SPACs: An alternative to the IPO

A SPAC is an alternative to a traditional Initial Public Offering (IPO), allowing a privately held company to become a public company without the constraints of a classic listing. This is because the company becomes publicly traded after being acquired by an entity that is already listed. The determining factor is that the listed company is a legal structure with no operating business, revenues, or assets, and only has cash that been contributed by its investors. This unusual entity is called a SPAC, a Special Purpose Acquisition Company, and its simple purpose is to find a private company that will agree to combine with it to become a public company. As well as cash, a SPAC has a lean team and a timeframe of 18 to 24 months to carry out its purpose. If this does not happen, the structure is self-liquidating, and the capital is returned to its shareholders.

As there is no operating business, the main driver of attracting capital is the reputation of the people involved. This is why the SPAC's team usually consists of experienced and well-known executives. This team does not have to commit to a full-time role and does not receive a salary or bonus. Their compensation is directly tied to the success of the acquisition, as the management team receives a significant stake in the acquired company (normally 20% of the stake acquired by the SPAC) subject to a 12-month lock-up. It is a lucrative opportunity for the team to help a company and its management team handle the various elements involved in the transition to being a listed company.

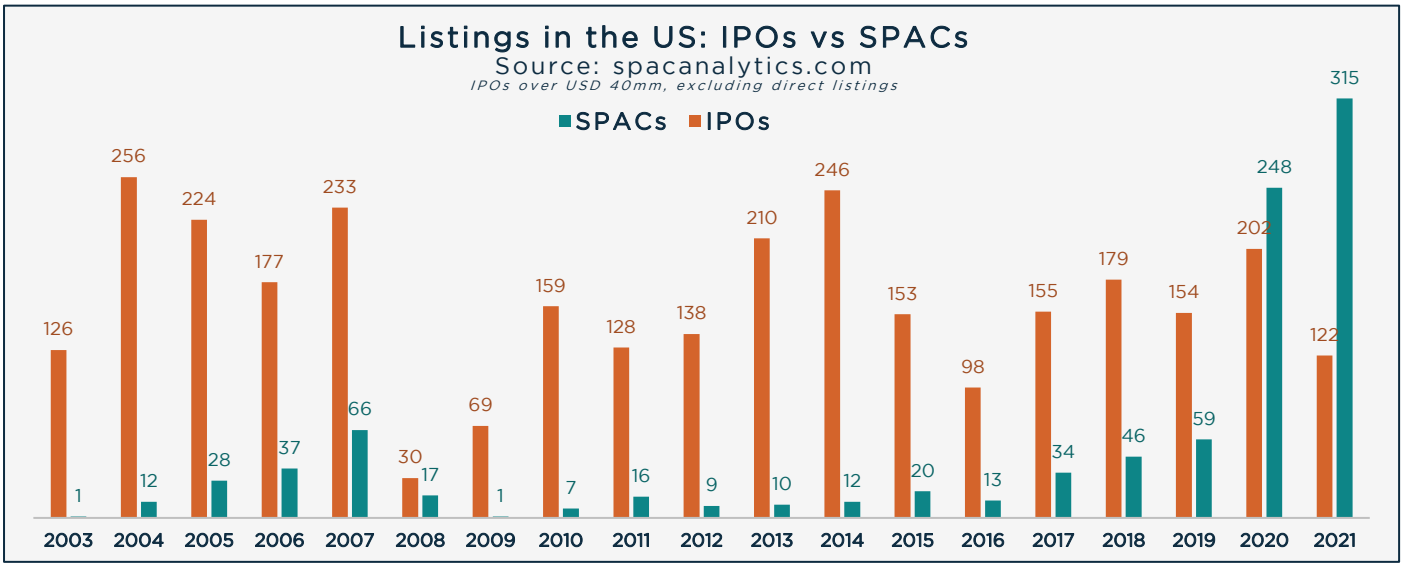
The SPAC goes through its own IPO process in which to attract initial investors. However, as it has no financial history or assets, the process is much easier and can be carried out in weeks. The initial investors are usually institutional investors who are attracted by the combination of the team's reputation and the attractive terms of this particular arrangement. The structure of a SPAC involves units that are made up of a share and a warrant (an option to buy a share). Another unusual feature is that when the target company is announced, the shareholders have the right to redeem their share and receive their principal (plus accrued interest) back if they do not agree with the proposed deal. In other words, the shareholder in a SPAC has a high degree of optionality and can capture significant upside if the share price appreciates as well as the right to withdraw from any deal.

