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SPACs are Back – A Review of Options for Private Equity Firms

Interest in special purpose acquisition companies (or SPACs) has exploded in the last couple of years. Despite their sometimes being seen as a fad, rather than a mainstay, investment option, recent changes in market landscape and maturation of the SPAC structure may be changing this perception and give the trend a longer runway than before. In this article, we discuss the pros and cons of some alternatives for private equity firms looking to participate in this market.

Overview

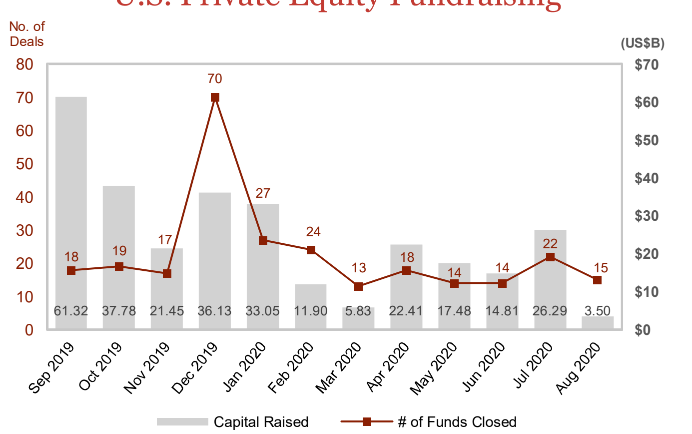
SPACs are companies formed to acquire one or more unspecified businesses or assets, using proceeds from an initial public offering and sometimes concurrent private placement of warrants or units. SPACs will go through the typical IPO process of filing a registration statement with the U.S. Securities and Exchange Commission; however, after the IPO, SPACs pursue an acquisition opportunity with proceeds from the IPO being held in trust until needed to fund the business combination. Following the announcement of the signing of a definitive agreement, the SPAC will seek approval of its shareholders, including offering investors the right to return their shares in the SPAC in exchange for roughly the amount of the IPO price paid. If the business combination is approved by shareholders (and any other necessary parties, such as external financing sources), the business combination will be consummated and the SPAC and target combine into one publicly traded, operating company.

Recent surge in SPAC popularity

SPACs have surged in popularity in recent years despite past debate over some of their records on governance, deal completion and returns. From 2015 to 2019, the number of SPAC IPOs grew from 20 to 59, and the average SPAC IPO gross proceeds grew from $180.6 million to $204.9 million.[1] In 2020, 109 SPACs have raised approximately $38 billion, representing approximately 44% of all dollars raised in the 2020 IPO market.[2] Further, reports indicate that 2020 has also seen several SPAC milestones, including the largest SPAC ever (Pershing Square Tontine Holdings; $4 billion), the largest announced SPAC merger (United Wholesale Mortgage and Gores Holdings IV Inc.; $16 billion), and the best first-day pop for a SPAC (Therapeutics Acquisition; 20%).

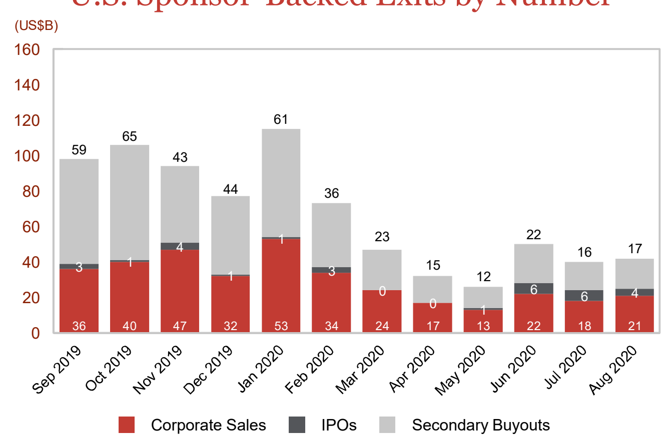
What's driving this surge in popularity? While the causes are varied, current market conditions and the maturation of SPAC structures and experience feature large. For one, SPACs have recently gained additional legitimacy due to launches by larger, notable firms, the involvement of well-known industry players and agreements of several high profile firms to be acquired by SPACs.

