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SPACs Were Red Hot. Why They Suddenly Slammed on the Brakes.

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Special purpose acquisition companies, or SPACS, had a red-hot start to the year, but recent accounting guidance from regulators helped cool things off in a hurry.
After a torrid run in the second half of 2020 and early 2021, the number of SPAC stock listings in the second quarter plunged by nearly 79% from the first quarter, to 64 offerings, valued at $13.5 billion, Dealogic says. Mergers by SPACs also dropped by 23% from the first quarter, to 76 combinations, valued at $157.3 billion.

Bankers and lawyers emphasize that the sharp slowdown is temporary, and that investors can expect a bounceback later this year. But it won’t be as busy a market as it was earlier this year.

The chief culprit for the cooling off was an April 12 statement from the Securities and Exchange Commission that analyzed warrants issued by an unnamed SPAC. The regulator determined that the warrants in question should be classified as liabilities and not equity, according to the statement.

The agency also warned companies that they may have to restate financial statements, which could affect “several fiscal quarters and years” of a business’ previously filed reports.

The SEC announcement “temporarily brought the SPAC market to a halt,” says Jocelyn Arel, a partner at law firm Goodwin Procter.

Barron’s analyzed more than 100 of the biggest SPAC mergers for the 12 months ended May. All but a handful of deals have been forced to restate their financial statements as a result, including Grab Holdings’ $40 billion merger with Altimeter Growth (ticker: AGC), Lucid Group’s (LCID) $12 billion combination with Churchill Capital IV, and Social Capital Hedosophia Holdings V’s $8.65 billion buy of SoFi

“Blank check” companies have existed since the 1990s. But they were a small part of the initial public offering market, and the Big Four accounting firms largely shied away

from them—until late last year, executives say. “SPACs weren’t as popular a vehicle as they are today,” says Jeffrey Weiner, chairman and CEO of the accounting firm Marcum.

Two firms, WithumSmith+Brown and Marcum, dominate the market for SPACs. For nearly two decades, the firms categorized warrants, effectively a call option for the stock, as equity, executives say. “Accounting for warrants as equity has been a longstanding position by all national audit firms and finance organizations in the SPAC ecosystem,” Withum spokeswoman Kelly Materia says.

Earlier this year, a Big Four accounting firm and a client questioned the accounting treatment of warrants for a certain situation and asked the SEC for direction, people familiar with the situation say. The regulator analyzed the situation and provided its interpretation of how to account for warrants.

“The SEC staff guidance did not lay down new law or accounting principles but simply put a spotlight on issues that were already there,” says John Coates, the SEC’s general counsel, who was acting director of the agency’s division of corporation finance at the time.

Not all of the slowdown in the SPAC market can be laid at the feet of the SEC. Returns for some companies haven’t been great. The IPOX SPAC Index, which tracks the aftermarket performance of SPACs, is down nearly 28% from its high in February.

Still, some have wondered why it took the SEC so long to take a stand, noting that the regulator had signed off on hundreds of deals before making the April 12 statement. The answer is that the SEC doesn’t perform a detailed accounting review of every issue for every filing. Instead, the regulator will respond to requests for guidance and often relies on issuers themselves to alert them to problems.

“People routinely come to the SEC staff with questions about application of U.S. GAAP [generally accepted accounting principles] to complex instruments and arrangements, to make sure that they understand our view on those questions,” Coates says.

Ultimately, it won’t be a big deal for investors, Marcum’s Weiner says. “You wind up in the same place economically,” he notes. “They didn’t change the economics of warrants. They just changed the accounting treatment.”

For now, the market is adjusting. This has caused some SPACs to get rid of warrants altogether or change their terms so that they aren’t accounted for as liabilities, says Demetrios Frangiskatos, co-leader of the SPAC Assurance practice at BDO USA.

Carl Daikeler, co-founder and CEO of Beachbody (BODY), says the SEC advisory came in the middle of his company’s three-way merger with Myx Fitness and Forest Road Acquisition. “It delayed us by a few weeks to complete the merger,” he says.

The SPAC, Forest Road, ended up restating its audited financial statements for the year ended Dec. 31. The merger was completed on June 25. “The good news is we have lots of accountants and lawyers that did all the work,” he says. “I’m sure they were up late at night. Now it’s done.”