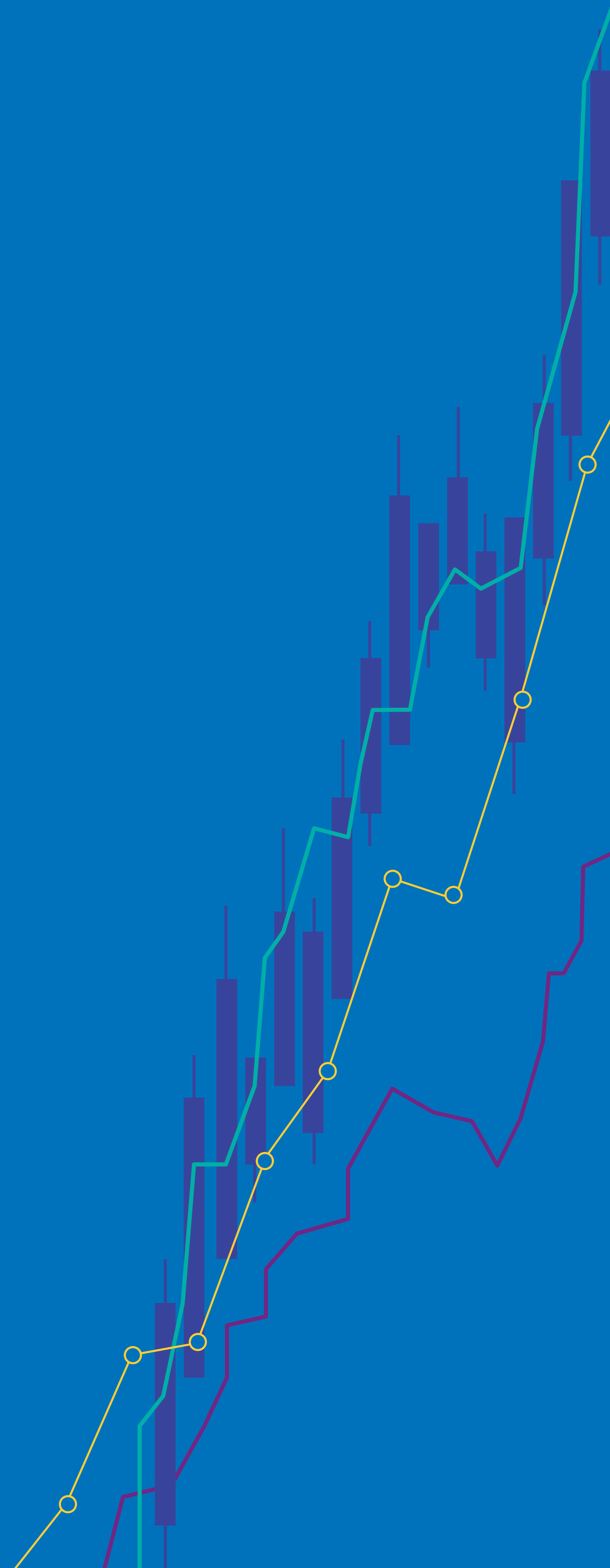
SPACs: a big deal again

Selling to a special-purpose acquisition company can be quick and lucrative—if you know the risks, complexities and tradeoffs



