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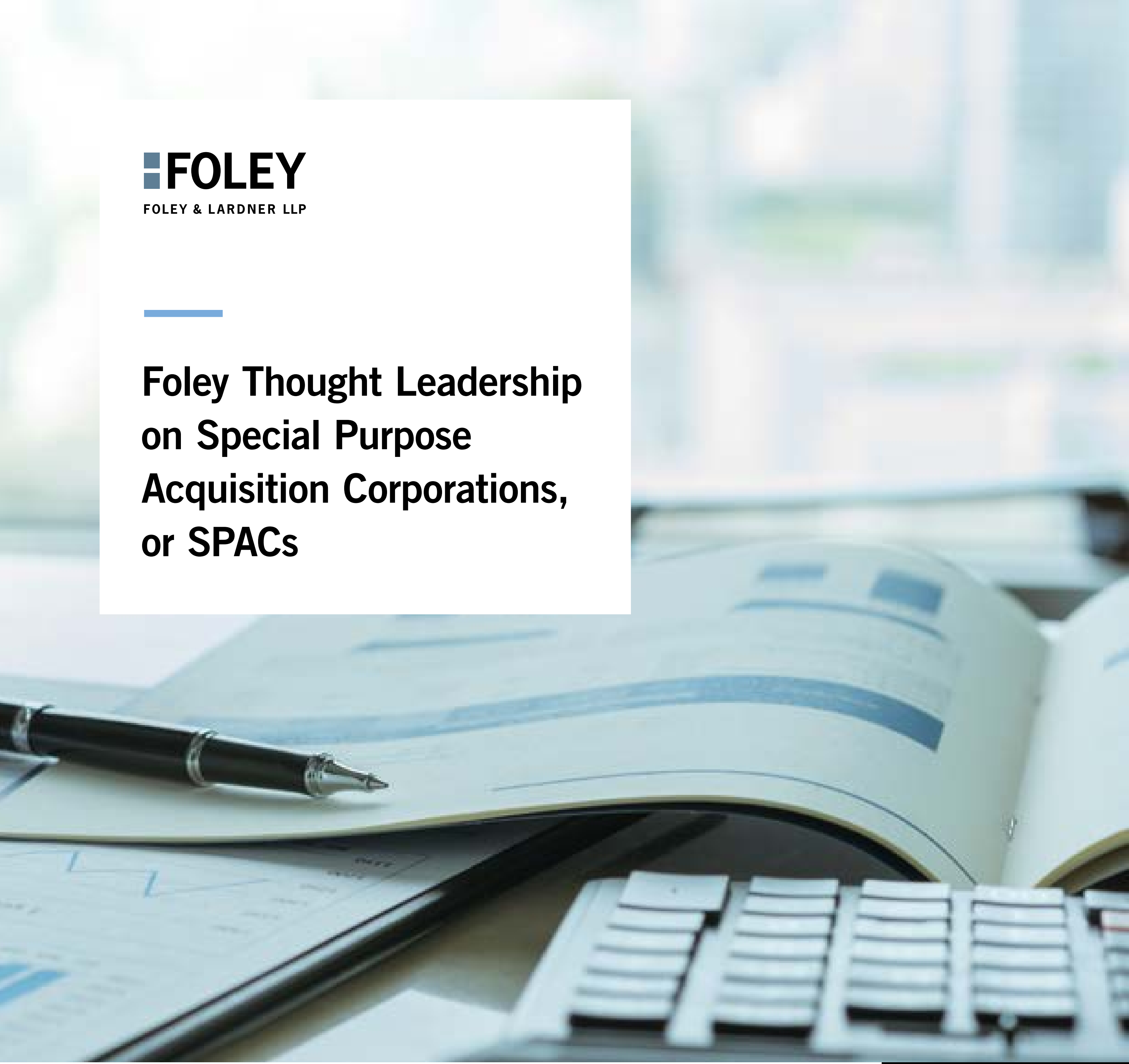
Foley Thought Leadership on Special Purpose Acquisition Corporations, or SPACs



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The SPAC Slowdown: What You Need to Know

AUTHOR

Louis Lehot | llehot.foley.com

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Delisting

Special-purpose acquisition companies (SPACs), organizations that raise funds in the public markets for the purpose of acquiring a private company and taking it public, had their heyday during the COVID-19 pandemic. In 2020, 248 companies went public through mergers with SPACs, exceeding the number of such deals in the past ten years combined, according to SPAC Data.

While the craze continued through the first quarter of 2021, issuance ground to a stunning halt in April. SPAC Research reports a nearly 90 percent drop in SPAC merger filings from March 2021 to April 2021. The overall market value of SPAC mergers has fallen as well; CNBC's SPAC Post Deal Index, which is comprised of the largest SPACs within the last two years, has fallen more than 20 percent year-to-date. The plaintiffs' bar has found SPACs, and have announced a plethora of stock-drop investigations and class-action lawsuits.

Now that it seems the SPAC bubble has burst, what's next?

These are five things to keep in mind as we watch the market for what's to come.

Market response is crucial

The SPAC slowdown is part of a market response to over issuance, soaring prices and a pending regulatory crackdown ahead of the bubble bursting.

In April 2021, the Securities and Exchange Commission (SEC) issued accounting guidance changing longstanding interpretation that SPAC warrants should no longer be classified as equity, and henceforth as liabilities. Warrants give investors a right to purchase a company's shares in the future at a specified price; when these prices rise, investors can profit quickly by exercising these warrants.

To clear a pending transaction with the SEC, SPACs have had to go back and restate their financial results to properly account for warrants, slowing down the de-SPAC process.

Concurrently, the SEC announced that warrant redemptions negotiated as part of the de-SPAC process needed to comply with the tender offer rules, further slowing down the process.

Looking to the future, however, the SEC has prepared the market for what will be the most fundamental change that de-SPAC transactions get marketed to investors. Reuters reported that the SEC is preparing interpretive guidance to close the safe harbor for forward-looking projections in de-SPAC transactions under the Private Securities Litigation Reform Act. It is this safe harbor that made a de-SPAC transaction a much more attractive path to fundraising and public listing than a traditional initial public offerings for pre-revenue and early stage technology companies. Whereas PSLRA's safe harbor is not available for initial public offerings, the SEC has allowed, and even required, that SPACs disclose forward-looking projections in marketing documents to stockholders considering de-SPAC transactions. Going forward, according to Reuters, the SEC will interpret de-SPAC transactions like IPOs and close off reliance on the safe harbor, effectively limiting the marketing of these transactions.

Don't panic

To the naked eye, this stark shift in trends, numbers and regulations could easily seem like cause for alarm. However, not only is this to be expected, it is actually indicative of healthy market growth. While it's important to keep an eye on the market, it's too soon to tell if this drop portends a long-term pullback, though there are several factors at play that could do so in the coming months.

Additionally, remember that there are other contributing factors that can impact the market above and beyond the SEC's guidance. For example, the flurry of activity in Q1 may have been the last remnants of pent-up demand from 2020.

The announcement of proposals to significantly increase capital-gains and other taxes could also be encouraging the sudden pullback. As Congress marches down the road to compromise, the increases will not likely be as large as those initially proposed, the markets will price them in, and countervailing and mitigating measures will be introduced and implemented.

Prepare for a change of pace

The complexity associated with the new SEC accounting guidelines means that SPACs will need to be more meticulous with their accounting and sharing of forward-looking information. Since mindful disclosure takes time, expect that high-quality SPACs will find ways to minimize warrant issuance, restrict redemption terms and avoid detailed projections. Additionally, it is highly likely that the market will find some sustainable level of SPAC IPO activity, since the numbers suggest the market was not just oversaturated, but that companies are still figuring out how best to use this new investment vehicle.

Bear opportunity costs in mind

A recent report by PitchBook on the SPAC market notes that they have benefited from interest rates approaching historic lows. These record-breaking lows have created an environment where the opportunity cost of locking money in SPACs is also low. This means investors are much more likely to risk their money in SPACs due to the possibility of better returns.

Don't worry about obsolescence

SPACs are still useful. A merger with a public SPAC will remain a reasonable alternative for a late stage private company ready to go public that wants to quickly capitalize on a market window. It is also a great option for a heavily capital intensive business going after a big disruptive opportunity that will require more than what venture capital or private equity can fund alone. Think rocket ships to outer space, air taxis, or green hydrogen pipelines criss-crossing the planet. As we look forward to find ways to finance the rollout of 5G wireless spectrum for consumers, or refinance highways, railways, airports and shipyards, SPACs may yet have a big roll to play.

