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2020 was a transformative year for the SPAC market — Where does it go from here ?

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2020 in review

The special purpose acquisition company (SPAC) market in the United States had a transformative and unprecedented year in 2020. More than $83 billion was raised in 248 initial public offerings SPACs, more than all other years combined. The SPAC IPO market accounted for over half of all IPO's in the U.S. in 2020.

The league tables for SPAC IPO's last year were dominated by Wall Street's bulge bracket banks, led by Credit Suisse, Citigroup, and Goldman Sachs, in that order. Other investment banks that were very active underwriting SPAC IPO's last year included Jeffries, UBS, Morgan Stanley, Deutsche Bank, JP Morgan, and BofA Securities.

Driving the SPAC IPO market in 2020 was the acceptance by the private equity community that SPAC capital is a legitimate alternative for their deal-making activities. Private equity firms that raised SPAC capital last year include Apollo, TPG, CC Capital, Neuberger Berman, RedBird Capital, and the Gores Group. Pershing Square made headlines by raising $4 billion with a SPAC IPO in 2020, the largest SPAC to date. Most SPAC's raised $100 million to $500 million in their IPOs.

There is now over $90 billion sitting in SPAC trust accounts that needs to be spent in 2021 and 2022, primarily in the information technology, health care, and consumer discretionary industries. Given that a typical SPAC merges with a business that is three to five times its size, that means there is a potential for $270 billion to $450 billion in merger activity for the next few years.

What is a SPAC, and why have private equity firms embraced them?

The SPAC has been around for many years, known as "blank check companies." Sponsors have used them to raise capital in a quick IPO based on the strength of a high-profile and well-regarded management team in a particular industry. SPACs have been used to raise capital to buy cannabis businesses, sports teams, electric vehicle manufacturers, education companies, fintech businesses, biotech and health care companies, as well as oil and gas, packaging, and manufacturing businesses.

Proceeds from a SPAC IPO are placed into a trust account and must be used to buy a business, by way of a reverse merger, generally within two years (the SPAC trust can only invest in safe, interest-bearing instruments). If the shareholders of a SPAC do not approve of the proposed merger, or the SPAC term expires, then the IPO capital must be handed back to the investors. Initial investors in a SPAC are typically issued warrants to incentivize them to subscribe for IPO shares and to vote in favor of the proposed merger. Sponsors of a SPAC are issued founders' shares, typically equal to 20% of the value of the SPAC, which stake-holding becomes diluted post-merger.

Private equity firms have discovered that the SPAC market is a quick way to raise capital, or "assets under management," from a new class of retail investors, with generous private equity-like economics. "At-risk capital" is limited to filing fees, fees for attorneys and accountants, as well as half the underwriting commissions for the SPAC IPO—the other half of those commissions are typically paid if and when the SPAC consummates a successful merger. A SPAC is a much quicker way to go public than a traditional IPO, providing more deal and pricing certainty in a volatile capital market.

The SPAC IPO market in 2020 has undoubtedly benefitted from robust activity in the stock markets, generally, with Wall Street exchanges reaching historic highs in 2020. The pandemic may also have lifted the SPAC IPO market, as a blank check company is a shell with no need to conduct an extensive in-person road show. It has been an easy way for private equity firms and other sponsors to reach new investors during the pandemic.

The SPAC market is being institutionalized

Until the last few years, and 2020 in particular, many investors and sponsors viewed SPACs with skepticism. In years past, hedge funds and other big institutional traders would buy shares with warrants in a SPAC IPO as a safe arbitrage play. The hedge fund would be able to place capital into a safe SPAC trust account for a few years, ultimately voting down the proposed merger to get its capital back, but keep the warrants in the event the merger succeeds. This arbitrage frustrated the attempts of many serious SPAC sponsors and management teams to merge and caused them to redeem their shares, or "de-SPAC," leaving the SPAC IPO market to languish for many years.