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Introduction

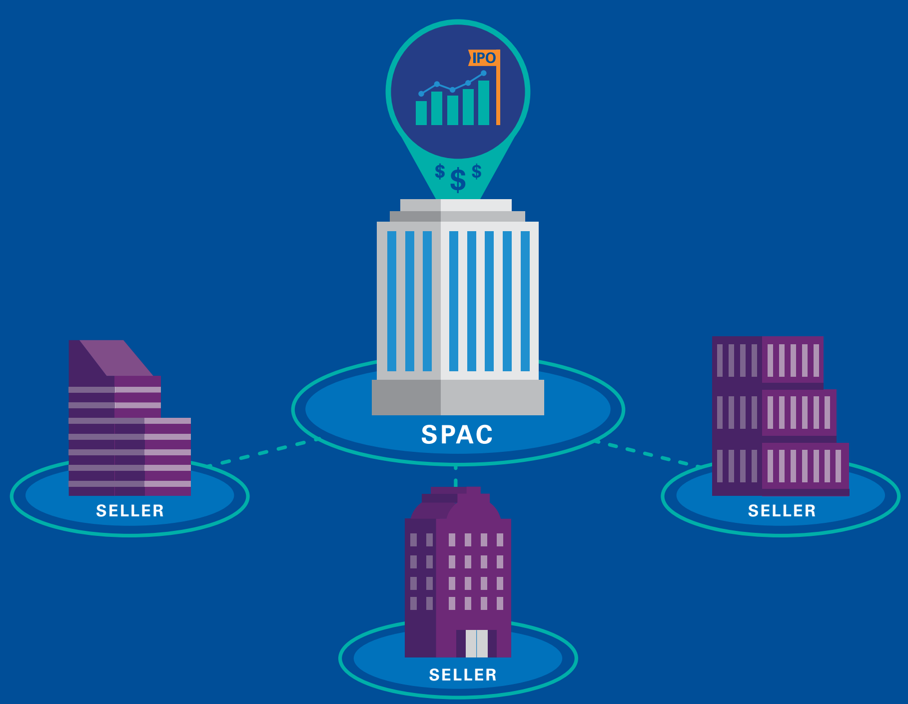
The return of Special Purpose Acquisition Companies or SPACs is yet another sign of how hot the M&A market has become. SPACs—publicly traded entities created for the sole purpose of acquiring one or more companies—were popular before the global financial crisis of 2007-08, but fell from favor afterward as the overall economy struggled. Now, they're back. In 2018, SPACs raised $9 billion in 43 initial public offerings, up from $3.5 billion and 19 IPOs just three years earlier.

SPACs provide a path to a quick, well-priced transaction, and they can be particularly attractive to private-equity sellers and international investors. SPACs are funded through IPOs, and sellers are paid with public money, either in cash or publicly traded shares. Typically, sellers wind up acting as co-investors, using the SPAC transaction as a source of growth capital for a long-term holding. SPAC sponsors have the expertise to complete a transaction quickly and know how to realize post-deal value beyond the generic synergies. Sometimes, sponsors form a SPAC with a specific target in mind. Often, they file the IPO and then start the hunt.

But SPACs are not simple transactions. They are closely regulated by the Securities and Exchange Commission and selling to a SPAC is like trying to float an IPO at deal speed.

To sell to a SPAC, a seller must complete SEC filing requirements, audit requirements, and a due-diligence process. Moreover, everything must be done on tight deadlines because SPACs expire—if a deal is not completed by a certain date, the SPAC must liquidate, leaving the seller to start over again. This race against time could give the seller an advantage since the SPAC is motivated to complete the transaction, but at the same time involves additional work and challenges to the deal process. Sellers should also remember that, as in an IPO, there will be a lock-up period of up to a year, during which sellers cannot sell their SPAC shares.

In this paper we look at the opportunities and risks that PE firms and other sellers face when dealing with SPACs. We look at the tradeoffs between SPAC advantages and the challenges that a deal entails. We provide practical advice for performing pre-acquisition due diligence, dealing with SEC filing requirements, providing required audit history, and successfully completing a deal under the pressure of the liquidation deadline.

