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5x5 series: Insights and actions

Seller considerations for transactions between carve-outs and SPACs

As a result of the recent sharp increase in mergers between Special Purpose Acquisition Companies (SPACs) and private companies, there are beginning to be fewer remaining private companies attractive to SPACs. While traditional SPAC transactions will remain, SPACs will need to evaluate other transaction constructs to utilize their raised capital in the specified time period. One potential transaction construct for a SPAC is acquiring a portion of a larger organization that can stand alone as an independent business, commonly known as a carve-out transaction. Carve-out transactions traditionally occur when a parent entity wishes to pursue a sale, spin-off, or initial public offering of a portion of the parent entity. SPACs have now created a new, non-traditional path for companies looking to divest a component of their business.

5 things you should know

Insight #1 – Time Constraints. A SPAC typically has two and a half years to identify and complete a business transaction, which results in a very real time constraint that adds pressure on the seller to accelerate their timeline to prepare carve-out financial statements and operationally separate the business being sold.

Insight #2 – Separation and Day 1. When a SPAC acquires a carved-out entity, it may not be buying a business that has the corporate operating functions and infrastructure that are necessary to operate as a standalone public company on Day 1.

Insight #3 – Private vs. Spin vs. SPAC Reporting. Public company reporting, which is required by a SPAC purchase, is more arduous than private company carve-out reporting requirements. Financial reporting requirements are similar for both public spins and SPAC purchases due to both transactions requiring public company reporting standards; however, there are a few key differences primarily related to the SPAC filings which are not applicable to Form 10 filings.

Insight #4 – Audit and Control Materiality. Even though a carve-out entity may be part of a larger public company that was audited, significant additional audit and control work will likely need to be performed with a lower level of materiality and higher level of scrutiny for the PCAOB audit requirement.

Insight #5 – Counterparty Considerations. Divesting a carved-out entity through a sale to a SPAC brings an element of negotiation that is not present in a traditional spin-off. Under a deal process, selling price and terms become negotiated levers influenced by the diligence process and direct interactions with each potential buyer.

5 actions you can take

1 **Related action #1.** Evaluate the anticipated timeline required for financial and operational separation for the carve-out entity under a potential SPAC transaction to ensure timing feasibility.

2 **Related action #2.** Evaluate the types of transition service agreements (TSAs) the seller would be willing to provide and identify additional headcount and infrastructure necessary to stand-up a public entity on Day 1.

3 **Related action #3.** Review the uplift procedures needed from a private company to public company standards for a PCAOB audit opinion. Additionally, understand the differences in pro forma (including equity structure) and projections for a SPAC S-4 vs. a public spin Form-10.

4 **Related action #4.** Consider the control structure and SOX requirements impact of the carve-out being a separate entity. Understand specific control areas where uplift procedures might be needed for public company reporting requirements and the associated audit procedures.

5 **Related action #5.** Prepare in advance for the diligence process by understanding specific buyer motivations and areas of interest. This includes areas such as evaluating economic deal EBITDA vs. GAAP carve-out EBITDA, and clearly mapping goals for negotiating certain deal terms such as transferring employees, supply agreements, working capital targets.

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