SPACs offer flexibility in an industry that depends on it. In a market that has seen such explosive and impressive growth, investors may temporarily choose to turn away from SPACs for a time and focus on their existing investments. However, as long as SPACs can provide a viable path for companies to raise capital and go public, they have a seat at the table.

Financiers seem to agree that SPAC deals will continue to move forward, and that investors should be prepared to adjust in accordance with regulations and market pace. While it's impossible to predict the future of SPACs off of a single data point, it's important that investors and companies keep an eye on long-term trends. While this correction is a healthy move for the market, it's too soon to tell if this signals a long-term shift.

While legal constraints, regulatory restrictions and investor protections should tighten up as we approach the summer of 2021, do not expect the SEC to permanently shut down a viable path for the capital markets to fuel global growth.

SPACs v. IPOs

This article was originally published on Today's General Counsel on June 1, 2021.

AUTHOR

Louis Lehot | llehot.foley.com

One of the hottest investment trends in the past year is the rise of special purpose acquisition companies, commonly called SPACs. SPACs are shell companies that exist to raise capital to acquire other companies, which is why they are also known as "blank-check companies."

The concept is an old idea, dating back to at least the late 19th century, when Henry Villard sought to raise capital to buy the Northern Pacific Railroad without revealing the name of the target company. Modern-day SPACs have existed since the mid-1990s. Today, these investment vehicles have been used across industries, from a manufacturer of electric cars to an aerospace startup to a cryptocurrency mining company.

Although SPACs have been around for decades, they have seen explosive growth in the last few years. SPACInsider reports that the number of SPAC IPOs grew from one in 2009 to 34 in 2017. Two years later, there were 59, and interest exploded to 248 in 2020. This year is already on track to set a record.

The level of SPAC activity has accelerated to unprecedented levels in the M&A markets as well as in the IPO markets. According to Deal Point Data, the amount of capital pursuing "public-ready" private targets is 1.85 times larger than the total gross proceeds raised in traditional IPOs in all of 2020, and 298 times 2019's IPO proceeds.

How is a SPAC different? For the target company, a SPAC acquisition provides a means of separating the IPO from the company itself. Investors buy shares of the SPAC, not of the target company. After the merger, the shares of the SPAC effectively become shares of the original corporation.

This abstraction of the IPO from the underlying company explains the increasing popularity of SPACs.

"Easier access to liquidity and a faster transition to public trading make SPACs very attractive."

They provide a streamlined alternative to traditional IPOs. While a traditional IPO takes one to two years to complete, a SPAC merger can close in under six months. PwC notes that SPAC mergers can help the target companies gain liquidity without as much uncertainty in valuation, which is especially important when markets are volatile. Crunchbase notes that companies that would likely benefit from a SPAC acquisition over a traditional IPO are those that could launch a traditional IPO but want to accelerate their entrance into public markets in order to gain liquidity and capital.

The actual merger between the SPAC and the target company is called the de-SPAC transaction. This process functions similarly to regular mergers, but the SPAC's shareholders usually need to approve the acquisition before proceeding. And because investments in the SPAC are held in escrow, operating funds are not easy to access. The SPAC really is just a vehicle for investors to purchase the target. Once the merger is complete, the SPAC fades away while the shareholders gain their corresponding stakes in the target.

If you are considering taking your company public, a SPAC acquisition may be worth investigating. Easier access to liquidity and a faster transition to public trading make SPACs very attractive. SPAC mergers are not magical solutions, but they could be right for you.

Going public means having internal controls, disclosure controls and enterprise operating systems in place to satisfy stringent standards of the U.S. Securities and Exchange Commission and strong enough to withstand the plaintiffs' bar, which can be unforgiving in civil litigation, plus an ability to forecast revenues to satisfy Wall Street investors.

A SPAC is particularly well suited for a business that requires amounts of capital investment that exceed the ability of venture capital firms to fund them, and that is "public ready." It's also well suited for a well-prepared private company looking to go public quicker and cheaper than the traditional IPO. But it's not for everyone, especially retail investors who are less well positioned to evaluate the probability of forward-looking estimates of future revenue, and not able to withstand a significant reduction in value.

Whether with a SPAC or an IPO, the year 2020 marked the reversal of the multi-year trend of more companies deciding to go private rather than public.

Are SPACs Dying Off? a Few Points to Consider About the Future of SPACs

AUTHOR

Louis Lehot | llehot.foley.com

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SPACs have had a fantastic run in the last year through the end of Q1 2021, rising from a total IPO count [1] of 59 in 2019 to 248 in 2020 and a whopping 311 in just the first quarter of 2021. Yes, the number of SPAC IPOs in the first quarter of this year exceeded the total of all of 2020. But the number of new IPOs dropped sharply in April.

SPACInsider lists 85 SPAC IPOs in January, 96 in February, 109 in March, but only 13 in April. While the SPAC market had been growing by 13% per month in the first quarter, April's total showed a drop of 88% compared to March's.

"SPACInsider lists 85 SPAC IPOs in January, 96 in February, 109 in March, but only 13 in April."

The drop in April was stark, but the real question is whether the drop portends a long-term pullback. We can't extrapolate a trend from a single data point, so any guess will simply remain that: a guess, at least until we have a few more months of data. Anticipating the trend will require first identifying some important market factors and regulatory hurdles.

One important point is that a correction is a healthy move for the market. Double-digit growth month over month is almost certainly not sustainable long-term, so a pullback is not just expected but also indicative of a healthy market.

PitchBook recently released a new report [2] on the SPAC market and noted that current interest rates near historic lows have created an environment in which the opportunity cost of locking money in SPACs is very low, so investors are much more likely to risk their money in SPACs because the returns can be so much better than investments that rely on interest rates.

Certainly, other contributing factors also affect the market. For example, the flurry of activity in Q1 may be the last vestiges of the pent-up demand from last year. However, the possibility of a sharp increase in capital-gains taxes could be encouraging the sudden pullback.

Regulators have raised concerns about whether SPAC mergers — whereby a shell takes a target company public — bypass investor protections in traditional IPOs. Some market participants say legislative attention could prod regulators to move faster, regardless of whether bills get enacted.

PitchBook also noted that the SEC is rumored to be considering a rule change regarding SPACs:

The main issue seems to be that the changes in the warrants' fair market value would now flow through as accounting earnings for the SPAC, complicating

the once-simple SPAC financial statements. This adjustment may disincentivize the inclusion of warrants in new SPAC IPOs which, as noted earlier, are a critical benefit to the SPAC IPO investors.

The big difference between a SPAC IPO and a traditional IPO [3] is that a traditional IPO is selling based on three years of trailing revenues, whereas a SPAC is selling on three years of future revenue. The playing field is not level. Pending Congressional or SEC action could change that.

Some wonder whether a SPAC is a useful vehicle to advance technology innovation. SPACs offer simplicity and efficiency in an industry that simultaneously depends on both while also struggling with regulations at odds with them. But in a market that has seen such explosive growth, investors may choose to focus on their existing investments for now, rather than pursuing new ones.

"Long-term, the market will find some sustainable level of SPAC IPO activity."

Long-term, the market will find some sustainable level of SPAC IPO activity. Increasing by 13% per month only to drop by 88% the next month perhaps suggests that the market was not just oversaturated but that companies are still figuring out how best to use this investment vehicle that, while 30+ years old, has only recently gained widespread market acceptance. As long as SPACs can provide some measure of simplicity to companies going public, they will likely remain popular.

Keep an eye out for any Congressional action, legislation or proposed rulemaking from the SEC, and see what effects any rise in interest rates or tax changes will have on SPACs, while also looking for any waning in investor SPAC fatigue.

