SOLIC

SPACs: What's Next?

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Robert E. Annas
Senior Managing Director
rannas@soliccapital.com

Alex Rowe
Vice President
arowe@soliccapital.com

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SPACs certainly have had a meteoric rise in recent years. Between 2019 and 2021, with rapidly rising public company valuations, SPACs surged in popularity as a faster and less expensive way for companies to go public relative to a traditional IPO process. In fact, SPACs accounted for 15% of all private equity exits in 2021.

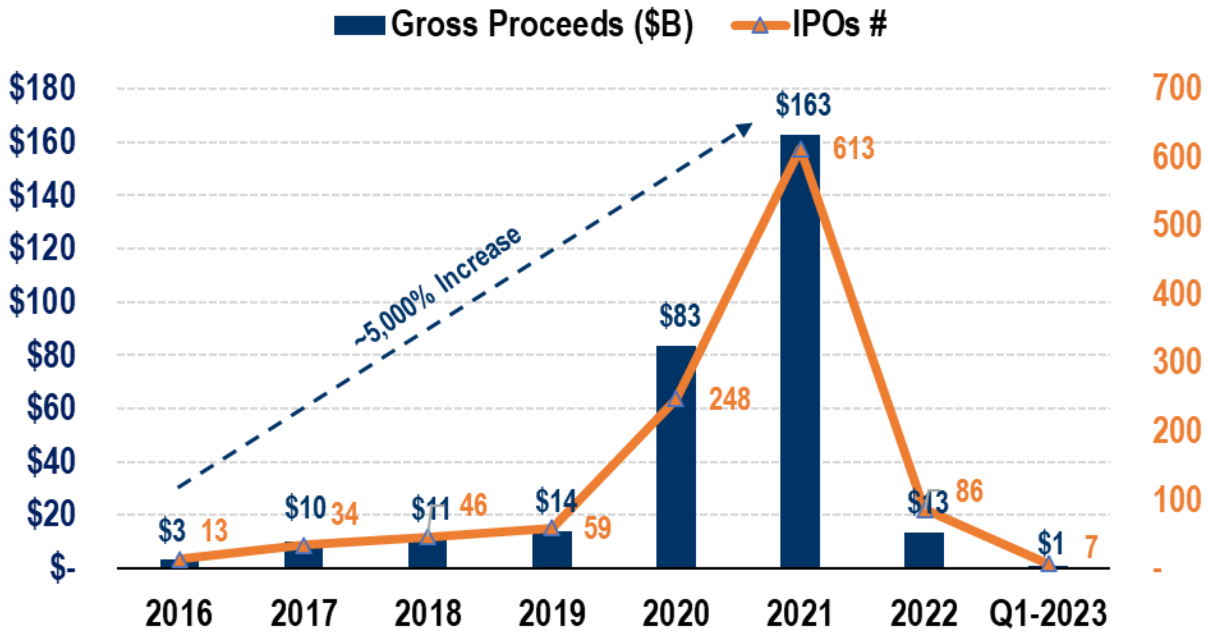
What Gives?

The rise of SPACs has not been without controversy and since 2021 SPAC activity has fallen significantly. More and more critics point to four key points leading to SPACs' decline:

1. Over-zealous valuations, resulting from the sense of urgency to get a deal done
2. Rapid and insufficient diligence of potential "De-SPAC" targets creating situations that weren't ready for prime time (i.e., the burdens of public companies)
3. Limited oversight and regulatory scrutiny from an IPO standpoint creating less transparency and accountability
4. The impact of rising interest rates, creating significant cash flow and financial obligation challenges in the SPAC market, leading to negative market sentiment as demonstrated by extreme underperformance

All of this means many SPACs are likely going to be forced to head down a capital and operating restructuring path. Let's take a closer look at these four issues that lead us to believe this path is a likely outcome over the next year or so.

