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Deloitte M&A Views podcast: SPACs: The M&A players behind tomorrow's IPOs

Greg: Welcome to Deloitte M&A Views, a Deloitte podcast series exploring the latest trends and topics in mergers and acquisitions. I'm Greg Jarrett. Today we'll discuss the considerations for companies being acquired by a special purpose acquisition company or SPACs. We're joined today by Mike Dziczkowski, Jeff Bergner, and David Oberst, M&A transaction service partners with Deloitte and Touche LLP. Right out of the box, that name SPACs, what is that all about? Mike, how about giving us some orientation? What are SPACs, and where do they come from?

Mike: Sure. So just as the name references, a SPAC is put together for a special purpose. It's basically a shell company that has no business of its own but rather it's there to make an acquisition of another company. And these companies have really come into favor lately for a couple of reasons. One, they're a way for the target companies to go public, the targets being those companies that SPACs acquire, and secondly, because there's so much money in the system, we have found that the number of SPACs that have recently gone public over the last three years has really seen an uptick. The initial offering for a SPAC is where the IPO really lies.

For a SPAC, you typically have a founder who is well known in the investment community, and that founder goes and raises capital from other investors, and the purpose of the SPAC is to go out and do an acquisition. Those investors that are making that initial investment understand the target industry that the SPAC is interested in, but outside of that, they really don't know what the SPAC is going to do with the money. And for that reason, there's a limited life to a SPAC. Usually it's about two years. So a SPAC has a short fuse in terms of the amount of time that it has to use the funds to go out and do an acquisition, but they really have come into favor, like I said, over the last several years. Really, the last three years, we've seen a big uptick, but they're something that have been around since the early '80s.

Greg: You talked about money, Mike. Jeff, we're talking about a lot of money. SPACs are in the news and the money that's being mentioned is in the trillions. What are the factors shining a spotlight on SPACs right now, and do you see this trend lasting?

Jeff: We definitely see this trend lasting. The Pershing SPAC, the $4 billion that was completed at the end of June, has the potential to be a game changer, a SPAC 2.0, so to speak. It's going to create even more market momentum. They went out and got an experienced deal team, all of which have large private equity backgrounds, they changed the rules a little bit. Most SPACs have founder shares in which the founders are 20% in the money compared to other investors, and Bill Ackman and team waived that on this environment. The founders typically get warrants, and these warrants are priced higher than what other fundraisers have done, and then with Pershing and Bill Ackman in the background, obviously he's been all over CNBC, Wall Street Journal, and all other news sources touting his SPAC, but it's put it front and center on the news. As Mike said, we've really seen an uptick in the last couple of years, probably starting in 2017 in which there were 34 SPACs, 2018, 2019, in the 40s and 50s with the average SPAC value of $230 million.

Already this year, we have 57 SPACs, $23 billion almost raised in total capital with an average IPO size of over 400 million, and we're just continuing to see more and more SPACs come to market. Part of the reason for that is in the current market, in this pandemic, people don't really know where to put their money. There's lots of bad press about existing public companies, in their search for yield, you can't get interest rates for anything, bonds to bank accounts, etc. A typical investor doesn't have access to traditional PE funds. Some of these SPACs are out talking about access to new technology. We see several talking about being a cyber roll-up, and some are online gaming-focused.

There's been several SPACs that have done electrical vehicle acquisitions, including one here the first week of August. We've seen others that have gotten into healthcare management. I think investors look at this and say, "This is my way to get into new technology." And with these electric vehicles, I guess everybody wants to be the next Elon Musk. So we think they're at least here to stay for the next several years, and the momentum is only going to continue.

And Mike touched on this a little bit. That's just the fundraising of the SPAC, but the SPAC has got to work quick. It has two years on a typical SPAC to announce a deal, an additional six months then to close that transaction, and preparing for this, we've seen a bunch of online publications that were tracking the dates of SPACs, and when they're going to click out if they don't announce a deal because if they don't get a deal announced, they have to return the money. So if I was someone, or one of our clients that was looking at being acquired by a SPAC, first thing I would do is look to see how long does that SPAC have left before they need to close a deal, because there may be a sense of urgency on the other side to get a deal closed, and they may be able to use that to their advantage.

Greg: But, David, you look like you have something that you want to jump in and add here. Go for it.

David: Yeah. Thank you, and I agree with everything you said, Jeff, but the last thing I would want to add to that is we're now in a situation where a lot of companies 20, 30 years ago would have been public by now, but now they've been capitalized by several different private equity firms throughout their lifespan, and so if these private equity firms are looking to monetize that investment, going into the public markets is a very advantageous way for them to do that and SPACs offer kind of an alternate way to get to the capital markets because a lot of these companies don't actually need a cash infusion, they just want to have access to the capital markets for further growth down the road. And so, to Jeff's point, I think we're going to continue to see this trend continuing as more businesses look for creative ways to get to the public markets.

Greg: As long as we're talking, David, can you give me a little more about the benefits for businesses planning to go public?