1. https://bit.ly/2SSY817
2. https://bit.ly/3fmtc12
3. https://bit.ly/3fkKjjE

专访硅谷律师Louis Lehot：SEC后续监管或取消“避风港”，将增加与SPAC合并上市风险

> 我相信证监会将取消“避风港”，这样一来，目标公司根据3年预测来出售自己就变得风险更大

SPAC去年至今在美国金融市场大火，而美国监管部门近期接连发布相关的提示或声明。为何美国证券交易委员会（SEC）今年上半年接连出台关于SPAC的声明？背后是什么原因？21世纪经济报道记者就此采访了硅谷的律师**Louis Lehot**。

Louis Lehot 是 **Foley & Lardner** 律师事务所的合伙人和商业律师。业务领域涉及私募股权和风险投资、并购和交易业务以及科技、医疗保健、生命科学和能源行业。其从事律师业务超过20年。

对两类企业de-SPAC是一个很好且有利的工具

21世纪： 无论是去年还是今年，SPAC在金融市场大火。根据您的观察，通过SPAC合并上市，会在科技行业中尤其受到某类企业的期待吗？

Louis Lehot: 通过SPAC上市的“空壳公司”(blank check company)，最终找到“目标公司”(target company)，双方实现合并的过程，通常叫de-SPAC。de-SPAC 对于两类企业来说，是一个很好而且有利的工具。

第一类情景是现在想迅速上市的企业，因为比传统的IPO更快，所需时间很短。第二种情况是，一个公司未来需要大量的资本，比风险资本能提供的（资本）更多，并且在3年后有很好的前景，但目前没有收入，期待可能3年后才会有收入。除非它是一家生命科学公司，有明确的路线图，并在今年取得了明显的成功，否则就不是传统上市市场（IPO）上的最佳候选者。这类（希望走SPAC合并上市的）公司是可以根据对3年后的收入预期，让市场判断。

我们已经看到许多行业做了许多成功交易。因此，我不认为有一个行业重点，只要符合上述两类，都是可以选择的。

AUTHOR

Special Correspondent Fang Shanshan,
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SPAC交易市场会放缓

21世纪： 怎么看待SEC最近出台的各类声明？例如要求企业对财务报表的重述 (restatement financial)

Louis Lehot: 这需要分开来看。SPAC 是可以对投资者声明目标收购公司3年后的收入预期，从而让投资者判断是否参与。但是，传统IPO是不允许这样做的。这无形中是一个避风港 (safe harbor)，让这些公司可以对外表示，投资者根据这家公司3年后的收入来判断是否今天要参与。这也是为什么会受到某些企业的欢迎，例如电动汽车、自动驾驶、氢气车等企业，因为他们可能离产生收入还有3年的时间。

当任何公司要在美国上市时，美国证券交易委员会（SEC）会审查公司的财务情况。除非你是“新兴增长公司”(Emerging growth company,EGC)，在财务报告和披露要求有多项减免。但如果你是更大型的公司的话，你就需要提供更多的财务状况。

过去的几周，SEC说在审核SPAC与私人公司合并时，希望看到这些公司有更适当的认股权证核算 (a proper accounting warrants) 。认为认股权证必须以不同的方式进行核算，这一点基本上会导致SPAC交易市场的放缓。

取消避风港？

21世纪: 你认为在这系列声明发布之后，证券交易委员会是否会有任何后续的法规？

Louis Lehot: 是的，我相信SEC正在研究 "避风港法则" (safe harbor rules),该规则要求SPAC与后面的投资者分享，他们从目标公司获得3年后得到的预测。我相信证监会将取消避风港 (safe harbor), 这样一来，目标公司根据3年预测来出售自己就变得风险更大，因为仅有3年时间（要实现目标）。

21世纪: SEC多项声明背后的目的是什么？可以理解为为了保护普通投资者吗？

Louis Lehot: 对。现在SPAC市场面临的挑战是，散户投资者所投资的公司可能有风险，或者事实上风险很大，因为当这些收入预测不能实现时，股价会崩溃。散户投资者将失去他们的钱，他们会找SEC说，你为什么让这种情况发生？SEC不希望受到指责。所以，我认为SEC将采取一些行动，例如关于财务报表中权证的监管解释，以及要约收购 (tender offer rules) 必须保持至少20个工作日开放等，都只是一种策略，以减缓市场热度，直到它可以拿出一个永久性的规则制定。预计这将在今年初夏发生。

太多壳公司在追逐一个不够大的目标池

21世纪: 此前跟一位投资人聊过，他表示目前市场上壳公司多于目标上市公司，您怎么看待这一现象？

Louis Lehot: 这是一个很有趣的现象。资本市场上有很多投资者想进来，他们每天都在组建各种SPAC，可以说现在有太多的壳公司是公开上市的车辆，追逐一个不够大的目标池。结果是，标的物的价格被抬高了。这是我认为SEC正在努力解决的另一个问题，因为SEC的设计不是为了评估市场风险，它是试图为透明、有序的投资系统创造一个公平的竞争环境，阻止人们做出错误的判断。这是有道理的。

21世纪: 通常空壳公司在找到目标公司后，de-SPAC大约需要 3-6 个月的时间完成合并，如果超过正常时间，SEC仍在审核，背后通常是有什么考虑原因呢？

Louis Lehot: 这意味着 SEC 对这个合并还没有明确的观点，或许有一些我们不知道的问题。

（记者注：de-SPAC包括向SEC提交授权委托书、由SEC审阅并发表意见、向SPAC股东寄送授权委托书以及召开股东大会等。从签署de-SPAC交易的最终协议之日起，具体流程可能需要3-6个月时间完成）

21世纪: 您对散户投资SPAC有什么建议？

Louis Lehot: 个人投资者应该进行基于事实的投资，就像对任何其他公司投资一样，对公司和其目前状态进行评估。投资者可以重视现金流，但3年后的现金流在目前的市场上是要大打折扣的。

作者：特约记者房珊珊 编辑：李艳霞

Understanding SPACs' Hidden Capital Costs

This article was originally published on Law360.com on April 5, 2021.

Over the past year, we have witnessed a boom in special purpose acquisition companies, with the SPAC method of going public seeing a meteoric rise in popularity as an alternative to the traditional initial public offering.

In 2020 alone, there were more than 200 SPAC IPOs, and that number is expected to be much larger in 2021.

Even though this method is gaining steam and has been utilized for decades now, there are still plenty of misconceptions about SPACs and their perceived cost benefits.

As the anatomy of the SPAC process reveals, there are, in fact, hidden costs of capital associated with SPACs that should be fully understood, and as with any kind of boom, we could be headed for a bust.

A SPAC involves a blank-check company, or shell company, raising money from investors in a public offering and then later merging with a target company. That merger results in the target raising money and becoming a publicly traded company.

Years ago, the target companies involved in these transactions were typically companies that were seen as not ready to go public, but today, the targets are much more sophisticated firms.

SPACs have become particularly popular today in the tech industry, as venture capital investors view them as a better liquidity solution that eliminates the pricing and timing inefficiencies of a traditional IPO.

However, while SPACs are perceived to have many benefits in terms of cost and speed, they are not always the best option. The many costs and complexities must also be taken into consideration before choosing the SPAC method.

AUTHORS

Nicole Hatcher | nhatcher@foley.com

Natasha Allen | nallen@foley.com

One widely held misconception is that SPACs are faster and less expensive than the traditional IPO process. While this can prove to be true in some cases, it is not always the case.

In order to more accurately measure the total cost, various factors must be taken into account. First, the cost of capital is very high for the retail investor.

There is also the fee the SPAC would pay to the investment bank, which is a percentage of the money it raises. Total costs should also include the cost of the initial IPO for the blank check company, the money that sits in escrow for years, and the cost of the actual M&A transaction as well as its review.

In addition, the target company may incur costs associated with going public on an accelerated timeline, e.g., increased accounting fees due to financial reporting complexities.

There is also a massive overhang of sell-side supply with a SPAC. Everyone involved with a SPAC is looking to sell.

There are those with the initial purchase in the SPAC IPO, the sponsors who select the target company also receive 20% ownership and want to monetize it, and then there is the SPAC target, which has long-term shareholders.

All of these stakeholders are looking to sell, creating the need to find a new universe of long-term investors looking to buy. As SPACs are typically overhyped and end up underperforming, this creates a problem in securing those long-term buyers.

SPACs also involve lockups that can last anywhere from one to five years. As we are about to hit the one-year mark of this SPAC boom, that also means that the one-year lockups will start to roll off in the coming months, and this has the potential to bring the SPAC boom to a bust.

