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Get the Facts About SPACs

SPACs (Special-Purpose Acquisition Companies) are changing the way companies go public

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Of all the financial acronyms in the news these days, SPACS are getting some of the most buzz. A SPAC — **standing for Special-Purpose Acquisition Company** — is a vehicle to take a company public.[1] However, unlike a traditional initial public offering (IPO), where investors back a known company, a SPAC:

1. First raises cash through an IPO, which is held in a trust.

2. Then looks for a private company to take it public with that cash. This is done by selling common stock (shares typically sold at $10 apiece), along with a warrant to give investors the opportunity to buy more stock later at a fixed price.

Oftentimes, SPACs are considered to be more similar to a private sale than a public offering. As a result, there may be more diligence and capital considerations. However, companies considering going public through a SPAC are not required to keep silent. They can drum up excitement through the media and other nontraditional outlets, such as touting a celebrity investor.

What Happens After the Common Stock Is Sold?

SPAC sponsors are under enormous pressure to find a deal after the common stock is sold. If the SPAC doesn't find a company in a given period (usually after a deadline of two years), the SPAC expires, de-liquidates, and investors get their money back. This incentive often drives SPAC sponsors to offer high valuations to the acquired entity in order to "get a deal done."

SPACs typically supplement their commitment with a PIPE (private investment in public equity) or additional capital raised after selecting a company to acquire. If the PIPE investors — who are usually large, sophisticated financial players favor the deal — it will likely be approved by the SPAC investors. PIPEs also provide much of the working capital needed to fund the underlying private company that is being taken public.

1 "What is a SPAC?" CNBC.com, November 9, 2020.

Why a SPAC?

> An IPO is a company looking for money, while a SPAC is money looking for a company.
>
> - Don Butler, Managing Director at Thomvest Ventures

SPACs have recently become increasingly popular. In 2020, SPACs drove the majority of IPO growth, with 248 companies going public via SPAC. But SPACs have actually existed since the early 1990s, where they were predominantly used as a way to help small companies go public. In 2021, SPAC interest continued to break records, with $87.9 billion[3] raised in the first three months of 2021 alone.

Here are some of the reasons companies, investors, and sponsors are drawn to SPACs:

Private Company Benefits

- **Certainty:** Unlike a traditional IPO, companies can negotiate the terms of their public offering — most importantly, an upfront valuation, giving employees and shareholders more assurance. Also, many SPACs are well-capitalized via the PIPE, allowing the company to plan and pursue long-term missions.

- **Speed:** The SPAC merger can take 3-4 months — much shorter than the 6-9 months of a traditional IPO.

- **Strategic partnership:** Some SPACs are combined with an experienced team and / or board of directors to help guide the company.

2 Metinko, Chris. "SPAC vs Traditional IPO: Investors See Benefits of Blank-check Companies." Crunchbase News, December 3, 2020.

3 Li, Yun. "SPACs break 2020 record in just 3 months, but the red-hot industry faces challenges ahead" CNBC.com, March 19, 2021.

Investor Benefits

- **Redemption option:** If the SPAC sponsor can't find a target company in two years, or if investors are unhappy with the chosen acquisition, initial shareholders can redeem their shares and get their money back.

- **Warrants:** Some SPACs allow their initial investors to vote against a planned merger and redeem shares, but retain their warrants. This optionality has a lot of value should an approved SPAC perform well in the after-market.

- **Additional profit opportunities:** Institutional investors can purchase additional shares after the acquisition once they invest in the initial SPAC.

Sponsor Benefits

- **Easy access to capital:** The SPAC IPO process is relatively simple, as the shell company faces fewer complications compared to traditional IPOs. Moreover, raising a SPAC is usually much easier than raising a new VC fund.

- **Significant upside:** Sponsors typically receive 20% of the SPAC shares post-IPO (the "promote"), which can lead to many millions of dollars in gains even if the target company shares drop after the merger.

- **Opportunity to invest in late-stage companies:** The SPAC merger allows sponsors to invest in later-stage private companies where extraordinary gains have been made over the last years. This is one of the reasons why SPACs have been of such interest to hedge funds that historically have focused on public market investing.