David: Yeah, absolutely. There's certainly some benefits to going public through a SPAC. The first one is that the process is typically faster. The reason being is that you do not have to go out and market the business to a bunch of individual investors and banks. This public transaction happens through one purchase agreement. And another advantage of going public through a SPAC is that you'll have more certainty about the amount of capital that's going to be transacted. So if you are going public, typically you get kind of an indicative view of what the value of the company might be, but that's going to change, it could be dependent on how well your road show goes, it could be dependent on external events that you have no control over, and where you thought your value was two weeks before your go public, it may not be there two weeks later. You're not going to have that issue when you have a signed purchase agreement.

Another advantage if you're the owner of the company that's being bought is that you will get quicker access to the capital that you receive in the transaction. Typically, in an IPO, as an owner of the company, you'll have a lockup period where you can't sell the shares, and certainly every deal is different, but SPACs do offer an opportunity for owners to immediately get the cash from the transaction.

The last thing I would just say is that there is just a higher likelihood of getting the price right. A lot of times in IPOs, you'll see a huge pop on day one of being public, which might indicate that you had priced the IPO too low. Because there's more diligence done by a single investor, there's a higher likelihood of getting the right price on the transaction.

Greg: SPACs sound great. I mean, it almost sounds like all upside. Mike, I don't want to rain on the SPAC parade, but there has to be a downside.

Mike: And there can be. Unlike a transaction where I'm a company, I'm thinking about going public, and someone comes along and just buys me, say another corporation comes and buys me, typically what that would mean is I get my purchase price, the operations of my company get assimilated into the other company, and life goes on. Here, when you get acquired by a SPAC, ready or not, you have to be a public entity that can operate like a public entity, and some companies just aren't ready to do that. And so, what we have talked to our clients about, what we've seen in the marketplace, is that a lot of clients go through a process where they're thinking of going public. I'm a private company, I'm looking at how I can become a public company, and I go through a process of IPO readiness. How ready am I to act in the public market? What kind of gaps do I have in my operations, in my reporting capabilities, things like that, that would allow me to be a public company and operate efficiently?

And, in the case of a SPAC, you have no reliance on the company or the SPAC that's acquiring you for any of those operational things that you might have gaps in because, as we said in the beginning of this, it's a shell company. There's nothing else there. And so, if you can't do it as a standalone entity, whether it be being able to report on time your financial information, being able to talk to analysts, being able to forecast what your business is going to look like, if you can't do those things, which every public company needs to be able to do, you're not going to get that assistance from the SPAC, and so you might not be ready to go public. Companies have to know where they are on that journey and be willing to really self-assess if they're ready. And if they're not, they have to figure out, "Is a SPAC the right thing for me?"

Greg: You know, I was thinking earlier in the conversation that everybody should use a SPAC, but I guess that's not the case, right, Jeff?

Jeff: Well, no, not at all. And a lot of these companies, they just put themselves for sale. It's just like putting your house for sale, and you don't know who the ultimate bidder or winner is going to be, and lo and behold, they find that it is a SPAC. An IPO was not even a thought process for these entities and now they are told, "Not only do you have to go public, but we need you to go public as quickly as possible." And we'll spend some more time on that at the end of this, but so you need to hurry up and get to the finish line. And Mike just addressed all the issues of there's getting public, but then there's being a public company and trying to be a timely registrant with your 10Qs and 10Ks, and if that wasn't on your radar, that's not an easy transition to make.

Greg: If you don't mind, let's do a hypothetical here, David. I find my company the target of a SPAC. I'm being bought. Is there anything special I should be thinking about?

David: Yeah, absolutely. And, Jeff and Mike both hinted at it, but you really should be thinking about things from two different perspectives. One, "What do I need to do to get my financial statements on file so that I can actually start the voting process for the transaction to happen?" That's kind of the first thing you should think about. The second one is, ""What are the fundamental changes I need to make to my business processes so that I am capable and ready to be a public company?" If we start with the first category, which is, "What do I need to do to get ready to file my financial statements with the SEC?" you should be looking through the lens of, "I am going to do an IPO," because the requirements to get your financials on file are the same as an IPO.

You will need to upgrade your audit opinion from an AICPA opinion to a PCOB opinion. In my experience over the years, I've found that can take upwards of two to three months, and in this environment, it can be extra challenging because everybody's working remote, and you may need to go back and do three full years of PCOB opinions, so to the extent that you have a lot of support and materials on site, there could be a lot of coordination in place just to get that ready for the audit. In addition to upgrading the audit, you actually have to upgrade the basis of your financial statements. And so you have to be ready to put them on a public company basis. And what that can mean is a few things.

One would be changing some private company accounting standards to public company accounting standards. A lot of private companies, for instance, amortize goodwill. You can't do that as a public company, so you'd have to go back and actually do goodwill impairment tests for every year that's being audited. On top of that, there are certain requirements of public company financials that don't relate to private company financials, such as segments in EPS, and then you also really need to think about new accounting pronouncements and whether or not you've fully implemented those or implemented those on a public company basis. Just your financial statements themselves to get those up to speed can require a lot of time and effort.

