What’s The Deal With SPACs?

By Jeff Weinstein aka SPACboi

December 17th, 2020

DISCLAIMER

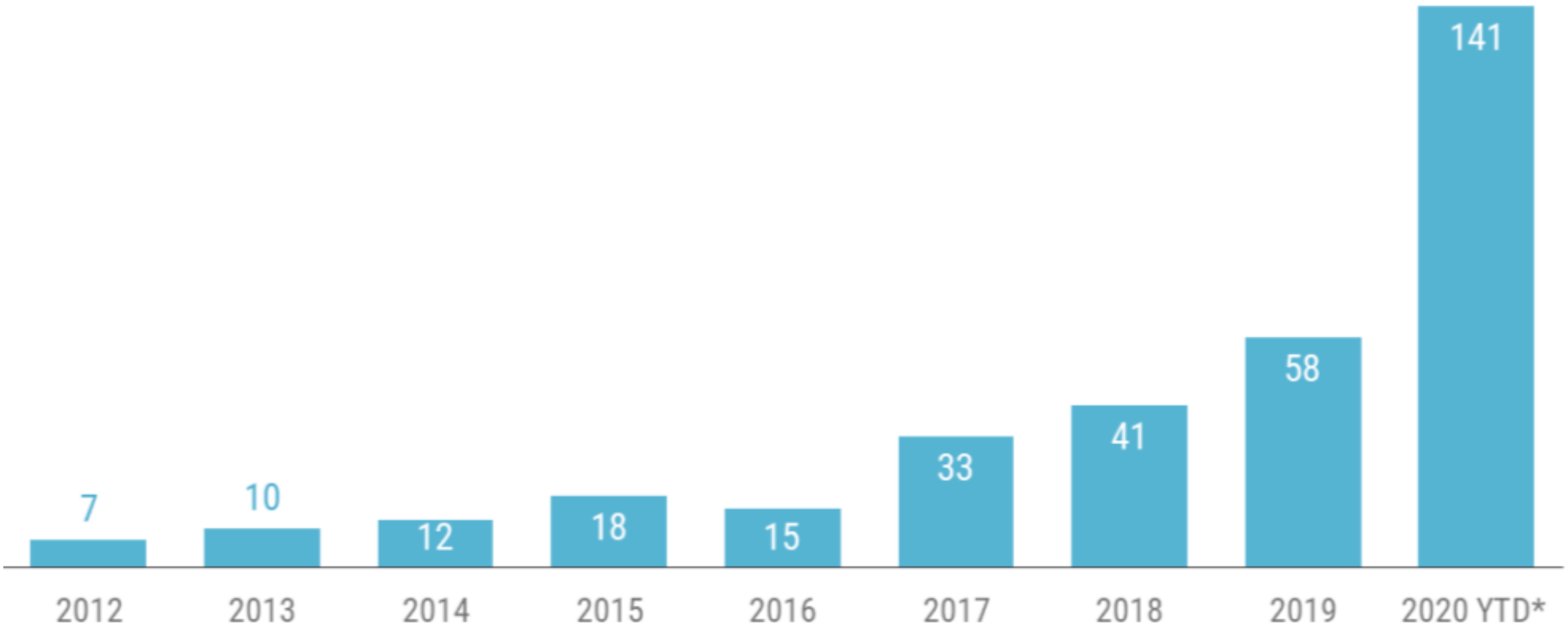
- Nothing here is investment advice or anything like it!
- I am a simple VentureBoi who is fascinated by markets and SPACs.
- These are my views only!

SPAC MANIA!

