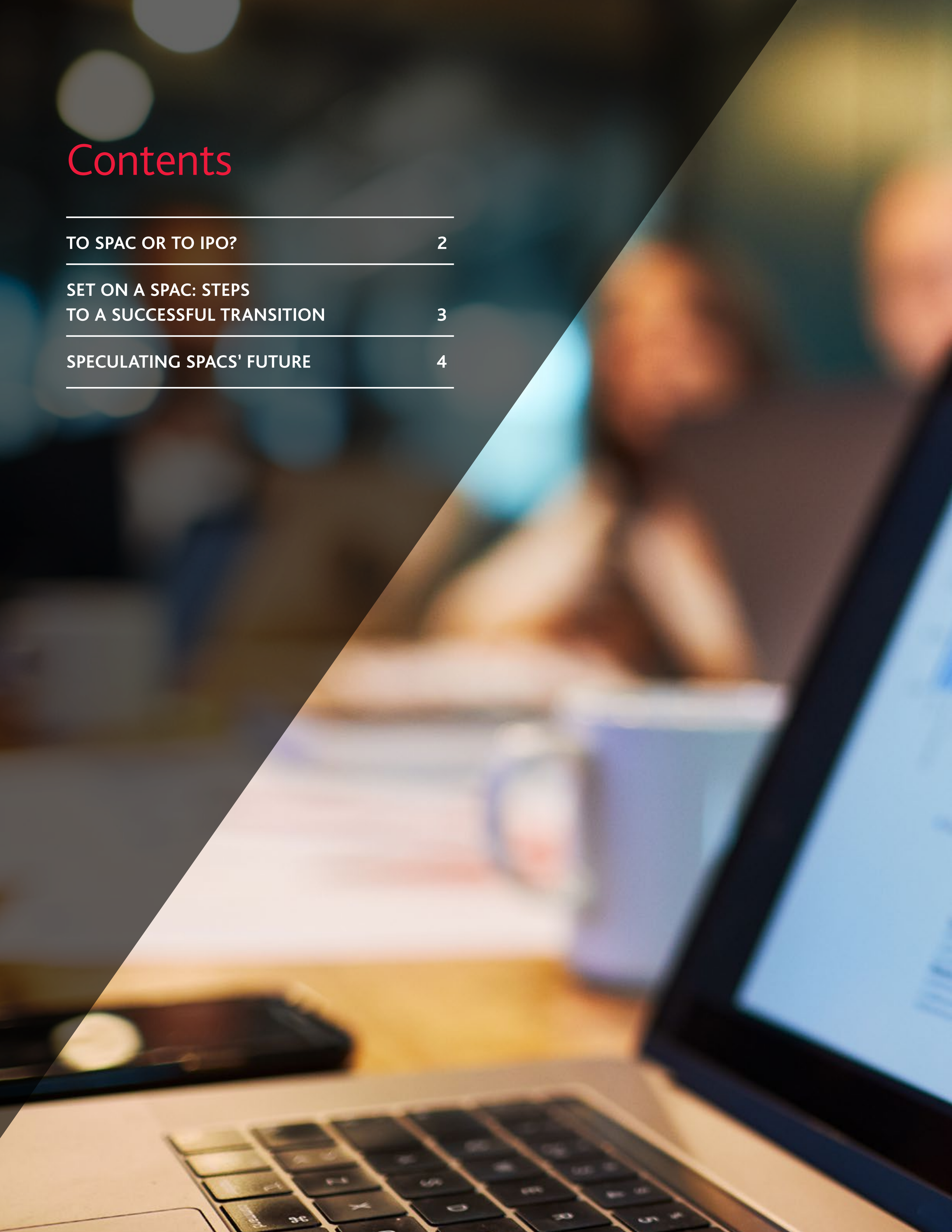
SPACS IN THE SPOTLIGHT

Private Equity's Roadmap for SPAC Readiness and Success



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Special Purpose Acquisition Companies—commonly referred to as SPACs—have been making major headlines and accelerating at an unprecedented pace since the start of the COVID-19 pandemic, ending 2020 with 248 listings raising $83 billion—representing year-over-year increases of 320% and 513%, respectively. Through mid-March 2021, more than 275 SPACs have raised over $89 billion.

