of the waste management services segment increased approximately 40% to \$13.6 million in the third quarter of 2016 compared with \$9.7 million in the third quarter of 2015. The waste management services segment includes waste disposal brokerage and management services, captive landfill management operations and salt water injection well operations.

The net operating revenues of the waste brokerage and management services business increased to \$13.1 million in the third quarter of 2016 from \$9.2 million in the third quarter of 2015. This increase was due to an increase of \$5.3

million, or a 203% increase, in net operating revenues attributable to event work relating to multiple projects. Event work is defined as bid projects under contract that occurs on a one-time basis over a short period of time. Such work can fluctuate significantly from year to year. Net operating revenues related to event work were \$7.9 million in the third quarter of 2016 compared with \$2.6 million in the third quarter of 2015. Net operating revenues relating to continuous work of the waste disposal brokerage business decreased \$0.5 million, or a 9% decrease between periods. Net operating revenues related to continuous work were \$4.8 million in the third quarter of 2016 compared to \$5.3 million in the third quarter of 2015. Net operating revenues relating to managerial, consulting and clerical services decreased to \$0.4 million in the third quarter of 2016 compared to \$1.3 million in the third quarter of 2015. Net operating revenue relating to managerial, consulting and clerical services, which is performed for one customer, is entirely dependent on that customer's needs.

The net operating revenues of the captive landfill management operations were approximately \$0.5 million in the third quarter of 2016 and 2015. The net operating revenues of the captive landfill operations are almost entirely dependent upon the volume of waste generated by the owner of the landfill for whom Avalon manages the facility.

Due to the temporary suspension of the salt water injection wells there were no operating revenues during the third quarter of 2016 and 2015. As a result of a seismic event with a magnitude of 2.1 occurring on August 31, 2014, the Chief of the Division of Oil and Gas Resources Management ("Chief" or "Division") issued Orders on September 3, 2014, to immediately suspend all operations of both of Avalon's saltwater injection wells. The Orders were based on the findings that the two saltwater injection wells were located in close proximity to an area of known seismic activity and also that the saltwater injection wells pose a risk of increasing or creating seismic activity. The two saltwater injection wells are located approximately 112 feet apart. Based on these findings, the Chief ordered the immediate suspension of all operations of the two saltwater injection wells, until the Division could further evaluate the wells.

On September 5, 2014, Avalon submitted the information required by the Chief's Order in regards to its AWMS #1 injection well. The Division reviewed all the information submitted by Avalon and additional data. Based upon this review, the Division concluded that with reasonable scientific certainty, the injection operations of AWMS #1 were not related to the deep seismic event that occurred on August 31, 2014. As a result, the Order suspending all operations of AWMS #1 was terminated effective September 18, 2014. As such, Avalon resumed injection operations of AWMS #1 consistent with all terms and conditions of the permit issued on July 18, 2013.



On September 19, 2014, Avalon submitted the information and a written plan required by the Chief's Order proposing the establishment of certain operations and management controls on injections at the AWMS #2 injection well. The plan called for injection to resume at AWMS #2 at lower levels and monitored for seismicity. Under the plan, Avalon would gradually increase injection volumes over time based upon data obtained through monitoring.

On October 2, 2014, Avalon filed an appeal with the Ohio Oil and Gas Commission disputing the basis for suspending operations of AWMS #2 and also the authority of the Chief to immediately suspend such operations. On November 19, 2014, Avalon filed a Motion to Stay the execution of the suspension order.

On March 11, 2015, an appeal hearing was held and post hearing briefs were filed thereafter. The Chief stated during the hearing that the suspension is only temporary, and that he expects that AWMS #2 will be allowed to inject once the state's final policymaking is complete.

On August 12, 2015, the Oil and Gas Commission upheld the temporary suspension of injection operations of AWMS #2 stating that the temporary suspension will allow the Chief to more fully evaluate the facts in anticipation of the Division's implementation of a comprehensive regulatory plan that will specifically address injection-induced seismicity. In October 2015, the Division informed the Company that they were currently drafting the hydraulic fracturing induced seismicity policy and will start the Class II injection well policy once that was complete. In conjunction with the August 12, 2015 decision, Avalon temporarily suspended operations of AWMS #1 and will resume operations when a favorable ruling on AWMS #2 is received.