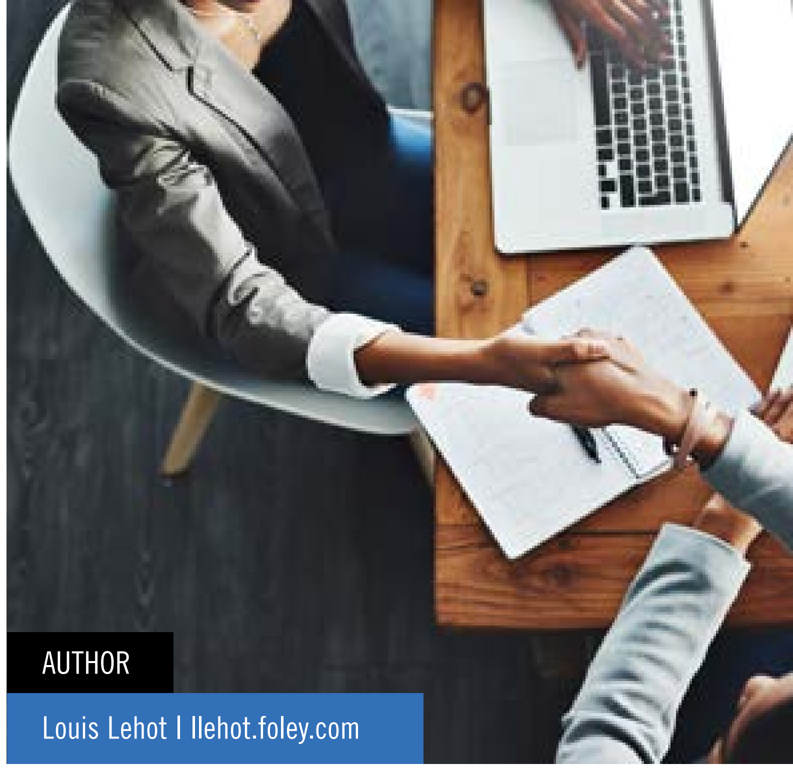
There is already evidence that a crash could be starting already as several high-profile SPACs declined well below their highs in February, and many are now selling for less than their cash holdings.

This kind of crash would undoubtedly be followed by a regulatory response, particularly since SPACs bypass some of the U.S. Securities and Exchange Commission's regulatory safeguards, one of the aspects that makes them a more attractive option.

As outlined above, there are myriad hidden costs spanning from the cost of the initial IPO to the final merger and everything in between. Despite these added expenses, a SPAC could still be a viable option for companies to go public.

As signs of a crash are becoming increasingly evident, it is more important than ever to fully understand the real costs of a SPAC and the implications a crash could have on the market moving forward.

Examining the Risks and Benefits of IPO Alternatives: Direct Listings & SPACs



Louis Lehot | llehot.foley.com

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With the recent, highly publicized Coinbase and Roblox direct listings and the SPAC boom over the past year, alternatives to the traditional IPO are in the spotlight. It seems that more and more companies are looking for ways to bypass the IPO process and go public through these alternative methods.

While these IPO alternatives are generally viewed as faster and cheaper methods to take a company public, there are, of course, many factors to consider when looking at any avenue to go public.

Traditional IPOS

Most experts feel that the traditional IPO is not going anywhere and will continue to be the most widely used method for going public. According to Renaissance Capital's Q1 IPO Market Review, the US IPO market had its busiest quarter in over twenty years, with Q1 of 2021 seeing 102 IPOs raising $40.3 billion. These numbers follow the momentum built during 2020 when there were 218 IPOs, totaling $78.2 billion in proceeds.

"Because of the expense and time associated with IPOs, many companies are considering alternatives or waiting much longer to go public."

The traditional IPO is the ultimate liquidity event for "healthy" companies interested in raising capital and providing an exit via the public markets for their early founders and financial sponsors, but many companies feel this process leads companies and investors to leave too much money on the table.

In a traditional IPO, companies utilize investment banks to help them through the process, with the bank setting up a (now virtual) roadshow to shop it around to institutional investors.

The investment bank, functioning as an underwriter of the price to public, also sets the initial offering price, which is designed to be below market, provide a discount to the bank's best customers, limit after-market trading via lock-up agreements, and lead to a jump on the first day of trading and an orderly and upward trading market thereafter.

This is very beneficial for the bank and its institutional investors, but some founders and early investors in the company will complain about the size of the IPO discount and the amount of value that is transmitted to the investment bank and its customers.

There is also the issue of time. The traditional IPO process is seen as incredibly time-consuming with the roadshow process, paperwork, and financial disclosures.

Because of the expense and time associated with IPOs, many companies are considering alternatives or waiting much longer to go public. When looking at other methods to go public, there are several options, with direct listings and SPACs being the most popular today.

What is a Direct Listing?

Direct listings[1] are less common than a traditional IPO or a SPAC, with only a handful of high-profile listings in the past few years. The interest in direct listings started with the Spotify and Slack offerings a few years ago and just got a recent boost from the much-anticipated Coinbase listing.

This option allows companies to bypass working with a bank or going through the roadshow process, leading to cost savings and a much less time-consuming process. It also allows the company to control the listing price and avoid lock-ups.

Direct listings used to be viewed as an attractive option for companies who had wide consumer followings, a significant employee shareholder and early investor base, a vibrant trading market in the secondary markets, and who do not need to raise capital, letting investors sell their shares, but not issuing any new shares.

That changed when the SEC updated the rules surrounding direct listings, allowing companies to list directly while also issuing new shares. This change makes the direct listing appealing to a broader range of companies.

Because companies do not work with a bank in a direct listing and bypass the investor roadshow, they are generally best suited for companies with a higher level of name recognition. When companies don't have a Wall Street underwriter selling their story, it becomes increasingly essential for the company to be well known.

What are SPACS?

Special Purpose Acquisition Companies or Blank Check companies have had a meteoric rise in popularity in the past year. Renaissance Capital's Q1 IPO Market Review noted that there had been more SPAC offerings in Q1 of 2021 than all of 2020, which is impressive considering that in 2020 more than 200 SPAC offerings were bringing in about $75 billion in proceeds.

"When companies don't have a Wall Street underwriter selling their story, it becomes increasingly essential for the company to be well known."

A group of investors creates SPACs with the sole purpose of acquisitions. The SPAC[2] is a public company that acquires private companies they target, and that acquisition takes the target company public.

Just like a direct listing, SPACs are generally seen as cheaper and faster. They also bypass the high costs of an IPO by eliminating the need for a banking partner or roadshow, and the time savings is significant. The SPAC IPO process can take just months.

This method could be a better option for pre-revenue companies or those that might be seen as not ready to go public. The SPAC founders also keep 20% of the equity, making them less favorable for the target company.

There is also the issue of SPAC oversaturation. With so many SPACs popping up, companies could now be the target of multiple blank check entities leading to higher acquisition prices.

The long-term after-market trading of companies that merge with SPACs is yet to be proven[3], with significant downward pressure exerted by the overhang of so many shares of common stock and warrants issued to the SPAC promoters and initial investors.

On the surface, direct listings and SPACs might seem like much more attractive options to the traditional IPO, especially as they become more high-profile. But as with anything, there is much more below the surface. Each option comes with its own hidden costs, and each company must carefully consider which method will be the most beneficial for their specific circumstances.

1. https://bit.ly/3nwdMe0
2. https://bit.ly/2R4Jjrr
3. https://bit.ly/3uhISK0

SEC Signals Enhanced Scrutiny of SPAC Transactions

AUTHORS

Thomas J. Krysa | tkrysa@foley.com

Brooke D. Clarkson | bclarkson@foley.com

Adrian L. Jensen | ajensen@foley.com

On March 31, 2021, the SEC's Division of Corporation Finance and Acting Chief Accountant issued separate public statements concerning Special Purpose Acquisition Companies ("SPACs"). In these recent statements, the SEC is putting private companies on notice of the myriad of regulatory requirements they will be subject to after becoming public companies. Whether coordinated or not, these statements continue to signal the SEC's increased scrutiny of SPAC transactions.

The Division of Corporation Finance's statement focuses on the "accounting, financial reporting and governance issues" that private companies should consider prior to undertaking a business combination with an SPAC. Of note, the statement highlights the following:

- SPACs, as shell companies, are subject to certain restrictions including a requirement for the acquired business to file financial statements four business days after the completed business combination; the combined company will be ineligible to incorporate Exchange Act reports and proxy statements by reference on Forms S-1 for three years; the combined company will be ineligible to use Form S-8 to register compensatory securities for a period of time; and the combined entity will be an "ineligible issuer" under Securities Act Rule 405 for three years.
- Combined entities will be subject to the books and records and internal control requirements of the Exchange Act and private companies must use advance planning and investment in resources necessary to have these systems in place.
- Combined entities must be prepared to satisfy quantitative and qualitative listing requirements to remain listed on national securities exchanges.

