

FAIR VALUE OF WARRANTS ISSUED BY SPACS

According to a recent SEC statement, certain warrants issued by SPACs may need to be recorded at fair value as a liability in their financial statements, including previously issued financials.

Overview

On April 12, 2021, the Securities and Exchange Commission (SEC) released a statement (the “Statement”) entitled *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies (“SPACs”)*. According to the Statement, certain SPAC-issued warrants may not be recorded as equity (as typically recorded), but rather should be recorded as liabilities, measured at fair value on the SPAC’s balance sheet.

SPACs and their accountants may need to engage a third-party valuation firm to determine the magnitude of the liability represented by the warrants. The determination of whether warrants should be considered as equity or as a liability will depend on the terms of the warrants issued by the SPAC. Below are extracts from the Statement providing two examples of fact patterns supporting the treatment of SPAC-issued warrants as liabilities:

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- Warrants included provisions that provided for potential changes to the settlement amounts dependent upon the characteristics of the holder of the warrant;
- Because the holder of the instrument is not an input into the pricing of a fixed-for-fixed option on equity shares, such a provision would preclude the warrants from being indexed to the entity’s stock;
- Thus the warrants should be classified as a liability measured at fair value.

Tender Offer Provisions

- Warrants included provisions that in the event of a qualifying cash tender offer (which could be outside the control of the entity), all warrant holders would be entitled to cash, while only certain common stockholders would be entitled to cash;
- GAAP includes a general principle that if an event that is not within the entity’s control could require net cash settlement, then the contract should be classified as an asset or a liability rather than as equity;
- GAAP provides an exception to this general principle whereby equity classification would not be precluded if net cash settlement can only be triggered in circumstances in which the holders of the shares underlying the contract also would receive cash;
- Thus the tender offer provision where only certain common stockholders would be entitled to cash would require the warrants to be classified as a liability measured at fair value.

If a SPAC determines it has misclassified warrants, the SPAC will need to evaluate the terms of such warrants, whether the terms of the warrant should result in liability treatment versus equity treatment, and whether the impact in accounting treatment is material, thus requiring a restatement of previously issued financial statements.

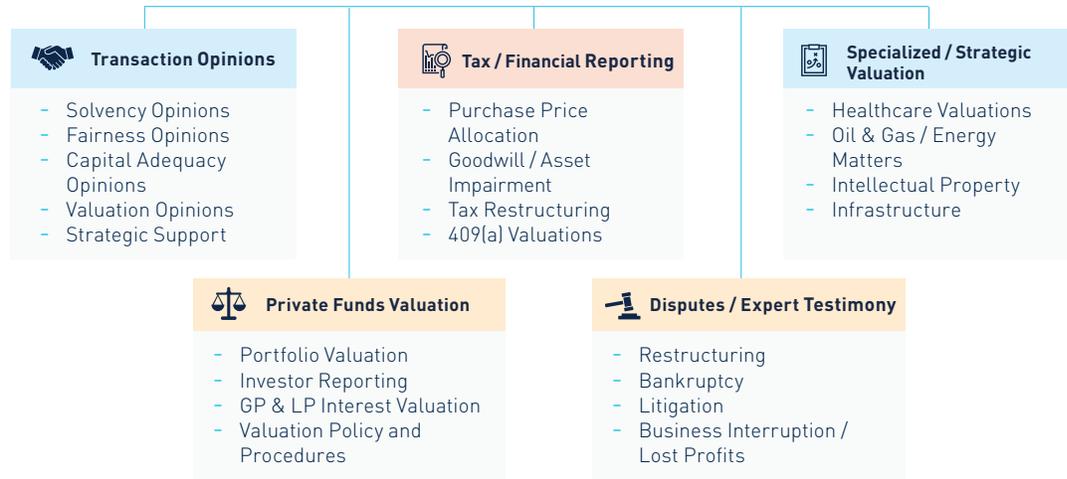
¹ Note that text has been modified from original statement for clarity. SEC, *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies (“SPACs”)* (April 12, 2021), available at: <https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs>

Valuation of Warrants

The recent SEC Statement may require certain SPACs to determine the fair value of warrants to record the liability represented by the warrants on their balance sheet. BRG professionals have advised numerous clients on the fair value of complex financial instruments including warrants, options, and convertible securities. To estimate the fair value of complex financial instruments we typically employ generally accepted valuation methodologies including Monte Carlo simulations and option pricing models.

Our valuation opinions are prepared in accordance with the requirements of the Financial Accounting Standards Board (FASB), International Financial Reporting Standards (IFRS), Internal Revenue Service (IRS), and other regulatory bodies. Our valuation professionals have performed fair value analyses of complex securities in support of tax and financial reporting requirements and successfully defended our valuation methodologies before auditors, the SEC, the IRS, and international tax courts.

Valuation Services



We typically interact with the company's internal and outside audit teams throughout each engagement to discuss and agree upon the appropriate valuation framework and methodologies to ensure efficiency and compliance with the relevant standards. In addition, we routinely interface with valuation professionals from the major accounting firms, thus facilitating the audit review process and eliminating issues prior to filing.

Team

Our valuation team brings extensive valuation experience through years of working with some of the world's leading alternative investment managers and their investors.

We have a unique blend of experience. Our professionals have worked in a variety of valuation roles in leading organizations, including alternative investment management, leading third-party valuation advisors, and Big Four audit firms.

In addition, we add meaningful depth to the valuation process through our global network of BRG senior industry experts and professionals. Through their involvement, our valuation team can provide unparalleled insight into current and future market trends, specific industry dynamics, and regulatory risks for valuation engagements that require additional depth.

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