On September 8, 2015, Avalon filed an appeal with the Franklin County Court of Common Pleas. Avalon also filed a notice of appeal addressed to the Division. On October 16, 2015, the Division filed a motion to dismiss stating that although Avalon filed its notice of appeal with the Franklin County Court of Common Pleas, it did not file the notice of appeal with the Oil and Gas Commission as mandated by the Ohio Revised Code. On October 20, 2015, Avalon filed its notice of appeal with the Oil and Gas Commission. On December 18, 2015, the Franklin County Court of Common Pleas concluded that Avalon untimely filed its notice of appeal with the Oil and Gas Commission and thus did not comply with the Ohio Revised Code and that the Division's motion to dismiss was granted. On January 4, 2016, Avalon filed an appeal with the Franklin County, Ohio 10<sup>th</sup> District Court of Appeals regarding the motion to dismiss ruling on the September 8, 2015 appeal. On April 6, 2016, an appeal hearing was held. During the hearing it was noted that Commission did not comply with the proper procedural requirements for providing Avalon with its August 12, 2015 decision. On May 5, 2016, Avalon's assignment of error was rendered moot by the Ohio 10<sup>th</sup> District Court of Appeals and the judgment of the Franklin County Court of Common Pleas was reversed and subsequently the Commission re-notified the parties of the decision. Avalon thereby filed an appeal in the Franklin County Court of Common Pleas. On November 1, 2016 an appeal hearing was held in that court. The Company is currently awaiting judgment from the court. Operations of Avalon's AWMS #2 injection well is still suspended under the Chief's order but Avalon will continue to fight the suspension until a favorable ruling lifting the temporary suspension is received.

Avalon was not in violation of any law, Ohio Regulation governing its operations or any of the terms and conditions of its injection permit, as acknowledged by the Division. The observed seismic events the Division used to justify the suspension order were of such magnitudes that occur every day in the State of Ohio. There were no documented complaints from the public concerning the observed seismic events. Avalon does not believe that there is substantial risk that the operations of AWMS #2 present an imminent danger to public health, safety or damage to the environment. The argument is further evidenced by the publication “Potential Injection-Induced Seismicity Associated with Oil & Gas Development: The Primer on Technical and Regulatory Considerations Informing Risk Management and Mitigation” released in 2015 stating that seismic events below 3.0 (approximately 22 times stronger than the August 31, 2014 event) are generally not felt by humans. This report was developed by the StatesFirst Induced Seismicity by Injection Work Group (“ISWG”) members (the State agencies) with input from the ISWG technical advisors (subject matter experts from academia, industry, federal agencies, and environmental organizations) to help better inform the public on technical and regulatory considerations associated with evaluation and response, seismic monitoring systems, information sharing, and the use of ground motion metrics. In addition, the Company also contends that other Class II injection wells within Ohio have produced seismic events with similar and/or higher magnitudes and have been allowed to continue operations.

On August 26, 2016, Avalon filed a complaint in the 11<sup>th</sup> Appellate District Court in Trumbull County, Ohio for a Peremptory Writ of Mandamus to compel the Director of the Ohio Department of Natural Resources (“ODNR”) to initiate appropriations procedures to determine damages from the illegal regulatory taking of the Company’s property, or issue an alternative remedy at law. There is currently no implemented state-wide policy on induced seismicity and The ODNR has refused to communicate with the Company regarding the status and requirements of any policymaking. The Company believes that the actions, and lack of responsible actions, by ODNR, which were triggered by a seismic event that presented no hazard or risk to any individual or to the environment, is a clear violation of the Company’s property rights and a violation of the Fifth and Fourteenth Amendments to the U.S. Constitution; Article I, Section 19 of the Ohio Constitution; and Ohio Revised Code Chapter 163. On September 26, 2016, the ODNR filed a motion to dismiss Avalon’s Writ of Mandamus complaint. The Company intends to vigorously pursue the Complaint and obtain due process and fair compensation.

Income before income taxes for the waste management services segment increased to approximately \$1.0 million in the third quarter of 2016 compared with \$0.6 million in the third quarter of 2015. Income before income taxes of the waste brokerage and management services business was approximately \$1.0 million in the third quarter of 2016 compared to \$0.7 million in the third quarter of 2015. The increase was primarily attributable to the increased sales between periods. The overall gross margins of the waste brokerage and management services business was approximately 16% during the third quarter of 2016 compared to 17% in the third quarter of 2015. The overall decrease in gross margin is due to the increase in lower margin event work in the third quarter of 2016 when compared to the third quarter of 2015. Income before income taxes of the captive landfill operations were approximately \$0.1 million in both the third quarter of 2016 and 2015. During the third quarter of 2016, the salt water injection wells incurred a loss before income taxes of approximately \$0.1 million due to depreciation expense recorded on the facility and legal costs incurred relating to Avalon's appeal process and writ of mandamus complaint. During the third quarter of 2015, the salt water injection wells incurred a loss before income taxes of \$0.2 million due to the limited amount of water accepted for disposal as a result of a seismic event described above, depreciation expense recorded on the facility and legal costs incurred relating to Avalon's appeal.

