

# De-SPACing — Accounting and Securities Law Considerations

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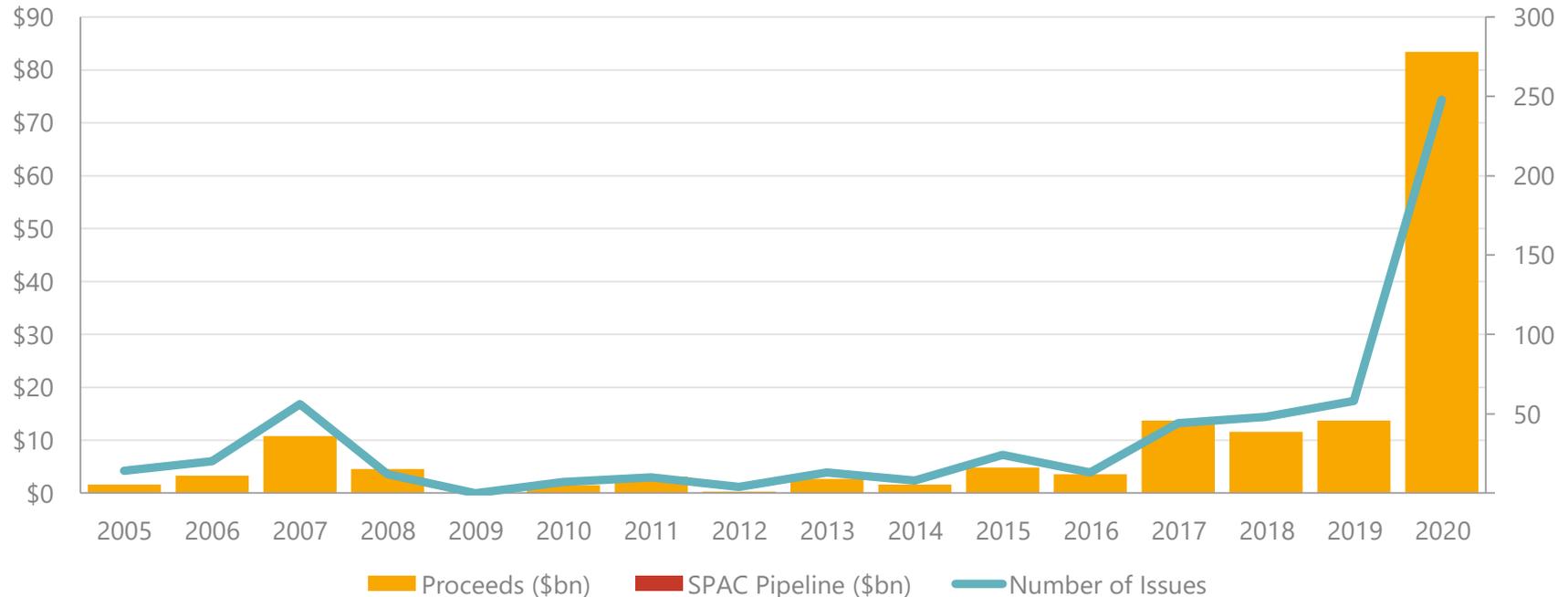
# Agenda

- Principal reasons for choosing a proxy statement versus a registration statement on Form S-4
- Principal disclosure requirements for the proxy statement or S-4
- Inclusion of forecasts in the proxy/prospectus
- Publicity after public announcement of business combination
- Financial statement requirements for the target company
- Determining the accounting acquirer
- Determining EGC status following completion of the transaction
- Age of financial statements and periods required to be presented
- Super 8-K requirement
- Rule 144, Form S-8, eligibility for Form S-3 and other issues to consider

