BetterInvesting Rocky Mountain Chapter

The SPACtacular Rise of Special Purpose Acquisition Companies

Rocky Mountain Chapter Stock Study Club

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1

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What is a SPAC aka "Blank Check Company"?

- A company organized to acquire one or more operating companies through a business combination
  - Essentially a big pool of cash listed on an exchange looking for a business
- "Blank Check Company" because investors in the SPAC invest long before an acquisition target is identified
  - Investors are trusting management of the company to find a good merger target
- First Blank Check Company went public in mid-1980s
- Blank Check companies came under SEC regulatory scrutiny due to fraud and market manipulation – led to adoption of Rule 419 by SEC

2

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Formation of a SPAC

- Founders form the SPAC and invest initial capital (nominal amount)
- Founders typically own about ~20% interest in the SPAC (commonly known as "founder shares")
- SPAC files registration statement with the SEC
  - Its "business" is to find and buy a business
  - Sometimes specify the market segment they want to invest in, e.g., technology, electric vehicles

3

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SPAC IPO

- Public shareholders purchase the remaining ~80% interest in the IPO
- IPO consists of "units," composed of shares and warrants
  - Typically, 1 share and warrants to purchase a fraction of a share in the future (e.g., ½ or ⅓ of a share)
  - Warrants cannot be exercised until after consummation of reverse merger – often not allowed to be exercised until other specific events are triggered, e.g., the passage of time, achievement of revenue targets
- Units issued in SPAC offerings begin trading upon completion of IPO

4

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Restrictions on a SPAC

- 90% of the money raised by a SPAC in the IPO must be placed in an interest-bearing trust account pending an acquisition (Nasdaq rule)
- SPAC must merge with a target within 2 years
  - If no merger within 24 months, SPAC liquidates and the IPO proceeds are returned to the public shareholders
- Fair market value of target business must exceed 80% of the amount in the SPAC's trust account (Nasdaq rule)

5

5

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Acquisition of the Target

- Once a target company is identified and a "reverse" merger is announced, the SPAC's shareholders must approve the transaction
  - SPAC is the surviving entity but has the target's business
- If public shareholder(s) don't like the deal the SPAC makes, they may vote against the transaction and elect to redeem their shares (ask for their money back)

6

6

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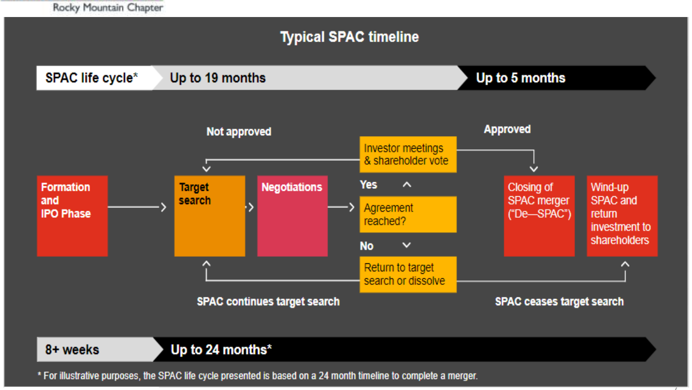

7

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Who Has a SPAC?

- Shaquille O'Neal, former NBA star
- Paul Ryan, former House Speaker
- William Ackman, silver-haired hedge-fund billionaire
- Chamath Palihapitiya, former Facebook executive and venture capitalist (his SPAC merged with Virgin Galactic)

And even ....

- Colin Kaepernick (to focus on companies with a "social mission")

"If you don't have your own SPAC, you're a nobody."
(said one research analyst)

8

8

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What Companies Have Merged with a SPAC?

- Virgin Galactic Holdings, 2019
- DraftKings Inc., 2020
- Palantir Technologies (data-analytics software for the military, private companies and many government agencies), 2020
- Nikola Corp. (electric truck company), 2020
- Barkbox Inc. (pet retailer), pending 2021
- Social Finance Inc. (financial-technology), 2021
- Sunlight Financial (solar loans to homeowners), 2021
- EVgo Services LLC (EV charging stations), pending 2021

9

9

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SPAC Attack!

- In 2020, 237 SPACs went public
  - Raised nearly $80 billion in gross proceeds—the biggest year on record for SPACs
  - More money was raised in 2020 by SPACs than in the 10 prior years
- 131 SPACs have gone public so far in 2021 (WSJ, 2/12/21)
  - $38.3 Billion
  - Average of 5 new SPACs launched each day
- Boston-area investment firm Easterly Alternatives plans a fund that will invest in as many as 15 SPACs
  - A blank-check company to invest in other blank-check companies

10

10

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Advantages of Merging with a SPAC

- Accelerated IPO process
  - Skips the long process and large fees of a traditional IPO
  - Bypasses normal scrutiny an IPO receives by SEC
  - Officers, directors and major SH of private company avoid lock-up period
- Target company gains the expertise of a sponsor who has brought other companies to the public markets
- Allowed to tout their long-term growth forecasts (YouTube) instead of staying silent as a company would have to in traditional IPO
  - Loophole in the SEC's rules to protect investors
- SPAC's typically acquire companies at a premium, adding value to the private company for its earliest investors and management team
- Management can focus on operations instead of on fundraising
- Readily available funding – cash sitting in SPAC is available to target after merger

11

11

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Why Do People Form SPACs?

- Founders are the BIG winners!
- Average returns = more than 8 times their original investment*
- Only put up enough money to cover expenses before SPAC goes public
- Typically allowed to purchase warrants directly from the SPAC at a deep discount after SPAC IPO

Cons:

- Not permitted to be compensated by SPAC
- Underwriters may require founders shares to be subject to a lock-up agreement

* *Kristi Marvin, creator of data provider SPACInsider.com*

12

12

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Why Invest in SPACS – or Not

- Investors are depending on management of the SPAC to select a good company
  - Bet on me!
  - Financial incentives of management may differ from interests of public shareholders
- Speculative
  - You don't know what you're investing in until the SPAC makes a deal (BUT you have the chance to get your money back if you don't like the deal)
- No opportunity to analyze the company's fundamentals before investing
  - Access to less information post-merger
- Investor's percentage ownership may be diluted by subsequent fund-raising efforts as well as if other investors exercise their warrants
- Target has often operated at a loss
- After merger, often thinly traded and more volatile than other stocks

13

13

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What You Should Do Before Investing in a SPAC*

- Understand what the objectives of the SPAC are
- Carefully read the SPAC's IPO prospectus as well as its periodic and current reports filed with the SEC after IPO
- And, as always, any investment should align with your objectives, risk tolerance, time horizon, liquidity needs, and other factors relevant to your specific situation

**Advice to investors from the SEC*

14

14

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Questions?

Thank you!

15

15