### ***Golf and Related Operations Segment***

Net operating revenues of the golf and related operations segment increased approximately 13% to \$5.6 million in the third quarter of 2016 compared with \$4.9 million in the third quarter of 2015. Avalon's golf and related operations segment consists of three golf courses and associated clubhouses which provide dining and banquet facilities, a hotel which provides lodging, dining, banquet and conference facilities and a travel agency.

Net operating revenues increased primarily as a result of \$1.4 million of net operating revenues related to The Avalon Inn during the third quarter of 2016 compared with \$0.7 million during the third quarter of 2015. The increased net operating revenue related to The Avalon Inn was due to increased room rental revenue and food and beverage sales.

The average number of members during the third quarter of 2016 was 4,741 compared with 4,027 in the same period in the prior year. Although the net operating revenues from membership dues increased to \$1.2 million during the third quarter of 2016 compared to \$1.1 million during the third quarter of 2015, the average net operating revenues per member from membership dues decreased due to a change in the mix between social and golf members and from promotional membership programs. Social membership annual dues are lower than the rates charged for the golf membership packages offered by Avalon. During the third quarter of 2016, annual membership dues rates were increased. The increased rates become effective for existing members on the member's renewal date.

Income before income taxes for the golf and related operations segment increased to \$0.6 million in the third quarter of 2016 compared with \$0.5 million in the third quarter of 2015. The change between periods was primarily due to higher occupancy and associated room rates attributable to The Avalon Inn and an increase in membership dues revenue. This improvement was partially offset higher employee related costs and increased depreciation expense

attributable to The Avalon Inn when compared to the prior period.

*General Corporate Expenses*

General corporate expenses were \$0.7 million in the third quarter of 2016 compared to \$0.6 million in the third quarter of 2015. The increase is due to higher employee related costs in the third quarter of 2016 when compared to the comparable prior period.

*Net Income*

Net income attributable to Avalon Holdings Corporation common shareholders was \$0.8 million in the third quarter of 2016 compared with \$0.5 million in the third quarter of 2015. Avalon recorded a state income tax provision in both the third quarter of 2016 and 2015, which was related entirely to the waste management and brokerage operations. Excluding the effect of this state tax provision and some minor tax credits, Avalon's overall effective tax rate was 0% for both the third quarter of 2016 and 2015. The overall effective tax rate is different than statutory rates primarily due to a change in the valuation allowance. Avalon's income tax on the income before taxes was offset by a change in the valuation allowance. A valuation allowance is provided when it is more likely than not that deferred tax assets relating to certain federal and state loss carryforwards will not be realized. Avalon continues to maintain a valuation allowance against the majority of its deferred tax amounts until it is evident that the deferred tax asset will be utilized in the future.

## **Performance in the first nine months of 2016 compared with the first nine months of 2015**

### ***Overall Performance***

Net operating revenues increased 17% to \$45.8 million for the first nine months of 2016 compared with \$39.2 million for the first nine months of 2015. This increase was due to an increase of \$4.8 million, or a 17% increase, in net operating revenues of the waste management services segment and an increase of \$1.7 million, or a 15% increase, in net operating revenues of the golf and related operations segment when compared to the same period in the prior year. Costs of operations increased to \$37.6 million for the first nine months of 2016 compared with \$32.7 million for the first nine months of 2015. The increase in the cost of operations between periods is due to the increased net operating revenues between periods as these costs vary directly with the associated net operating revenues. Depreciation and amortization expense was approximately \$2.1 million for the first nine months of 2016 compared to \$1.8 million for the first nine months of 2015. The increase is primarily the result of depreciation expense associated with The Avalon Inn. Consolidated selling, general and administrative expenses were \$5.9 million for the first nine months of 2016 compared to \$5.7 million for the first nine months of 2015. Net income attributable to Avalon Holdings Corporation common shareholders was \$0.3 million, or \$0.08 per share for the first nine months of 2016 compared with a net loss attributable to Avalon Holdings Corporation common shareholders of \$0.5 million, or \$0.14 per share for the first nine months of 2015.

### ***Segment Performance***

Segment performance should be read in conjunction with Note 11 to the Condensed Consolidated Financial Statements.

### ***Waste Management Services Segment***

The net operating revenues of the waste management services segment increased approximately 17% to \$32.6 million in the first nine months of 2016 compared with \$27.8 million in the first nine months of 2015.