BREAKING: new $10bn SPAC just launched with an all-star sponsor roster

SPAC IPOs have spiked in 2020

Number of SPAC IPOs annually, 2015 – 2020 YTD (10/15/20)




ACKMAN'S "SPAC"
Targets: mature unicorns, family-owned businesses, large private equity portfolio companies, and companies that would go public through traditional IPO
BREAKING NEWS
ACKMAN: THIS IS FIRST SPAC WITH NO SPONSOR COMPENSATION


INTRODUCING
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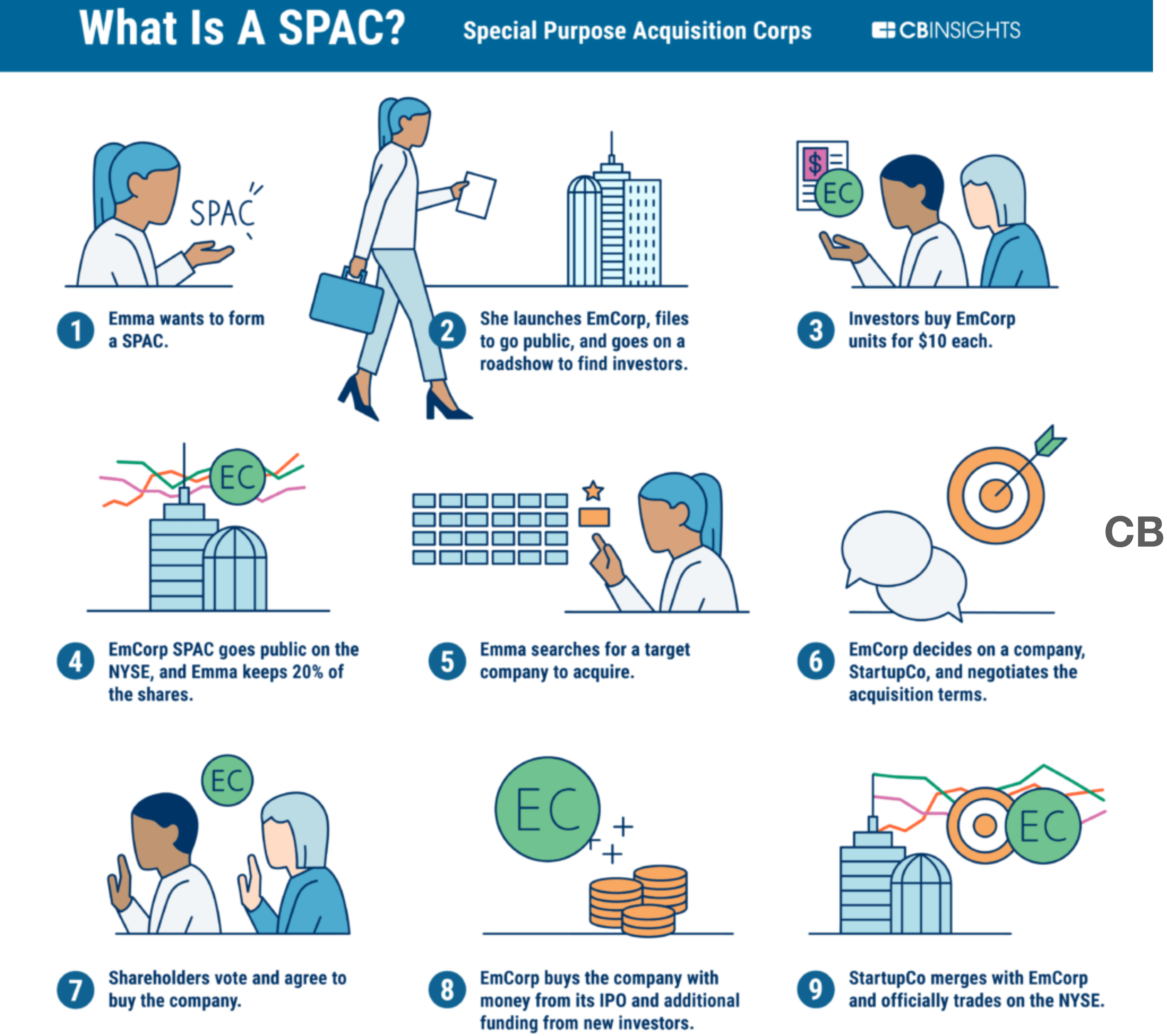
What is a SPAC?