Similarly, the Acting Chief Accountant's statement highlights key considerations "related to the unique risks and challenges" for a private company entering the public markets through an SPAC business combination. The statement notes that in the first two months of 2021, both the number of new SPACs and amount of capital raised has already matched 75% of the SPAC activity from last year. Some takeaways from the Acting Chief Accountant's statement include the following:

- Private companies must be prepared to meet financial reporting and listing requirements prior to the business combination.
- Combined entities should have the personnel and processes in place to produce high quality financial reporting.
- Combined entities must be prepared to maintain internal controls over financial reporting ("IFCR") and disclosure controls and procedures ("DCP").
- Combined entities should have competent board and audit committee oversight which includes having independent directors.
- Combined entities need to prepare for having audited financials in accordance with PCAOB standards by public audit firms registered with the PCAOB.

With the proliferation of the number of SPACs in the market, the SEC is also expected to increase its enforcement scrutiny of SPAC transactions. The SEC will likely scrutinize any failure to disclose conflicts of interest or other material information associated with SPAC transactions. Additionally, misstatements and omissions in registration statements filed in connection with SPAC transactions could result in private securities lawsuits. For questions about the litigation and enforcement risks associated with SPACs, or questions about an SEC enforcement matter, please contact a member of Foley's Securities Enforcement and Litigation Team.

The IPO Markets Are Changing, and so Is the Lock-Up Agreement

AUTHORS

Louis Lehot | llehot.foley.com

Eric Chow | echow@foley.com

An initial public offering (IPO) is a crucial time in the life of a company and its stakeholders. Initial investors, employees, and executives can profit from the public listing, and the company can raise additional capital. But IPOs come with a number of limitations, some required and some just common. Today, lock-up agreements, once a common feature of IPOs, face a changing and uncertain future.

What is a lock-up agreement?

A lock-up agreement is a set period of time during which company insiders are restricted from selling shares, subject to limited and highly negotiated exceptions. As the SEC notes, this lock-up period usually lasts for 180 days, and while federal laws require companies to disclose these agreements, lock-ups are not mandated except in certain states with "blue sky laws."

Lock-up agreements exist to help minimize fluctuations in a company's share price when the stock first hits the public market. By preventing insiders from dumping shares quickly, a lock-up agreement restricts the supply of stock for sale on the public market, which, in turn, reduces the risks of potentially causing the stock price to plummet at an especially critical time. In addition, a company typically agrees not to issue additional securities. The lock-up agreement is usually heavily negotiated with the underwriter. As Crunchbase notes, once a lock-up period ends, the free-market sale of stock shares by insiders can serve as a barometer of sorts. If insiders hold their shares, perhaps they believe the price will rise, but selling shares may suggest otherwise.

With all the changes in market dynamics, investor priorities, and consumer interests due to the pandemic, the outlook for 2021 may be difficult to discern, but we can follow some trends. From our experience, the 180-day lock-up period is still, by far, the most common length. But despite that consistency, in recent times, there is a trend for companies to structure lock-ups with different lock-up periods for different parties.

Lock-up agreements in de-SPAC transactions

SPACs, or special-purpose acquisition companies, are also gaining traction as an alternative to IPOs to get private companies to market faster and at a lower price point. In a SPAC transaction, a newly formed company raises funds in the public markets via IPO, and then uses the proceeds to acquire a private operating company. Lock-up periods for SPAC transactions are typically longer than traditional IPOs (e.g., one year or more).

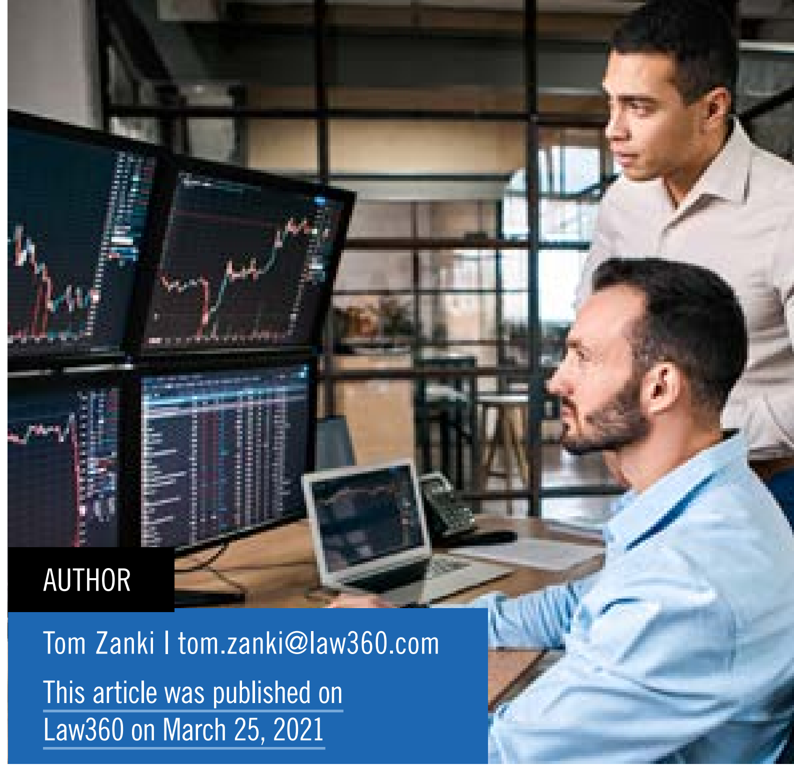
No lock-up agreements in direct listings

On the other hand, some companies are opting to achieve public listing by way of direct listings, as opposed to IPOs. In direct listings, existing shares are made available for trading in a public market without an underwritten offering, and, thus, without restrictions imposed by standard lock-up agreements, giving its existing shareholders immediate liquidity. Although underwriters are not engaged and these companies can save on costs, the companies' ability to raise new capital is more restricted compared to IPOs. Spotify, Slack, Asana, and other well branded e-commerce businesses have successfully gone public via direct listing. Companies with track records of strong growth and healthy financials are good candidates for direct listings and can go public with no lock-up agreements.

What to expect

To a certain extent, the deviations from the standard 180-day period of the lock-up arrangements should not be surprising. We have seen similar trends of increasing democratization and disintermediation, particularly in the technology industry. Time will tell whether lock-up agreements will be less important in listing processes going forward, or even end entirely.

SEC Inquiry Into Blank-Check Boom Could Be Just the Start



AUTHOR

Tom Zanki I tom.zanki@law360.com

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Law360 (March 25, 2021, 8:58 PM EDT) -- Reports that the U.S. Securities and Exchange Commission is inquiring deeper into the explosion in blank-check offerings could be a prelude to further investigation to assure that investor protection concerns are being met, attorneys said Thursday.

The SEC's focus reportedly centers on the practices of investment banks that underwrite initial public offerings by blank-check vehicles, also known as special purpose acquisition companies, or SPACs, which lay the groundwork for an eventual merger. Once a subset of the IPO market, these so-called blank-check offerings now far outstrip traditional IPOs and are shaking up capital markets in ways that regulators and market participants are still sorting out.

Foley & Lardner LLP corporate partner Nicole Hatcher expects that the SEC is concerned about risks posed to ordinary investors, noting some similarities between the SPAC surge and the 2017 boom in crypto-based financings known as initial coin offerings, which led to stricter oversight.

"I think this is the first step in making sure that folks know the SEC is watching and that they will start taking further actions," said Hatcher, who works in the firm's Silicon Valley office in San Francisco, a region where SPACs are proliferating.

The extent of the SEC's latest inquiry is not fully clear.

Reuters reported late Wednesday that the SEC is seeking information on how underwriters are managing risks involved with SPACs, citing anonymous sources. SEC enforcement officials sent letters to Wall Street investment banks inquiring about fees, volumes and what controls banks have in place to police the deals internally, Reuters reported, adding that banks were asked to provide information voluntarily and that the inquiry is not considered a formal investigation.

Bloomberg reported that investment banks are expecting letters from regulators asking about the potential dangers of underwriting a torrent of deals, also citing anonymous sources. The news organization reported that the inquiry so far appears to be mostly fact-finding.

The SEC did not respond to requests for comment Thursday.

SPACs have been around for decades but exploded in the early phase of the coronavirus pandemic and have stayed red-hot. Year to date, 296 SPACs have completed IPOs and raised more than $96 billion, according to spacinsider.com. That eclipses the total for all of 2020, which exceeded the entire past decade.

SPACs are shells that raise money through an IPO in order to acquire a private business and take it public, handing the target a ready-made listing. These vehicles can provide target companies a quicker path to public markets than a conventional IPO, among other advantages for targets including more flexible rules regarding the discussion of financial projections with investors.

