TBH Consulting LLC

SPAC Transactions

Executive Summary

Table of Contents

I. What is a SPAC?

Definition of a SPAC

SPACs (Special Purpose Acquisition Companies) are blank-check companies that are created to raise capital in an IPO (Initial Public Offering); they then use those proceeds to acquire businesses not yet identified at the time of the IPO. SPACs provide private companies with an alternative to the traditional IPO process.

SPACs vs. traditional IPOs

For some companies and their investors, SPACs can be an appealing alternative to traditional IPOs. The listing of a shell company is often lower in cost since the filing is simpler, meaning there will likely be fewer comments from the Securities and Exchange Commission ("SEC"). There is also greater flexibility in acquiring new companies since funds are readily available in a trust account. Additionally, they often require less debt funding than traditional private equity deals, resulting in a quicker transaction.

TBH Insight

For some companies and investors SPACs are an appealing alternative to the traditional IPO process. They can often be less costly and provide more flexibility.

II. Funding the SPAC

Capital funding

A SPAC is initially funded by the management team and other early investors that sponsor the SPAC. This team contributes capital to cover all offering expenses, including underwriting costs and initial working capital, in exchange for founder shares. The SPAC then goes through the traditional IPO process and files an initial registration statement with the SEC.

Capital structure

The members of the management team of the SPAC purchase founder shares prior to the initial filing with the SEC. These shares often comprise about 20% of the total shares outstanding after the IPO.

Public investors in SPAC IPOs are typically sold units, which include one share of common stock and a portion of a warrant to purchase a share of common stock in the future. These warrants are exercisable once a SPAC acquires its first target.

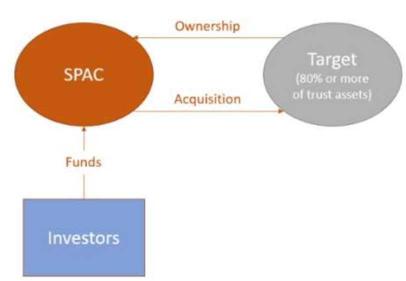
While public investors receive fractions of warrants, sponsors typically receive warrants to purchase whole shares. Upon the acquisition of a target, whole warrants can be exercised, and the strike price is generally out-of-the money.

Typically, proceeds raised in an IPO, less certain expenses, are held in a trust account. This money is held by a third party until the initial business combination or liquidation of the SPAC for not having completed an initial business combination within the specified time period. Although no specific rules regarding the investing of the SPAC proceeds, generally, these proceeds are invested in relatively safe instruments.

III. "De-SPAC" Transactions: Acquiring Business Targets

De-SPAC transactions

From the date of its IPO, a SPAC has 18 to 24 months depending on its charter to acquire an initial target company. This first acquisition is also known as a De-SPAC transaction.



Funding for De-SPAC transactions

Funding for these acquisitions comes from the trust account. If additional funds are needed, sources may include loans provided by the sponsors or additional issuance of common stock to public investors. Private investment in public entity (PIPE) commitments may also be used to finance part of the acquisition. The sponsors might also enter into forward purchase agreements for preferred equity if the De-SPAC transaction requires additional funding.

Shareholder rights

Once an initial target is identified, shareholders may redeem their shares for a pro rata portion of the funds held in the trust account if they do not want to invest in the target company.

After the De-SPAC transaction

Once the shell company has acquired the business target, the entity resulting from the business combination is a publicly traded company. The sponsors may act as management of the new combined company, or they might retain management of the target.

IV. Financial Reporting Requirements

Financial statements/proxy statement

Once the target for the De-SPAC transaction is identified, the SPAC must file a proxy statement on Schedule 14A or file a proxy statement and joint registration on Form S-4 if it plans to register new securities as part of the transaction.

The filing should include financial statements of the SPAC, the target, and entities that may have been acquired by the target or are equity method investees of the target. These financials, even if the targets are private companies, should comply with Regulation S-X Rules 3-05 and 3-09. The joint statement should also include the unaudited proforma information illustrating the proposed acquisition, management's discussion and analysis ("MD&A") of the SPAC and target, selected historical financial data of the SPAC and target (including pro forma financial data), and comparative per share information (including pro forma per share data).