In addition to your actual audited financial statements, there's a lot of other parts of that SEC document that need to be created that you probably have never done before or haven't put a lot of thought into, and that's things like MD&A, your liquidity section, your non-GAAP measures, how are you going to report the business out to investors, what is the story that you want to tell to investors about your business? If you've done a lot of acquisitions recently, you may need to do pro forma financial statements, you may need to go back and get audited financial statements of your recent acquisitions.

Lastly, on the financial statement side, you also are going to be subject to control requirements that you weren't used to as a private company. Now, depending on the size of the business, you may have several years before you need to implement a full SOX audit. With your first 10Q, the CFO and CEO of the company have to certify the financial statements. And that's going to require putting a lot of process around transactions that you may not have done previously. And again, all this needs to be done on a timeline that is significantly faster than how long it takes for companies typically to get ready for an IPO.

Mike: And I would add there that we find a lot of private companies are great at selling their products. They may be even really good at selling the vision or the dream of what the company is, but when you become a public company, there's a level of governance and messaging that it's a different mindset when you're dealing with analysts, it's a different mindset when you're dealing with shareholders. And so, companies need to learn that, and because of the condensed amount of time that you have when you're being acquired by a SPAC, leadership of the company may not have enough time to learn those differences. And they may not be able to drive that down into their organization so that everybody understands you're no longer working for a private company, you're working for a public company and so statements that you may make outside of the company really matter.

And so those type of controls, that type of governance is one of the areas that companies really need to focus on if they're thinking about going down this path because it's not only a monetary issue, it could become a legal issue. And so, I think it becomes even more important to make sure the governance is in place.

Greg: Well, David, as long as we're talking about this, any leading practices for those listening to consider with regard to these types of deals?

David: If you're thinking about building out a process to go through to become a public company, first, I think it's important to build and identify a core cross-functional team that's going to drive the process, and it needs to be people across the spectrum of the company, both financial, tax, legal, controls, and outside investor relations to the extent that you have it. One thing that I've seen is that sometimes those teams are too narrow, and they don't have enough doers, they only have executives, and so make sure to broaden it enough that you have people that will go out and really drive the outcomes.

Secondly, you want to build out a comprehensive project plan and understand the interdependencies between the different workstreams. And the way they do that is to make sure you're being collaborative and communicating with each other because oftentimes the decision made on tax could drive an outcome on financial and vice versa.

Third, do an honest assessment of your organization and identify weaknesses or holes that you have in your current team, and make sure that you have a plan to supplement those weaknesses with either new hires or external advisors. And lastly, and this is probably the most important, is making sure that you focus not only on the act of becoming public, but on being a public company. I like to say that going public is an event, but being a public company is a lifestyle, and too many companies focus on just getting all the work done to becoming a public company and don't think enough about what it's like to be a public company. And that's where you need to think about the things like the governance that Mike was talking about and making sure you have systems and processes in place that are going to support all of the new requirements that you have as a public company.

Greg: Mike, given the current environment, a lot of people are doing things differently. I mean, let's go back to Valentine's Day. It really was all hearts and flowers, especially compared with right now. Is there anything different about governance with the current situation and these deals?

Mike: Well, one of the things is, as these companies are going public, the need for them to bring on new board members, not only for the purpose of being on the board, but also being on board committees. In the past, I would tell you that that was a rather exclusive club that you would see where the names on those lists would be a short list of people and the backgrounds and skill sets that they would have wouldn't really lend themselves to the kind of diversity that companies are trying to achieve now on boards. So the good news is that while the number of companies going public is increasing, the pool of potential candidates for boards is actually also increasing because boards are opening up and trying to become more diverse, adding women to the board, adding people of color to the board, who have incredible skill sets, who have name recognition and can bring a lot of value to those companies.

I think people are certainly more willing to do that today than they were just several years ago, and quite honestly, I think it's almost a requirement and a good one. And so, I think as companies are looking to not only diversify, but bring the right skill sets on, we're seeing new people join boards that in the past really didn't have those opportunities.

Greg: Gentlemen, thank you for your time. We learned a lot about SPACs, special purpose acquisition companies. I'm Greg Jarrett, and thanks for listening to Deloitte M&A views, sponsored by Deloitte's M&A Institute. This podcast contains general information only and Deloitte is not by means of this publication rendering accounting, business, financial, investment, legal, tax, or other professional advisor services. This podcast is not a substitute for such professional advice or service, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this podcast. For additional information about Deloitte, go to deloitte.com/about. We also release new podcasts regularly, and if you subscribe, you won't miss a single one. To stay connected and receive more information on Deloitte's M&A service offerings, visit deloitte.com/us/m&asubscribe and follow us on Twitter at DeloitteM&A. Until next time.