The spike can be explained by travel restrictions making the typical IPO roadshow and route more cumbersome, thus SPACs emerged as a more viable alternative. In addition to the increased efficiency, broader market factors—including economic volatility— can also explain the rise in SPACs. For investors, SPACs are seen as a relatively low risk and the potential for returns are high given the access to capital, low interest rates, and ability to move quickly to close an acquisition. This provides target companies with the potential to grow exponentially, despite the economic downturn, as companies continue to seek access to additional capital.

With the uptick in relevance in the capital market, PE firms are increasingly considering where SPACs could make sense in their investment decisions.

To SPAC or to IPO?

SPACs are **often viewed** as an express path to going public; the speed to transaction is faster and often less costly and burdensome than a traditional IPO and offers an additional exit route for PE funds looking to cash in on a hot M&A market.

However, with speed comes an increased risk of bumps in the road becoming potholes that could steer a deal off course. PE firms looking at potential SPAC transactions for their portfolio companies should be careful not to overlook a number of important considerations.

First, PE funds and their portfolio companies should evaluate whether the portfolio can monetize its investment by going public via a SPAC. If the valuation cannot support the sale and achieve the level of returns originally desired, the SPAC path may not be the best investment vehicle for that company.

Second, PE funds should assess the state of readiness of their portfolio company to function as a public entity, including, whether it is prepared to make SEC filings, shareholder reports, etc. Given the condensed timeline of the De-SPAC transaction, companies pursuing this route do not have the same amount of time to compile their financial statements and other documents needed for the reporting process that comes with going public. In fact, the preparation stage can be cut by up to 75%, since the timeline of a SPAC is usually three to four months versus up to a year with a traditional IPO. Despite the accelerated deadlines, accuracy in financial reporting cannot be compromised. In addition to the accounting and disclosure aspects, it's critical for PE funds to be frank about what aspects are being met, somewhat met or insufficiently met before exiting, including but not limited to: internal controls, board structure, audit committee composition and human resources policies.

That said, readiness also should come from the SPAC's side. Because of capital competitiveness and the heightened number of SPACs looking for targets, the negotiation process is shortened since the target company likely has several other options with which to go public. SPAC sponsors should make sure to submit their bids promptly while instilling confidence to the target that the deal will go through. A trustworthy sponsor-target relationship is critical for an effective transaction and companies should also be prepared to disclose their chosen SPAC team. Note that acting quickly can also reduce the timeframe of the merger, underscoring the importance of the portfolio company preparing to function as a public company.

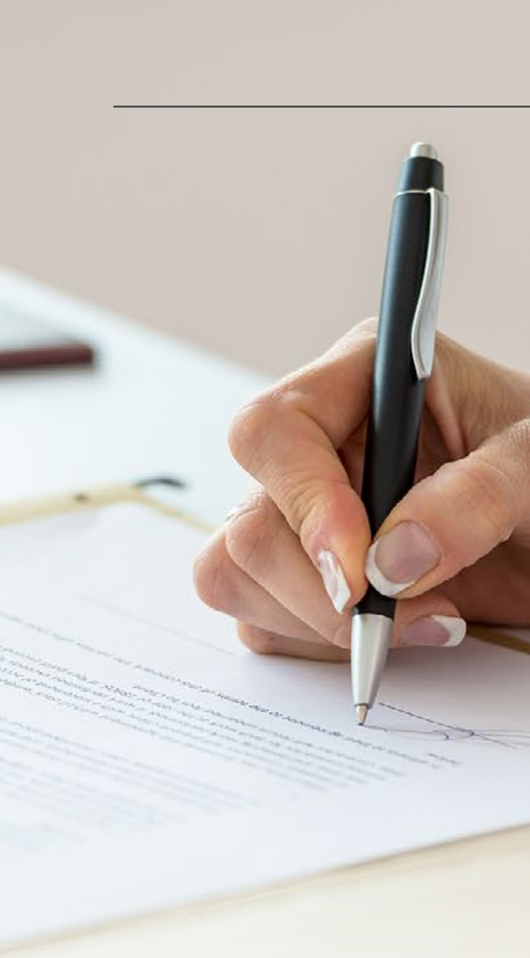
UNDERSTANDING "DE-SPAC"

If an acquisition is approved by the shareholders and other conditions specified in the acquisition agreement are satisfied, the acquisition is consummated. This is otherwise known as the De-SPAC transaction. Generally, the funds in the trust account may not be released (except for permitted withdrawal of interest as required to pay any income or franchise taxes or other specified expenses) until the earlier of the completion of an initial De-SPAC transaction or the redemption of any shareholders who elect to not participate in the De-SPAC transaction.