The net operating revenues of the waste brokerage and management services business increased to \$31.1 million in the first nine months of 2016 from \$26.0 million in the first nine months of 2015. This increase was due to an increase of \$7.0 million, or an 80% increase, in net operating revenues attributable to event work relating to multiple projects. Event work is defined as bid projects under contract that occurs on a one-time basis over a short period of time. Such work can fluctuate significantly from year to year. Net operating revenues related to event work were \$15.8 million

during the first nine months of 2016 compared with \$8.8 million during the first nine months of 2015. Net operating revenues relating to continuous work of the waste disposal brokerage business decreased approximately \$0.3 million, or a 2% decrease between periods. Net operating revenues related to continuous work were \$13.9 million during the first nine months of 2016 compared to \$14.2 million during the first nine months of 2015. Net operating revenues relating to managerial, consulting and clerical services decreased to \$1.4 million during the first nine months of 2016 compared to \$3.0 million during the first nine months of 2015. Net operating revenue relating to managerial, consulting and clerical services, which is performed for one customer, is entirely dependent on that customer's needs.

The net operating revenues of the captive landfill management operations were approximately \$1.5 million during the first nine months of 2016 compared to \$1.6 million during the first nine months of 2015. The net operating revenues of the captive landfill operations are almost entirely dependent upon the volume of waste generated by the owner of the landfill for whom Avalon manages the facility.

Due to the temporary suspension of the salt water injections wells described above, there were no operating revenues during the first nine months of 2016. The net operating revenues of the salt water injection wells were approximately \$0.2 million during the first nine months of 2015.

Income before income taxes for the waste management services segment increased to approximately \$2.0 million during the first nine months of 2016 compared with \$1.2 million during the first nine months of 2015. Income before income taxes of the waste brokerage and management services business was approximately \$2.3 million during the first nine months of 2016 compared to \$1.7 million during the first nine months of 2015. The increase was primarily attributable to the increased sales between periods. The overall gross margins of the waste brokerage and management services business was approximately 17% during the first nine months of 2016 and 2015. Income before income taxes of the captive landfill operations was approximately \$0.2 million for the first nine months of 2016 compared to \$0.3 million during the first nine months of 2015. During the first nine months of 2016, the salt water injection wells incurred a loss before income taxes of \$0.5 million due to depreciation expense recorded on the facility and legal costs incurred relating to Avalon's appeal process and writ of mandamus complaint. During the first nine months of 2015, the salt water injection wells incurred a loss before income taxes of \$0.8 million due to the limited amount of water accepted for disposal as a result of a seismic event described above, depreciation expense recorded on the facility and legal costs incurred relating to Avalon's appeal.

### ***Golf and Related Operations Segment***

Net operating revenues of the golf and related operations segment increased approximately 15% to \$13.2 million during the first nine months of 2016 compared with \$11.5 million during the first nine months of 2015. Net operating revenues increased primarily as a result of \$3.2 million of net operating revenues related to The Avalon Inn during the first nine months of 2016 compared with \$1.5 million during the first nine months of 2015 and to a lesser extent an increase in membership dues revenue between periods. The increased net operating revenue related to The Avalon Inn was due to increased room rental revenue and food and beverage sales. The increased net operating revenues noted above were partially offset by a decrease in food and beverage revenue relating to the golf courses and associated clubhouses.

Due to adverse weather conditions, net operating revenues relating to the golf courses, which are located in northeast Ohio and western Pennsylvania, were minimal during the first three months of 2016 and 2015. The average number of members during the first nine months of 2016 was 4,588 compared with 3,926 in the same period in the prior year. Although the net operating revenues from membership dues increased \$0.3 million to \$3.5 million in the first nine months of 2016 compared to \$3.2 million in the first nine months of 2015, the average net operating revenues per member from membership dues decreased due to a change in the mix between social and golf members and from promotional membership programs. Social membership annual dues are lower than the rates charged for the golf membership packages offered by Avalon. During the third quarter of 2016, annual membership dues rates were increased. The increased rates become effective for existing members on the member's renewal date.

Income before income taxes for the golf and related operations segment was \$0.5 million during the first nine months of 2016 compared with income before income taxes of approximately \$0.1 million in the first nine months of 2015. The change between periods was primarily due to higher occupancy and associated room rates attributable to The Avalon Inn and an increase in membership dues revenue. This improvement was partially offset higher employee related costs and increased depreciation expense attributable to The Avalon Inn when compared to the prior period.

The ability to attract new members and retain members is very important to the success of the golf and related operations segment. Avalon is continually using different marketing strategies to attract and retain members, such as local television advertising and/or various membership promotions. A significant decline in members could adversely impact the financial results of the golf and related operations segment.

