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SPAC FAQs

What is a SPAC?

A special purpose acquisition company (or blank check company), which is formed for the purpose of acquiring or merging with an operating business by a specific date, typically 24 to 30 months after the SPAC's IPO. SPACs have been in the news lately. From the beginning of 2020 to July 22, 2020, there have been 48 SPAC IPOs, raising almost $18 billion. By contrast, in 2016, less than $3 billion in total SPAC IPO proceeds were raised. Notable companies that have merged with or been acquired by SPACs (and hence are now publicly traded) include DraftKings and Virgin Galactic, to name a few.

How are SPACs structured?

A SPAC will raise money in the public markets via an IPO from institutional and retail investors. Typically, all of the cash raised in the IPO will be placed in a trust account. This cash will be released only upon a closing of the business combination or if no business combination is consummated by a specified date.

As an incentive to investors, SPACs typically offer units in their IPO, with each unit comprising one share of common stock and one warrant to purchase a share of common stock (though sometimes the warrants are exercisable for only one-half of a share or less). Some SPACs do not even offer warrants. Units are typically priced at $10.00 per unit and the warrant is usually priced "out of the money" with an exercise price greater than the per unit price offered in the IPO.

Some SPACs include a "crescent term" which is an antidilution adjustment to the warrant exercise price. This adjusts the warrant strike price if additional securities are issued below a certain threshold. The strike price is typically adjusted to 115% of the higher of (i) the market value or (ii) the price of the newly issued securities.

The units become separable after the IPO and if a business combination is consummated, the warrants become exercisable.

Each shareholder has the option to redeem its shares at the closing of the business combination for a pro rata portion of the cash held in the trust account. This provides some downside protection for investors in SPACs.

What is a Sponsor?

A sponsor will form the SPAC and lead the IPO process. A sponsor will typically purchase founder shares in the SPAC for nominal consideration, which will comprise about 20% of a SPAC's outstanding shares of its common stock following its IPO (this is the sponsor's "promote"). In order to fund the SPAC so that it can pay expenses, a sponsor will also acquire warrants at fair market value in a private placement that closes concurrently with the SPAC's IPO. These private warrants are virtually identical to the public warrants, which form a portion of the units. A SPAC may also be funded with PIPE investments.

What is the IPO process?

A SPAC will use Form S-1 in connection with its IPO, and the process will be similar as with any other company. A SPAC will typically qualify as an emerging growth company.

Because a SPAC will have no operations, the registration statement will extensively discuss the SPAC's structure, business strategy (and a discussion of the proposed industry focus, if any), and its management team. Note that the experience and network of the management team will likely be the SPAC's most valuable asset, so discussion of management should be thorough.

Of course, a SPAC cannot have a target at the time of the IPO. Otherwise, the name of the target would need to be disclosed. As a result, SPACs typically state in their registration statements that they do not have any identified targets.

A SPAC is unable to use a free writing prospectus in its IPO or in subsequent offerings within three years of completing a business transaction. A SPAC cannot use Form S-8 to register an equity incentive plan until 60 days after the consummation of the business combination.

In addition, most SPACs choose to list on the Nasdaq Capital Market, and these SPACs must also meet Nasdaq's listing requirements. These include requirements that (i) the initial business combination must be with one or more businesses having an aggregate fair market value of at least 80% of the value of the SPAC's trust account, (ii) a business combination must be completed within 36 months from the effective date of the SPAC's or an earlier deadline as specified in its registration statement, and (iii) if a shareholder vote on the business combination is not held for which the SPAC must file and furnish a proxy or information statement, the SPAC must provide all shareholders with the opportunity to redeem all their shares for cash equal to their pro rata share of the aggregate amount in the trust account. Solicitation of shareholder votes is done in compliance with Regulation 14A. The SEC will also comment on proxy statements. Financial information about the target must also comply with SEC rules, including Regulations 14A, S-K, and S-X. Because of the aforementioned 80% rule, a relatively small company would likely not be an attractive SPAC target. SPACs typically seek target companies with a value of 2 – 4 times the amount of the SPAC's IPO proceeds in order to limit the dilutive impact to the founder shares and warrants. In addition, the SEC has issued informal guidance that the proxy statement and tender offer materials should contain financial statements audited under PCAOB rules, which further makes smaller companies unattractive SPAC targets.

What is the timeline to complete a business combination?

Commencing with the closing of the IPO, a SPAC can hold substantive discussions with a target. If a SPAC needs more time than is set forth in its organizational documents, it can seek a shareholder vote to amend its organizational documents to extend the deadline. With each vote to extend the deadline, the SPAC's organizational documents typically also provide that the SPAC must offer shareholders the right to redeem their shares for a pro rata portion of the cash held in the trust account. Typically, it takes around 4 – 5 months from the signing of the definitive documents to closing. From the closing of the SPAC's IPO to the closing of the business combination, the average time frame is approximately 16 months.

What are the benefits of SPACs?

From the sponsor's perspective, raising money in the public markets may be easier than the private markets. The sponsor will also enjoy an outright ownership interest in the post-combination company via its founder shares and warrants.

From a target's perspective, the prestige of being a public company (without going through a traditional IPO process, which includes pricing and market risks) can often be attractive. In addition, the target's owners may also have an opportunity to retain a significant (sometimes controlling) stake in the post-combination company and the target's management team may also continue in their roles in the post-combination company. Given the current popularity of SPACs, there is also potential for valuations to grow for strong SPAC targets.

From a public investor's perspective, there is an opportunity to invest in a company which is led by experienced investment professionals. In addition to any potential increases in the SPAC's stock price, there is also further upside potential with the warrants. Investors also have downside protection because shareholders have the option to have their shares redeemed for a pro rata portion of the trust.

Are SPACs here to stay?

As with everything, time will tell. SPACs are certainly hot right now. Notable non-M&A figures such as former Speaker of the House Paul Ryan and baseball executive Billy Beane are getting in on the action, which may be a sign that SPACs are too popular. SPACs will certainly continue to grow in the next few years. But if you start seeing Instagram ads on how to form your own SPAC, that may be a sign that the boom is on its way out.

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