For more on an overview of SPACs, **click here**.

QUESTIONS TO ASK WHEN CONSIDERING A DE-SPAC TRANSACTION FOR YOUR PORTFOLIO COMPANY

- Is the SPAC operating on a limited timeframe (i.e., how much time does it have to make an investment)?
- How ready is the portfolio company to meet the reporting requirements of being a public company?
- Does the portfolio company have a clear perspective on requirements that are met, partially met, or not met?
- Does the portfolio company have a plan to address unmet requirements and is it able to meet those requirements with existing resources within a limited timeframe?
- Does the portfolio company have the right level and type of resources for the transaction and post-transaction reporting requirements?
- Have you assessed the income tax function of the portfolio company? Further consideration is required if the portfolio company was treated as a partnership.



Set on a SPAC: Steps to a Successful Transition

Most PE funds have experience with IPOs, but it takes a specialized team to accomplish a seamless De-SPAC transaction. Even with a seasoned financial team, there may not be sufficient experience in the specific requirements for going public. Bringing a portfolio company from its current state to its ideal state may be challenging to do alone considering the bandwidth of resources needed to address the complexities.

Public company remediation is a crucial step for portfolio companies gearing up for a De-SPAC. This is the period between the time the letter of intent is issued and the time the merger agreement is executed, where the portfolio company should work out any kinks prohibiting it from successfully operating as a public company. Early preparation is vital for SPAC target companies to remain compliant with complex regulations. This extra lift may go beyond the financial team's typical duties and may therefore require an outside provider. The key is to have someone on board who has previously worked in a public company environment and can advise on the transition appropriately.

Once the transaction is closed between the portfolio company and the SPAC, the merged public company must consider whether it has the ability to comply with the '34 Act reporting obligations—the normal recurring periodic filings—or any subsequent '33 Act filings registrants. If not, the company will need to bring those resources in house quickly or look to an external advisor to provide assistance to the company to meet public company reporting requirements including ASC 740 and related reporting. Some companies may have elected private company council accounting elections and presented them accordingly in their historical reporting documents. For filings related to the De-SPAC transaction, as well as prospectively, the company will have to unwind those prior elections and go through an accelerated adoption of accounting standards that were not previously reflected in their historical financial statements. This primarily refers to leases under ASC 842 or the adoption of CECL under ASC 326 but can also include accounting for goodwill amortization and impairment testing, intangible assets acquired in a business combination and possible consolidation considerations for variable interest entities ("VIE") whereby the private company was determined to be the primary beneficiary of the VIE.

The consequences of not complying with reporting standards can be costly. The biggest risk is that the deal could fall through, and while there are no breakup fees with SPACs as is the case in many traditional acquisitions, the damage done to all parties involved can be detrimental financially, reputationally and in lost time that is difficult to make up.

- **Public company remediation**
- **The transaction is closed between the portfolio company and the SPAC.**
- **Can the merged public company comply with reporting standards?**
- **If not, bring resources in house quickly or look to an external advisor to provide assistance to the company to meet public company reporting requirements as consequences of not complying can be costly.**