The predecessor entity whose financial statements will become the historical financial statements of the new combined company needs to be determined; the predecessor entity typically represents a major portion of the business, but judgment can be applied to determine this. The entity deemed the predecessor should be audited in accordance with PCAOB standards and is required to include public company disclosures in its financial statements. Entities not deemed as the predecessor may be audited in accordance with AICPA standards.

> Private entities that are targets must retrospectively revise their financial statements if they have elected private company accounting alternatives.

Presentation requirements

If the target is an emerging growth company and the SPAC has not yet filed a 10-K, the proxy or joint statement may present two years of the target's audited financial statements and unaudited financial statements for any interim periods. If the SPAC has submitted a 10-K, the proxy or joint statement should present three years of the target's audited financial statements (unless the target is a smaller reporting company).

These financial statements must have an "as of date" *no earlier* than 134 days (non-accelerated filers) or 129 days (accelerated and large accelerated filers) before the date of the filing. The only exception is third-quarter data, which is deemed effective through the 45th day of the most recent fiscal year end.

SPACs must also present in their pro forma financial information a minimum redemption scenario (meaning no shares are redeemed by public shareholders) and a maximum redemption scenario (all shares redeemed). This is required since shareholders may redeem their shares if they elect not to invest in the target.

The proxy statement or joint statement should also include MD&A prepared in accordance with Regulation S-K Item 303, selected historical financial data prepared in accordance with Regulation S-K Item 301, and selected pro forma financial data presented in the same manner as the selected historical financial information. Entities should also present comparative per share information for the same periods pro forma financial information is presented. This comparative per share information includes book value per share, cash dividends per share, and basic and diluted income or loss per share from continuing operations.

TBH Insight

Required filings upon acquisition of a target include both Schedule 14A or Form S-4 and a Super 8-K.

V. Common Questions on SPACs

What happens if the SPAC does not acquire a target within the specified time frame?

If the SPAC does not acquire a target within the specified time frame (usually 18-24 months depending on the company), the SPAC is dissolved, and all funds in the trust account are returned to investors. A SPAC may extend the time period if it has shareholder approval. If a SPAC is listed on an exchange, it is required to complete an initial business combination within three years of its IPO.

Who is the accounting acquirer in the De-SPAC transaction, and why does it matter?

The accounting acquirer is the entity that obtains control of the other entity. The accounting acquirer may be different from the legal acquirer. Determining the accounting acquirer is essential when determining the accounting treatment of the transaction. If the SPAC is the accounting acquirer, ASC 805 purchase accounting guidance applies, and the acquired assets and assumed liabilities of the target company should be stepped up to fair value. This is considered a forward merger. If the target company is the accounting acquirer, the transaction should be accounted for as a reverse recapitalization since it is likely the only asset of the SPAC before the merger was cash from investors.

Determining whether the transaction is accounted for as a forward merger or reverse recapitalization also impacts financial statements after the De-SPAC transaction is completed. Forward mergers would result in a change in the reporting entity with financial statements of the successor and predecessor periods separated by a black line. On the other hand, reverse capitalizations would not have a change in reporting entity, and the financial statements of the new combined company would simply be a continuation of the target's financials. However, there are also special considerations regarding the combined entity's equity, EPS, and transaction costs.

Does the combined entity need to comply with SOX internal controls requirements?

Once the De-SPAC transaction is complete and the acquired target becomes a public company, management should consider if the acquired company has a framework of internal controls over financial reporting in compliance with Sarbanes Oxley. Compliance with Section 404(a) of Sarbanes Oxley is not required in the filing of the first 10-K following the initial De-SPAC transaction. If a De-SPAC transaction occurs shortly after year-end and an amended 8-K is required to update the target's financial statements, this filing is seen as the entity's first annual report, and any subsequent 10-K filings must include management's report on internal controls over financial reporting. One notable exception to this requirement is emerging growth companies which are not required to provide management's report on internal controls over financial reporting as long as they continue to qualify as emerging growth companies.

TBH Insight

Entities should ensure good controls even if not required to report under SOX 404.

What are some common comments the SEC provides on SPAC transactions?

The SEC frequently has comments on the Super 8-Ks provided in a De-SPAC transaction. A SPAC must file a Super 8-K within four business days of completing the De-SPAC transaction. Entities should pay special attention to required disclosures under Items 2.01, 5.01, and 9.01 of Form 8-K, as the SEC notes these are common areas on which they provide comments.