- **S**pecial **P**urpose **A**cquisition **C**ompany (or a “blank check company”)
- First invented in 1990s. Gradually gained popularity starting in 2014, but really exploded in 2020.
  - Initially had sketchy reputation, suffered from adverse selection as fees were exorbitant and companies often failed and stock underperformed. Frequent pump and dump schemes.
  - Gained mainstream investor acceptance in the past 5 years
- A shell company designed to take companies public without the traditional IPO process
- Investors raise a blind pool of capital in an IPO, which they then use to go take a company public through a reverse merger.
- Typically raise ~$200M (Smallest is $40M, largest ever has been $4B).
  - SPAC size dictates the terms. $200M SPAC + $400M PIPE = $600M txn, 20% dilution, ~$3B valuation
- Units typically price at $10/share on Nasdaq (75% of SPACs) and then trade
- **Use it or lose it!** Sponsor has to close a transaction in 2 years or they have to return $.



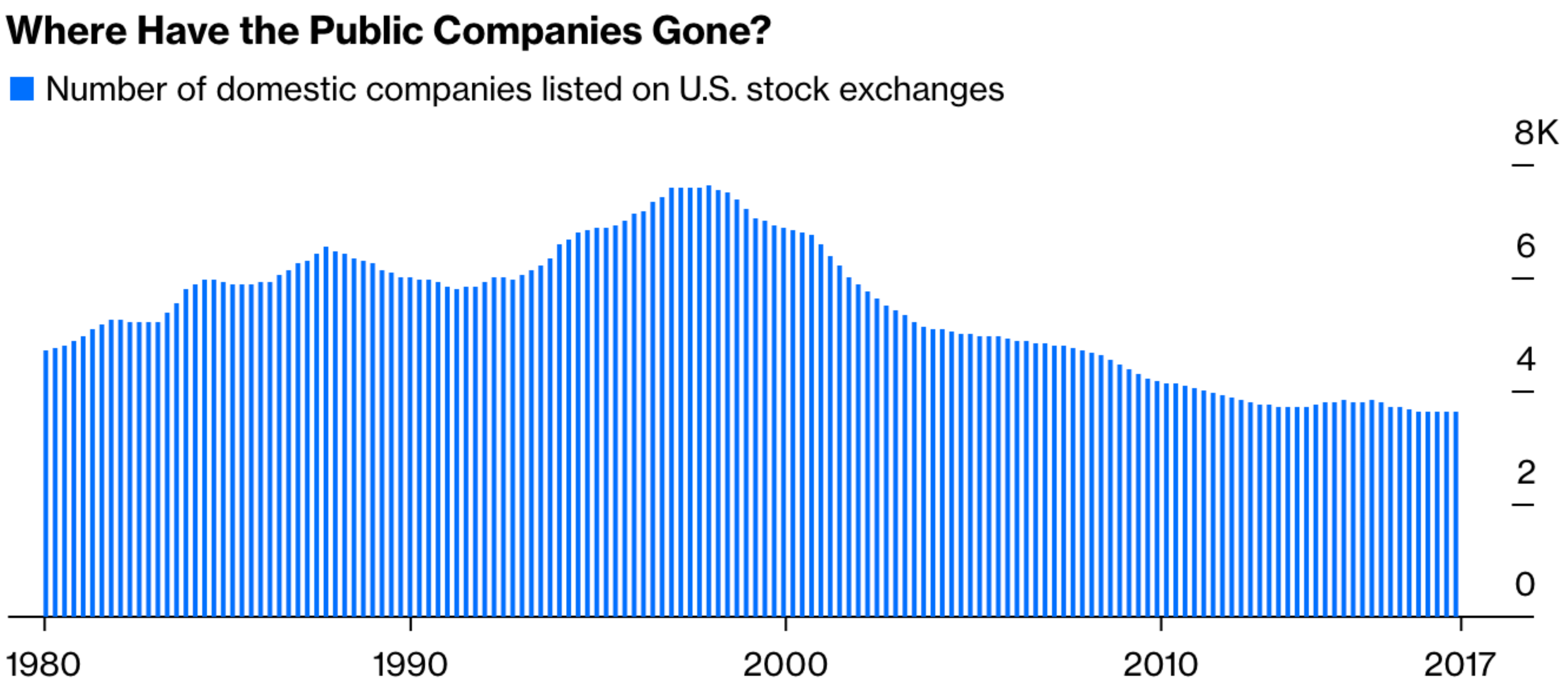
CB Insights report: "What is a SPAC"
-Recommended reading!