Over the last few years, however, structuring techniques have been employed by SPACs to defeat the hedge fund arbitrage play, including adopting restrictions on the percentage of shares that may be redeemed from a stockholder or group (called "Bulldog provisions") or increasing shareholder voting thresholds, limiting the ability of hedge fund players to vote down a proposed merger. Another technique now in vogue is the use of a PIPE (a private investment in a public equity) with a friendly investor just prior to the merger to secure the requisite votes needed to de-SPAC. A PIPE is used by a SPAC to consummate a private placement to investors that promise to vote in favor of its proposed merger.

Additionally, as the SPAC investor class has grown, underwriters now have a far wider universe of investors and do not need to offer SPAC shares and warrants to hedge funds with reputations for voting down SPAC mergers.

The on-going evolution of SPAC structures, the growing percentage of SPACs that have successfully consummated their mergers, and the broadening investor class interested in SPACs have led to the growing institutionalization of SPAC capital as a legitimate source of capital on Wall Street.

Going forward: SPAC trends

Aside from the embrace of SPACs by the private equity community and their institutionalization on Wall Street as an alternative source of capital, below are some of the other important SPAC trends shaping the market going forward.

SPAC capital for M&A activity

2021 will see an increased acceptance by private companies and businesses that merging into a SPAC is a legitimate way to go public. Given that there is over $90 billion sitting in SPAC trust accounts, it is now incumbent on the boards of public companies to explore whether merging with a SPAC is a way to grow. These boards should be discussing the SPAC alternative with their legal and financial advisors. Over the last few years, a cottage industry of SPAC industry reporting has grown, some of which provide excellent surveys of all SPACs that have been launched, descriptions of their management teams, and summaries of the industries that they are looking to merge into. All these facts also happen to be matters of public record, as there are summary descriptions of these items in the registration statements each SPAC has to file with the Securities and Exchange Commission.

Private equity firms are not the only ones using SPACs

It's not just private equity firms that are launching SPACs. Family wealth offices, management teams, foreign private equity firms, and high profile investors are launching SPACs on U.S. stock exchanges. Some of these groups are teaming with underwriting firms and private equity firms to co-sponsor a SPAC launch and share the "at-risk capital." The U.S. SPAC IPO market promises a unique and unprecedented way to raise significant capital based on brand and reputation alone. While it remains to be seen whether foreign exchanges, like the Toronto Stock Exchange and the London Stock Exchange, will experience anything like the U.S. SPAC market going forward, there are no prohibitions on sponsors from those countries launching their own U.S. SPACs for deals in the U.S. and elsewhere.

Foreign companies are using SPACs to go public in the U.S.

Foreign companies and businesses have been using SPAC's listed on U.S. stock exchanges to go public in the United States. Businesses based in Europe, Canada, India, Singapore, and China have used a SPAC merger to go public in the U.S. Foreign companies are attracted to the ability to partner with a reputable U.S. private equity firm and/or the well-known American management of a SPAC as they go public in the United States. A traditional IPO on a U.S. exchange by a foreign company can often leave that company "stranded" on that exchange, with no profile in the U.S. and no secondary market trading or liquidity—this can limit a foreign company's ability to raise additional capital in the U.S. There are now numerous SPACs that have been launched and listed on the Nasdaq and the NYSE dedicated to merging with a Chinese, Indian, and other foreign business.

Conclusion

While it's true that the SPAC IPO market is benefitting from the general, historic upswing in the U.S. stock markets, it is equally true that the SPAC IPO market could fall with those stock markets. No one can tell whether there is a significant market correction coming. Still, a SPAC IPO generally takes half the time of a traditional IPO (three months vs. six months), allowing a SPAC sponsor to better time these uncertain capital markets.

Perhaps 2021 will see as many SPAC IPO's as 2020. Perhaps not. In either event, there is still over $90 billion currently sitting in SPAC trust accounts dedicated to being spent on merger partners within the next two years.

Whether you are considering raising SPAC money or thinking of merging with a SPAC, we can advise on all aspects. Launching a SPAC needs an understanding of current market terms and conditions, and those terms and conditions are evolving quickly. Similarly, merging with a SPAC requires sophisticated tax, M&A, and securities law advice, especially if it is a foreign business merging with a U.S. SPAC. We have a team of lawyers at Nixon Peabody with this expertise who would be pleased to assist your SPAC ambitions.

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