U.S. Private Equity Fundraising



Source: Pitchbook

U.S. Sponsor-Backed Exits by Number

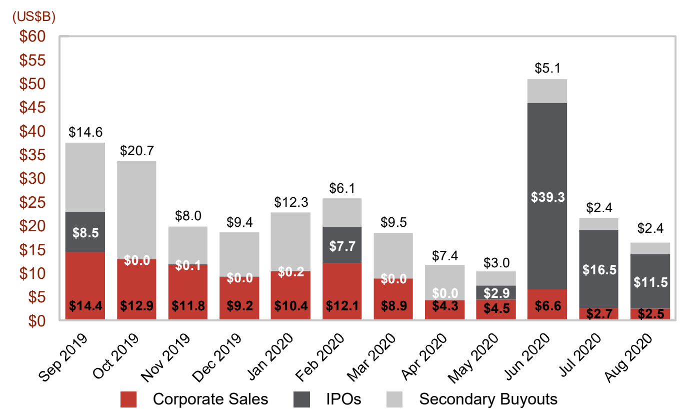


Source: Pitchbook

Another factor that may be contributing to the surge in popularity is the current market landscape, including the presence of high valuations and record low yields on debt. In these circumstances, SPACs are attractive for yield-focused investors, since the money SPACs raise in an IPO is placed in an interest-bearing trust account. Further, in addition to the upside potential from receiving a SPAC share and/or warrant and sharing in the gains if a business combination is consummated and successful, investment in a SPAC is a relatively low risk investment, since SPAC managers must return the money if they do not find a deal or if the investors do not approve the planned business combination.

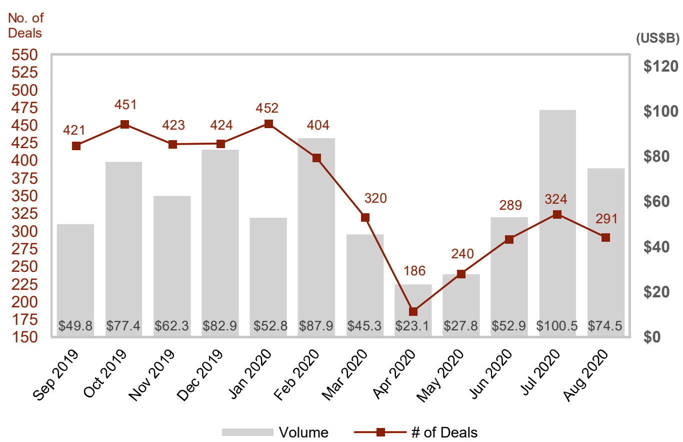
SPACs also provide access to the benefits of an IPO, such as obtaining access to public equity markets, while providing the flexibility of a traditional M&A deal, since financial terms of a SPAC are negotiated in private and finalized before a deal is announced. Access to public equity through a SPAC IPO is not only quicker, but also may be preferable with the potential for volatility in the IPO market come pricing time. While companies may still be required to conduct a roadshow to win approval for the ultimate transaction, with a SPAC deal, the target company would have the assistance, support and expertise of the SPAC managers and additional assurance that funds to complete the acquisition are in hand.