Why Now? #1: STONKS!

- Public market euphoria! Extreme risk-on environment.
  - Record low interest rates + unprecedented global fiscal stimulus has led to expansion of asset prices.
  - U.S. stock markets at all-time highs and IPOs popping 100% ($DASH, $ABNB)
    - Public market multiples have exploded past private ones. Financial incentive for being public.
  - Capital markets are wide open for IPO and SPAC issues
    - Institutions have caught wind of SPAC arbitrage opportunity
    - Retail hunger across speculative equities: Robinhood-ification of stock market (DDTG Global)
  - Chance for companies to tap public markets for minimal dilution.

Why Now? #2: Supply and Demand

- More late-stage private companies (500+ unicorns) than ever before.
- ~50% decline in number of public companies over the last 20 years



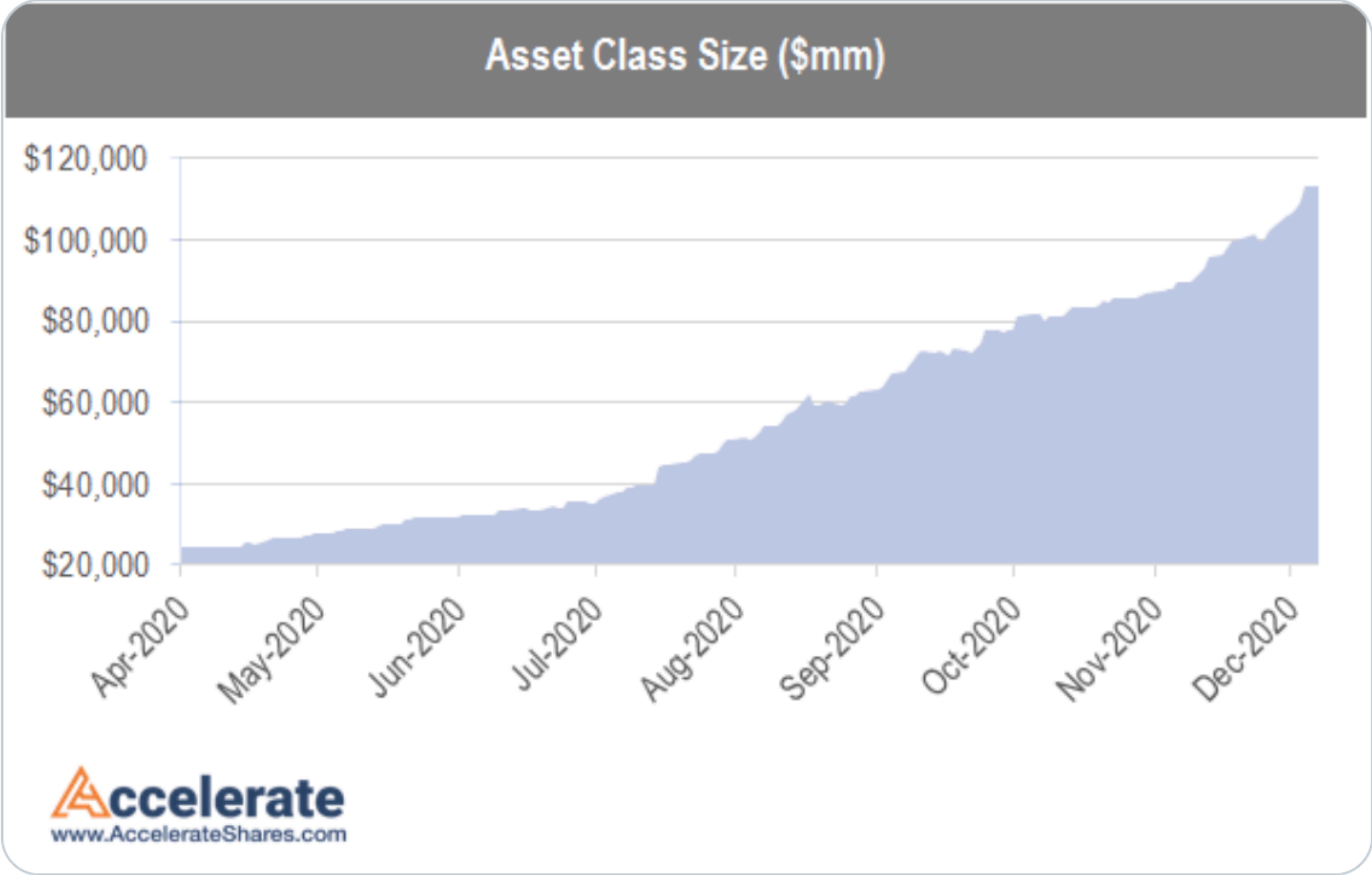
Why a SPAC? Sponsor Perspective

- **$$$$$$$$$$$$$$$$$$$$$$$$$$$$$$$$$$**
- Sponsor typically invests 2% of IPO raise. Pays a nominal amount ($25K) and typically gets 20% of IPO shares (aka “promote”) post-merger.
  - i.e. If a SPAC raises $100M and de-SPACs (reverse merges), Sponsor in total funds $2.025M and gets $27.025M of shares at merger valuation.
  - Even if combined stock drops by 90%, sponsor still makes money…….
  - Fees are *starting* to compress due to competition. But not there yet.
    - Bill Ackman raised the largest SPAC ever ($4B, $PSTH) and charged zero promote.

The Arbitrage King 👑
@JulianKlymochko

The current SPAC market of $113 billion represents nearly $23 billion of embedded compensation to sponsors

One of the greatest fee generators that asset management has ever seen



10:10 AM · Dec 15, 2020 · Twitter Web App

Why a SPAC? Company Perspective

- Speed and certainty.
  - Years to prep for a traditional IPO. SPAC process can be 3-4 months.
  - One counterparty (the acquiring SPAC) v. many in an IPO roadshow.
- Strategic partner / Brand Halo
  - Can partner with strategically relevant sponsors (who can be value-add). Chamath is Chairman of Virgin Galactic ($SPCE), super promotional, operational expertise
- SPACs let you offer **<u>forward guidance</u>**