***General Corporate Expenses***

General corporate expenses were \$2.1 million in the first nine months of 2016 and 2015.

***Net Income (Loss)***

Net income attributable to Avalon Holdings Corporation common shareholders was \$0.3 million in the first nine months of 2016 compared with a net loss attributable to Avalon Holdings Corporation common shareholders of \$0.5 million in the first nine months of 2015. Avalon recorded a state income tax provision in both the first nine months of 2016 and 2015, which was related entirely to the waste management and brokerage operations. Excluding the effect of this state tax provision and some minor tax credits, Avalon's overall effective tax rate was 0% for both the first nine months of 2016 and 2015. The overall effective tax rate is different than statutory rates primarily due to a change in the valuation allowance. As such, Avalon's income tax on the income (loss) before taxes was offset by a change in the valuation allowance. A valuation allowance has been provided when it is more likely than not that the deferred tax assets relating to certain federal and state loss carryforwards will not be realized. Avalon continues to maintain a valuation allowance against the majority of its deferred tax amounts until it is evident that the deferred tax asset will be utilized in the future.



## Trends and Uncertainties

In the ordinary course of conducting its business, Avalon becomes involved in lawsuits, administrative proceedings and governmental investigations, including those relating to environmental matters. Some of these proceedings may result in fines, penalties or judgments being assessed against Avalon which, from time to time, may have an impact on its business and financial condition. Although the outcome of such lawsuits or other proceedings cannot be predicted with certainty, management assesses the probability of loss and accrues a liability as appropriate. Avalon does not believe that any uninsured ultimate liabilities, fines or penalties resulting from such pending proceedings, individually or in the aggregate, will have a material adverse effect on its liquidity, financial position or results of operations.

The federal government and numerous state and local governmental bodies are continuing to consider legislation or regulations to either restrict or impede the disposal and/or transportation of waste. A portion of Avalon's waste brokerage and management services revenues is derived from the disposal and/or transportation of out-of-state waste. Any law or regulation restricting or impeding the transportation of waste or the acceptance of out-of-state waste for disposal could have a negative effect on Avalon.

Avalon's waste brokerage and management services business obtains and retains customers by providing services and identifying cost-efficient disposal options unique to a customer's needs. Consolidation within the solid waste industry has resulted in reducing the number of disposal options available to waste generators and may cause disposal pricing to increase. Avalon's waste brokerage and management services business may not be able to pass these price increases onto some of its customers, which, in turn, may adversely impact Avalon's future financial performance.

A significant portion of Avalon's business is generated from waste brokerage and management services provided to customers that are not subject to long-term contracts. In light of current economic, regulatory and competitive conditions, there can be no assurance that Avalon's current customers will continue to transact business with Avalon at historical levels. Failure by Avalon to retain its current customers or to replace lost business could adversely impact the future financial performance of Avalon.

Avalon's captive landfill management business is dependent upon a single customer as its sole source of revenue. If the captive landfill management business is unable to retain this customer, Avalon's future financial performance could be adversely impacted.

Saltwater disposal wells are regulated by the Ohio Department of Natural Resources ("ODNR"), with portions of the disposal facilities regulated by the Ohio EPA. As exploitation of the Marcellus and Utica shale formations by the hydrofracturing process develops, regulatory and public awareness of the environmental risks of saltwater brine and its disposal in saltwater disposal wells is growing and consequently, it is expected that regulation governing the

construction and operation of saltwater disposal wells will increase in scope and complexity. Increased regulation may result in increased construction and/or operating costs, which could adversely affect the financial results of Avalon.

There is a continuing risk during the saltwater disposal well's operation of an environmental event causing contamination to the water tables in the surrounding area, or seismic events. The occurrence of a spill or contamination at a disposal well site could result in remedial expenses and/or result in the operations at the well site being suspended and/or terminated by the Ohio EPA or the ODNR. Incurring remedial expenses and /or a suspension or termination of Avalon's right to operate one or more saltwater disposal wells at the well site could have an adverse effect on Avalon's financial results.

As a result of a seismic event with a magnitude of 2.1 occurring on August 31, 2014, the Chief of the Division of Oil and Gas Resources Management ("Chief" or "Division") issued Orders on September 3, 2014, to immediately suspend all operations of both of Avalon's saltwater injection wells. The Orders were based on the findings that the two saltwater injection wells were located in close proximity to an area of known seismic activity and also that the saltwater injection wells pose a risk of increasing or creating seismic activity. The two saltwater injection wells are located approximately 112 feet apart. Based on these findings, the Chief ordered the immediate suspension of all operations of the two saltwater injection wells, until the Division could further evaluate the wells.