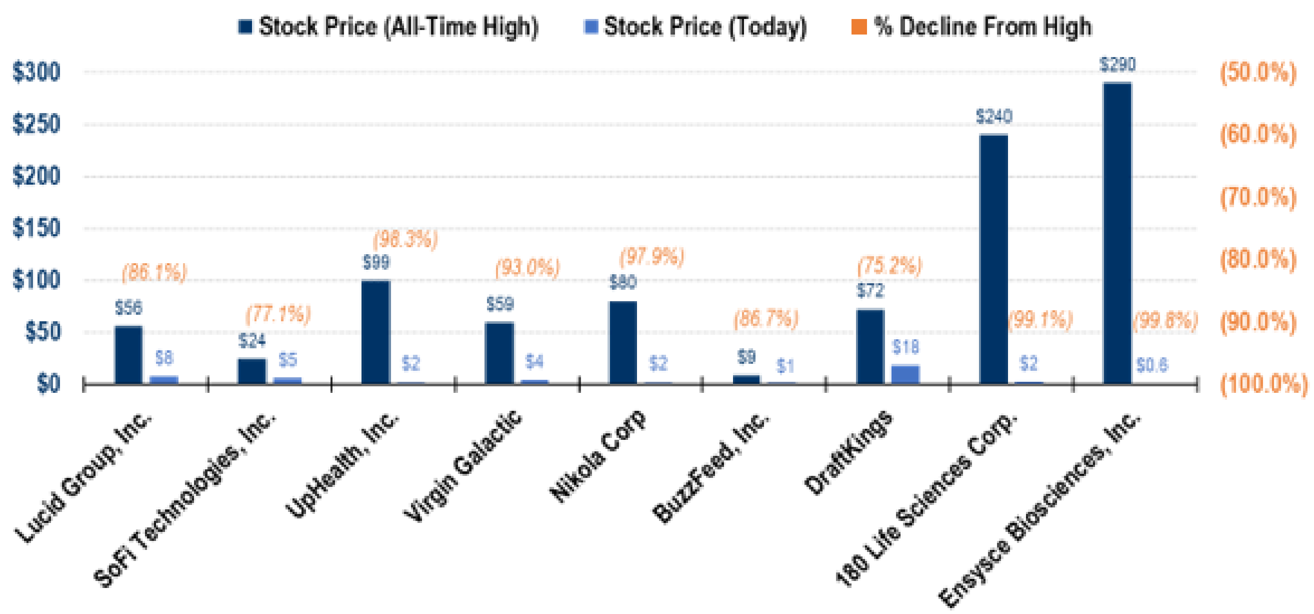
SPAC IPO Activity



Over-Zealous Valuations: How high can you go?

SPACs typically have a limited time frame (usually two years) to identify a suitable acquisition target and complete the merger. This constraint can create a sense of urgency, leading to hastily made decisions and inflated valuations of target companies. In some cases, SPACs may acquire companies with uncertain business models or unproven profitability. This can result in unrealistic expectations for growth and profitability, which the target company may struggle to achieve. Over time, this can lead to financial and operational instability.

