THE PROS AND CONS OF CHOOSING A SPAC OVER AN IPO

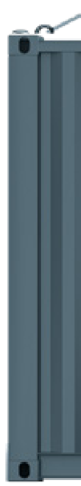
The exceptional environment for capital raising has led to a dramatic surge in the use of special purpose acquisition vehicles (SPACs). While SPACs offer several advantages for private companies ready to go to market, Dean Bell, Transaction Services Service Line Leader at KPMG US, points out some of the complexities to consider.

Arguably the best metaphor that signalled the meteoric rise of SPACs came in October 2019, when entrepreneur Richard Branson took his spaceflight company Virgin Galactic public through a $1.5 billion merger with Social Capital Hedosophia Holdings. Interest in SPACs – so-called "blank cheque companies" which exist solely to acquire other companies – has been stratospheric ever since.

According to data provider Refinitiv, SPACs have raised a staggering $79.4 billion globally since the beginning of the year, eclipsing the record-breaking $79.3 billion that flooded into SPACs in 2020. So far this year, 264 new SPACs have been launched, overtaking last year's record of 256. Clearly, the explosive growth of SPACs shows no signs of abating, and their advantages have left the conventional IPO route looking flat-footed in comparison.
As Dean Bell explains: "SPACs have proven themselves to be an extremely effective way for private companies to tap into public equity markets. It's more efficient from a cost and implementation perspective, and opting for the SPAC route to market can add up to 20% to a sale price or reflection of the public market premium (according to Ellenoff Grossman and Skoal LLP)."

THE ADVANTAGES OF SPACS

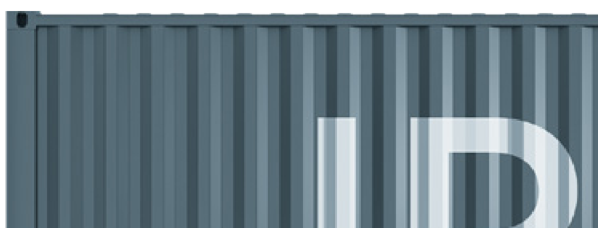
SPACs have become synonymous with speed. On average, a SPAC merger takes three to six months through to completion, whereas an IPO is likely to take 12-18 months. Naturally, reducing the timeframe is highly appealing as it minimises the possibility of the deal falling through. Another significant advantage SPACs have over a conventional IPO is the incentive of a guaranteed price. With an IPO, the price is dependent on market conditions at the time of listing, which can lead to disappointment during periods of volatility. With a SPAC, however, the price is negotiated before the transaction closes. Additionally, using a SPAC to go public gives companies the flexibility to raise additional capital when required.

