what is a SPAC?

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A special purpose acquisition company (SPAC) is a “blank check” shell corporation designed to take companies public without going through the traditional IPO process.

Though SPACs have been around for decades, the financial maneuver has gained traction in recent months as more private companies eye exit opportunities and as the Covid-19 pandemic creates uncertainty in the IPO market.

What Is A SPAC? Special Purpose Acquisition Corps

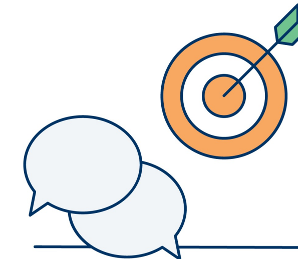
1. Emma wants to form a SPAC.

2. She launches EmCorp, files to go public, and goes on a roadshow to find investors.

3. Investors buy EmCorp units for $10 each.

4. EmCorp SPAC goes public on the NYSE, and Emma keeps 20% of the shares.

5. Emma searches for a target company to acquire.



6. EmCorp decides on a company, StartupCo, and negotiates the acquisition terms.

7. Shareholders vote and agree to buy the company.

8. EmCorp buys the company with money from its IPO and additional funding from new investors.

9. StartupCo merges with EmCorp and officially trades on the NYSE.

How Does a SPAC Work?

LISTED SPAC

Blind pool of cash raised by financial sponsor through IPO to acquire a private operating company

TARGET COMPANY

Fully operating private company

LISTED 'SUCCESSOR' COMPANY

Value generation through highly incentivized management structure

Step 1 - GOING PUBLIC

The sponsor — typically a person or team with significant business experience — decides to launch a SPAC. They create a holding company, then complete the normal filings associated with going public — but because the company doesn't do anything (i.e. it has no operational business), the filing process is fast and easy.

The sponsor then goes on a roadshow, to try to find interested investors. The difference here is that they are selling themselves, their team, and their experience, rather than a specific company. Once the sponsor has attracted enough interest, they sell units in the company. The money raised from the IPO is put into a blind trust, and is untouchable until the shareholders approve the acquisition transaction.

The SPAC goes public and trades on an exchange like any other publicly traded company. This is where retail investors get involved — they can purchase shares on the open market, but the future acquisition is still unknown. Instead, these investors are buying on the strength of the sponsor or the promise of a strong future acquisition. The sponsor also receives 20% of the shares of the SPAC as a fee, called a “promote” or “founders shares.”

Step 2 - ACQUIRING A COMPANY

- Once the SPAC is public, the sponsors can begin the hunt for a target company to acquire. There are no restrictions on the type of company a SPAC can acquire, though many will highlight a target industry before IPO. Typically, the sponsors have 2 years to find and announce an acquisition, or else the SPAC will dissolve and shareholders will get their money back. When the sponsors find a company, they then negotiate the terms of the acquisition with the target company, like purchase price or company valuation. Following a deal, the “de-SPAC” process begins.

Step 3 - DE-SPAC

After deciding on the terms of the acquisition, the sponsors must propose the acquisition target to shareholders. The initial shareholders have the opportunity to vote on the acquisition, which gives them some recourse if a sponsor chooses a company they do not like. Even if the acquisition is approved, shareholders can then redeem their shares for their money back.

Once the company is approved and all redemptions have been completed, the sponsor can move forward with acquiring the target company.

However, the initial SPAC raise usually only covers about 25-35% of the purchase price. Here, the sponsors can ask existing institutional investors (like large funds or private equity firms) or new outside investors for additional money using a Private Investment in Public Equity (PIPE) transaction.

Why A SPAC?

BENEFITS FOR COMPANIES:

Certainty

Unlike traditional IPOs, companies can negotiate the terms of their public offering, giving employees and shareholders more certainty.

Speed

The SPAC merger process can take 3–4 months, much shorter than the 24–36 months in a traditional IPO.

Strategic partnership

Some SPACs offer experienced leadership teams that a company could use for guidance after going public.

BENEFITS FOR INVESTORS:

Retail investor involvement

Retail investors can't access traditional IPOs – this structure allows them to get a piece of the pie, with some restrictions.

Redemption options

If the sponsor can't find a target company in 2 years or if investors are unhappy with the chosen acquisition, initial shareholders can redeem their shares for their money back.

Additional profit opportunities

Institutional investors can invest in the initial SPAC and purchase additional shares after the acquisition through warrants.

BENEFITS FOR SPONSORS:

Easy access to capital

The SPAC IPO process is relatively simple, as the shell company faces fewer regulatory hurdles than traditional IPOs. This makes this route potentially easier than, say, raising a new VC fund.

Significant upside

Sponsors typically receive 20% of SPAC shares post-IPO, which can lead to millions of dollars in gains even if the target company shares drop after the merger.

Invest in late-stage companies

The SPAC merger allows sponsors to invest in later-stage private companies and potentially help to drive strategy post-IPO.

The future of the IPO is not in jeopardy

Many high-profile companies that are looking to go public in the coming years are rejecting the SPAC option, opting instead to go public the traditional way. For example, Airbnb was reportedly approached by Bill Ackman's $4B SPAC, but the company ultimately decided against this route, instead filing a traditional IPO for December 2020.

It is still more expensive to go public via SPAC, and once the current market volatility dies down, there will be far less incentive to pay that higher price to reduce the uncertainty of a traditional IPO.

As for the SPAC merger, it's likely here to stay, though probably not in its current form. Today, sponsors are the big winners of the SPAC boom. However, as SPACs get more popular, sponsors also have more competition for deals, which could force sponsors to be more company-friendly to entice potential acquisition targets.

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