  - SEC prohibits IPOs from communicating forward guidance to private investors (quiet period). Have to stand on public financials. OK for SaaS (predictable revenue) but what about frontier tech? (**JW: Also the highest risk companies!!)**
  - With SPACs, you can educate investors in private and walk them through tech, nuances, etc!
- Price discovery
  - SPACs allow you to negotiate and set valuation w/ sophisticated sponsors, not potentially float mis-priced IPOs with many players ($DASH, $ABNB, $WEWORK)

Exit Option Comparion - h/t John Luttig

	SPAC	Bank-led IPO	Corporate M&A	PE buyout	Direct listing
Startup timeline	4-6 months	12-18 months	5-9 months	6 months	12-18 months
Fees	High	Highest	Low	Low	High
Existing shareholder upside	High	High	Moderate	Low	High
Founder control	High	High	Low	Low	High
Deal structure (earnouts, conditional fees)	Flexible	Rigid	Moderate	Flexible	Rigid
Diligence period	Flexible	15 days	Flexible	Flexible	15 days
# prospective investors	Low	High	Medium	Medium	High
Execution risk	Low	Medium	Low	Low	Low
Pricing accuracy	High	Low	Moderate	High	Perfect
Universe of eligible startups	Wide	Narrow	Moderate	Moderate	Very narrow

Why a SPAC? Institutional Investor Perspective

- In a low-yield world, this is an incredible pace for investors to park cash for optionality.
- In addition to shares in the SPAC, investors into the IPO (*not* retail bros) get:
  - Warrants to purchase more shares (Typically 25-100% coverage at $11.5 v. $10 issue) as soon as 30 days after merger (aka “de-SPAC”).
    - If company pops, you can exercise the warrants and immediately flip them.
- The ability to redeem at cost (plus interest) if you don’t like the target.
  - ***<u>Shareholders that redeem their shares keep the warrants that were in the units sold in the SPAC’s IPO!!!</u>***
- ***<u>= ARBITRAGE!</u>*** “Among the 2019-20 Merger Cohort, the mean annualized return for IPO investors that redeemed their shares was 11.6% – **<u>for a risk-free investment.</u>**”
  - Thus, institutions are fickle! Stanford/NYU Law study: the mean and median redemption rates in the 2019-20 Merger Cohort are 58% and 73%.
  - Bankers assist w/ post-transaction support/backstop.

