Practical Guidance

Market Trends 2020/21: Special Purpose Acquisition Companies (SPACs)

A Practical Guidance® Practice Note by
David A. Curtiss, Paul, Weiss, Rifkind, Wharton & Garrison LLP

David A. Curtiss
Paul, Weiss, Rifkind, Wharton & Garrison LLP

This practice note discusses recent market trends regarding special purpose acquisition companies (SPACs), covering notable transactions, deal structure and process, and other key market trends, and provides an outlook for the rest of the year.

For additional information on SPACs, see Special Purpose Acquisition Companies, A Surge of SPACs in a Turbulent Economic Climate, Top 10 Practice Tips: PIPE Transactions by SPACs, and 20 Key Considerations for Private Companies Evaluating Whether to be Acquired by a SPAC. For other market trends articles covering various capital markets and corporate governance topics, see Market Trends.

Overview

As described in Market Trends 2019/20: Special Purpose Acquisition Companies (SPACs), the SPAC market entered a "boom" last year as the first half of 2020 featured 37 initial public offering (IPO) transactions raising over $10 billion, nearly matching the full year of 2019's record activity. The second half of 2020 surpassed even that performance, featuring 210 additional IPOs raising over $60 billion and, put together, the full year of 2020 was nearly a five-fold increase over 2019's record totals, according to Deal Point Data. As the first quarter of 2021 closes, the SPAC IPO market has already exceeded 2020's record totals, featuring over 297 IPOs raising in excess of $86 billion, according to Deal Point Data.

The market for SPAC acquisitions (also known as initial business combinations or de-SPAC transactions) has shown similar trends, with significant increases in announced transactions between 2019 to 2020 from 39 to 100 and total deal value from $24.4 billion to $152.7 billion. That trend has continued into 2021 as the first quarter has already featured over 96 announced transactions valued at over $217 billion.

SPACs raise capital through an IPO and, in turn, seek to acquire one or more businesses within a proscribed period of time, often two years. A SPAC is typically marketed with a focus on potential acquisitions in a specific industry or geography, although at the time of the IPO, a SPAC will not have identified a particular target. In the IPO, the SPAC sells units to the public comprised of shares of common stock and warrants, or fractions of warrants, to purchase common stock with a strike price higher than the offering price of the unit. Fifty-two days following the pricing of the IPO, or earlier at the option of the underwriters, holders can separate the units into the underlying common stock and warrants, allowing the warrants and common stock to trade separately. The funds raised by the SPAC in the IPO are placed in an interest-bearing trust account which generally cannot be disbursed other than (1) for the closing of an acquisition or (2) to redeem shares at the option of the holder upon an acquisition or extension of the life of the SPAC. The SPAC typically has an 18- to 24-month period beginning on the IPO pricing date to consummate an initial business combination, which can only be extended with approval from shareholders. In connection with the initial business combination, a SPAC will often raise additional equity through a private investment in public equity (a PIPE investment) to supplement the capital available from the trust account and provide a third-party validation of the valuation agreed with the target company in the initial business combination. Following the consummation of the initial business combination, any remaining units are separated into the underlying common stock and warrants. The existing owners of the target company often roll over a significant portion or all of their investment, joining the holders of the SPAC's common stock and PIPE investors as equity owners of the combined public company, and the outstanding warrants become exercisable for the public company common stock pursuant to their terms.

While the past year or so has featured exponential growth across the SPAC market, a few trends have emerged that appear to be particularly fueling the market expansion:

- The increase in size of de-SPAC transactions and the PIPEs raised to support them
- The tendency of successful SPAC sponsors to have multiple vehicles in the market simultaneously
- Continued tweaking of deal terms such as exercisability of warrants

In addition, we have continued to see trends from last year continue, particularly the increasing participation by large asset management firms as buyers of both the IPO and the PIPE investments raised in connection with de-SPAC transactions. In addition, the significantly increased public visibility of the SPAC structure has only lifted its stature as an attractive vehicle for private companies to enter robust public markets.

A few years ago, the SPAC market was considered a niche corner of the capital markets landscape, but the past year has served to firmly plant SPACs at the center of the U.S. public markets.