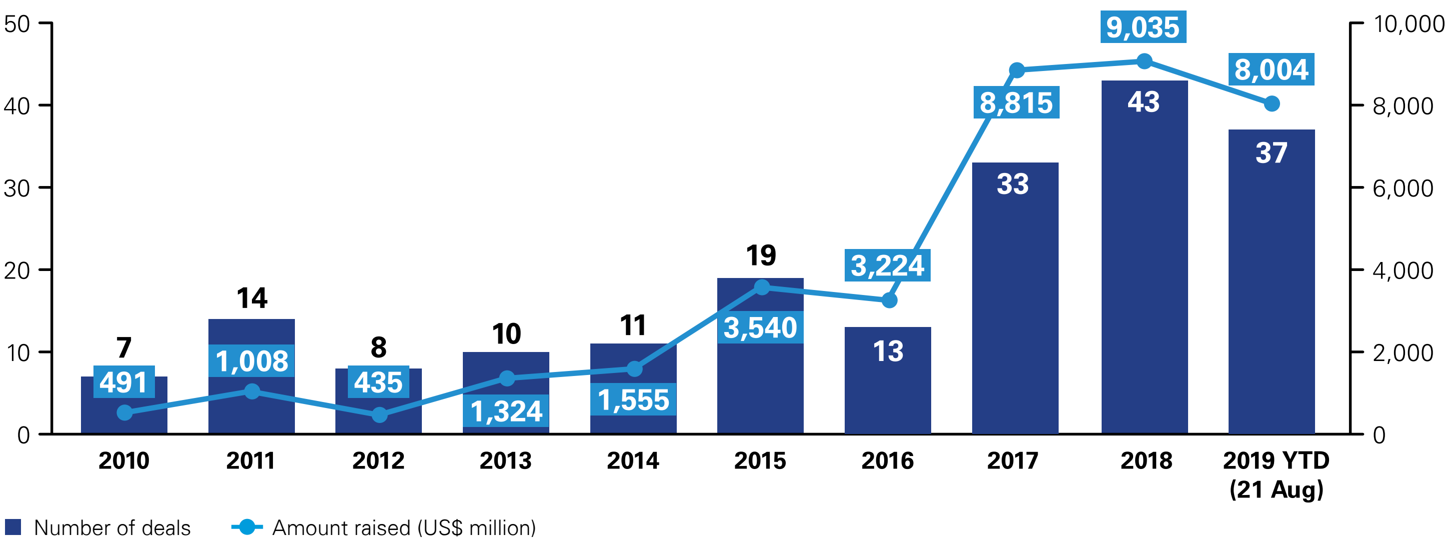


Why SPACs?

SPACs are not new. Also known as "blank check companies," they have been around for decades. They were used in the 1990s in deals across diverse industries and gained more prominence in the mid-2000s, with transactions involving such recognized names as American Apparel and Jamba Juice. More recently, in 2012, Burger King was acquired by a SPAC with the backing of prominent hedge fund manager Bill Ackman, CEO of Pershing Square Capital Management.

Since 2015, there has been a renaissance in SPAC issuance, primarily on NASDAQ and the NYSE. In 2016, $3.2 billion was raised by 13 SPACs, followed by $8.8 billion by 33 in 2017, and $9 billion by 43 SPACs in 2018, according to our deal count. In the first eight months of 2019, 37 SPAC IPOs raised $8 billion. Individually, these SPACs have raised anywhere from $40 million to $600 million (Exhibit 1). SPAC capital has been raised across industries. As Exhibit 2 shows, the largest amounts have been raised by SPACs in consumer ($1.96 billion), fintech ($1.25 billion) and energy ($1.14 billion).

Exhibit 1 — SPACs make a comeback



Source: KPMG Analysis

Exhibit 2 — Recent SPAC IPOs over $250 million

Company name	Offer amount	Date priced	Target sector
Thunder Bridge Acquisition II, LTD	$300,000,000	August, 2019	Fintech
Switchback Energy Acquisition Corp	$300,000,000	July, 2019	Energy
Churchill Capital Corp II	$600,000,000	June, 2019	Any
Haymaker Acquisition Corp. II	$350,000,000	June, 2019	Consumer
Diamond Eagle Acquisition Corp. \ DE	$350,000,000	May, 2019	Any
Landcadia Holdings II, Inc.	$275,000,000	May, 2019	Consumer
Act II Global Acquisition Corp.	$261,000,000	April, 2019	Consumer
Trine Acquisition Corp.	$261,000,000	March, 2019	Technology
Hennessy Capital Acquisition Corp IV	$261,000,000	March, 2019	Industrial
Acamar Partners Acquisition Corp.	$300,000,000	February, 2019	Consumer
Gores Metropoulos, Inc.	$375,000,000	February, 2019	Consumer
Fintech Acquisition Corp. III	$300,000,000	November, 2018	Fintech
Collier Creek Holdings	$400,000,000	October, 2018	Consumer
Gores Holdings III, Inc.	$375,000,000	September, 2018	N/A
Churchill Capital Corp	$600,000,000	September, 2018	Technology
Spartan Energy Acquisition Corp.	$480,000,000	August, 2018	Energy
Far Point Acquisition Corp	$550,000,000	June, 2018	Fintech
GS Acquisition Holdings Corp	$600,000,000	June, 2018	Industrial
Trinity Merger Corp.	$300,000,000	May, 2018	Property
Pure Acquisition Corp.	$360,000,000	April, 2018	Energy
Platinum Eagle Acquisition Corp.	$300,000,000	January, 2018	Any

Until it concludes an acquisition, a SPAC typically has no operating activities. Upon completion of a transaction, the firm acquired by a SPAC becomes a public company and is subject to all relevant filing requirements of the SEC, including earnings reports, disclosures, and compliance with the strict internal controls of the 2002 Sarbanes-Oxley Act. Thus, readiness as a public company for private firms being acquired by SPACs will be a crucial component of getting the deal done.