Arbitrage = All the "Smart Money" wants in

The Arbitrage King 👑 @JulianKlymochko · 23h

Getting SPAC IPO allocations is competitive af these days, with deals often 3-4x oversubscribed despite being upsized (I call this the Millennium / Citadel effect)

It's no surprise given the 2-6% first day bump

Everything is trading to a premium

New SPACs

IPO Date	SPAC	Market Cap ($mm)	Unit Price
15-Dec-20	Marquee Raine Acquisition	$344.5	$10.60
15-Dec-20	Blue Water Acquisition	$50.8	$10.15
15-Dec-20	KINS Technology Group	$305.1	$10.17
15-Dec-20	Americas Technology Acquisition	$132.0	$10.15
11-Dec-20	Thayer Ventures Acquisition	$194.1	$10.35
11-Dec-20	Motive Capital	$532.0	$10.28
11-Dec-20	Senior Connect Acquisition	$450.2	$10.35
11-Dec-20	RMG Acquisition II	$452.4	$10.49
11-Dec-20	Roth CH Acquisition II	$131.3	$10.29
11-Dec-20	Globis Acquisition	$103.0	$10.30

Why a SPAC? Retail Perspective

- Access:
  - Invest in compelling late-stage private companies that were previously inaccessible
  - Back a compelling sponsor who you believe in (Chamath, Bill Ackman, Firstmark, Ribbit Capital, Apollo, etc)
  - (Disclosure: I have a tiny position in FMAC.U)
- #STOCKSONLYGOUP / YOLO

SPACs can perform very well post-merger!

Market Summary > Draftkings Inc
NASDAQ: DKNG

+ Follow

53.80 USD +3.30 (6.53%)

Closed: Dec 16, 5:51 PM EST · Disclaimer
After hours 54.38 +0.58 (1.08%)

1 day | 5 days | 1 month | 6 months | YTD | 1 year | 5 years | **Max**

Open	50.82	Div yield	-
High	54.34	Prev close	50.50
Low	50.13	52-wk high	64.19
Mkt cap	21.07B	52-wk low	10.09

One More Wrinkle: The PIPE

- **P**rivate **I**nvestment in a **P**ublic **E**ntity.
- Almost every SPAC now has a PIPE as part of it (contingent on closing the SPAC)
- Unlike SPAC investors, PIPE investors know what they are investing in.
- Can be used to backstop equity redemptions or add additional equity.
- Typical PIPE:SPAC ratio of 1-2:1. If this is the case, then effective fee structure of whole transaction becomes a bit more reasonable (6-8% blended)
- Invest at the same price as the IPO.
- High-quality sponsors typically attract the best PIPEs investors: PE/crossover funds or strategics w/ long-term mindset. Offers stability in investor base and credibility.

Adverse Selection: The Flashing Yellow Light

- There are 200+ SPACs currently hunting for merger targets. The 2-year clock is ticking.
- Yet the best companies are still going public via IPO/direct listing ($DASH, $ABNB, $SNOW, $PLTR).
- <u>**SPACs HAVE NOT YET SHOWN THE ABILITY TO TAKE PUBLIC ELITE UNICORNS.**</u>
    - The companies in our ecosystem being SPAC-ed are not our superstars.
    - Current fee structures don’t make sense. And SPAC investors are typically short-term (ref: arbitrage)
    - IPOs are still the more prestigious, chosen, tried-and-true route for founders.

Why NOT a SPAC?

- **Company Perspective**
  - VERY expensive. SPAC fees (5% to banker, 20% to sponsor) are 3-4X what you pay in an IPO. Note: PIPE can defray this (more to come)
  - Short-term-minded new investors. Citadel, Millennium, Third Point etc. are not your friends!
- **Institutional Investor Perspective**
  - Arbitrage. Only downside is opportunity cost.
- **Sponsor Perspective**
  - Reputational risk if SPAC tanks. Might not outweigh get-rich-quick :)
- **Retail Bro Perspective**
  - You’re likely being dumped on. ***BEWARE***.