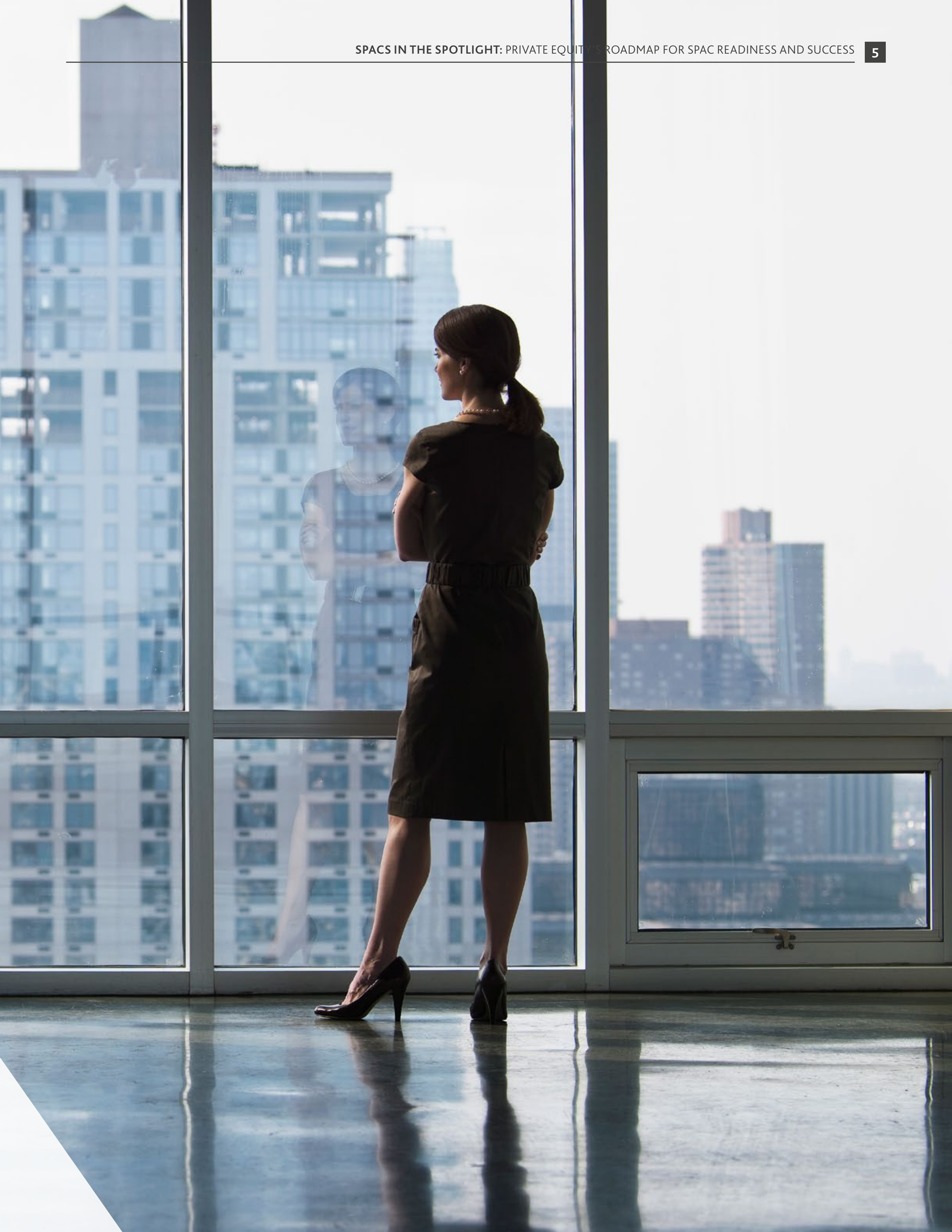
Speculating SPACs' Future

In addition to SPACs serving as an exit opportunity for portfolio companies, PE fund managers are also viewing them as an investment vehicle. Should the market continue to lend itself to SPAC activity, the uptick in PE funds sponsoring SPACs is expected to be on the rise as well. For much of 2020 and to-date in 2021, the majority of business operations have been far from what was previously considered normal. Time will tell whether SPACs will be deemed a temporary COVID crutch, or a permanent fixture in the private equity toolkit.

Companies should ensure they have experienced legal, financial and accounting professionals in place for a smooth transaction. If your organization is contemplating pursuing a SPAC as an exit strategy, consider obtaining the advice of trusted professionals who can help conduct a risk assessment and ascertain whether the deal is right for your organization. A professional advisor can help you leverage your negotiating power as the end of a SPAC's lifecycle approaches, manage the transition once a deal is made, and fulfill your technical accounting requirements and any other regulatory responsibilities.

THINKING ABOUT PURSUING A SPAC BUT NOT SURE WHERE TO START?

Check out our 7-part series on SPACs and reach out for more information. ▶



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