SPACs – Taking the Markets and M&A World by Storm

Start up Advisory
January 20, 2021

This practical guide by Varnum LLP is prepared for both investors and companies evaluating capital gains, exits or liquidity events and discusses the ins and outs of Wall Street's hottest trend.

Special Purpose Acquisition Companies (SPACs) took the IPO and merger and acquisition world by storm in 2020. SPACs raised $80 billion in 2020, more than all traditional IPOs combined. SPACs pushed the number of IPOs in 2020 to over 400, double the average number for the prior 10 years. There have already been 25+ SPAC IPOs in January 2021. High profile individuals from Reid Hoffman (LinkedIn founder) to Shaquille O’Neal to Billy Beane (baseball executive of Moneyball fame) have gotten in on the action by forming SPACs. The SPAC era has arrived.

SPACs are a funding source for companies looking to raise capital, grow or sell their business. A SPAC enables a company to go public without a lengthy traditional IPO process. High profile companies including DraftKings and Richard Branson’s Virgin Galactic used SPACs to go public.

Let’s break down what a SPAC is and how this boom can benefit you.

So what exactly is a SPAC?

It’s a type of “blank check” company. A SPAC raises money in an initial public offering and then finds a company to buy. Years ago, blank check companies were smaller, less common and often viewed with skepticism as something for smaller, shakier companies. In today’s world, SPACs are attracting big money and taking high profile companies public.

SPACs have some similarities to private equity funds. Both raise investor money then look for deals. But SPACs result in a publicly traded company while private equity funds are just that, privately held.

Often the SPAC is managed by someone with a track record of doing successful deals. Investors buy common stock and warrants to fund the SPAC, giving it a “blank check” to go buy a company. The SPAC may target a particular sector or type of business. The SPAC typically has 18-24 months to find and acquire a company. In the meantime, the SPAC common stock is publicly listed and ready to go even before the SPAC finds a business to
buy. If a deal does not get done by the deadline, the money is returned to investors.

When a SPAC agrees to acquire a company, the SPAC shareholders vote on whether to approve the deal. SPAC shareholders who do not like the deal can require the SPAC to redeem their shares. If the shareholders approve, the SPAC and the company complete the acquisition and the resulting operating company is a public company trading on NYSE or NASDAQ.

**Why would a company combine with a SPAC?**

The short answers are speed and certainty.

The traditional IPO process is a long and time-intensive road. A company prepares itself, hires an underwriting firm, files an extensive prospectus with the SEC and then does a road show to market the company to potential investors. It can easily take four to seven months. A company does not know how much money you will raise until the offering is priced at the end of the process.

Merging with a SPAC accelerates the going public process. A SPAC deal can be completed in three to five months, faster than an IPO. The SPAC is already publicly traded on NASDAQ or NYSE and the money has been raised.

Merging with a SPAC increases certainty. The merger agreement spells out exactly what the shareholders of the operating company will receive. The price is determined by negotiation between the company and the SPAC. In contrast, a traditional initial public offering is at the mercy of market conditions at the time the offering is priced and completed. Sharp downturns resulting from world events or other factors can reduce the stock price for companies in the IPO pipeline. Events and market conditions can even jeopardize the ability to complete the IPO. Companies that started the IPO process in early 2020 ran into a worldwide pandemic and market plunge in March. That unforeseen event scuttled many deals for reasons having nothing to do with the company or its long-term prospects. I represented a tech company that was in the middle of its investor road show on September 11, 2001 resulting in an unexpected indefinite delay.

Clover Health, a provider of Medicare Advantage plans, was far into the traditional IPO process when it pivoted to a SPAC deal. Clover raised $1.2 billion in a late 2020 SPAC deal. It is uncertain how much it would have
raised had it stayed on the IPO path (the Dow Jones sank six percent in October).

**What if the company is bigger than the SPAC?**

The price to acquire and fund a company may exceed the $300 million raised by the typical SPAC. Not to worry; there are ways to raise additional money to fund the deal. SPAC deals often involve private placements that raise equity funding from institutional investors and hedge funds. SPAC deals often include mezzanine borrowings. Private investment and mezzanine borrowing help leverage the SPAC's IPO cash to enable the acquisition of bigger companies.

**So is there a downside?**

There are pros and cons to every deal structure, including both underwritten IPOs and SPAC deals. SPACs offer speed and certainty. There are also risks. The SPAC shareholders might reject the deal. Or too many SPAC shareholders might elect to have their shares redeemed, hindering the ability to complete the deal. The compensation and equity received by the organizers of the SPAC must also be factored into a company's calculus. Plaintiffs attorneys have brought several lawsuits against SPACs and it remains to be seen how those lawsuits will play out. A company wanting to do a SPAC transaction must find a willing SPAC partner. Whether a SPAC is right for your company depends on your particular situation and objectives.

**Conclusion**

SPACs have taken the markets by storm and appear to be here to stay. SPACs are one more tool available to growing companies. If you are interested in learning more about SPACs, please contact Varnum's Venture Capital and Emerging Company team.