# Overview

# SPACs surge

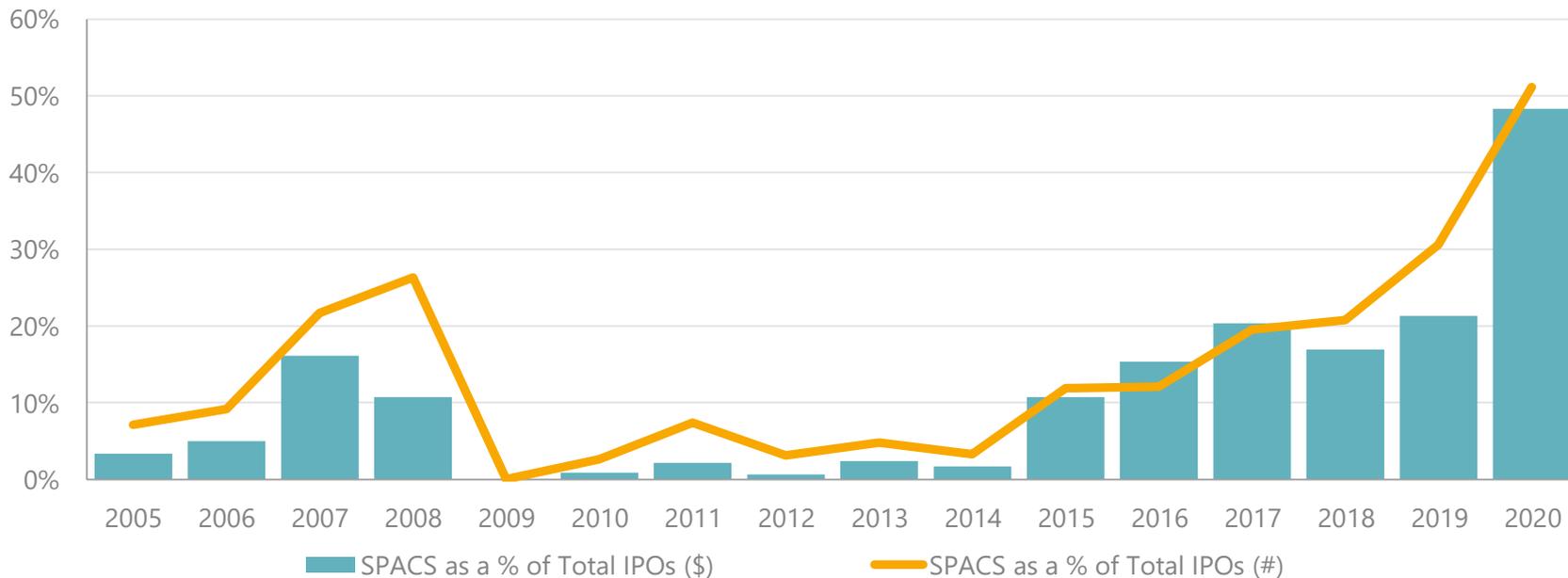
- US-listed SPAC volumes rose 275% year over year to all-time high of \$51.5 billion in 2020



\*Excludes deals less than \$50m in proceeds  
Source: Refinitiv and SPAC Alpha

# US-listed SPAC IPO activity

- By volume, US-listed SPAC IPOs accounted for more than half of overall US-listed IPOs in 2020 and 48% of proceeds raised



\*Excludes deals less than \$50m in proceeds  
Source: Refinitiv and SPAC Alpha

# SPAC activity continues in 2021



**Social Finance, Inc. ("SoFi"), founded in 2011, is a one-stop shop for financial services, including loan refinancing, mortgages, personal loans, credit cards, insurance, investing and deposit accounts.**

- Expected to go public through the SPAC route in the first quarter of 2021
- The SPAC raised approximately \$800 million in an IPO in 2020
- Transaction values SoFi at an equity value of \$8.65 billion post-money and is expected to provide up to \$2.4 billion in cash proceeds, including a fully committed PIPE of \$1.2 billion

Sources: SoFi; Businesswire; The Motley Fool



**BARK, founded in 2012, has a subscription service for dogs, BarkBox, providing toys, treats, home products and health services to 6.5 million customers, with 1.1 million active subscriptions.**

- Expected to go public through the SPAC route in the second quarter of 2021
- For the fiscal year ending March 31, 2021, the company projects revenue of approximately \$365 million and gross profit of approximately \$221 million
- Transaction values BARK at an enterprise value of approximately \$1.6 billion