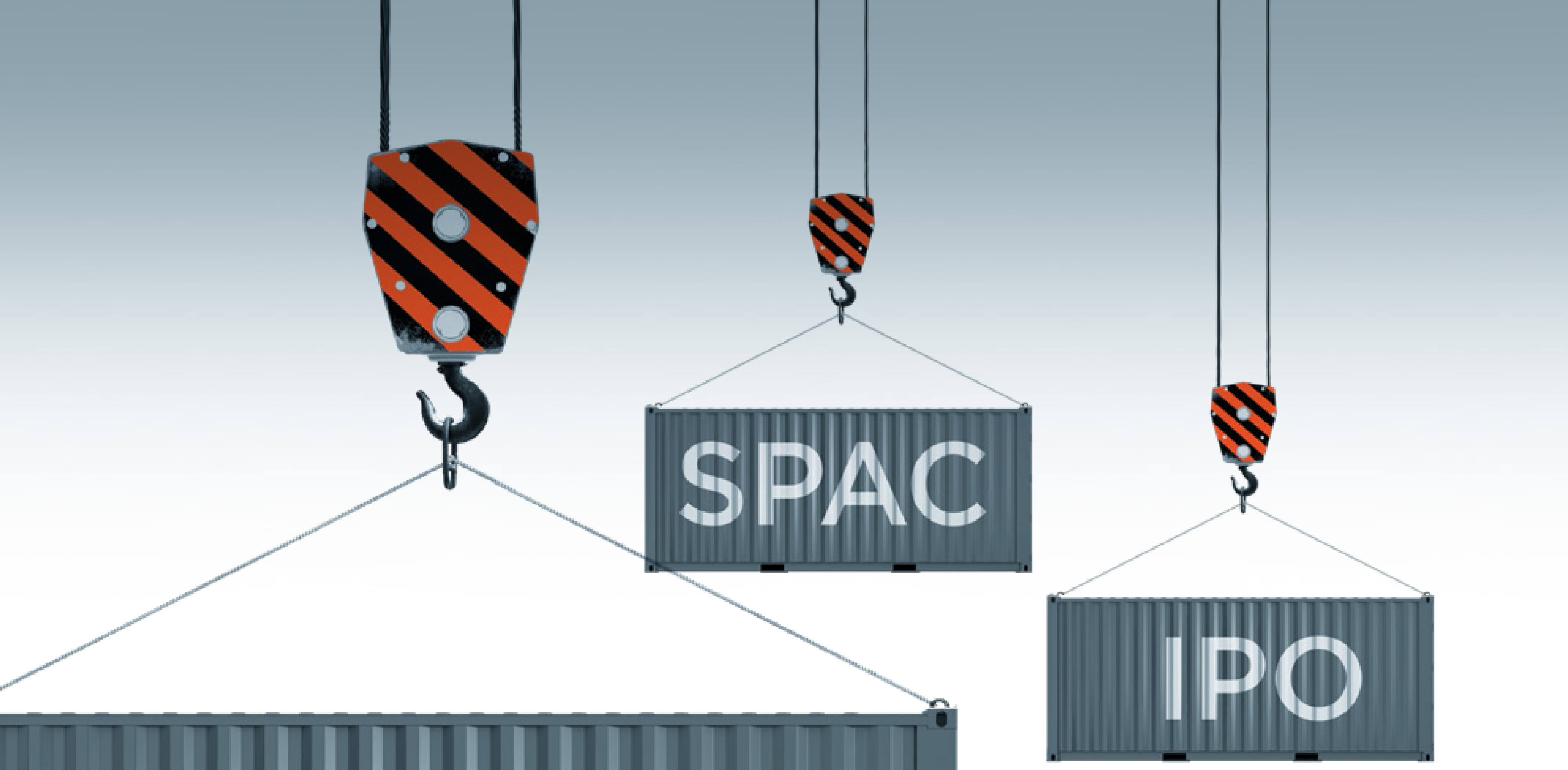


EXECUTION RISKS TO CONSIDER

While speed is often the decisive factor in choosing a SPAC over an IPO, compressing the timeline to "get ready" to go public can be hazardous. Although the SPAC sponsor may offer help during the merger process, the target company will usually bear the brunt of preparing financials, such as SEC filings, as well as establishing key internal controls and essential public company functions, including investor relations.

Similarly, the SPAC process does not require the rigorous due diligence of a traditional IPO, and a reduced timeframe introduces the risk of lower levels of financial diligence being conducted. In a worse-case scenario this could lead to potential restatements, incorrectly valued businesses, or even lawsuits.
Bell explains: "The more a company peels away at a SPAC merger, the more it is likely to find 'unknown unknowns' that need to be addressed and resolved at pace. That's why SPACs are really more suitable for companies that are demonstrating a degree of maturity, and where they have already embedded value creation and operational excellence."





QUESTIONS TO CONSIDER

Common targets for SPACs include companies currently held by private equity funds, as well as corporate spin-offs and family-owned firms with significant operational and internal controls. But before deciding, the boards of directors of such companies need to ask themselves whether they have fully assessed the advantages and disadvantages of choosing a SPAC merger over an IPO. This means having a clear understanding of the goals of the transaction, as well as conducting an honest appraisal of the company's own strengths and weaknesses.

DUE DILIGENCE, DISCLOSURE AND REPORTING

For example, it is important to ensure the company is capable of getting up to speed with public company reporting requirements. Does the Board believe that the company is prepared for the due diligence process, including making historical financial statements available? Are system upgrades urgently required? Does the company have an appropriate internal control structure? What would be needed to scale up compliance reporting and disclosure, including establishing proper board governance and investor relations teams?

LEADERSHIP AND STRATEGIC DIRECTION

Given that SPAC sponsors usually expect to take a 20% stake in the SPAC through founder shares, vetting any potential SPAC suitors, and determining their experience and sector expertise, should be a top priority. Does it have a track record in completing SPAC transactions? Is the Board still aligned with management on the strategic direction of the company? How might the strategy shift under new ownership and/or an infusion of equity capital? Given that initial SPAC investors can redeem their shares, is there a plan in place should redemptions result in a capital shortfall?

With SPACs in the ascendency, many private companies will be wondering whether merging with a SPAC would be preferable to an IPO. As Bell explains, there is no easy answer: "SPACs offer private companies the chance to fast-track an IPO process, but SPAC mergers aren't simple, and understanding all their intricacies can be daunting. Companies should therefore look beyond the attraction of speed and a guaranteed price and consider what is best for the company. It is essential to find an experienced partner with deep understanding of the complexities of the filing process, and to have a SPAC sponsor who understands the business and its long-term objectives." *

Contact:
Tim Toska
Global Head of Private Equity
+1 203 309 6120
Tim.Toska@alterDomus.com