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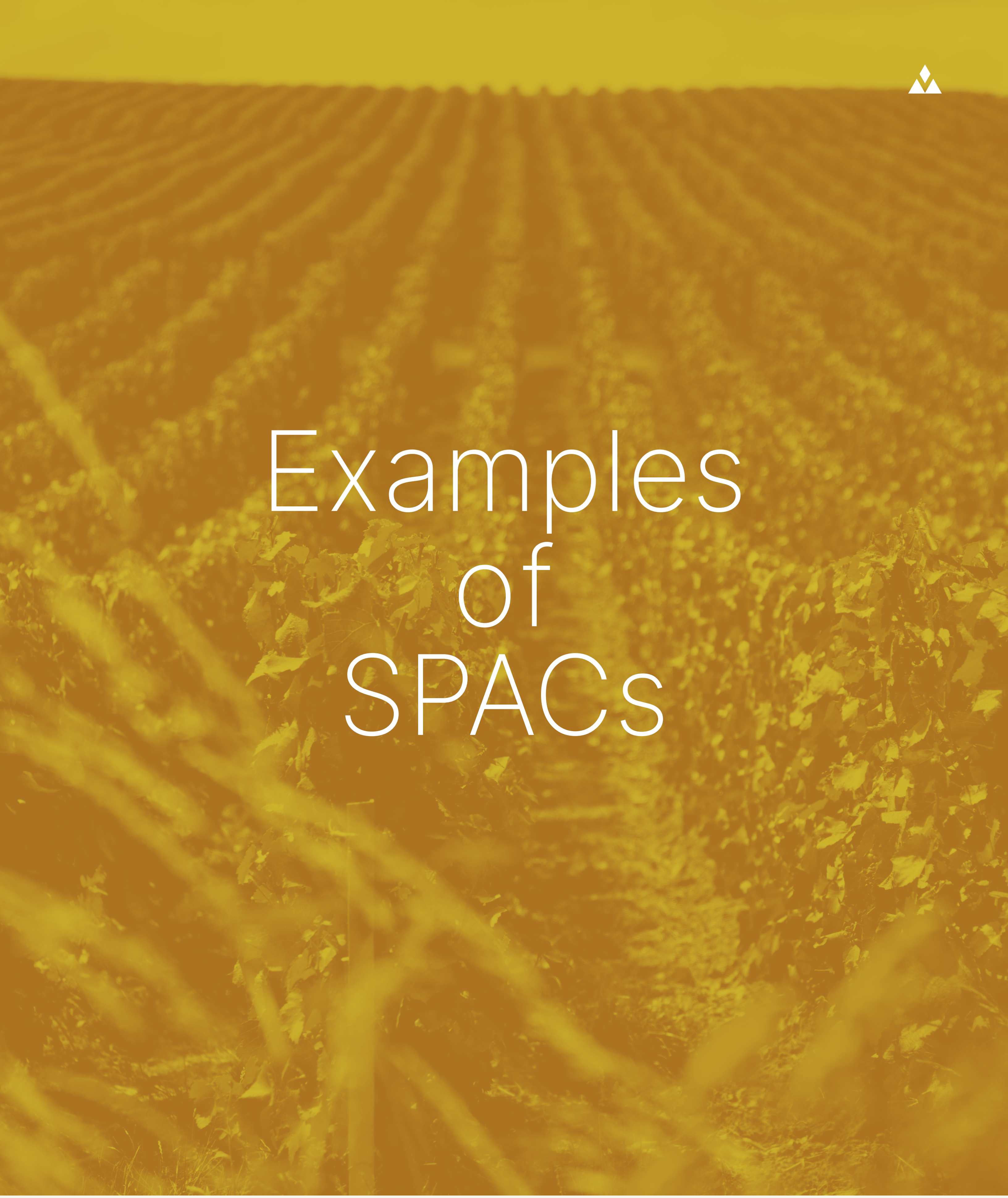

Examples of SPACs

One of the earliest and most successful SPAC IPOs of the modern era was for human spaceflight company **Virgin Galactic Holdings**. The company went public in 2019[4] in partnership with Chamath Palihapitiya's original Social Capital Hedosophia SPAC.