The SPACs advantage

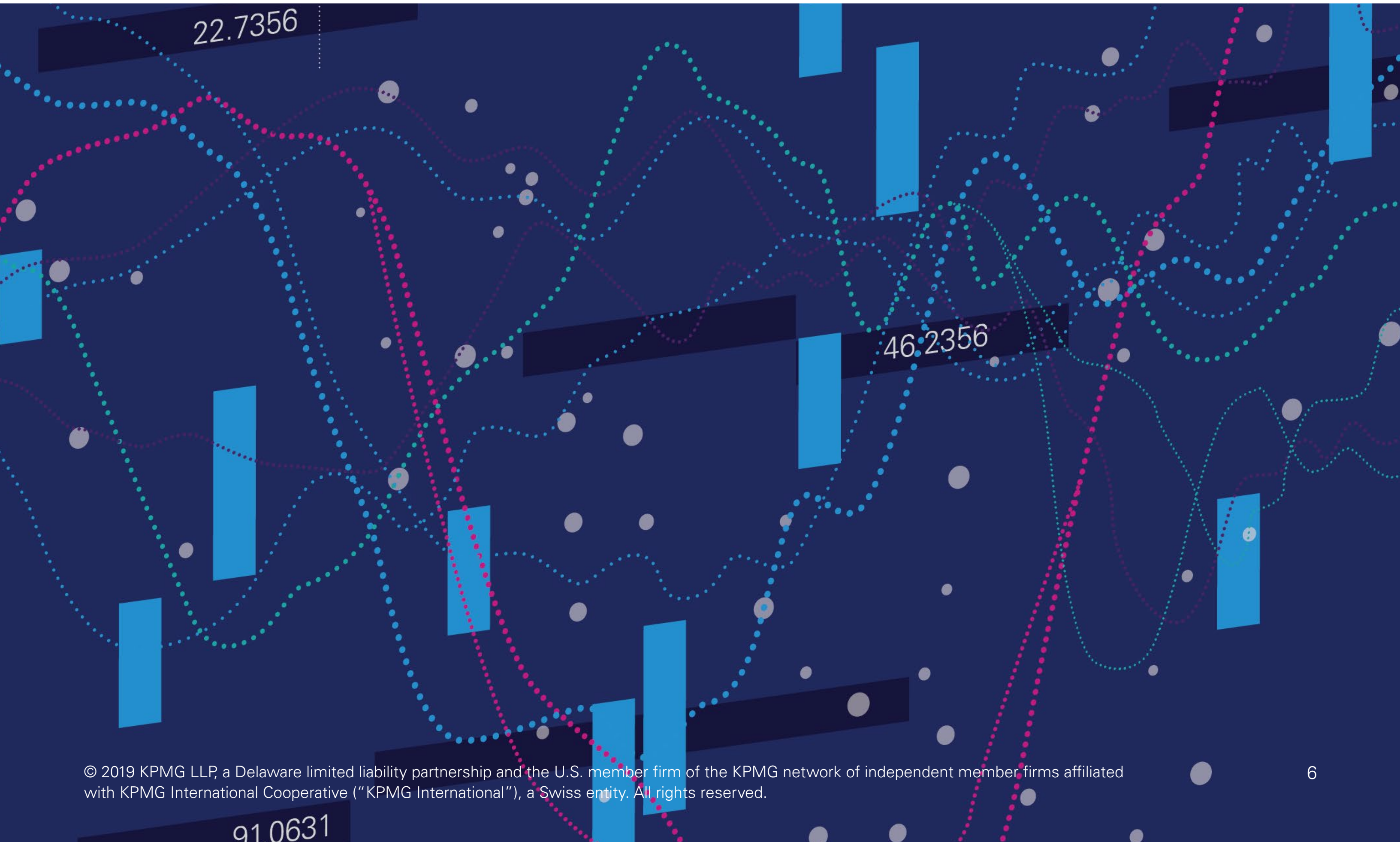
SPAC acquisitions provide a number of key advantages for PE sellers or management teams seeking the sale of a privately-held company. However, SPAC sales have some unique characteristics and requirements; thus, it is important for sellers to weigh the tradeoffs between the benefits and downsides.

What makes a SPAC sale attractive? For starters, SPAC deals can add up to 20 percent to a sale price, a reflection of the public-markets premium, according to Ellenoff Grossman & Schole LLP. Meanwhile, they have a lower reliance on debt than a typical PE deal, which can speed up the transaction.

SPACs offer a fast track into an IPO process with an experienced partner with deep understanding of the complexities of the filing process and the future requirements as a public company. Also, management teams and PE sellers will often retain stock in the company and get public access for their holdings. The acquired company benefits from increased flexibility since as a public entity, it will have access to public markets for future fundraising activities.