Notable Transactions

There were many notable SPAC IPOs and de-SPAC transactions in the last year given the extraordinarily active SPAC market, including Churchill Capital IV's initial business combination with Lucid Motors which featured the largest ever PIPE investment to date. In addition, the IPO market featured a significant uptick in repeat sponsors bringing iterative SPAC vehicles to market substantially simultaneously.

Churchill Capital IV's Initial Business Combination with Lucid Motors

In February 2021, Churchill Capital Corp IV (Churchill IV) announced its initial business combination with Lucid Motors, a transaction that had been the subject of market rumors which led to Churchill IV's stock price rising to over $55.00 per share in the days leading up to the announcement. The transaction valued the Lucid Motors business at $11.75 billion in the form of rollover equity and could provide the business with over $4.5 billion of capital to continue its growth: approximately $2.1 billion available from Churchill IV's trust account and a $2.5 billion committed common stock PIPE investment, purported to be the largest ever to support a de-SPAC transaction. The deal was subject to significant media attention when it was announced, in part because the PIPE priced at $15.00 per share, Churchill IV's net asset value. In general, the PIPE investment in connection with an initial business combination is sold at the same valuation as the underlying business combination so, in addition to its sheer size, the share price of the PIPE investment was a unique feature of this transaction. In addition, the PIPE investors agreed to a contractual lockup of their shares until at least September 2021, while PIPE shares in most transactions are freely transferrable post-close, subject to the combined company filing a registration statement. PIPE investors are not usually subject to significant lockup restrictions on transfer following completion of the transaction.

Social Capital Hedosophia SPAC IPOs

In the last two annual trends articles on SPACs, we featured the IPO and de-SPAC transaction of Social Capital Hedosophia, which completed its initial business combination with Virgin Galactic in 2019. Over the past year, the partnership between Social Capital and Hedosophia has exemplified another trend in the SPAC IPO market: the tendency of successful sponsors to have multiple SPAC vehicles in the market at the same time. In April 2020, Social Capital Hedosophia Holdings Corp. II and III completed their IPOs in the midst of the COVID-19 pandemic and have now both completed business combinations with Opendoor Technologies, Inc. and Clover Health Investments, Corp., respectively. After those successes, they followed in October 2020 with the IPOs of Social Capital Hedosophia Holdings Corp. IV, V, and VI. Social Capital Hedosophia Holdings Corp. V has since announced an initial business combination with SoFi, the financial services platform.

Social Capital Hedosophia is not alone in this trend. Numerous other prominent SPAC sponsors have ridden the wave of SPAC IPO activity to have multiple SPAC vehicles active.

Deal Structure and Process

Initial Public Offering

A sponsor typically forms the SPAC entity prior to making an initial filing of a registration statement—usually on Form S-1. A SPAC is most often sponsored by either (1) well-known professionals in the specific industry or geography of focus for the SPAC or (2) financial sponsors seeking to expand their investment opportunities.

The registration statement for a SPAC follows the same form requirements as any other IPO. However, since the SPAC has no operations to describe, the disclosure is relatively simple. The registration statement includes current financial information of the SPAC, including audited financial statements, and a detailed description of the SPAC structure. In addition, although the SPAC will not have identified a target, the registration statement will (1) describe the expertise of the sponsor and the executive team and (2) generally include a description of the investment opportunity in the industry or geography on which the SPAC will focus. For further information on IPOs in general, see Initial Public Offering Process, Registration Statement and Preliminary Prospectus Preparations for an IPO, Top 10 Practice Tips: Initial Public Offerings, and Initial Public Offerings Resource Kit.

Upon consummation of an IPO, the typical capitalization of a SPAC is as follows:

- 20% of the outstanding shares are issued for a nominal amount to the sponsor(s) in what is referred to as the "sponsor promote" or the "founders shares."
- 80% of the outstanding shares are issued to the public in the IPO as part of a unit that usually also contains a warrant or a fraction thereof at a price of $10.00 per unit. Each whole warrant is exercisable for a share of common stock at an exercise price of $11.50 per share, generally on the later of the first anniversary of the IPO and 30 days following completion of the initial business combination. The proceeds of the IPO, after paying a portion of the underwriting discount and other expenses, are placed in a trust account. A portion of the underwriting discount is then deferred and only paid upon the consummation of an initial business combination.
- The sponsor also purchases private placement warrants to fund the difference between the offering price to the public and the commissions and expenses paid by the SPAC such that there are enough funds in the trust to repurchase shares at the offering price of a unit upon redemption. The proceeds received by the SPAC from the privately placed warrants are referred to as the sponsor's "at risk capital" because upon a liquidation, these amounts are paid out to the public shareholders from the trust account and the warrants purchased would not have any value and would not receive any distributions.
- In addition, some SPACs include forward purchase arrangements or other equity commitments with their sponsor, its affiliates, and other investors at the time of the IPO to provide the SPAC with greater certainty that any equity funding necessary to complete an initial business combination will be available.