DraftKings has been an enormous success and is a highly popular SPAC due to its widespread consumer usage. The company went public in April 2020 and has consistently traded above $50 — which means a more than 400% return for its investors.

Other successful SPAC IPOs include:

- **Nikola:** Electric semi-truck company
- **Gemini Therapeutics:** Precision medicine company
- **AppHarvest:** Agricultural Tech Company

Some VC firms are even starting their own SPACs. For example, Thayer Ventures, a travel-focused VC based in the Bay Area, created a subsidiary brand[6] to focus on longer-term investments with disruptive, competitive advantages. This trend may be on the rise as it can be a cheaper, faster route to raising a venture fund, while still allowing the venture partners to invest in long-term, disruptive moonshots.

4 Smith, Rich. "When It Comes to Space Company IPOs, You Must SPAC It." The Motley Fool, March 22, 2021.

5 Gollan, Doug. "Wheels Up Announces SPAC-Based IPO Valued At $2.1 Billion" Forbes.com, February 1, 2021.

6 Hurley, Miles. "Thayer Ventures SPAC to file for $175m IPO." Shorttermrentalz.com, October 13, 2020.

While there are many examples of positive SPAC IPOs, not all are successful. For example, in April 2020 — due to market complications from the COVID-19 pandemic — TGI Fridays terminated their SPAC merger[7] with Allegro Merger.

In certain circumstances, however, failed traditional IPOs can potentially find success through a SPAC. An example is commercial real estate company WeWork merging with BowX Acquisition[8] after struggling to raise capital due to doubts about the company's business model.

7 Curry, Rachel. "A Cautionary Tale: SPACs That Failed to Merge" Marketrealist.com, September 29, 2020.

8 Eavis, Peter and Hirsch, Lauren. "After Failed I.P.O., WeWork Will Go Public Through a Merger" New York Times, March 26, 2021.

Are SPACs Here to Stay?

While SPACs have a slew of benefits and continue to become increasingly popular, are they positioned to overshadow typical IPOs?

The potential for weak returns presents one potential barrier to future SPACs.[9]

- The long-term operating performance of innovative private tech companies often does not match expectations, leading to downward pressure on the stock price.
- Moreover, the dilution hole created by the exercise of the warrants can create an artificial ceiling on the price of the stock unless the SPAC is executing its business model well.
- And sponsors have every incentive to sell their 20% ownership when and how they can, as they have a very low-cost basis. Given that the SPAC structure hasn't changed despite these "holes," suggests the poor performance trend could continue, and the bubble might burst.
- Finally, because new SPACs continue to be launched by the week with the need to close a transaction or risk expiry, it seems that either the quality of assets could fall or the acquisition prices could continue to rise. Both could potentially result in negative returns of the asset class.

Given that the SPAc structure...burst. That said, individual SPAC returns can be spectacular, as well as busts. Howard Lutnick, Chairman and CEO of Cantor Fitzgerald,[10] believes SPACs will fill a void between private equity and the IPO market. He stipulates that public investors who have largely been shut out of the private markets will give SPACs a competitive funding edge.

9 "Who Benefits — And Who Doesn't — From A SPAC." Cbinsights.com, November 5, 2020.

10 "Cantor Fitzgerald Chairman & CEO Howard Lutnick says special purpose acquisition companies are filling a 'gap' for investors between the initial public offering and private equity markets. 'SPACs are here to stay, they fill that void,' Lutnick says on Bloomberg TV." Cantor FItzgerald, February 2, 2021.

Can I Invest in a SPAC?

Unlike a traditional IPO, you do not need to be an accredited investor to invest in a SPAC, as a SPAC IPO costs less. According to Sylvia Jablonski the CIO of Defiance ETFs,[11] "Everyday investors are often left out of an IPO since share allocations are generally reserved for high-net-worth and high-earning investors." However, the typical price for a SPAC common stock is only $10 a share.

Through an online brokerage account, you can learn more about current SPAC offerings or invest directly.

11 Jackson, Anna-Louise and Curry, Benjamin. "Special Purpose Acquisition Company: What Is A SPAC?" Forbes, March 9, 2021.

Important Disclosure Information

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