Exhibit 3 — Acquisitions by SPACs, 2017-2019

Company Name	Acquired SPAC	Date Priced	Announced Deal Value (US$ mi)
Atkins Nutritionals, Inc.	Conyers Park II Acquisition Corp.	July, 2019	$730
Repay	Thunder Bridge Acquisition LTD	June, 2018	$581
HF Foods Group Inc.	Atlantic Acquisition Corp.	August, 2017	N/A
Concrete Pumping Holdings, Inc.	Industrea Acquisition Corp	July, 2017	$447-550
Falcon Minerals Corp	Osprey Energy Acquisition Corp	July, 2017	N/A
NRC Group Holdings Corp.	Hennessy Capital Acquisition Corp III	June, 2017	$660
Xynomic Pharmaceuticals Holdings, Inc.	Bison Capital Acquisition Corp.	June, 2017	$450
Magnolia Oil & Gas Corp	TPG Pace Energy Holdings Corp.	May, 2017	$2,420
Convergeone Holdings, Inc.	Forum Merger Corporation	April, 2017	N/A
Altus Midstream Co	Kayne Anderson Acquisition Corp.	May, 2017	$952
Alta Mesa Resources, Inc. /DE	Silver Run Acquisition Corporation II	March, 2017	$4,000
U.S. Well Services, Inc.	Matlin & Partners Acquisition Corporation	May, 2017	N/A
Verra Mobility Corp	Gores Holdings II	January, 2017	N/A



SPAC execution risks

On the flip side, selling to a SPAC has unusual risks. While the transaction can go quickly, sellers should understand the impact of the post-sale lockup on valuations. Sellers must do a great deal of extra work. In addition to preparing the IPO paperwork, they must produce audited historical financial statements under public company auditing standards, and they must carry out extensive pre-acquisition due diligence.

Public company readiness:

To fulfill many of the requirements for completing the merger, a seller must supply all necessary information to facilitate the SPAC's filing for SEC review. This includes producing audited historical financial statements in compliance with public company standards and appropriate level of disclosure about historical acquisitions that are material to the financial statements.

There are also important accounting differences between public and private companies to prepare for, including the application of the new accounting standards (notably, ASC 606 Revenue from Contracts with Customers, ASC 840 Leases and for financial services entities, a CECL reporting process), and disclosures around complexities such as historical acquisitions, stock compensation and segment disclosure.

The seller also must prepare to document internal controls for Sarbanes-Oxley reporting, as well as an appropriate level of oversight, including by establishing an audit committee.

Understanding audit history:

For the purposes of filing with the SEC, a private company will need to provide PCAOB[1] compliant audited financials for their business, and also for any acquisitions made historically that are deemed to be material to the financial statements if the acquisition is considered to be significant per SEC rule 3-05.

As a result, historical audited financial statements for acquired companies may be required, particularly in the case of private company roll-ups. If audited financials have not been prepared historically or prior to the acquisition, this can create complexity when seeking some form of dispensation in discussions with the SEC.

Being prepared for efficient due diligence:

Because SPACs are relatively short-lived vehicles, a SPAC sale puts additional pressure on sellers to smoothly navigate all the contingencies of the acquisition process. For instance, it is helpful for a seller to prepare a robust sell-side diligence materials as part of the seller due-diligence process. Seller management teams can also use the sell-side diligence process to communicate other critical deal considerations to SPAC buyers.

[1]Public Company Accounting Oversight Board

Conclusion: Do not underestimate the complexity

SPACs are an intriguing option for PE sellers. A SPAC transaction can be quick and lucrative. It can also put an asset in the hands of managers that can continue to build up the business for long-term value creation.

However, as the steps we outline in the previous pages make clear, a SPAC transaction is unlike other PE sales. To execute a successful deal, potential stakeholders must be mindful of all the nuts and bolts of working with SPACs—from SEC filing requirements to due diligence readiness. Realizing the full promise of a SPAC deal will depend on minimizing the complexities involved. This comes down to careful preparation. Be realistic about the special considerations and nuances of a SPAC deal. Take a systematic approach to building building the team and lining up the resources (both internal and external) to create a smooth SPAC sale process.

How KPMG can help

KPMG works with private-equity and corporate clients to help them realize value through transactions and from existing holdings, including by identifying opportunities for acquisitions, sales and partnerships. Our teams bring a market-leading, data-driven approach with proven methodologies to portfolio strategy, due diligence and post-transaction value capture.