A private company has a number of advantages when choosing the SPAC route and can benefit from one or more of the following elements:

- **Speed of listing:** by avoiding the tortuous path of having to choose an underwriter, followed by a road show and book building elements, a listing via a SPAC can take place in weeks rather than months.
- **Centralized and confidential negotiation:** no filing is required, and the company can choose to deal directly with just one SPAC, or as many as it wants.
- **Flexibility in using financial projections and forward guidance:** not allowed in an IPO, a private company has more flexibility in communicating with its potential investors when choosing to deal with a SPAC.
- **Earn-outs:** the possibility of including clauses allowing the company's executives to be compensated with more equity if the share price reaches a certain level. This is common in private M&A deals but is not allowed in an IPO.
- **Additional capital:** through PIPEs (Private Investment in Public Equity) and FPAs (Forward Purchase Agreements) a SPAC can offer more capital from institutional investors for the deal than just its own cash.

On the other hand, the cost of listing via a SPAC can be more expensive than a traditional listing for the private shareholders. Estimates put the costs of underwriting fees and sponsor remuneration (SPAC team) at more than 30% of the SPAC's capital.[1] However, these estimates are likely outdated as the terms of SPAC deal are flexible and have become progressively more founder friendly in an increasingly competitive environment.

We have seen a tsunami of listing of SPACs over the last 16 months. 248 SPACs were listed in the US in 2020, representing an aggregate volume raised of USD 83.5 billion. This represents a 320% increase in the number of SPACs and of over 500% in dollar volume when compared to the previous year!* Listings of SPACs accounted for 46% of total primary variable income volume issued in 2020.* These record figures were easily surpassed in just the first four months of 2021 when 311 SPACs raised over USD 100 billion, representing over 60% of total primary issuance volume.*



1 https://www.forbes.com/sites/antoinegara/2020/11/19/the-looming-spac-meltdown/?sh=417dd5b70d7e
* https://www.spacanalytics.com

It may be a surprise to many that SPACs are not a new concept and have actually existed in different forms since at least the 1920s.[2] However, it has a dubious past, particularly in the 1980s when the entities were known as ""blank check or "blind pool companies". More than 2,700 of these structures were listed from 1987-1990[3] and there were numerous occurrences of manipulation and fraud. The Securities and Exchange Commission (SEC) created a task force in 1988 to supervise and inspect these structures more aggressively[4] which eventually led to the introduction of new regulation, the Securities Enforcement Remedies and Penny Stock Reform Act of 1990. On the back of these new rules, blank check companies virtually disappeared from the market in 1990, as there were less than 15 blank check companies listed that year.

One of the rules introduced by the SEC in 1990 has become one of the most interesting features of the current architecture: giving the investor the option to withdraw from the deal after the target is announced. In 1992, David Nussbaum, a lawyer and CEO of GKN Securities[5], coined the term SPAC, incorporating in his new arrangement all the measures introduced by the SEC. He listed 13 of these new structures between 1993 and 1994[6] but SPACs faded away as capital became widely available for public offerings by start-ups and small companies during the tech boom

These structures resurfaced when the tech bubble burst in the early 2000s. In August 2003, the same David Nussbaum, now at EarlyBirdCapital, listed Millstream Acquisition Corporation and inaugurated a new fertile period of SPAC listings. More than 160 structures were listed by 2008.[7] The market cooled down again after the Great Financial Crisis of 2008 and less than 10 SPACs per year were listed in the following years.[8]

One of the most noteworthy SPACs of the last decade arose during this lull. Justice Holdings Limited, was created in 2011 in partnership by Bill Ackman, Nicolas Berggruen and Martin Franklin, well-known executives and investors. In April 2012, Justice announced the acquisition of 29% of Burger King Worldwide Holdings from 3G Capital, bringing the fast-food company back to the public market.

