PHYS.ORG

Investors lose out when investing in 'blank-check' SPACs

January 21 2022, by Kevin Manne

Credit: CC0 Public Domain

The more revenue growth a company projects when it announces it will be acquired by a special purchase acquisition company (SPAC), the more investors buy the SPAC's stock—and the less likely those projections are to come true, according to new University at Buffalo School of Management research.

The project is one of the first large-scale studies on the revenue forecasts that SPAC target firms disclose in their investor presentations.

"Due to litigation concerns, companies that go public via a traditional initial public offering (IPO) cannot provide forward-looking information to investors—but SPAC acquisitions fall under different regulations that allow them to make financial projections," says Michael Dambra, Ph.D., associate professor of accounting and law in the UB School of Management.

"Practitioners, regulators and the media have all expressed concern about the economic consequences of forward-looking statements from highly speculative, newly public firms," Dambra continues. "But previously, there was little evidence on the frequency of such disclosures or whether capital markets find those statements informative. Our study fills that gap."

SPACs are blank-check "shell companies" that raise capital to acquire a private company, a transaction known as a de-SPAC. In the past two years, the number of SPAC IPOs have more than doubled traditional IPOs.

The researchers analyzed hand-collected data on financial projections for 142 de-SPAC transactions from 2010 to 2020. They found more than 90% of SPAC targets provide at least one financial forecast, with revenue being the most commonly projected metric.

The study showed that when SPAC target firms make extreme revenue projections, capital markets respond favorably and the firm attracts retail investors. But once the firm enters the public market, they significantly underperform compared to their projections—and their peers.

Based on their findings, the researchers say investors should be cautious of any forecasts included in SPAC merger announcements.

"Firms going public via a SPAC acquisition exploit safe harbor provisions and provide misleading projections to elicit investments, especially from retail investors," says Dambra. "These companies are more likely to destroy long-term shareholder value, echoing concern from regulators and scholars that these lax regulations give firms a license to lie."

Dambra collaborated on the study with Omri Even-Tov, Ph.D., assistant professor of accounting; and Kimberlyn George, Ph.D. candidate, both from the University of California Berkley Haas School of Business.

More information: Michael Dambra et al, Should SPAC Forecasts be Sacked? *SSRN Electronic Journal* (2021). DOI: 10.2139/ssrn.3933037

Provided by University at Buffalo