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ADDING INDEPENDENCE
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CORPORATE TRANSACTIONS

John Agogliati III, CFA, ASA and Simon Koo, CFA of
Marshall & Stevens Transaction Advisory Services



Recently, Finance Monthly was delighted to speak with John Agogliati, Senior Managing Director, and Simon Koo, Director of Marshall & Stevens Transaction Advisory Services. Marshall & Stevens provides a full range of valuation services to deliver independent insights into the value of businesses, securities and assets for a multitude of purposes. John and Simon have been heavily involved in fairness opinions for Special Purpose Acquisition Company (SPAC) transactions since 2021. John was also featured in Finance Monthly in April 2022, explaining Fairness and Solvency Opinions. In that article, John explained, among other things, that the purpose of a fairness opinion is to independently determine if the transaction is fair from a financial point of view. Here, we follow up with a fascinating article concerning the hot topic of SPACs and Fairness Opinions.

Q How have fairness opinions for SPACs evolved in the past two years?

Our process has slightly evolved, but not significantly changed. We still perform the same methodologies, approaches, and rigorous due diligence. However, the biggest change to SPAC fairness opinions is the availability of information – specifically with regards to the financial projections that the target and the SPAC are willing to disclose to us and to the public shareholders. Many SPAC targets are pre-revenue or early revenue companies with little history. In 2021, SPACs would readily provide 5+ years of projections without hesitation. Now, with the potential removal by the Securities and Exchange Commission (SEC) of the Private Securities Litigation Reform Act of 1995 (PSLRA) safe harbor

provisions around projections, SPACs and targets generally want to provide only limited projections or none at all.

Q How do you perform a valuation without any projections?

This is a question we deal with almost weekly. As with any valuation assignment – the answer is “it depends on the facts and circumstances of the assignment”. The general rule is that we need projections in some form. Whether the target develops the projections, or we do, generally one needs to forecast the company’s future performance profile to have a defensible valuation. If the company is pre-revenue or very early revenue, no projections are provided, and the target will not cooperate with us in developing projections –

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sometimes the assignment cannot be done. We have walked away from some fairness opinion work for this reason as we need sufficient information to complete our task. If no projections are available, we typically find that the SPAC and the target's management are willing to assist us; in these cases with limited forward information, we increase our due-diligence efforts to fully understand their view of the target's value proposition, including such items as the target's competitive moat, their growth drivers, total addressable market, market share potential, and risks and challenges. We can often develop a supportable set of projections that we will also benchmark with industry and competitor data for reasonableness.

If we still feel that there are gaps in the information received, we will supplement this with our own research. For example, we may research the target company's competitors and their product price points to understand the competitiveness of the potential pricing pressures they may face in the future. Another example is that we may research growth and investment plans of the target company's top customers' to better understand if these customers' intentions are consistent with the target company's sales expectations. If there are potential inconsistencies, we present these points to the target company and give them an opportunity to explain. Our research may also translate into the development of sensitivity analyses. If, for example, we are concerned with the target's future product pricing plan, we may reflect this in our analysis by reducing profit margins in our discounted cash flow analysis. This

helps us understand the impact on value if the company were to face pricing pressure. These analyses are then considered, along with other datapoints, when we assess the overall fairness of the deal.

Q What are the key factors driving the changes in fairness opinions for SPACs?

The two biggest factors are the proposed rules by the Securities and Exchange Commission (SEC) and public opinion. The SEC disclosed proposed rule changes on March 30, 2022 (Release Nos. 33-11048; 34-94546). These proposed rule changes – which have yet to be adopted – affected several areas, including the projections issue discussed above. SPACs have also seen a lot of negative coverage in the media over the past two years – much of it misplaced. This has called for added scrutiny and disclosure requirements by the SEC on registration statements.

Q Have any notable shifts in the methodologies or approaches been used in the past two years relating to Fairness Opinions and SPAC transactions?

In general, and as stated above, our overall approach has remained consistent, which is based on commonly accepted valuation methods combined with robust financial analysis and research. One shift we have observed is a significant increase in deals that are structured with earnout or



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clawback provisions as part of the purchase consideration. A large part of this increase is due to the economic climate (e.g., higher interest rates, inflation, recessionary fears) throughout 2022 and the unfavorable de-SPAC performance over this same time period. Given these factors, SPACs have been attempting to mitigate their risks: from potentially over-valuing the target or from execution risks associated with the target's financial projections. Consequently, we have adopted option pricing methods to quantify the economics of such provisions. This is important – because if the earnout portion is material to the overall purchase consideration, the earnout could potentially over-dilute existing shareholders in the future and significantly reduce their rate of return on their investment. This is a concept that our clients often struggle with, because they incorrectly believe that the future performance of the company, post de-SPAC, will automatically cover the earnout and any dilution. A

simple question we usually pose is: “is an investment in a company with an earnout provision the same as an investment without an earnout provision?”. The answer is obviously “No” due to the potential for dilution. This will usually help them understand that the earnout does not have a non-zero value and that our approach to this piece of the analysis is appropriate and required.

Q How have investors' expectations and demands regarding fairness opinions for SPACs changed in the past two years?

Prior to the SEC proposed rules, less than approximately 15% of SPAC transactions obtained a fairness opinion. From our casual observations, it seems that the current picture is that most legal advisors to SPAC boards are encouraging their clients to obtain

an independent fairness opinion. Although there is no formal requirement for a fairness opinion currently, the proposals by the SEC were enough to create ‘best practices’ as if the proposed rules were enacted.

Q What potential implications or future trends regarding fairness opinions for SPACs can be anticipated?

We anticipate the need for independent fairness opinions to remain relatively constant for SPACs given that they are now perceived as a ‘best practice’ by many. We could also see a significant uptick in demand if the SEC’s proposed rules described above become final. While these rules do not explicitly require a fairness opinion, Item 1606(a) of the proposed rules would require a statement from the SPAC as to whether it reasonably believes that the de-SPAC transaction and any related financing transaction are fair or unfair to the SPAC’s unaffiliated security holders, as well as a discussion of the basis for this statement. Additionally, SPACs and their boards are beginning to see the fairness opinion process as an unbiased independent check on the value of the potential target, which provides them additional comfort when deciding whether or not to approve the transaction. If performed in an independent, unbiased manner, we view the fairness opinion as a ‘value-add’ to the transaction process versus a hindrance. In this respect, the “need” to have a fairness opinion converts to a “want”.