The 2010decade was marked by a zero-interest rate environment, an abundant supply of capital and a strong wave of innovation and startups. The easy monetary conditions allowed tech companies unprecedented access to private capital, This resulting in the postponement of public offerings and an extraordinary accumulation of unicorns (private companies with a valuation of over USD 1 billion). The few companies that did become publicly listed decided to do so at a much more mature state, and the average age on the IPO date jumped from 5 to 11 years.[9] One side effect of private investors' dominance over of the early growth phases of tech companies and the low tide of IPOs appears to be the avalanche of SPACs in 2020-2021.

With over 420 SPACs currently sitting on more than USD 137 billion*, the segment is at a real fever pitch. What were typically small structures with an average of less than USD 100 million[10] in capital, have risen to a new magnitude and we've wtitnessed the listing of 10 SPACs with over USD 1 billion of cash on hand. This includes Bill Ackman's Pershing Square Tontine Holdings with USD 4.9 billion.[11] This new wave also includes reputable figureheads such as Howard Marks (Oaktree Acquisition Corp), Peter Thiel (Bridgetown Holding), Chamath Palihapitiya (14 SPACs, including vehicles that merged with Virgin Galactic, Opendoor, and Clover Health) and Michael Klein (7 SPACs). Celebrities and former athletes have also joined the fray, such as Serena Williams (Jaws Spitfire Acquisition Corp.), Steph Curry (Dune Acquisition Corp.), Ciara (Bright Lights Acquisition Corp.) and Shaquille O'Neal (Forest Road Acquitision Corp.).

Brazil has not missed out, and we have a few SPACs with a Brazilian focus and/or sponsors. The pioneer was HPX Corp., launched in June 2020 with USD 220 million to acquire a Brazilian company. Its Co-Chairmen are Bernardo Hees (former CEO Kraft Heinz) and Rodrigo Xavier (former CEO and Chairman of Bank of America Merrill Lynch Brazil) and the CEO is Carlos Piani (former Chairman of Kraft Heinz Canada). In January 2021, we saw the launch of two SPACs with Brazilian elements, Itiquira Acquisition Corp and LDH Growth Corp I. Itiquira with USD 200 million also focused on the acquisition of a Brazilian company, which has as CEO and Chairman Paulo Gouvêa (Managing Partner of Ygeia Capital) and CFO Marcus Silberman (Partner of CH Global Capital and former Head of M&A in Latin America at Bank of America). LDH Growth Corp I was also launched with USD 200 million and intends to acquire a technology company in Latin America. It is sponsored by SoftBank, and Brazilian Paulo Passoni is a Managing Partner. The following month, Waldencast Acquisition Corp. was launched with USD 678 million. It has no geographic focus and aims to acquire a company in the beauty, personal care or wellness sectors. Felipe Dutra (ex-CFO of Anheuser-Busch InBev) is chairman and Cristiano Souza from Dynamo Capital is a board member. Both are Brazilian.

We cannot predict all the side effects of this current record-braking wave of SPACs, but what is certain is that there have never been so many financing options for private companies. Private equity players continue to operate at full steam (with their own record-breaking fundraising stats), a robust appetite for traditional IPOs, plus the newly tested direct listings (a mechanism pioneered by Spotify in 2018) and the plethora of SPACs. There have never been so many choices.

The SEC is closely monitoring the tsunami of SPACs and introduced new guidance related to warrant accounting in April. There are also rumors that it may introduce new restrictions on financial projections and forward-looking statements. Nevertheless, the market has cooled rapidly for new listings and the crop of companies that were listed through SPACs in the first four months of 2021 lost on average 39% of their market value by the end of April.[12] No doubt there are excellent reasons to cultivate a robust and permanent presence of SPACs in equity markets but, as we have seen in the past, the market tends to self-correct excesses (sometimes with the help of corrective actions by regulators) and balance things out. However, there are tell-tale signs that we have just witnessed another episode of excessive euphoria.

2 https://economics.sas.upenn.edu/sites/default/files/filevault/13-013.pdf pg 3
3 https://core.ac.uk/download/pdf/159610375.pdf *pg 532*
4 https://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1160&context=law_lawreview pg 936
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