KPMG has particular expertise in the following areas that are relevant to SPAC transactions:

- Sell-side due diligence, helping clients prepare assets for a smooth transaction.
- Public company readiness, helping private companies prepare for SEC and public company financial reporting and compliance requirements.
- Supporting and expediting the filing process, including updating historical financial statements to public company standards, addressing complex transaction-specific accounting and SEC filing issues, and preparing disclosures such as MD&A and pro forma financial information.
- Internal control and review, including assessment of SOX 404 readiness.

About the authors

Keyu Zhu and James Brannan both have assisted KPMG clients in negotiating SPAC transactions, including providing sell-side due diligence and public-company readiness.

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Keyu is a partner in KPMG's Deal Advisory practice and has 20 years of experience in accounting advisory, mergers and acquisitions, and audit. Keyu, formerly employed by the KPMG Audit Practice, provides accounting advisory and financial reporting support services for private-equity and corporate clients in transactions such as equity and debt offerings, mergers and acquisitions, and divestitures.

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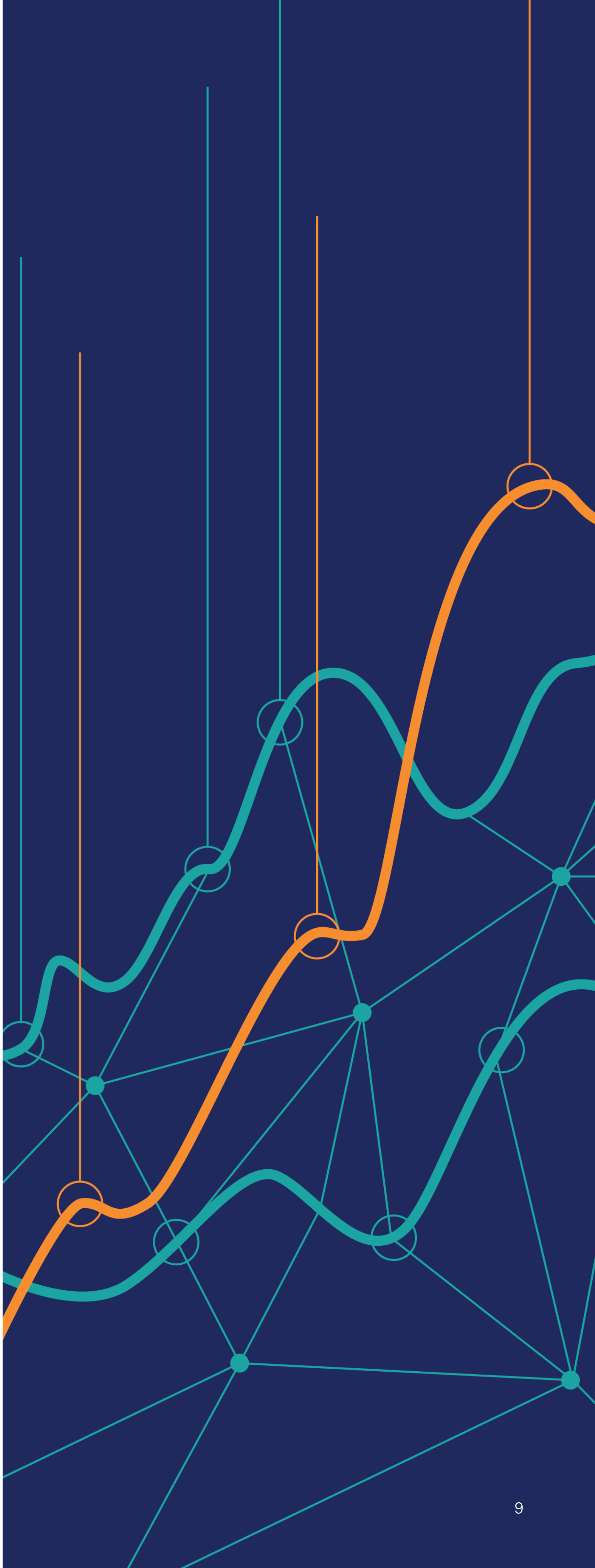
James is a managing director in KPMG's Deal Advisory practice, specializing in the Financial Services industry. He is a member of the Institute of Chartered Accountants in England and Wales. James has significant experience serving buyers and sellers in the global financial services industry. Since joining KPMG in 2005, he has worked in the London, Zurich and New York offices, serving top corporate and private-equity clients.



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