On September 5, 2014, Avalon submitted the information required by the Chief's Order in regards to its AWMS #1 injection well. The Division reviewed all the information submitted by Avalon and additional data. Based upon this review, the Division concluded that with reasonable scientific certainty, the injection operations of AWMS #1 were not related to the deep seismic event that occurred on August 31, 2014. As a result, the Order suspending all operations of AWMS #1 was terminated effective September 18, 2014. As such, Avalon resumed injection operations of AWMS #1 consistent with all terms and conditions of the permit issued on July 18, 2013.

On September 19, 2014, Avalon submitted the information and a written plan required by the Chief's Order proposing the establishment of certain operations and management controls on injections at the AWMS #2 injection well. The plan called for injection to resume at AWMS #2 at lower levels and monitored for seismicity. Under the plan, Avalon would gradually increase injection volumes over time based upon data obtained through monitoring.

On October 2, 2014, Avalon filed an appeal with the Ohio Oil and Gas Commission disputing the basis for suspending operations of AWMS #2 and also the authority of the Chief to immediately suspend such operations. On November 19, 2014, Avalon filed a Motion to Stay the execution of the suspension order.

On March 11, 2015, an appeal hearing was held and post hearing briefs were filed thereafter. The Chief stated during the hearing that the suspension is only temporary, and that he expects that AWMS #2 will be allowed to inject once the state's final policymaking is complete.

On August 12, 2015, the Oil and Gas Commission upheld the temporary suspension of injection operations of AWMS #2 stating that the temporary suspension will allow the Chief to more fully evaluate the facts in anticipation of the Division's implementation of a comprehensive regulatory plan that will specifically address injection-induced seismicity. In October 2015, the Division informed the Company that they were currently drafting the hydraulic fracturing induced seismicity policy and will start the Class II injection well policy once that was complete. In conjunction with the August 12, 2015 decision, Avalon temporarily suspended operations of AWMS #1 and will resume operations when a favorable ruling on AWMS #2 is received.

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August 12, 2015 decision. On May 5, 2016, Avalon's assignment of error was rendered moot by the Ohio 10<sup>th</sup> District Court of Appeals and the judgment of the Franklin County Court of Common Pleas was reversed and subsequently the Commission re-notified the parties of the decision. Avalon thereby filed an appeal in the Franklin County Court of Common Pleas. On November 1, 2016 an appeal hearing was held in that court. The Company is currently awaiting judgment from the court. Operations of Avalon's AWMS #2 injection well is still suspended under the Chief's order but Avalon will continue to fight the suspension until a favorable ruling lifting the temporary suspension is received.

Avalon was not in violation of any law, Ohio Regulation governing its operations or any of the terms and conditions of its injection permit, as acknowledged by the Division. The observed seismic events the Division used to justify the suspension order were of such magnitudes that occur every day in the State of Ohio. There were no documented complaints from the public concerning the observed seismic events. Avalon does not believe that there is substantial risk that the operations of AWMS #2 present an imminent danger to public health, safety or damage to the environment. The argument is further evidenced by the publication "Potential Injection-Induced Seismicity Associated with Oil & Gas Development: The Primer on Technical and Regulatory Considerations Informing Risk Management and Mitigation" released in 2015 stating that seismic events below 3.0 (approximately 22 times stronger than the August 31, 2014 event) are generally not felt by humans. This report was developed by the StatesFirst Induced Seismicity by Injection Work Group ("ISWG") members (the State agencies) with input from the ISWG technical advisors (subject matter experts from academia, industry, federal agencies, and environmental organizations) to help better inform the public on technical and regulatory considerations associated with evaluation and response, seismic monitoring systems, information sharing, and the use of ground motion metrics. In addition, the Company also contends that other Class II injection wells within Ohio have produced seismic events with similar and/or higher magnitudes and have been allowed to continue operations.

On August 26, 2016, Avalon filed a complaint in the 11<sup>th</sup> Appellate District Court in Trumbull County, Ohio for a Peremptory Writ of Mandamus to compel the Director of the Ohio Department of Natural Resources (“ODNR”) to initiate appropriations procedures to determine damages from the illegal regulatory taking of the Company’s property, or issue an alternative remedy at law. There is currently no implemented state-wide policy on induced seismicity and The ODNR has refused to communicate with the Company regarding the status and requirements of any policymaking. The Company believes that the actions, and lack of responsible actions, by ODNR, which were triggered by a seismic event that presented no hazard or risk to any individual or to the environment, is a clear violation of the Company’s property rights and a violation of the Fifth and Fourteenth Amendments to the U.S. Constitution; Article I, Section 19 of the Ohio Constitution; and Ohio Revised Code Chapter 163. On September 26, 2016, the ODNR filed a motion to dismiss Avalon’s Writ of Mandamus complaint. The Company intends to vigorously pursue the Complaint and obtain due process and fair compensation.