Source: PR Newswire



**Appharvest, founded in 2017, is a US-based agricultural technology that runs high-tech indoor farms.**

- Expected to go public through the SPAC route in the first quarter of 2021
- AppHarvest decided to go public through a merger with a SPAC to raise \$475 million in funding
- Will value the company at \$1 billion based on a price of \$10 per share for its stock, since the company expects the proceeds from private investment in valued equity transactions worth \$375 million from new and existing investors

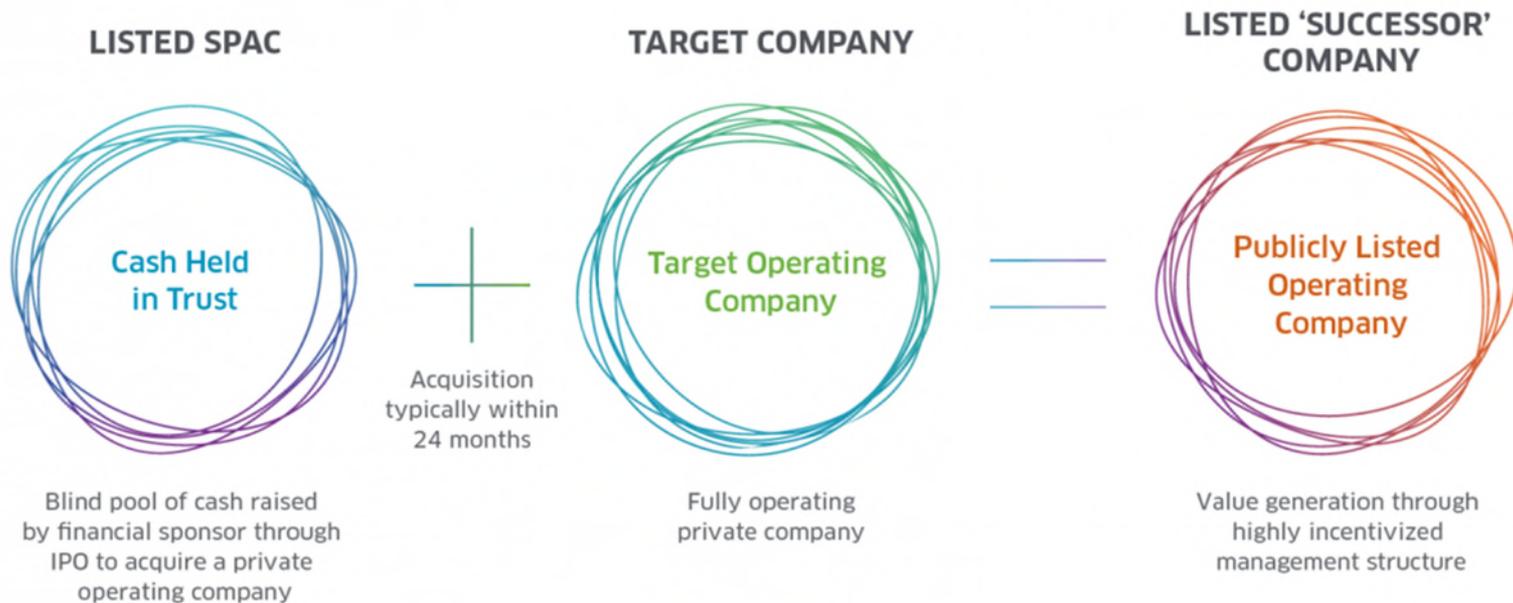
Source: Market Realist

# SPAC activity continues in 2021 *(cont'd)*

- There were **91 SPAC IPOs** in January 2021, raising **\$25.6 billion**, bringing the total number of active **SPACs seeking initial business combinations to 302**.
- A total of **nine initial business combinations were completed** in January, and another **60 initial business combinations were announced** and are pending.