Item 2.01 – Completion of Acquisition or Disposition of Assets states that a company must disclose an acquisition or disposal of a significant amount of assets other than in the ordinary course of business. If this company was a SPAC before the acquisition or disposal, it must include the information required in a Form 10 in its Super 8-K. The SEC notes that an acquisition includes "every purchase, acquisition by lease, exchange, merger, consolidation, succession or other acquisition."

Item 5.01 – Changes in Control of Registrant mandates that companies provide information about a change in control. As with the rule above, if this company was a SPAC before the change in control, it must include the information required in a Form 10 in its Super 8-K.

Item 9.01 – Financial Statements and Exhibits requires that the Super 8-K contain historical financial statements of all private operating businesses acquired through a De-SPAC transaction. Smaller reporting companies must provide up to two years of audited financial statements of acquired companies and unaudited, interim financial statements for the most recently completed quarter. This item also states non-SRCs must provide up to three years of audited financial statements of acquired companies and unaudited, interim financial statements for the most recently completed quarter. Frequent comments regarding Item 9.01 also serve to remind companies that they must provide certain pro forma information like how the company has accounted for the reverse merger.

Does the target qualify as a smaller reporting company?

Smaller reporting companies only need to provide up to two years of audited financial statements of acquired companies instead of three years. SRCs may also provide scaled disclosures per Regulation S-K and Article 8 of Regulation S-X. The requirements to be considered a smaller reporting company are as follows:

Those that have a public float of less than $250 million

OR

Those that have less than $100 million in annual revenues and either no public float or public float of less than $700 million

Entities should pay special attention to if they qualify as smaller reporting companies since this may result in reduced presentation requirements.

Does the new combined entity qualify as an emerging growth company?

Emerging growth companies can provide scaled disclosures and audited financial statements for two years instead of three years. EGCs also are exempt from providing an audit opinion over internal controls, and they may also have later deadlines for implementation of certain accounting standards.

TBH Insight

Entitles should pay special attention to if they qualify as smaller reporting companies or emerging growth companies since this may result in reduced presentation requirements.

To qualify as an EGC, a company must have total revenues of *less than* $1.07 billion as of its most recent fiscal year end. Section 101(d) of the JOBS Act also states that an issuer can only qualify as an EGC as long as it had not sold common equity securities under a registration statement as of December 8, 2011. A De-SPAC transaction may trigger a disqualification from the definition of emerging growth company. The SEC provides the following example in their "Generally Applicable Questions on Title I of the JOBS Act":

Example 1: Company A acquires Company B for cash or stock, in a forward acquisition. Company A is both the legal acquirer and the accounting acquirer.

Example 2: Company C undertakes a reverse merger with Company D, an operating company. Company D is presented as the predecessor in the post-transaction financial statements.

In each example, the companies' fiscal year is the calendar year; the transactions occur on September 30, 2012.

	Example 1: Forward Acquisition	**Example 2: Reverse Merger**
$1B annual revenues test	In 2012, look to Company A's revenues for 2011. In 2013, look to Company A's revenues for 2012, which will include Company B's revenues from Oct. 1, 2012.	In 2012, look to Company D's revenues for 2011. In 2013, look to Company D's revenues for 2012, which will include Company C's revenues from Oct. 1, 2012.
Five-year anniversary test	Look to Company A's date of first sale.	Look to Company C's date of first sale.
$1B issued debt during previous three years test	Look to Company A's debt issuances, which will include Company B's debt issuances from Oct. 1, 2012.	Look to Company D's debt issuances, which will include Company C's debt issuances from Oct. 1, 2012.
Large accelerated filer test	At Dec. 31, 2012, look to Company A's market value at June 30, 2012. At Dec. 31, 2013, look to Company A's market value (which will include Company B's) at June 30, 2013.	At Dec. 31, 2012, look to Company C's market value at June 30, 2012. At Dec. 31, 2013, look to Company C's market value (which will include Company D's) at June 30, 2013.

ABOUT US

TBH Consulting provides accounting and financial reporting services. We deliver Big 4 level of experience to our clients at competitive rates. We can mobilize the right resources at the right time to meet our clients' needs, whether such clients are Fortune 500, middle-market public companies or pre-IPO companies.

CONTACT US

For more information on this or other topics please email us at:

info@tbhconsulting.com