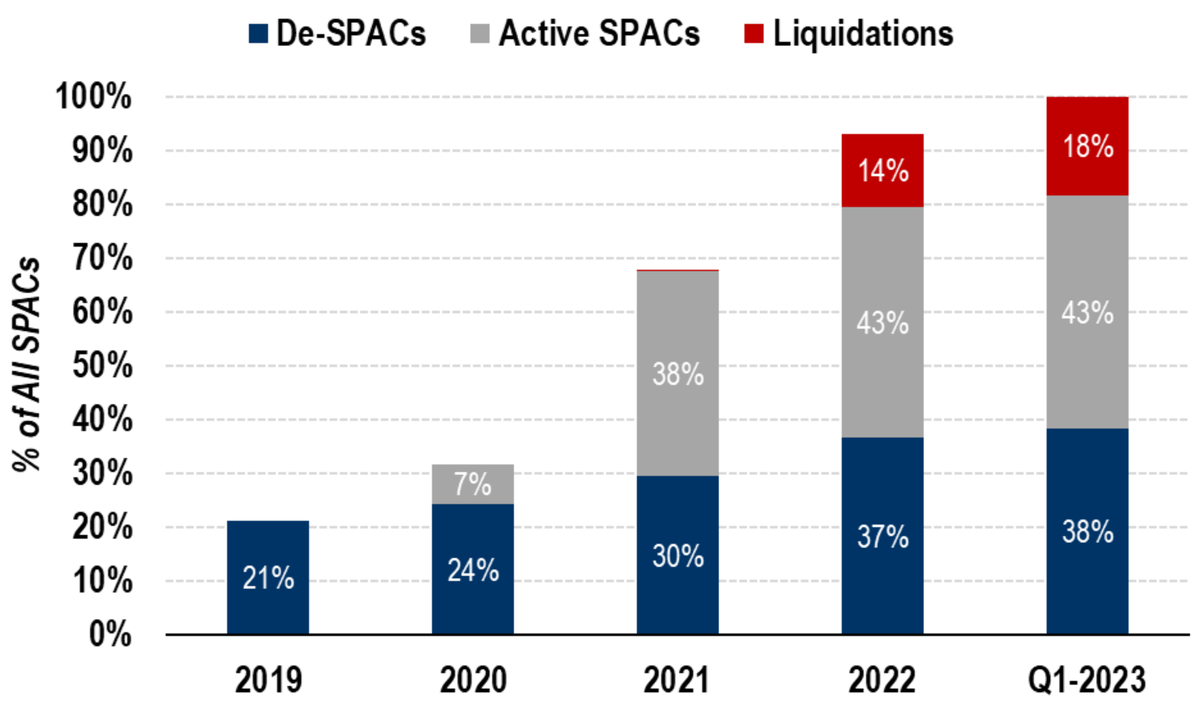
Select SPAC Stock Performance



Insufficient Diligence and Unprepared Target Companies.

The traditional IPO process involves a thorough due diligence procedure, which helps identify potential risks or issues that may arise once the company goes public. In contrast, SPACs often do not undergo the same level of scrutiny, and target companies may not be adequately prepared for public trading. This lack of preparation often leads to operational and financial issues, leading to a path of restructuring. SPACs face pressure to identify a suitable merger or acquisition target ("De-SPAC") within their specified time frame. If they don't, the money raised goes back to the investors in the IPO. Not surprisingly, rushed decision-making ensues just to snare a target. Given the lower hurdle of SEC disclosure requirements as mentioned below, due diligence processes for SPACs are often less rigorous than for traditional IPOs which can lead to more decisions based on "hunches" and creating higher risk profiles. This lack of information can contribute to financial and operational instability and potential bankruptcy filings.

SPAC Status



Limited Oversight and Regulatory Scrutiny From an IPO Standpoint Creating Less Transparency and Accountability.

When privately held entities opt for an IPO they must navigate a labyrinth of regulatory prerequisites, including exhaustive documentation, to ensure adherence to SEC guidelines. They must furnish comprehensive disclosure to potential investors and comply with securities legislation. A notable distinction with SPACs lies in the absence of preliminary regulatory examination and scrutiny, stemming from the perception that these entities do not engage in the sale of goods or services. At the most fundamental stratum, SPACs are deemed mere shell corporations from the IPO's inception. The initial capital amassed via a SPAC IPO remains in escrow until an investment culminates in a "De-SPAC" transaction or a two-year period passes without a deal.

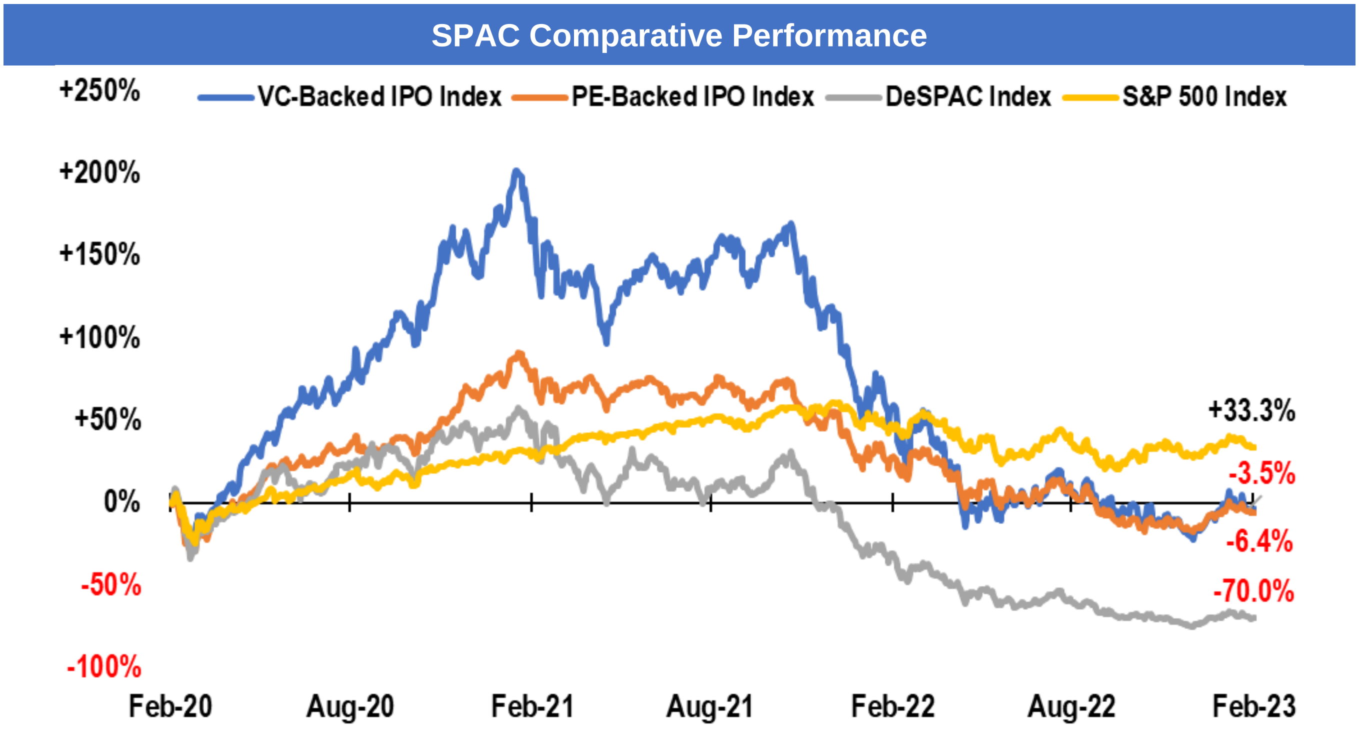
Rising Interest Rates – Focus on Servicing the Debt Not the Company.