Business Combination

Upon consummation of the IPO, the SPAC is typically listed on either The Nasdaq Stock Market (Nasdaq) or the New York Stock Exchange (NYSE) and management of the SPAC turns its attention to seeking an existing business or assets to acquire in the SPAC's initial business combination. For additional information on listing on Nasdaq or NYSE, see New York Stock Exchange, NYSE Initial Listing Requirements Table, NYSE Continued Listing Requirements Table, Nasdaq, Nasdaq Initial Listing Requirements Table, and Nasdaq Continued Listing Requirements Table. Management of the SPAC is typically a group of people affiliated with or on loan from the sponsor who dedicate part of their time to seeking an initial business combination. Pursuant to stock exchange rules, the initial business combination must occur with one or more target businesses that together have an aggregate fair market value of at least 80% of the assets held in the trust account (excluding the deferred underwriting commissions and other items).

After signing a definitive agreement for the initial business combination, the SPAC must either (1) seek stockholder approval of the initial business combination—in connection with which stockholders may seek to have their shares redeemed (regardless of whether they vote for or against the initial business combination)—or (2) provide stockholders with the opportunity to sell their public shares to the SPAC by means of a tender offer. For additional information on seeking shareholder approval under Nasdaq or NYSE rules, see 20% Rule and Other NYSE and Nasdaq Shareholder Approval Requirements, Shareholder Approval Rules Compliance Checklist (NYSE), and Shareholder Approval Rules Compliance Checklist (Nasdaq). Whether through redemption or a tender offer, the price the SPAC must pay for the shares is an amount in cash equal to the stockholder's pro rata share of the aggregate amount then on deposit in the trust account, including interest but less amounts permitted to be withdrawn for taxes and for working capital purposes. Many SPACs restrict holders (together with others they are acting in concert with) from redeeming more than a certain percentage—generally 10% to 20%—of the outstanding public shares in order to discourage holders from accumulating large blocks of shares. This is often referred to as the "Bulldog provision" (named after an activist investment fund that in 2008 accumulated a large stake in TM Entertainment and Media and attempted to replace the board of directors and force an early liquidation of the SPAC).

The choice to seek stockholder approval of the initial business combination or to conduct a tender offer for its shares is in the discretion of the SPAC, generally in consultation with the counterparties to the business combination. The decision is based on a variety of factors, including whether the completion of the business combination otherwise requires approval of the SPAC's stockholders (such as authorization to amend the formation documents or to issue 20% or more of the outstanding shares) and the timing of the transaction. In addition, a business combination is often structured to supplement the trust account (or to backstop any redemptions) through issuance of new equity in the combined company at closing through previously arranged equity instruments or through a PIPE investment. The PIPE investment, the terms of which may vary widely, may be committed at signing or marketed to potential investors between the signing and closing of the business combination. Initial business combination transactions can also include additional financing transactions, such as committed debt financing to refinance existing debt of the target company. The process from signing to closing typically takes two to five months, depending on the stockholder and regulatory approvals necessary to complete the transaction.

Proxy

If the SPAC submits the initial business combination to a shareholder vote, it will typically either prepare and file a proxy statement with the SEC on Schedule 14A to be mailed to shareholders or prepare a registration statement on Form S-4 to register shares issued in the initial business combination and include the proxy statement in the registration statement. The SPAC proxy contains all the information that is typical for a large merger, including the target's current and historical audited and interim financial statements as well as other detailed disclosure about the target company or companies. Often targets in initial business combinations are not regularly preparing financial statements that meet SEC filing requirements or being audited under the standards of the Public Company Accounting Oversight Board. In that case, preparing the information can be a significant impediment to timely filing the proxy statement, which affects the timing of closing the transaction. The proxy will also contain a complete description of the post-transaction company and its management, directors, governance structure, and material contracts (including any debt financing agreements related to the de-SPAC transaction). The proxy is also used to offer the shareholders their redemption rights pursuant to the SPAC's charter documents. For additional information on proxy statements, see Proxy Statement and Annual Report Drafting, Solicitation, and Distribution, Proxy Statement and Annual Meeting: Creating a Timeline and Checklist, Top 10 Practice Tips: Proxy Statement and Annual Meeting, and Proxy Statement and Annual Meeting Resource Kit.