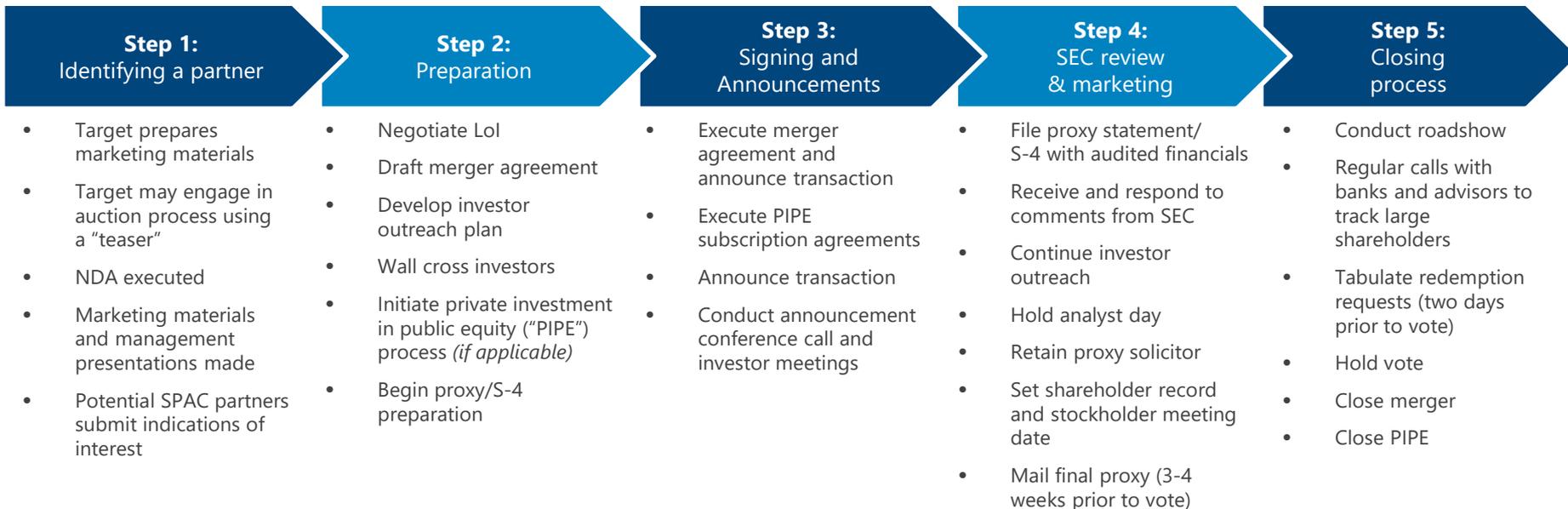
# De-SPAC process

# How does a SPAC work?



# Process overview

- The process from announcement of a definitive agreement (and proxy/S-4 filing) to close may take between two and five months (*not all that different from an IPO process*)



# Proxy statement or proxy/prospectus process

- SPAC must file a proxy statement on Schedule 14A
  - If SPAC intends to register new securities as part of transaction, SPAC must also file a proxy/prospectus on Form S-4 (or F-4)
  - The continuing company may be able to qualify as a foreign private issuer (“FPI”)
- Generally, the filing is made as soon as possible following the announcement of the transaction
- The timing of filing is not driven by any regulatory requirement; however, the market will want additional information about the transaction beyond the information that was made public in the Form 8-K filed to announce the entry into the definitive agreement. Similarly, PIPE investors will want to see the filing made promptly. Often the definitive agreement will stipulate a timetable.

# Proxy statement or proxy/prospectus process

*(cont'd)*

- Proxy statement or proxy/prospectus statement will contain substantially the same the type of information that is required were the target company to do an IPO
- The SEC review of the proxy statement or proxy/prospectus will be similar to that for a traditional IPO filing
- The SEC will generally take 30 days for the first review of the filing, issue a comment letter, and the working group will respond to the comment letter with a comment response letter and responsive amendments
- Subsequent amendments will require shorter SEC review periods (as is typical in a traditional IPO)
- Generally, the review process for a proxy statement may be shorter than the review process for a proxy/prospectus