At December 31, 2015, in accordance with the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 360-10-35, *Property, Plant and Equipment – Overall – Subsequent Measurement* (“ASC 360-10-35”), Avalon assessed the recoverability of the carrying values of the salt water injection wells based on the Chief of the Division of Oil and Gas Resources Management’s decision to temporarily suspend operations of the wells. Avalon estimated future cash flows directly associated with and which are expected to arise as a direct result of the wells once the temporary suspension is lifted. The assumptions used by management in developing the estimates of future cash flows were based on current market conditions and comparable prior periods while in operation. Based on the estimated undiscounted sum of the future cash flows, the net book value of the property, plant and equipment relating to the wells of approximately \$4.8 million at December 31, 2015 was recoverable in less than the estimated remaining useful life of those assets. There were no changes to this assessment at September 30, 2016.

Management continues to consider whether indicators of impairment are present and tests for recoverability, as necessary, in accordance with ASC 360-10-15. There can be no guarantee that the salt water injection wells will resume operations. If management concludes that the suspension is other than temporary and the carrying amount of the salt water injection wells are not recoverable, Avalon may record an impairment charge up to \$4.4 million, the carrying value of the salt water injection wells.

Economic challenges throughout the industries served by Avalon may result in payment defaults by customers. While Avalon continuously endeavors to limit customer credit risks, customer-specific financial downturns are not controllable by management. Significant customer payment defaults would have a material adverse impact upon Avalon’s future financial performance.

The Avalon Golf and Country Club operates golf courses and related clubhouses at each of its three facilities. The Avalon Golf and Country Club facilities also offer swimming pools, fitness centers, tennis courts, dining and banquet facilities and spa services. In addition, The Avalon Inn provides guests with a self-contained vacation experience, offering hotel guests golf packages to all of the golf courses of the Avalon Golf and Country Club and allows its guests to utilize the facilities at each of the clubhouses. Members of the Avalon Golf and Country Club also have access to all of the amenities offered by The Avalon Inn. The Avalon Golf and Country Club competes with many

public courses and country clubs in the area. Although the golf courses continue to be available to the general public, the primary source of revenues is derived from the members of the Avalon Golf and Country Club. Avalon believes that the combination of its three facilities and the addition of The Avalon Inn will result in additional memberships in the Avalon Golf and Country Club. The ability to retain current members and attract new members has been an ongoing challenge. Although Avalon was able to increase the number of members of the Avalon Golf and Country Club, as of September 30, 2016, Avalon has not attained its membership goals. There can be no assurance as to when such goals will be attained and when the golf and related operations will ultimately become profitable. Avalon is continually using different marketing strategies to attract new members, such as local television advertising and various membership promotions. A significant decline in members could adversely affect the future financial performance of Avalon.

All three of Avalon's golf course operations and The Avalon Inn currently hold liquor licenses for their respective facilities. If, for some reason, any one of these facilities were to lose their liquor license, the financial performance of the golf and related operations would be adversely affected.

Avalon's operations are somewhat seasonal in nature since a significant portion of those operations are primarily conducted in selected northeastern and midwestern states. Additionally, Avalon's golf courses are located in northeast Ohio and western Pennsylvania and are significantly dependent upon weather conditions during the golf season. As a result, Avalon's financial performance is adversely affected by adverse weather conditions.

## Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (“ASU”) 2014-09, *Revenue from Contracts with Customers* (“ASU 2014-09”), to clarify the principles used to recognize revenue for all entities. Under ASU 2014-09, a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The new guidance establishes a five-step approach for the recognition of revenue. ASU 2014-09 is effective for annual periods beginning after December 15, 2017. Avalon is currently evaluating the impact the adoption of this guidance will have on its financial position, results of operations, cash flows and related disclosures and does not anticipate that the new guidance will fundamentally change our revenue recognition policies, practices or systems.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties About an Entity’s Ability to Continue as a Going Concern* (“ASU 2014-15”). The new standard provides guidance on determining when and how to disclose going-concern uncertainties in the financial statements. Under ASU 2014-15, management will be required to perform interim and annual assessments of the Company’s ability to continue as a going concern within one year of the date the financial statements are issued. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter, with early adoption permitted. The adoption of this standard is not expected to have an impact on Avalon’s financial statement disclosures.

