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LOS ANGELES BUSINESS JOURNAL®
Vol. 47, No. 11 THE COMMUNITY OF BUSINESS™ March 17 - 23, 2025 • $5.00

Market Shifts Away From SPACs

Once seen as an easy workaround to going public, the Special Purpose Acquisition Company – or SPAC – platform has seen middling success among its early users.

By KENNEDY ZAK
Staff Reporter

Kyle Kazan became a longtime supporter of marijuana legalization after he saw firsthand the detrimental effects drug charges could have on vulnerable populations while working as a police officer during the aftermath of what came to be known as the War on Drugs in the 1990s.

He founded Glass House Brands with the goal of making cannabis as affordable in the legalized market as it is when purchased illicitly. Glass House is involved in all aspects of the cannabis industry spanning production, wholesale, retail and consumer packaged goods.

To execute his goal, Kazan knew he needed to produce cannabis in high quantities to get the most out of farming upkeep costs. In 2021, an opportunity came along to purchase a 5.5-million-square-feet greenhouse farm facility which would give Glass House the ammunition it needed to skyrocket production.

In talking with the farm's previous owner, Kazan was able to strike a deal to purchase the farm for $118 million as well as some stock in the company. The only problem was that Glass House wasn't public.

Enter the de-SPAC.

Leader: Kyle Kazan's Glass House Brands used a de-SPAC to go public. (Photo by Thomas Wasper)

Overview of de-SPAC's history

A de-SPAC transaction is when a special purpose acquisition company – a "blank-check" entity created for the sole reason of taking another company public – acquires a private company, allowing it to bypass the traditional IPO process which requires higher levels of scrutiny.

These types of transactions began gaining traction in 2020, ultimately peaking in 2021 when a total of 613 de-SPACs were completed in the United States, compared to 248 in 2020 and 86 in 2022, according to data from SPAC Research. In 2023 and 2024, there were just 35 and 57 de-SPAC transactions, respectively.

It's clear this trend was short lived as skeptics' notions surrounding de-SPACs proved mostly true.

During the onset of the de-SPAC boom, James Park, a pro-

Banker: Lloyd Greif is the CEO of Greif & Co.

fessor at UCLA School of Law and a former assistant attorney general in the Investor Protection Bureau for the state of New York, found himself "very skeptical" of the transaction type. This was primarily because of the difficulties in properly valuing private companies – which Park called a "gamble" without the traditional IPO scrutiny – as well as the incentive structure at play in SPAC deals.

Since SPACs are created with the goal of completing a deal and will be substantially compensated for doing so, they may not always care about longevity and due diligence, Park said.

"There were good intentions …(but) in practice, the vision was problematic," Park said. "There were just not enough safeguards. There is a reason why it is difficult to become a public company…I don't think there are any real shortcuts if you want to protect investors."

To Lloyd Greif, founder and chief executive of downtown investment bank Greif & Co., the de-SPAC frenzy looked an awful lot like the dotcom bubble of the late 1990s.

"De-SPAC avoided the normal due diligence that you're supposed to perform. It avoided the research analysts signing off on the company as being worthy of being publicly traded," Greif said. "A lot of these companies weren't ready for prime time. They should never have been public vehicles."

As the de-SPAC bubble burst, it left behind a trail of disheveled companies with plummeted stocks, lawsuits from angry investors and damaged reputations. A few companies were able to escape this fate; Glass House seems like one of them.

Willing to take the risk

When approached by a SPAC amid the frenzy, Kazan recalled initially saying "no, no, no, no, no."

"The idea of a SPAC always seemed dirty to me," Kazan said.

Nonetheless, when he realized he could get enough money to purchase the 5.5-million-square-feet greenhouse facility from a SPAC deal but not enough through the traditional IPO route, he decided to take the risk.

While many companies who did de-SPACs have filed for bankruptcy, saw their stocks drop below $1 or were forced to go back private – or some combination – Glass House is still standing.

To succeed, Kazan stressed the importance of maintaining control of the company and staying competitive in the market. With the giant land purchase that the de-SPAC helped fund, Glass House is able to execute a production cost of about $100 per pound. Comparatively, excluding cultivation taxes, Statista estimated the cost of cannabis production per pound in the legal market to be $551 in a 2020 report.

Thus, Glass House is able to sell its products for significantly cheaper than its competitors with one of its brands, Allswell, being a top retailer in California. Allswell sells 3.5 grams of cannabis flower for $9.99, while typical prices range from $23 to $45 in California.

Through its utilization of massive outdoor space, Kazan said Glass House is built for the future – and by this he means widespread legalization – while its competitors, most of which use warehouses, are built for the past and present.

"We're built for the walls to come down," Kazan said. "The others are built for prohibition and the current structure, the status quo. We are winning in the status quo, but that's not what we're built for."

Impact of legalization on stock

While things are going relatively well for Glass House, they

Faraday Future's all electric FF91 vehicle. The company has faced legal scrutiny over its use of a SPAC to go public.

aren't perfect as can be seen from its fluctuating stock performance. From summer 2021 to the end of 2022, Glass House was on a slippery slope, going from an all-time high of $12.71 to an all-time low of $1.78. It looked like the company may have been destined for the same fate as the other de-SPACs.