# Proxy statement or proxy/prospectus: which to file?

- When will a proxy statement be used? Versus an S-4 or F-4?
  - Generally, if target's stock is closely held, and the holders are accredited investors, the SPAC will use a proxy statement instead of a registration statement on Form S-4
  - However, if a proxy statement is used, any securities received by target stockholders will be "restricted securities," and their resale will be limited to resales under Rule 144 (one-year holding period for a SPAC) or resales pursuant to a resale registration statement
  - By contrast, securities issued to target stockholders pursuant to a registration statement on Form S-4 will be freely transferable (unless held by affiliates or control persons)
  - As noted earlier, the review process for an S-4/F-4 may be somewhat longer as it involves the offer of securities; whereas a proxy statement does not
  - Also, an S-4/F-4 is a registration statement and contains a prospectus, so, from a liability perspective, the analysis as between a proxy statement and the registration statement also will differ

# Basic requirements for an S-4/F-4

- Letter to Stockholders
- Notice of Special Meeting
- Summary Term Sheet
- Questions and Answers
- Summary of the Proxy Statement/Prospectus
- Selected Historical Financial and Operating Data of Target Company
- Non-GAAP Financial Measures
- Selected Historical Financial Information of SPAC
- Cautionary Note Regarding Forward-Looking Statements
- Risk Factors
- Unaudited Pro Forma Condensed Combined Financial Information
- Comparative Share Information
- Capitalization of Combined Entity
- Special Meeting of SPAC Stockholders
- Proposal No. 1 — The Business Combination Proposal
- [Additional Proposals]
- Proposal No. [●] — The Adjournment Proposal
- Unaudited Pro Forma Financial Statements
- Management's Discussion and Analysis of Financial Condition and Results of Operations of Target Company
- Business of Target Company
- Management's Discussion and Analysis of Financial Condition and Results of Operations of SPAC
- Information About SPAC
- Executive Compensation
- Management After the Business Combination

# Basic requirements for an S-4/F-4 *(cont'd)*

- Description of Securities
- Comparison of Rights of Securityholders
- Beneficial Ownership of Securities
- Prior Sales
- Certain Relationships and Related Party Transactions
- Independent Registered Accounting Firm
- Householding Information
- Transfer Agent and Registrar of Post Business Combination Company
- Submission of Stockholder Proposals
- Future Stockholder Proposals
- Enforceability of Civil Liabilities Under U.S. Securities Laws
- Where You Can Find Additional Information
- Index to Financial Statements (both SPAC and Target)

# Background of the merger section

- The proxy/prospectus will usually contain a discussion of the background of the merger
  - Among other things, this section will provide a discussion of valuation for the target
  - In presenting the valuation, projections will be included
    - These projections should be diligenced; the projections usually also will be shared in a data room or in investor materials with PIPE investors
    - The investor materials used in connection with marketing the PIPE transaction will be made public at the announcement of the entry into the definitive initial business combination and the PIPE transaction
  - While the SPAC is a public company and forward-looking statements will benefit from the safe harbor, careful consideration should be given to the forecasts for the target

# SEC Guidance

- The SEC has released guidance for deSPAC proxy statements/prospectuses
- The focus is on (1) conflicts of interest for the sponsors and (2) the rigor of the search process for an acquisition target. For example, the SEC asks:
  - Have you clearly described any conflicts of interest of the sponsors, directors, officers and their affiliates in presenting this opportunity to the SPAC and how the SPAC addressed these conflicts of interest?
  - Have you described any interest the sponsors, directors, officers or their affiliates have in the target operating company, including, if material, the approximate dollar value of the interest, when the interest was acquired and the price paid?
  - Have you provided detailed information about how you evaluated and decided to propose the identified transaction? Have you explained how and why you selected the target company? Who initiated contact? Why did you select this target over other alternative candidates? Have you explained the material terms of the transaction? How did you determine the nature and amount of consideration the SPAC will pay to acquire the private operating company? Have you clearly described the negotiations regarding the nature and amount of consideration?