Post-Merger/De-SPAC Returns…No Bueno

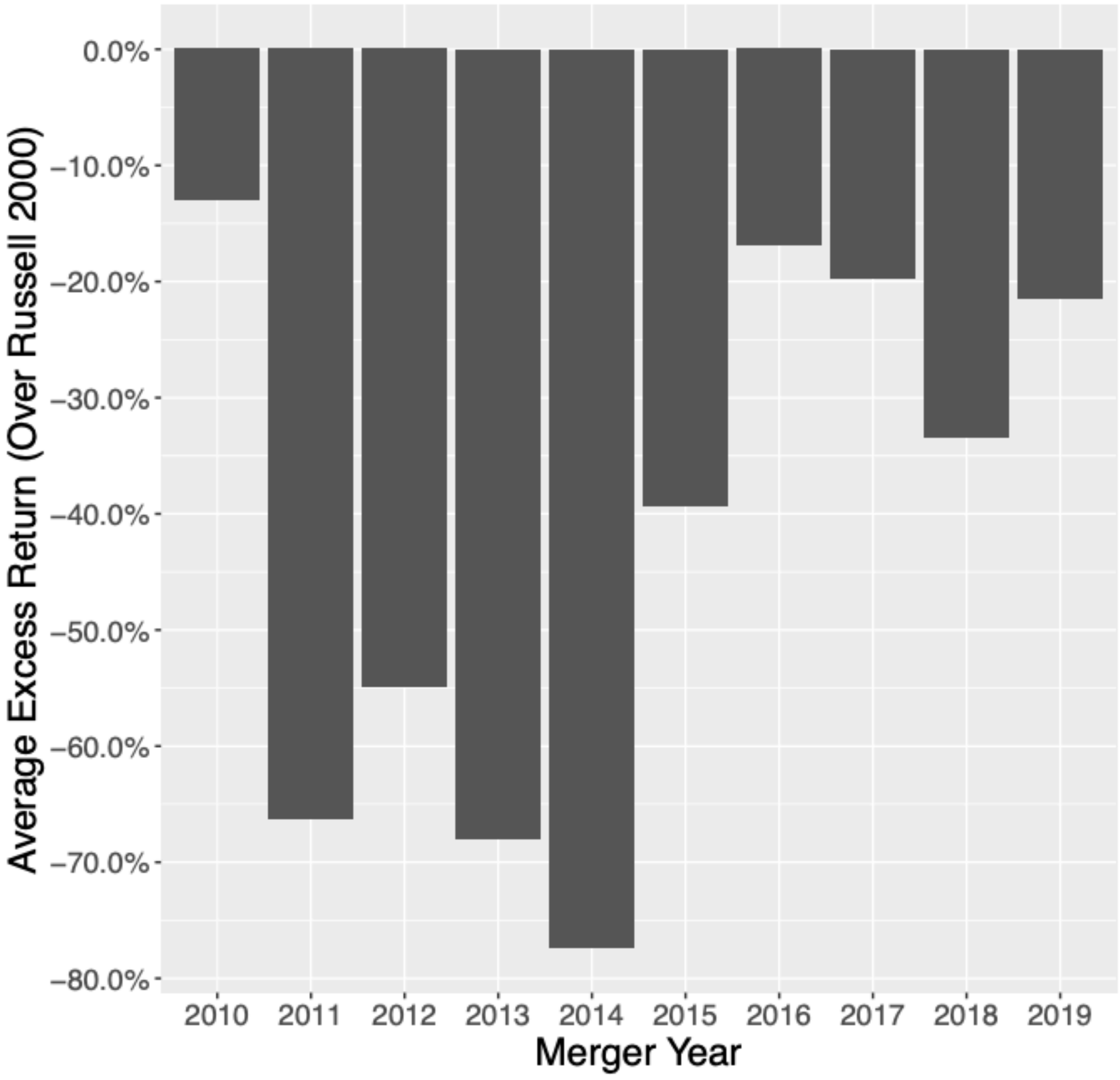
- From Stanford + NYU Law School “A Sober Look at SPACs” - November 19, 2020
- Analyzed 47 SPAC mergers between January 2019 between and June 2020

