SPACs – A Primer (Part III)

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In the spirit of the season, workers unwrapping the Christmas tree at NYC's Rockefeller Center last month found a little present. The 75-foot high Norway spruce trucked from Oneanta, NY was sheltering what appeared to be a baby owl.

The unusual stowaway turned out to be an adult northern sawhet, one of the smallest species. None the worse for wear from its journey, "Rocky" had hidden among the branches until it was discovered and rescued. No word whether this feathered tourist planned other holiday stops.

Another feature of year-end festivities is the upsurge of SPAC announcements and closings. As we've covered in our special series, blank-check companies are taking share from regular-way IPOs. As "IPOs about nothing" (as one Barron's piece called them), it's not until an acquisition is made does the cash get deployed.

With many SPACs launching, there will be plenty of appetite for deals. "There's been a significant surge of activity on the front end," one attorney specializing in SPACs commented, "so there needs to be an increase in [merger] activity."

No surprise, then, SPAC structures and how they differ from other IPOs are coming under greater scrutiny. "Every facet of SPACs is bespoke," an observer noted.

Yet there are some constants. The process is streamlined – there is one investor for selling founders to deal with. This eases negotiations on issues such as valuations. Also there are no roadshows – an attractive benefit in this pandemic year.

Because SPACs are already public, borrower financial forecasts are allowed. Also, investors mainly piggyback off the sponsor's due diligence, not just the investment bank's.

There's also less reliance on regulatory oversight, though S-4 documents sponsors' file with the SEC when identifying target businesses do have similar disclosures to S-1s.

Investment banking fees (5-6%) paid for SPACs are in the same range as regular-way IPOs (5-7%). However, much attention has been paid to the "promote," i.e. allocating 20% of the stock to the deal sponsor, often at a significant discount.

This practice has drawn criticism from some quarters as disadvantaging the retail public. On the other hand, sponsors take the initial risk, finance start-up costs, uncover investment opportunities, and perform significant due diligence.

Nevertheless, more transactions are tying promotes to longer-term stock performance.

Finding the right target is anything but assured. A fair number of SPACs historically run up against their two-year deadlines, and are forced to unwind. While investors get cash back, it's not the present they hope to find under their tree.