# Financial statement and financial disclosures

## (cont'd)

- Excerpt from Financial Reporting Manual:
  - 2200.7 Form S-4 Audit Requirements – Target is a non-reporting company (whether or not the issuer's shareholders are voting) – The requirement to audit depends on whether or not the Form S-4 is to be used for resales by persons considered underwriters under Securities Act Rule 145(c). See Item 17(b) of Form S-4.
  - In transactions where the registrant is a SPAC, the target's financial statements become those of the registrant upon consummation of the merger. In light of this fact and the staff considers the transaction to be equivalent to an initial public offering of the target, the staff would expect the financial statements of the target to be audited in accordance with the standards of the PCAOB. (Last updated: 10/30/2020)

S-4 to be used for resales	S-4 <u>not</u> to be used for resales
<p><b>Required to be audited for the periods specified in S-X 3-05(b)(2) or S-X 8-04(b), as applicable.</b></p>	<p><u>Latest Fiscal Year</u> Need be audited only if practicable to do so. To determine whether an audit is practicable, consider the feasibility of completing the audit on a timely basis. Since the target's audited financial statements will be required to be included in a Form 8-K filed 71 calendar days after the 4<sup>th</sup> business day following consummation of the acquisition, the registrant should be able to explain why audited financial statements cannot be completed in time for the Form S-4, but can be completed in time to meet the Form 8-K requirements.</p> <p><u>Fiscal years before the latest fiscal year</u> Need not be audited if they were not previously audited.</p>

# Financial statement and financial disclosures

*(cont'd)*

- The proxy or S-4 will be required to include pro forma financial information. Preparation of pro formas will require determination of the accounting acquirer, which will depend on:
  - Relative voting rights in the combined company
  - Board composition
  - Composition of management of the combined entity
  - Relative size of the combining entities
  - Terms of the exchange of equity interests

# Pro forma financial information

- Pro forma financial information must reflect closing of the transaction
  - Historical information of the SPAC
  - Historical information for the target
  - Pro forma adjustments
  - Pro forma totals

# Financial statement and accounting considerations

# Financial statement requirements for the target company in proxy/S-4 registration statement



- SPAC SEC registrant
  - Does not have substantive operations and assets other than cash, hence it is considered a “shell company” as defined by the SEC
- Target company – ordinarily considered “predecessor business”
  - Financial statements have to be compliant with Regulation S-X
    - Age requirements in Rule 3-01 and 3-12 (audited BS not more than 134 days old from filing or effective date of registration statement or mailing date of proxy statement)
    - Line item disaggregation requirements per Rules 5-02 and 5-03, Schedules per Article 12
    - Financial statement disclosures per Rule 4-08 (ETR reconciliation, identify related party balances on face)
  - **Public company** disclosures under US GAAP (typically: EPS, reportable segments)
  - **PBE** disclosures and standards adoption timeline, unless both SPAC and Target are EGC and the SPAC elected the option to transition to new accounting standards at the non-PBE timeline
  - No **Private Company Council (PCC)** alternatives (e.g., amortization of goodwill)

# Age of financial statements and periods required to be presented in proxy/S-4



- Target Company (predecessor business, US GAAP reporting)
- Default: Annual FS for last 3 years + any applicable interim periods
- Audits in accordance with both PCAOB & AICPA standards
  - PCAOB does not expect CAMs to be included in audit report if Target would be EGC if it were to conduct its own equity IPO and combined company expected to stay EGC after merger
- Reduced to 2 years + any applicable interim periods when
  - Target would be a SRC if it were a registrant (that is, it had less than \$100m revenue in the most recently completed annual period for which FS are available)
  - The SPAC is an EGC **and** has not yet filed (or been required to file) its first annual report on Form 10-K **and** the target would qualify as an EGC if it were conducting its own straight IPO of common equity (annual revenues less than \$1.07 billion and no more than \$1 billion of non-convertible debt over the past three years)