But Glass House turned out to be the SPAC that smiled back, increasing its stock by 245% from March 2023 to March 2024. Since pulling off a reverse bell curve, the company's stock began falling again more recently, hovering around $6 since the end of 2024.

Kazan contextualizes Glass House's stock performance in a couple of ways, the most prominent appearing to be the government's status surrounding legalization.

Entering into the public market alongside former President Joe Biden's administration, the stock performed well as folks anticipated progress toward legalization. However, Kazan said as nothing seemed to move forward, people seemed to lose faith. Simultaneously, following the purchase of the giant greenhouse facility, it took some time to get everything up and running in terms of production which added to investors' impatience.

Nonetheless, once the farm was functioning, the stock began to shoot back up in early 2023 until around August when it began to dip back down.

Kazan in part attributes this to expectations as the country watched Biden's recommendation in May 2024 to move marijuana from a schedule I drug to schedule III not come to fruition. And as President Donald Trump was reelected, sentiments around conservative views on marijuana caused further uncertainty on legalization.

That said, Glass House is not the only one seeing this performance dip, as New Cannabis Ventures reported cannabis stocks down 15.2% in 2024.

"We're still trading at a better multiple than (other public cannabis companies)…but I know when we're down, our investors get kicked in the teeth," Kazan said, adding that it is why Glass House released updated quarter four estimates in February which showed better performance than originally reported in November.

This release estimated record high revenue for the full year of 2024 of about $200 million, 25% higher than the year-over-year midpoint guidance. Additionally, quarter four's earnings before interest, taxes, depreciation and amortization (EBITDA) is estimated to be between $7 million and $9 million compared to the previous estimate of $3 million and $5 million.

"It's basically showing our investors that we're still doing fine," Kazan said. "We're just not going at a breakneck pace because of legalization."

Official year end financials will come out March 25.

Additionally, on March 3, Glass House received a $50 million credit facility which will result in a net cash inflow of $8.1 million.

Greif sees this access to debt capital as a positive sign for the company, noting that Glass House appears to be in better shape than others in the same industry.

"It sounds like they're angling to be one of the last men standing in the cannabis space where there has definitely been a thinning of the herd," Greif said. "…The question is, how long can they hold on (waiting for legalization). It's a play where you're at the mercy of the government."

Because of the government's role, Greif said investors must be aware that there are things simply out of the company's control that impact its stock price.

With regard to investor relations, Kazan said: "If your name is Glass House, you better be transparent…and (legalization) is just something I can't control."

de-SPAC legal implications

Glass House has never faced litigation from disappointed investors – which not every de-SPAC company can say. After many companies who underwent de-SPACs began drastically underperforming, it's no surprise investors took legal action and, in many cases, the courts took their sides.

Take Faraday Future Intelligent Electric as an example. The Gardena-based EV development company went through a de-SPAC in 2021 and was since ordered to pay $7.5 million to investors in 2024 after a shareholder class action suit which alleged that the company misled shareholders before going public. This suit came after "numerous production delays, missed financial targets, and (the repeated postponement of) the launch of its much-anticipated vehicles," according to law firm Pomerantz LLP.

Once going public, Faraday's stock went from trading at more than $140,000 to $1.29 as of Wednesday. The company did not respond to the Business Journal's request for comment.

To succeed in these types of lawsuits, Park said it often comes down to proving fraudulent intent.

The first case resulting in a complete dismissal of an investor lawsuit related to de-SPAC companies involved Canoo Inc., an EV company founded in Torrance. Investors sued Hennessy Capital Acquisition Corp. IV, the SPAC which took Canoo public, though the judge wrote in the 2024 ruling that "poor performance is not…indicative of a breach of fiduciary duty."

Legal experts have called it a defining decision in the de-SPAC litigation realm as it determined that negligence was not sufficient when arguing breach of fiduciary duty, even though this is not the same standard held in cases involving the traditional IPO process.

This victory was not enough to guarantee Canno's success, however, as the company filed for bankruptcy just before the new year and has ceased operations. The company also did not respond to a request for comment.

'Something that just doesn't seem to work' with de-SPAC deals

In response to the de-SPAC boom, the Securities and Exchange Commission increased regulatory requirements for these transactions in 2022 and again in 2024.

While the de-SPAC bubble burst right around the same time the SEC first cracked down on regulations, correlation does not always equal causation, according to Park.

"I think the more likely explanation (for de-SPAC decline) is that there's something that just doesn't seem to work with respect to these sorts of transactions…The structure…enriched sponsors over the investors," Park said. "Investors have lost too much money so that they are wary regardless of the sorts of disclosure you offer and regardless of what the regulation is."

Regarding the de-SPAC companies still standing, Greif said these are the exception, not the rule. In Glass House's case, he said its position is likely due to its "diversity of income streams and divisions" in terms of having its own branded products and retail combined with in house production and wholesale, adding that this gives Glass House "some greater resilience."

Nevertheless, Greif does not ever foresee a comeback with this type of transaction.

"The de-SPAC boom is dead, and deservedly so," he said.