Rising interest rates pose an escalating challenge for companies, especially those that went public through a SPAC route (de-SPAC). This heightened financial stress can disrupt the regular funding needed for day-to-day operations. De-SPAC companies, particularly those laden with substantial debt or experiencing weak cash flows, may find debt refinancing or securing additional financing increasingly challenging. This difficulty may induce defaults under credit agreements, while also triggering negative market sentiment, potentially tarnishing the company's prospects. Such a pessimistic outlook may obstruct the acquisition of new clients, necessitating both operational and financial restructuring initiatives to conserve enterprise value and transform the capital structure into a more viable configuration.

10-Year Treasury Yield

Underperformance of Many SPACs Dampens the Mood on the SPAC Market in General.

Many SPACs have underperformed in recent years, with some notable examples experiencing significant declines in their stock prices. This underperformance has led to a negative market sentiment surrounding SPACs, potentially making it more challenging for them to raise additional funds after the merger, which to many is key to survival. As a result, these companies can face liquidity issues, which force them down a restructuring path.



What's Next?

Based on these facts, a wave of SPAC restructurings is expected in the coming year. All the factors listed above will compound and move the perception of SPACs into a reality. The key for these companies is getting ahead of it all, planning, restructuring around the core business model that hopefully exists at its core, and pressing forward. How do you get ahead? The key to "getting ahead of it" is to step back and look at the following with your senior leadership team and board:

1. What is the realistic outlook for our forecast? Both from a profit and loss perspective as well as cash flow.

2. What are limiting factors preventing successful growth? Too much focus on managing cash and not enough on running the business? Has the market failed to rationalize as quickly as the original business premise spelled out?

There are many other causative factors, but the key is to really dig deep and do a rapid full assessment of the business and figure out the options that exist both from a capital and an operating perspective.

About the Authors

Robert Annas serves as a Senior Managing Director in Restructuring Services and Co-Head of Direct Investing at SOLIC Capital Advisors. He has over 25 years of experience in both operating and restructuring roles, including 15 years of working and advising in turnaround situations, distressed and special situation portfolio management, and distressed control private equity investing. In addition, he specializes in providing critical positioning, investment analysis, diligence, and execution support, facilitating acquisitions and divestitures through multiple transaction vehicles. Mr. Annas received his Master in Accountancy, as well as Bachelor of Science in Business Administration, from the University of North Carolina. He holds an AIRA certification as a Certified Insolvency & Restructuring Advisor and is FINRA Series 79 and Series 63 licensed.

Alex Rowe is a Vice President at SOLIC Capital Advisors in Restructuring and Investment Banking Services. He has over 15 years of experience specializing in financial services for corporate clients and private equity investors. In addition, Mr. Rowe has extensive transaction advisory experience involving both growth oriented and distressed companies through sell-side representations, buy-side management, financial and operational restructurings, and the placement of capital initiatives on behalf of the firm's clients. Mr. Rowe received his Bachelor of Science degree in Business Finance and Business Communications from Millikin University. He is FINRA Series 7, Series 79, Series 82, Series 65, and Series 63 licensed.

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