# Determining the accounting acquirer



- When SPAC pays shareholders of the Target in cash (or other assets or incurs a liability) to acquire their equity in the Target, the accounting acquiror is the SPAC
  - New basis of accounting to the Target in pro-forma transaction adjustments
- When SPAC pays shareholders of the Target with its own shares (or a combination of its shares and cash), the SPAC is the legal acquiror because it issues shares, but the Target often is the accounting acquiror (Reverse Merger)
  - No new basis of accounting to SPAC as it holds substantially only cash
  - No new basis of accounting to Target as it is the accounting acquiror
  - Reverse recapitalization of Target
    - Combined company assets and liabilities are those of Target at their historical CV
    - Combined company equity – historical share balances and APIC of Target retrospectively adjusted to reflect the share issuance transaction of the SPAC
    - Qualifying transaction costs charged to equity (not expensed)

# Determining the accounting acquirer *(cont'd)*



- Acquiror is shareholder or group of shareholders that obtain control over the combined entity
- When merger is effected primarily by two groups of shareholders exchanging their equity interests: **(A)** those of the SPAC and **(B)** those of the Target, concluding which group of shareholders obtains control is complex. ASC 805-10-55-12 and 13 require evaluation of a series of factors:
  - The relative voting rights in the combined entity after the business combination
  - The existence of a large minority voting interest in the combined entity
  - The composition of the governing body of the combined entity
  - The composition of senior management of the combined entity
  - The terms of the exchange of equity interests
  - The relative size of the two entities that combine

# Age of financial statements and periods required to be presented in Super 8-K (after merger close)



- File within 4 business days of merger close – content of Form 10
- Target (predecessor business) financial statement
  - Ordinarily Super 8-K contains the same Target FS that were included in the effective S-4/proxy and updated pro-forma to include actual financing for the transaction
    - Unless the Super 8-K filing date crosses 134 days after the last interim/annual balance sheet or 45 days after the FYE of the Target – then updated target financial statements would be required in the Super 8-K
  - **Avoid gap or lapse in the Target’s FS periods** – if the last set of financial statements in the effective S-4/proxy are through September 2020 and the merger closes on March 1, 2021, assuming SPAC is a non-accelerated filer:
    - File an 8-K/A by the end of March 2021 (90 days after the Target’s FYE) with the Target’s 2020 annual audited FS.
    - SPAC files its last annual report on 10-K by end of March 2021 with its audited 2020 FS and subsequent event disclosure about the merger close

# Determining EGC status following completion of the transaction



- SEC Staff FRM Section 10120.2
- Company C completes a reverse merger with Company D (Operating company). Company D is presented as the predecessor in the post-transaction financial statements. C and D have calendar year-ends and merger occurs on September 30, 2012

	<b>Reverse Merger</b>
\$1.07 B annual revenue	Look to D's revenues which include C from 10/1
Five-year anniversary	Since C's date of first sale
\$1B debt in last 3 years	D's debt issuances and C's since 10/1/2012
LAF test	C's public float at end of June 2012 (for 2012 10-K) C's public float at end of June 2013 (for 2013 10-K)

# Transaction accounting considerations



- **International deal considerations**

- Domestic SPAC must provide Target financial statements in US GAAP when the Target will be the predecessor business
- FPI SPAC may provide “foreign business” Target FS in either:
  - IFRS-IASB
  - Domestic GAAP reconciled to IFRS or US GAAP
  - US GAAP
- SEC staff pre-clearance to include IFRS-IASB financial statements of the Target in a domestic SPAC’s S-4 when the combined entity would qualify to be an FPI

# Transaction accounting considerations *(cont'd)*



- **Multiple Operating Company Targets**

- One would be designated “predecessor business”, the remaining would be tested for significance under Rule 3-05:
  - Against the SPAC for the S-4/proxy filing
  - Effectively all other Operating Companies would be significant and trigger Rule 3-05 financial statements since the SPAC has no revenues and pre-tax income of its own
  - Request SEC staff waiver to omit financial statements of any of the other operating companies

# Other Securities Considerations

# Publicity after public announcement of business combination

- Rules 165 and 425 allow SPACs to avoid making prohibited offers, sometimes known as “gun-jumping”
  - Section 5(c) - Before a registration statement is filed – Offers for securities to be issued in a registered offering in a business combination may be made from the date of “first public announcement” of the transaction.
  - Section 5(b)(1) – Prospectus requirements after a registration statement is filed – Any written communication relating to a business combination transaction need not qualify as a Section 10 prospectus.
- Requirements: (1) Written communications must be filed with the SEC on or before the date of first use and (2) specified legends.
- Written communications are still “prospectuses” and subject to anti-fraud rules
- Available to any party to a business combination transaction and their authorized persons.