In February 2015, the FASB issued ASU 2015-02, *Amendments to the Consolidation Analysis* (“ASU 2015-02”). The new standard makes changes to the variable interest model. ASU 2015-02 requires all reporting entities involved with limited partnerships to re-evaluate whether these entities qualify for consolidation and revise documentation accordingly. During the first quarter of 2016, the Company adopted ASU 2015-02. The adoption of this standard did not have an impact on Avalon’s financial position, results of operations or financial statement disclosures.

In November 2015, the FASB issued ASU 2015-17, *Balance Sheet Classification of Deferred Taxes* (“ASU 2015-17”), which simplifies the presentation of deferred income taxes by eliminating the need for entities to separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position. This amendment is effective for annual periods beginning after December 15, 2016. The Company is currently evaluating the potential impact that ASU 2015-17 may have on its financial position and results of operations. The adoption of this standard is not expected to have an impact on Avalon’s financial position, results of operations or financial statement disclosures.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. The new standard establishes a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach

is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. Avalon is currently evaluating the impact the adoption of this guidance will have on its financial position, results of operations, cash flows and related disclosures.

In March 2016, the FASB issued ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)* (“ASU 2016-08”), which clarifies how to apply revenue recognition guidance related to whether an entity is a principal or an agent. ASU 2016-08 is effective for annual periods beginning after December 15, 2017. Avalon is currently evaluating the impact the adoption of this guidance will have on its financial position, results of operations, cash flows and related disclosures.

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*, which simplifies several aspects of the accounting for employee share-based payment transactions including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification of related amounts within the statement of cash flows. The new standard will become effective beginning with the first quarter of 2017, with early adoption permitted. Avalon is currently evaluating the impact the adoption of this guidance will have on its financial position, results of operations, cash flows and related disclosures.



The Company reviews new accounting standards as issued. The Company has considered all other recently issued accounting pronouncements and does not believe that adoption of such pronouncement will have a material impact on its financial statements.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Avalon does not have significant exposure to changing interest rates. Based on the current debt level at September 30, 2016, if market interest rates increased one percent, Avalon's interest expense would increase approximately \$0.1 million annually. Avalon does not undertake any specific actions to cover its exposure to interest rate risk and Avalon is not a party to any interest rate risk management transactions. Avalon does not purchase or hold any derivative financial instruments.

### **Item 4. Controls and Procedures**

As required by Rule 13a-15 under the Securities Exchange Act of 1934 (the "Exchange Act"), Avalon's management conducted an evaluation, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2016. For purposes of the foregoing, the term disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's ("SEC") rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Avalon's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives as outlined above. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that they believe that, as of September 30, 2016, our disclosure controls and procedures were effective at a reasonable assurance level.

### **Changes in Internal Controls over Financial Reporting.**

There were no changes in our internal controls over financial reporting during the fiscal quarter ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.



## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

Reference is made to “Item 3. Legal Proceedings” in Avalon’s Annual Report on Form 10-K for the year ended December 31, 2015 for a description of legal proceedings.

### **Item 2. Changes in Securities and Use of Proceeds**

None

### **Item 3. Defaults upon Senior Securities**

None

### **Item 4. Mine Safety Disclosures**

None

### **Item 5. Other Information**

None

### **Item 6. Exhibits and Reports on Form 8-K**

#### **(a) Exhibits**

Exhibit 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 101.INS\* XBRL Instance

Exhibit 101.SCH\* XBRL Taxonomy Extension Schema

Exhibit 101.CAL\* XBRL Taxonomy Extension Calculation

Exhibit 101.DEF\* XBRL Taxonomy Extension Definition

Exhibit 101.LAB\* XBRL Taxonomy Extension Labels

Exhibit 101.PRE\* XBRL Taxonomy Extension Presentation

XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

(b) Reports on Form 8-K

On August 28, 2016, Avalon filed a complaint in the 11<sup>th</sup> Appellate District Court in Trumbull County, Ohio for a Peremptory Writ of Mandamus to compel the Director of the Ohio Department of Natural Resources to initiate appropriations procedures to determine damages from the illegal regulatory taking of the Company's property, or issue an alternative remedy at law.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AVALON  
HOLDINGS  
CORPORATION  
(Registrant)

Date: November 10, 2016 By: /s/ Bryan P.  
Saksa  
Bryan P. Saksa,  
Chief Financial  
Officer and  
Treasurer  
(Principal  
Financial and  
Accounting  
Officer and Duly  
Authorized  
Officer)