U.S. Sponsor-Backed Exits by Dollar Volume



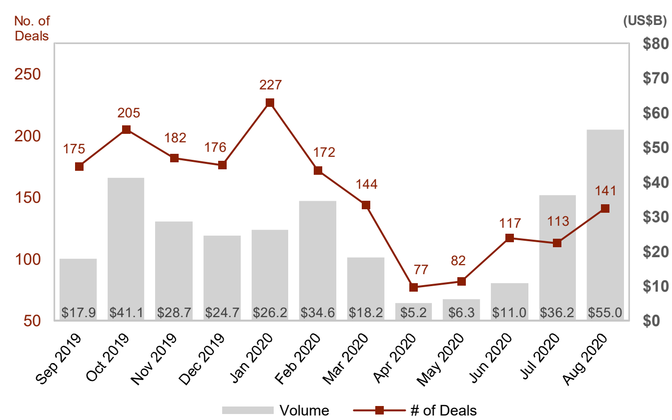
Source: Pitchbook

Global Sponsor-Related M&A Activity



Source: Cortex

U.S. Sponsor-Related M&A Activity



Source: Cortex

Each metric in this publication that references deal volume by dollar value is calculated from the subset of the total number of deals that includes a disclosed deal value.

Options for private equity sponsors interested in participating in the SPAC market

Private equity sponsors who would like to participate in the SPAC market have a number of alternatives available. We discuss below the pros and cons of the following possible avenues: (1) sponsoring its own SPAC, (2) partnering with another sponsor, (3) participating in a forward purchase agreement, (4) providing an anchor order in a SPAC IPO and (5) participating in a PIPE on the SPAC backend.

Options	Pros	Cons
Sponsoring its own SPAC	• Opportunity to make decisions and pursue acquisitions appropriate for the particular PE sponsor • Flexibility to choose the SPAC management team • Ability to sponsor multiple SPACs over time, each focusing on different sector verticals or other objectives • If SPAC is organized outside of (rather than as a subsidiary of) the PE sponsor's fund(s), more flexibility for PE sponsor to retain economics and maximize fee income	• Substantial resource and time commitment • Contribution of 100% of risk capital • Potential conflicts with PE sponsor's other funds with respect to, among other things, allocation of investment opportunities, "key person" time commitments, affiliate transactions and fiduciary duties
Partnering with another sponsor	• Reduce capital outlay as partners share in the investment of up-front risk capital • Possibility of leveraging the partner sponsor relationship for their relative expertise in addition to their financial support • Involvement of multiple PE sponsors may in and of itself help validate investment thesis of SPAC to public market	• May limit control over SPAC management and ultimate outcome • Adds deal complexities inherent in partner relationships
Participating in a forward purchase agreement at SPAC IPO (*i.e.*, committing to subscribe for common stock upon business combination consummation, subject to certain conditions)	• PE sponsor participation may enhance momentum for the IPO as it provides third-party validation of SPAC thesis and management team • No up-front capital outlay while still providing PE sponsor with opportunity to share in economics associated with the forward purchase agreement and partner with a credible sponsor team • Can be structured with contingencies (*e.g.*, final investment subject to PE sponsor approvals)	• Capital commitment prior to knowledge of specific acquisition • FPA size determined prior to knowledge of precise funding requirement of business combination • Limited control over SPAC management and outcome
Providing an anchor order in a SPAC IPO	• PE sponsor participation may enhance momentum for IPO as it provides third-party validation of SPAC thesis and management team • Structure provides simplicity; existing structure of SPAC/acquisition is not affected • PE sponsor retains full redemption/voting rights associated with anchor investment • Allows PE sponsor to partner with a credible sponsor team with potentially smaller capital outlay relative to sponsoring own SPAC vehicle	• No incremental economics associated with anchor investment; the investment is on the same terms provided to public investors • No ability to structure contingencies or other special terms • Limited control over SPAC management and outcome
Participating in a PIPE on SPAC backend	• Provide capital commitment with more certainty, since business combination terms and size of capital requirement are known • Avoids potentially over-raising capital at the outset • Potentially more favorable terms relative to FPA • Substantial structuring flexibility	• Execution risk at time of business combination • Firm capital commitment (no redemption right) • Illiquidity risk until PIPE shares are registered

[1] Source: Deal Point Data as of September 23, 2020

[2] Source: Deal Point Data as of September 23, 2020

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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