If the business combination contemplates a tender offer in lieu of a proxy/redemption, the SPAC will prepare a Schedule TO, which includes a similar level of disclosure about the target company or companies and the terms of the transaction as the proxy statement. For more information on tender offers, see Tender Offers Distinctive Characteristics and Commencement of the Tender Offer.

Liquidation

Pursuant to its formation documents, if a SPAC is unable to complete the initial business combination within a set time period (usually 18 to 24 months from the IPO, subject to extension), the SPAC will (1) cease all operations except for the purpose of winding up; (2) redeem the then outstanding public shares for cash at a per share price equal to the aggregate amount then on deposit in the trust account, including any earned interest, divided by the number of then outstanding public shares; and (3) as promptly as reasonably possible following such redemption, dissolve and liquidate, subject in each case to the SPAC's obligations under applicable law, including to provide for claims of creditors. A SPAC can seek to have the initial time period to seek a business combination extended, so long as it offers holders of the outstanding public shares the redemption rights they would have upon liquidation currently with seeking such extension. The SPAC's officers and directors waive their rights to liquidating distributions from the trust account with respect to any shares held by them prior to the IPO, but not with respect to any public shares they acquire in the IPO or in the public markets thereafter.

Other Key Market Trends

While the SPAC market has seen significant growth over the past year, the structure of the SPAC continues to be refined. One recent adjustment is the increasing appearance of warrants which do not include the requirement they remain unexercisable for a year following the IPO. Traditionally, the warrants have been exercisable on the later of the first anniversary of the IPO and 30 days following the business combination. In addition, traditionally the warrants include a redemption feature that has the effect of giving the company the option to force holders to exercise the warrant if the stock is trading above a prescribed trading price (usually either $10.00 with a make whole provision or $18.00 per share). The primary driver for the one-year seasoning of the warrant stems from a Securities and Exchange Commission (SEC) requirement that the common stock underlying the warrants would need to be registered on the initial S-1 registration statement if the warrants were exercisable less than a year from their issuance.

Historically, there has been a desire to minimize SEC filing fees and thus choose not to register the shares underlying the warrants. However, as the time between a SPAC IPO and the consummation of an initial business combination has decreased, more and more SPACs are finding that potential target companies prefer the flexibility to redeem or force the exercise of the warrants sooner. As a result, SPACs are starting to choose to register the shares underlying the warrants simultaneously with the IPO and provide for warrants with terms that do not require a one-year seasoning period following the consummation of the IPO. This has the added benefit of allowing the combined company to accelerate the redemption of warrants following the initial business combination and address the potential dilution from the exercise of warrants on an expedited basis.

Market Outlook

The SPAC market experienced unprecedented growth in 2020, and continued that pace into 2021. The SPAC structure provides privately held businesses with a tried and true path to becoming publicly traded on an expedited time line compared to a traditional IPO, diverting less of management's time to the transaction process and allowing management to focus on running the business. The plethora of SPACs that have completed an IPO should provide a robust pipeline of de-SPAC transactions over the next few years as existing SPACs seek partners for their initial business combinations. In addition, the first quarter of 2021 has shown that market interest in SPAC IPOs remains strong following on the heels of a record breaking 2020. Following the deluge of SPACs entering the market in the past few quarters, we would expect activity in the de-SPAC market to continue to grow as SPACs find targets and work to close initial business combinations.

David A. Curtiss, Counsel, Paul, Weiss, Rifkind, Wharton & Garrison LLP

A counsel in the Corporate Department, David Curtiss focuses his practice on initial public offerings, "follow-on" equity offerings, high-yield debt offerings, SPAC transactions, private preferred equity and PIPE investments, in and out of court restructuring transactions, leveraged buy-outs, and investment grade debt offerings.

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