# “Super 8-K” requirement

- Within four days of the closing of the SPAC merger, the combined company must file the “Super 8-K” that includes:
  - Item 2.01 Completion of Acquisition or Disposition of Assets
  - Item 5.01 Changes in Control of Registrant
  - Item 5.06 Change in Shell Company Status
  - Item 9.01 Financial Statements and Exhibits
- The “Super 8-K” essentially contains all Form 10 registration statement information, which may require updating (due to age requirements) financial statements and requires updated pro forma financial information

# Rule 144

- deSPAC companies cannot benefit from Rule 144 until after one year has elapsed from the filing of the Form 10 information (via the “Super 8-K”)
- **Practical effect?**
  - Target stockholders should be aware of this limitation, especially if only a proxy statement was used, or if they are control persons
  - Target stockholders may want to insist on a resale registration rights
  - PIPE investors may be insistent on the deSPAC company maintaining the effectiveness of a resale registration statement for a longer time period
  - Counsel may not want to remove the restricted legend for restricted securities of a deSPAC regardless of the holding period making it impossible to hold such securities in a brokerage account

# Eligibility for Form S-3 and Form S-8

- Among other requirements, generally to use Form S-3 a registrant must have been subject to the periodic reporting requirements of the Securities Exchange Act of 1934 for 12 months.
  - Question: May a deSPAC company count the time the SPAC was a public company against this 12 month requirement?
  - Answer: In word: “no.” The SEC has put out guidance stating that a deSPAC company may not count the “SPAC time.” The clock starts when the business combination is completed.
- deSPAC companies are eligible to use Form S-8 once 60 days have passed since the “Super 8-K” has been filed.

# Additional resources

# Supplemental materials

- [What's the Deal? – Special Purpose Acquisition Companies](#)
- [Chart: Traditional IPO vs. Merging with a SPAC](#) 
- [Top 10 Practice Tips: PIPE Transactions by SPACs](#) (Lexis Nexis)

## Listen to our MB Microtalks

- [An Overview of Special Purpose Acquisition Companies](#)
- [PIPE Transactions in Connection with SPAC Business Combinations](#)
- [Special Securities Law Considerations for SPACs & SPAC Transactions](#)



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# EY SPAC publications and articles



Publication/article	Details
<p><a href="#"><u>SPAC market expansion: why more private companies are electing the SPAC path</u></a> (Published August 2020)</p>	<p>Topics include:</p> <ul style="list-style-type: none"><li>• SPAC market expansion</li><li>• Merging with a SPAC</li><li>• Recent changes that have enhanced the SPAC path</li><li>• Key considerations for private companies</li></ul>
<p><a href="#"><u>Why investors see growing opportunity with SPAC mergers</u></a></p>	<p>SPACs continue to gain in momentum. In the coming months it's likely we will see continued growth in the number and size of SPAC IPOs, as well as increasing numbers of high-profile mergers.</p>
<p><a href="#"><u>How a SPAC merger could help your company finance its future</u></a></p>	<p>SPACs offer private company owners, entrepreneurs and founders an efficient, rapid path to capital. SPACs are formed to raise capital with the sole purpose of acquiring one or more unspecified private companies after going public.</p>
<p><a href="#"><u>Technical Line: Navigating the requirements for merging with a SPAC</u></a> (Published May 2019)</p>	<p>Topics include:</p> <ul style="list-style-type: none"><li>• Key considerations</li><li>• SPAC merger requirements</li><li>• Super 8-K requirements</li><li>• Post-SPAC merger considerations</li></ul>

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