Plus, SPAC founders are well compensated for their efforts. They often receive up to 20% of the target company's public shares, providing founders a strong incentive to complete an acquisition.

As SPACs surge in volume, observers are scrutinizing their performance. Academic studies show that shares of companies that went public through blank-check vehicles lag the broader market, suggesting that many public shareholders are not benefiting from these deals.

"The speed at which SPAC transactions move creates a lack of transparency," Hatcher said. "One of the major issues is that the incentives of the SPAC sponsors are not aligned with investors."

Market participants will also be watching to see how shares of companies taken public by SPACs fare in the coming months, when lockup periods that so far have constrained insiders from selling shares begin to expire. An increase in shares being sold could place further downward pressure on the stocks of such companies, potentially worrying regulators.

"When the ball drops, [the SEC] will be asked: What did you do to prevent this?" said Foley & Lardner partner Louis Lehot. "A lot of the lockups in these transactions are going to be expiring in the summer. We think that that will be a critically important time for the SPAC product."

Word of the SEC inquiry has been preceded by signs that regulators are paying closer attention to this sector. Acting SEC Chair Allison Herren Lee recently expressed concern that studies show that SPAC "performance for most investors doesn't match the hype."

The SEC's Division of Corporation Finance also issued guidance in December advising companies on sound disclosure practices to assure that investors understand how valuations are determined in SPAC mergers and are notified of conflicts of interest. Lehot said SEC staff is likely collaborating on its oversight of SPACs, which could result in more enforcement actions and new rulemaking.

SPAC proponents tout these vehicles as an efficient way to bring more public companies to market, including emerging businesses at earlier stages of their growth. SEC Commissioner Hester Peirce has also warned against regulatory overreach in response to the SPAC boom.

"Well-intentioned increased regulatory obligations around SPACs could make them less cost-effective," Pierce told the SEC's Investor Advisory Committee earlier this month.

Hatcher cautioned that it can also be unwise for private companies to pursue public markets at early stages, especially if they haven't fully developed a product.

"It feels a little bit like the Wild West out here," Hatcher said. "I think we need some more oversight."

What Are SPACs, and How They Are Different From IPOs?

AUTHORS

Louis Lehot | llehot.foley.com
Nicole Hatcher | nhatcher@foley.com
Natasha Allen | nallen@foley.com
Brandee L. Diamond | bdiamond@foley.com
Catherine Zhu | czhu@foley.com

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What you need to know about going public in 2021

One of the hottest investment trends in the past year is the rise of special-purpose acquisition companies, commonly called SPACs. SPACs are shell companies that exist to raise capital to acquire other companies, which is why SPACs are also known as "blank-check companies."

The concept is an old idea, dating back to at least the late nineteenth century, when Henry Villard sought to raise capital to buy the Northern Pacific Railroad without revealing the name of the target company. Modern-day SPACs have existed since the mid-1990s. Today, these investment vehicles have been used across a myriad of industries—from a manufacturer of electric cars to an aerospace startup to a cryptocurrency mining company.

While SPACs as they are known today have been around for decades, they have seen explosive growth in the last few years. SPACInsider reports that the number of SPAC IPOs grew from one in 2009 to thirty-four in 2017. Two years later, there were fifty-nine, and interest exploded to 248 in 2020. This year is already on track to set a record, with 237 SPAC IPOs as of March 9, and proceeds almost equaling the total from all of last year.

The level of SPAC activity has accelerated to unprecedented levels in the M&A markets as well as the IPO markets. According to Deal Point Data, the amount of capital pursuing "public-ready" private targets is 1.85x larger than the total gross proceeds raised in traditional IPOs in all of 2020, and 298x 2019's IPO proceeds. The 544 SPACs seeking targets represents 1.42x the number of non-SPAC IPOs priced in 2019 and 2020 combined.

But how is a SPAC different? For the target company, a SPAC acquisition provides a means of separating the IPO from the company itself. Investors buy shares of the SPAC, not of the target company, but after the merger, the shares of the SPAC effectively become shares of the original corporation.

This abstraction of the IPO from the underlying company explains the increasing popularity of SPACs. They provide a streamlined alternative to traditional IPOs. While a traditional IPO takes one to two years to complete, a SPAC merger can close in under six months. PwC notes that SPAC mergers can help the target companies gain liquidity without as much uncertainty in valuation, which is especially important when markets are volatile. Crunchbase notes that companies that would likely benefit from a SPAC acquisition over a traditional IPO are those that could launch a traditional IPO but want to accelerate their entrance into public markets in order to gain liquidity and capital.

The actual merger between the SPAC and the target company is called the de-SPAC transaction. This process functions similarly to regular mergers, but the SPAC's shareholders usually need to approve the acquisition before proceeding. And because investments in the SPAC are held in escrow, operating funds are not easy to access. The SPAC really is just a vehicle for investors to purchase the target. Once the merger is complete, the SPAC fades away, while the shareholders gain their corresponding stakes in the target.

If you are considering taking your company public, a SPAC acquisition may be worth investigating. Indeed, 290 SPAC IPOs were in registration as of February 28, 2021, versus 70 traditional IPOs, up from 129 and 99 respectively as of the end of Q3 2020, which marked the first quarter end for which interest in SPACs exceeded traditional IPOs. Easier access to liquidity and a faster transition to public trading make SPACs very attractive. SPAC mergers are not magical solutions, but they could be right for you.

Going public means having internal controls, disclosure controls and enterprise operating systems in place to satisfy stringent standards of the US Securities and Exchange Commission and strong enough to withstand the plaintiffs' bar that can be unforgiving in civil litigation, and an ability to forecast revenues up and to the right to satisfy Wall Street investors.

When is a SPAC a better vehicle than a traditional IPO for your business? A SPAC is particularly well-suited for a business that requires amounts of capital investment that exceed the ability of venture capital firms to fund them, and that is "public ready." It's also well-suited for a well-prepared private company looking to go public quicker and cheaper than the traditional IPO. But it's not for everyone, especially retail investors who are less well-positioned to evaluate the probability of forward-looking estimates of future revenue, and not able to withstand a significant reduction in value.

Whether a SPAC or an IPO, the year 2020 marked the reversal of the multi-year trend of more companies deciding to go private than go public.

Special Report: SPACs — They're Back

Fueled by piles of capital, special-purpose acquisition companies want to take your company public. But are they the best route to a listing?

This article was published on CFO.com on December 3, 2020

AUTHOR

Vincent Ryan

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Scott Henry, CFO of Skillz, is a veteran of capital raising and exits. He steered Beats Music through its $3 billion sale to Apple in 2014. A decade before, he saw casino gaming company Las Vegas Sands through a $690 million public listing. But in August, when Henry joined Skillz, a monetization platform for game developers, he jumped headfirst into a different kind of transaction: a special-purpose acquisition company IPO.

SPACs, a kind of "blank check" company, are flooding U.S. equity markets. They raise capital in an initial public offering and use the proceeds to acquire a public-ready operating business not yet identified. Once a SPAC selects a target operating company, that business merges into the SPAC shell company and becomes publicly traded.

For example, Skillz is merging with Flying Eagle Acquisition, the sixth SPAC raised by former MGM CEO Harry Sloan and CBS Entertainment president Jeff Sagansky. The deal is expected to close in the fourth quarter. Though Skillz management had already chosen the SPAC route before Henry joined Skillz, he says the structure offers speed, greater flexibility, and other benefits over a traditional IPO. A SPAC deal, in many ways, is just as akin to a merger as an IPO.

This kind of backdoor IPO transaction "is a faster path to market—three to four months versus the typical six to nine months for a traditional IPO," Henry says (once the SPAC and target have agreed to combine). That means less distraction for the target's management throughout the process.

Skillz has a lot of company. About 175 SPAC vehicles listed this year on U.S. exchanges (as of November 10), compared with 59 in 2019, according to SPACInsider. The average size is $363 million. About 18 of those SPACs have announced the target company they are acquiring. (SPACs have up to two years to find an operating company to buy.) So, there is an enormous amount of raised capital looking for midsize to large companies to purchase.

Numerous factors kicked off the 2020 SPAC revival (the buildup of private capital looking for big returns, choppy equity markets, mixed success for traditional IPOs). The market is getting so heated that big names like Richard Branson, former Congressman Paul Ryan, and Donald Trump adviser Gary Cohn are getting in on the action. However, there are sound reasons why these transactions particularly appeal to some CFOs.