Table 6: Post-Merger SPAC Returns – 2019-2020 Merger Cohort

	Three-Month			Six-Month			Twelve-Month		
	All	**HQ**	**Non-HQ**	**All**	**HQ**	**Non-HQ**	**All**	**HQ**	**Non-HQ**
Mean Return	-2.9%	31.5%	-38.8%	-12.3%	15.8%	-37.6%	-34.9%	-6.0%	-57.3%
Median Return	-14.5%	-4.6%	-46.9%	-23.8%	-15.9%	-43.0%	-65.3%	-34.6%	-66.3%
Mean Return (Excess over IPO Index)	-13.1%	25.1%	-53.0%	-33.0%	0.4%	-63.1%	-47.1%	-11.8%	-74.6%
Median Return (Excess over IPO Index)	-32.8%	7.1%	-52.1%	-43.2%	-31.0%	-56.3%	-56.5%	-54.8%	-89.9%
Mean Return (Excess over Russell 2000)	-1.3%	37.5%	-41.9%	-10.9%	22.5%	-41.0%	-21.5%	9.7%	-45.7%
Median Return (Excess over Russell 2000)	-16.1%	16.9%	-47.2%	-17.5%	-2.4%	-57.0%	-44.9%	-36.3%	-55.0%
N SPACs	47	24	23	38	18	20	16	7	9

Post-Merger SPAC Returns. YIKES.

Figure 8: Average One-Year Post-Merger Returns (Excess Russell 2000) for Earlier SPACs



When DO SPACs Make Sense Today?

- Frontier tech companies who can offer forward guidance
    - Desktop Metal ($DM, Lux-backed 3D printing company)
    - Quantumscape ($QS, Bill-Gates/Khosla/VW backed battery company)
    - Nikola ($NKLA, electric car super-fraud)
    - *JW question: biotech companies IPO all the time. This lack of revenue traction hasn't stopped them in the past. Is the difference clinical trial data?*
- Strong consumer appeal ($DKNG, $SPCE)
- No clear public comps (pre-rev tomato growing company AppHarvest…)
- (*Potentially*) Elite unicorns w/ superstar sponsors (i.e. Stripe <> Ackman or Reid Hoffman's SPAC?)

Some LEGIT VCs Are Doing SPACs

FIRSTMARK

DRAGONEER INVESTMENT GROUP

Ribbit Capital

GENERAL CATALYST

ALTIMETER CAPITAL

LUX

Why Are VCs doing SPACs?

- VCs can pitch to founders “We can fund you from Seed all the way to IPO”
- Who knows private companies better than the VCs who evaluate and invest in them?
- Can you take a portco public?
    - Potential conflict of interest, but yes. Can be mitigated w/ independent board members, recusing yourself from target BoD. Hasn’t been done yet AFAIK.
- VC fund (not management) typically serves as sponsor (i.e. Lux Ventures 6 serves as the Sponsor). Aligns incentives and can potentially juice fund returns big-time!
    - Imagine a $500M fund that sponsors a $300M SPAC ($60M of promote for ~$6M down with massive upside potential). Crazy IRR/MOIC!

My Take:

- We are in a mania. Most SPACs are pump-and-dumps (particularly some of the EV stocks). $NKLA is still trading at $6.5B valuation. $QS is $30B 5 years out from any revenue and unproven tech.
  - Retail bros are going to get hurt. Badly.
  - The SEC will (and probably should) regulate SPACs more in response. Right now it is the Wild West out there. Read up on Trevor Milton and the Nikola story.
- **<u>BUT</u>** this model is very compelling and seriously players are starting to get involved. **<u>The SPAC is here to stay.</u>**
  - VC/PE interest is real and logical.
  - Fees will compress (See Ackman/$PSTH).
  - Value proposition to all sides (minus retail) makes sense.
  - Some elite companies will go public via this model w/ the right economics and the right sponsors.

Questions? Thank you!