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Should SPAC Forecasts be Sacked?

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Since 2020, the number of initial public offerings (IPOs) by Special Purpose Acquisition Companies (SPACs) has outpaced the number of traditional IPOs. SPACs are blank-check companies that raise capital from investors with the intent of finding a private target to merge with, effectively taking it public through a process known as a de-SPAC merger. For private firms, one of the benefits of going public through a de-SPAC merger rather than a traditional IPO is the ability to provide forward-looking statements. Under the Private Securities Litigation Reform Act of 1995, public companies are provided qualified safe harbor from liability for forward-looking statements, provided they issue appropriate cautionary language. However, given skepticism of the information integrity of private firms, Congress excluded IPOs from the safe harbor. Thus, SPACs provide private firms an alternate route to going public that permits disclosure of forward-looking information without facing an increase in litigation risk.

Practitioners, regulators and the media have expressed concern about the consequences of permitting speculative private firms to make forward-looking statements when going public ([Brown 2021](#), [Coates 2021](#)). However, it is unclear whether such forward-looking statements are beneficial or harmful to investors. Forward-looking statements provide valuable information to SPAC shareholders who must approve the acquisition by a majority vote. Forward-looking information may help shareholders make decisions about a proposed de-SPAC merger more capably and confidently, especially given that many private targets have limited historical performance. However, despite these benefits, there are several reasons why investors should be cautious of forward-looking statements in the SPAC setting. First, target firms going public through a de-SPAC merger tend to be younger and more speculative with limited historical information. The lack of historical performance may increase investor reliance on forward-looking statements. Second, SPAC sponsors' compensation is tied to the completion of the acquisition. Thus, sponsors are incentivized to provide optimistic, forward-looking information to ensure that the acquisition shareholder vote does not fail. Third, private firms' valuations are often based on forward-looking information. Thus, de-SPAC targets are incentivized to provide more aggressive projections to increase the transaction price.

With hand-collected data on financial projections provided in investor presentations for 142 de-SPAC transactions from 2010 – 2020, [we offer the first large-scale study](#) on revenue forecasts disclosed in investor presentations given by SPAC targets. We first document the frequency of forward-looking projections made by private SPAC targets. Over 90 percent of SPAC targets provide at least one financial forecast, with revenue being the most commonly provided projected metric. We observe that the market initially responds positively to more aggressive forecasts. Specifically, the stock return response to the SPAC acquisition is increasing in forecasted revenue growth in the five-day window surrounding the investor presentation filing date. When we examine the reaction of retail and institutional investors separately, we find that

abnormal retail trading volume increases as a function of forecasted revenue growth. In contrast, abnormal institutional trading volume does not.

To examine whether the positive market response to forecasted revenue growth is warranted, we collect actual revenue realizations in the two years after the merger. On average, target firm revenue projections are optimistically biased, and the magnitude of this bias increases in the intensity of revenue projections. When examining stock return performance over the two years after merger completion, we find that all SPACs in our sample tend to underperform. However, those with the highest revenue growth projections perform the worst over six, twelve, and twenty-four-month horizons after the de-SPAC merger effective date.

Collectively, our evidence suggests that the capital market responds favorably to de-SPAC merger announcements with high revenue projections. In particular, retail investors are attracted to de-SPAC targets with the highest projected revenue growth. However, we find that the safe harbor-protected financial projections made by SPAC targets are overly optimistic. Those firms with the most aggressive revenue projections underperform in the long-term. Our findings are especially timely, given that on May 24th, 2021, the U.S. House Committee on Financial Services received draft legislation to exclude all SPACs from the safe harbor exemption for forward-looking statements. If passed, forward-looking statements in documents such as proxy statements soliciting stockholder approval for de-SPAC transactions would no longer be protected from legal liability.

The complete paper is available for download [here](#).