The Advantages

Fewer and fewer management teams are willing to go through the time-intensive process of a traditional S-1 filing. While the filing requirements for a SPAC deal are not trivial, the target doesn't have to disclose historical financials or offer a lengthy list of business risks, according to the Harvard Law School Forum on Corporate Governance.

SPACs also protect the target (somewhat) from the whims of the market. Market volatility and unpredictable investor sentiment affect the pricing of a traditional IPO, according to a Deloitte report, "Private-Company CFO Considerations for SPAC Transactions." A SPAC deal, however, values the target outside the market through negotiations between the SPAC and management.

That occurs months before the merger transaction closes and the target company is listed.

Another advantage to SPAC deals, Henry points out, is that the target company can share forward financial projections as part of its regulatory filings. "In a traditional IPO, the internal model is not shared with the investor [and analyst] community; in a SPAC, it is shared."

Also, in a SPAC merger, the target company can devote a large portion of the proceeds from the merger to providing secondary liquidity to early investors. "In a traditional IPO, investors would view that level of secondary proceeds [70%, in the case of Skillz] unfavorably," Henry says.

Finally, as SPACs increase in popularity, and more SPAC money chases target companies, a snowball effect occurs: the cost difference between the SPAC route and the traditional IPO route narrows, says Henry. SPAC targets can now negotiate better terms on warrants and other deal elements. "A lot of that has flattened out," he says.

Spotty Past

All that may sound ideal for a private company wanting a listed acquisition currency to grow the business and give stakeholders liquidity. But CFOs need to step back and look at the details of these transactions and how the shares of companies that list via SPACs traditionally perform. Not all is wine and roses.

SPAC transactions haven't rid themselves of a sketchy past. Unscrupulous operators once used shell companies like SPACs as fronts for "pump and dump" scams. And not all SPAC transactions are squeaky clean now either. Nikola Motor reverse-merged with SPAC VectoIQ in June, but by September had received subpoenas from the Department of Justice and the Securities and Exchange Commission about the accuracy of its disclosures.

Additionally, in June 2019, the SEC sued Ability, an Israeli-company that defrauded shareholders of a Florida-based SPAC, Cambridge Capital Acquisition.

Into the Pool

This year special-purpose acquisition vehicles have raised more than four times the proceeds they did in 2019.

Year	Number	Gross Proceeds ($M)
2009	1	$36
2010	7	$470
2011	15	$1,081
2012	9	$491
2013	10	$1,447
2014	12	$1,739
2015	20	$3,902
2016	13	$3,499
2017	34	$10,049
2018	46	$10,752
2019	59	$13,600
2020*	175	$63,631

*Through November 10
Source: SPACInsider

Image from CFO.com

And in November, health care company MultiPlan became the target of short-seller Muddy Waters, which claims the SPAC model provides "perverse" incentives.

Today, though, many executives feel there is little negative connotation with the term SPAC, says CFO Henry. "A Flying Eagle was a diamond in the rough in the past," he says. "But today, there are higher caliber sponsors with experience and a proven track record with shareholders."

Going the SPAC Route

A "backdoor" IPO suits some companies, but not all.

By Louis Lehot

If the pros outweigh the cons, or if the stars are aligning for a business to merge with a publicly-traded SPAC, the following are some essential items to think about before pressing "go."

- Are the SPAC sponsors going to be good long-term partners for the business? Not all SPAC sponsor teams are created equal. While having a great basketball player like LeBron James is worth millions on the court for a sports franchise, do we know if his celebrity will translate into financial success in a non-sports related public company?
- Will there be sufficient post-closing capital to enable growth on a go-forward basis? As noted, shareholders in the SPAC IPO have the right of redemption. If they redeem in too high a percentage, the business will not have sufficient capital to grow. Sometimes, a concurrent private placement of capital into the combined company solves this problem.
- Is your business predictable three to four quarters out, such that you will not shock and disappoint Wall Street once public?
- Is your business ready to build out the internal controls over financial reporting and other governance requirements for a company to withstand public scrutiny and the plaintiffs' bar?
- Will the combined company post-closing provide sufficiently active and large enough trading volume to give liquidity to stakeholders?

Image from CFO.com

The choice of SPAC partner is the critical decision for the target company, and it's a decision made early in the process. The transaction team needs to consider the sponsor's reputation, track record, and knowledge of the target's industry sector, among other characteristics. "It's a partner you're going to live with, not just through the transaction." Indeed, the SPAC partner often has a seat on the target's board of directors. For example, Skillz expects Sloan or another executive from Flying Eagle to be on its board.

The SPAC vehicle is intricately tied to the ultimate success of the stock, also. In the initial SPAC listing, investors park their capital for up to two years in exchange for downside protection (redemption rights, if the SPAC fails to find an acquisition target or the investor is unhappy with its choice) and additional upside (warrants), says Louis Lehot of L2 Counsel, a Silicon Valley M&A and securities lawyer.

In return for sourcing an acquisition of an operating company, negotiating the deal, and bringing the target public in a reverse merger, the SPAC sponsor earns some portion of the company's stock, called "promote" stock, says Lehot. The sponsor promote can amount to about 20% of the total capital raised at IPO. To fund the IPO expenses and working capital, the SPAC sponsor also purchases additional private placement warrants for proceeds representing as much as 6% of the SPAC IPO.

Shifting Shareholders

There are plenty of risks for a target company looking to list via a SPAC, even with the right partners. After an acquisition is proposed, both the SEC and the SPAC's investors — typically at least 80% of them — must approve it, Lehot says. Stockholders may choose to vote against a target and redeem their shares for cash.

Indeed, these short term and momentum-focused investors represent another hurdle for the operating target. SPAC investors (traditionally hedge and arbitrage funds) are typically different from the growth-oriented investors (pension and 401(k)-type funds) that would invest in a traditional IPO, explains Henry. The so-called "de-SPACing" process (which officially begins after a letter of intent is signed) is about bringing growth-oriented investors into the stock.

A way to kick-start the de-SPACing process and draw institutional investors is a private investment in public equity (PIPE) transaction. "The PIPE is a hard forward commitment, very much like how you allocate a book before an IPO," Henry says.

PIPEs can finance a significant portion of the target's acquisition price and provide post-merger operating cash. (The initial SPAC raise rarely covers all of the merger price.) PIPEs also earn the target company validation from respected long-money investors, "so there's a little bit of a branding element to it," Henry says. The PIPE investment for Skillz is $158.5 million and is led by Wellington, Fidelity, Franklin Templeton, and Neuberger Berman.

Performance Problems

Even with a PIPE, capturing long term investors while keeping the stock price up can be tricky. After the reverse-merger's close, the target's shares face immense pressure from stockholders trying to run for the exits, says Lehot. In contrast, in a traditional IPO, only 10% to 20% of the company is sold, and all existing stockholders are locked up for 180 days. "The very limited liquidity pushes up demand," says Lehot.

In contrast, "in a SPAC, there is always a ton of supply of common stock on the market for sale that depresses the stock price," he adds. The supply comes from the

20% SPAC promoter interest and the warrants issued to the purchasers in the initial SPAC IPO.

Renaissance Capital, a provider of IPO exchange-traded funds, found that of the 313 SPACs IPOs since the start of 2015, 93 have completed mergers and taken a company public. Of those, the common shares have delivered an average loss of -9.6% and a median return of -29.1%, compared with the average aftermarket return of 47.1% for traditional IPOs. Only 29 of the SPACS in the group (31.1%) had positive returns as of late September.

Lehot is blunt about whether SPACs are worth the risk. If a company can list via a traditional IPO or find an exit via private equity or a strategic purchase, especially with some management rollover, investors are better served, he says. He calls those routes "eminently preferable."

But SPACs may be here to stay regardless, especially if the stocks of companies that have taken the SPAC route start to perform better.

"Every Wall Street investment bank and law firm is promoting a SPAC conference and making hay while the sun is shining," Lehot says. "Long-term performance and continued availability of capital will be required to prove whether these efforts are a flash fad or a sustainable trend."

For his part, Scott Henry says his opinion of SPACs has become much more favorable: "I think of it as one of the potential tools that the modern-day CFO has as an approach to going public."

Amidst a Global Pandemic, Why are so Many Companies Rushing to Go Public Via the SPAC, Despite Producing Lower Returns for Investors?

AUTHOR

Louis Lehot | llehot.foley.com

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In recent years, the world has seen a gold rush of private companies rushing to go-public via a reverse merger with a special purpose acquisition corporation, or "SPAC." This article will attempt to answer why. We will also clarify what it means for entrepreneurs, what it costs, why it matters, and who will be disrupted. Finally, we will look for some market indicators to watch out for.

