Beware of These Five SPAC Risks

With the onset of the pandemic, special purpose acquisition companies (SPACs) regained popularity as a potentially less costly way to go public and an enticing alternative to an initial public offering (IPO).

Many companies, particularly in high-growth industries, have been eyeing SPAC acquisitions as a possible route to an influx of cash. However, going public through a SPAC comes with its own considerations. The rushed timeline for SPACs to identify a target and close an acquisition, typically within two years, combined with the ultimate reporting requirements of the new public entity, can result in an uphill battle not foreseen at the start of the process.

Those evaluating a SPAC investment should be familiar with the following risks of this remerging trend.

1. Goal Alignment
2. Reaching the Finish Line
3. Be Aware of Timelines
4. The Responsibilities of Going Public
5. Talent Retention

1. GOAL ALIGNMENT.

Many SPAC management team members have a professional investment background and do not necessarily have expertise in the specific market segment in which the target company is focused. It is important that both SPAC management and the operating company management agree on significant issues, such as target markets and key operating metrics at a granular level.

2. REACHING THE FINISH LINE.

Although a SPAC and an operating company may enter into exclusive negotiations, it is less than certain that the acquisition will actually be completed. Some deals never make it to the finish line after months of due diligence (financial, tax, legal HR, IT, etc.), not to mention more meetings and calls than teams care to remember. These deal collapses were driven by a variety of factors, including changes of heart by either the buyer or the seller, or external environmental factors, including turbulent financing markets and the global COVID-19 pandemic.

3. BE AWARE OF TIMELINES.

Typically, a SPAC has a limited time horizon in order to invest. During this time, the SPAC must not only identify a target and negotiate a deal, but also complete the deal and comply with all reporting requirements. While a SPAC acquisition may require less time than the traditional IPO, the merged company must still comply with all Securities and Exchange Commission (SEC) filing requirements, including complex financial statement and other financial reporting requirements, which can take significant time to prepare.

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4. THE RESPONSIBILITIES OF BEING PUBLIC.

It is sometimes said that going public (despite its challenges) is easy, while being public is the hard part. Many private companies are not prepared to be a public registrant and do not possess the sustainable processes and controls required for the rigors required of public company financial reporting. While many private companies compile management reporting on a monthly basis, the current team should also be able to produce timely and accurate quarterly financial information (including international consolidation, tax provisions, share-based compensation, etc.), with appropriate reviews, and a Form 10-Q due to the SEC within 45 days after the end of the quarter.

5. TALENT RETENTION.

All companies face the risk of key employees leaving for another opportunity. In the case of a SPAC-acquired entity, the cultural and regulatory environment can change overnight as the company becomes a public registrant. While many employees may view this as an opportunity, there is the risk that some employees, including key members of management, may leave pre- or post-transaction.

CONCLUSION

It is important to consider accommodating potential outcomes to plan for a successful investment; for more information about SPACs and the IPO market, reach out to us at info@dhg.com.