	SPAC IPOs	Traditional IPOs
2009	1	63
2010	7	154
2011	15	125
2012	9	128
2013	10	222
2014	12	275
2015	20	180
2016	13	105
2017	34	160
2018	46	192
2019	59	159
2020 (thru 9/13/20)	95	112

The market for SPACs vs. traditional IPOs in the last decade

The market for SPACs vs. traditional IPOs in the last decade

To demonstrate the phenomenon that we are seeing the markets, following is a comparison of the volume of SPACs vs. traditional IPOs in 2014 to the present:

Why are so many private companies rushing to merge with a SPAC to go public?

In two words: time and money. Private companies have found the process of going public via a reverse merger with a SPAC can happen in much less time at a much lower cost than a traditional IPO or direct listing. A traditional IPO can take 6 months or more of extremely time-intensive management attention, while a SPAC IPO can get done in less than half the time with minimal effort. The cost involved in a traditional IPO typically reaches 10% or more of the amount of capital raised, while a SPAC IPO can be done for a fraction of that amount. The process of a traditional S-1 filing for a private company has become so time-intensive and so expensive that fewer and fewer companies have been willing to go through this process since 2000. According to Statistica, while over 400 companies went public via IPO in an election year in 2000, fewer than 160 were willing to do this in one of the greatest economic booms in history in 2019.

Today, many private companies would rather merge with a publicly traded SPAC than go through the time-consuming and expensive process of raising money through a more traditional initial public offering. That's especially the case during the coronavirus pandemic.

What does it mean for entrepreneurs?

For entrepreneurs, particularly for operating businesses with healthy operating metrics, but where an IPO or M&A exit were not achieveable, particularly because access to capital was constrained, the SPAC is a pot of cash combined with listed acquisition currency with which to grow and give liquidity to stakeholders.

What does it mean for investors?

According to Rennaissance Capital, a provider of IPO ETFs and institutional research, however, the data between 2015 and mid-2020 shows that SPACs offer lower returns on average than conventional deals. Indeed, the sample set of 89 SPACs that had completed reverse mergers during the period had delivered an average loss of 18.8% and a median return of minus 36.1%, compared with an average after-market return from traditional IPOs of +37.2% in the same period. During the period, only 26 of the SPACs in the cohort had registered positive returns, according to this same study.

DraftKings CEO Jason Robins told Business Insider that while SPACs work for some companies, they're not a good fit for everyone.

Palihapitiya cites two factors for the popularity of SPACs with investors: a scarcity of places where public investors can get big returns, and the inefficiency and cost of doing traditional IPOs. Another factor in the surge in SPACs is this year's choppy stock market response to COVID-19.

What is a SPAC, and what attributes make it attractive for the market?

At inception, a SPAC is a blank-check company that raises capital to become publicly-traded. The capital raised is often called a "blind pool," because it is for the purposes of acquiring a single, public-market ready operating business not yet identified. SPACs were first invented in the 1980's, and have evolved extensively over the past 4 decades through market convention and SEC regulation.

In the initial SPAC IPO, investors effectively park their capital for up to two years in exchange for downside protection (redemption rights) and additional upside (warrants).

In return for sourcing an acquisition of an operating company, negotiating that deal, and bringing the target public in a reverse merger, and potentially providing ongoing support, the SPAC sponsor earns some portion of the company's stock, which is referred to in the jargon as "promote" stock. The sponsor promote can amount to approximately 20% of the total capital raised at IPO.

To fund the IPO expenses and working capital, the SPAC sponsor purchases additional private placement warrants for proceeds representing 2.5% to 6% of the SPAC IPO, depending on the size of the IPO.

A successful SPAC IPO can be a lucrative opportunity for a sponsor who gains equity in the combined company (via the promote), additional upside (private placement warrants) and potential governance rights in the post-merger combined company.

With opportunity comes risk. The SPAC sponsors may not be able to locate an acceptable target, and stockholders may choose to vote against a target and redeem their shares for cash. In addition, the significant market overhang of the warrants can dampen the post-closing common stock price per share. There is reputational risk. The target may not perform post-closing.

Three evolutions in the market for SPACs have contributed to its recent surge. First, shareholders in the initial SPAC IPO are no longer required to vote against the subsequent "de-SPAC" reverse merger in order to redeem their shares, thereby improving the probability of the SPAC obtaining the requisite shareholder vote to the deal. Second, as we will discuss below, the SPAC instrument has been embraced by celebrity investors, increasing the product's credibility and profile, allowing them to raise greater pools of money. Lastly, SPACs have come to the lucrative technology and life science markets, where higher betas unlock the potential for greater returns.

What kinds of operating companies should consider a SPAC?

Businesses that have healthy operating metrics, have the internal controls in place to provide audited financial statements that can withstand the scrutiny of auditors, the SEC and Wall Street analysts, and are not otherwise able to access a traditional IPO or private equity exit, should consider a SPAC.

But even the best-laid plans can land in the rough. DraftKing and Nikola had massive run ups after initially completing their SPAC mergers. DraftKings dipped as low as $10 a share and is now trading near a high of $50 a share. On the other hand, while Nikola initially traded up as high as $79 a share, it has since dropped back to earth at $24 a share, and is now under investigation by multiple government agencies about the accuracy of its disclosures. Virgin Galactic, initially founded by Richard Branson, merged with Silicon Valley venture capitalist Chamath Palihapitiya's SPAC called Social Capital Hedosophia, and traded as high as $33 a share before dropping down to $18 a share.

What kinds of operating companies should avoid the SPAC vehicle?

If you can get to a traditional IPO or private equity or other exit, this is imminently preferable to a SPAC. Furthermore, real estate investment trusts or other vehicles that trade on some derivative of net asset value are not suitable. Single investments subject to restrictions under the Investment Company Act of 1940 are also not appropriate. Finally, companies that could get a complete exit (albeit with some management rollover) for their investors are better served by a sale to a strategic or financial investor than a SPAC.

Why is that? Because the SPAC has significant market overhang, limited liquidity, and typically a lot of financial investors (think hedge and arbitrage funds) looking to get out of the stock, as opposed to fundamental investors (think pension and 401k type funds) looking to build a long-term position in the stock. Indeed, post-closing of a reverse-merger, the SPAC faces immense pressure from existing stockholders who seek to run for the exits, as opposed to the traditional IPO, where only 10–20% of the company has been sold, there is limited liquidity for fundamental investors to build positions, and where there is a better correlation of supply and demand for the stock.

Key considerations for entrepreneurs to consider in selecting a SPAC vehicle

If the pros outweigh the cons, or if the stars are aligning for your business to merge with a publicly traded SPAC, following are some key items to think about before pressing "go":

- Are the SPAC sponsors going to be good long-term partners for your business? Not all SPAC sponsor teams are created equal. While having a

great basketball player like LeBron James is worth millions on the court for your sports franchise, do we know if this celebrity will translate into financial success in a non-sports related public company?

- Will there be sufficient post-closing capital to enable growth on a go-forward basis? As noted, shareholders in the SPAC IPO have the right of redemption. If they redeem in too high a percentage, the business will not have sufficient capital to grow. Sometimes, this is solved by a concurrent private placement of capital into the combined company.
- Is your business predictable 3–4 quarters out, such that you will not shock and disappoint Wall Street once public?
- Is your business ready to build out the internal controls over financial reporting and other governance requirements for a company to withstand public scrutiny and the plaintiffs' bar?
- Will the combined company post closing provide sufficiently active and large enough trading volume to provide liquidity to stakeholders?

Are SPACs here to stay, or is this a flash in the proverbial pan?

This is the 64 million dollar question. After previous surges and flame-outs, is the SPAC IPO market here to stay? How will we know? The answer is whether or not the recent co-hort of SPAC IPOs, from Virgin Galactica to DraftKings, to Nikola, to Pershing Square, can outperform the market. If valuations continue to surge, and maintain the surge over time, expect more SPACs.

Finally, with more capital in the market, more deals will become available, and terms may evolve. If the terms become more favorable to SPAC promoters and target entrepreneurs, expect the vehicle to continue to gain popularity and traction as an alternative to the traditional IPO or M&A exit.

Every Wall Street investment bank and law firm is promoting a SPAC conference and making hay with the sun is shining. Long-term performance and continued availability of capital will be required to prove out whether these efforts are a flash fad or a sustainable trend.

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