



Taking stock: How to assess SPACs and other IPO options in a post-pandemic market

Quick: What do Bill Ackman, Condoleezza Rice, and Paul Ryan now have in common?

As it turns out, the hedge-fund manager, the former Secretary of State, and the ex-Speaker of the House are each involved, to one degree or another, in launching a special purpose acquisition company (SPAC).

Sometimes referred to as “blank-check” companies, [SPACs](#) reverse the traditional IPO process, wherein an operating business taps the capital markets for funds. SPACs go public first, with a well-regarded executive or team raising money based on its intention to identify and acquire a private company that it can then fold back into its public shell, usually within two years.

Investors are betting on the reputations and skills of the SPAC’s management team and sponsors to identify and consummate a value-creating deal. And in a year beset by a pandemic, a healthy appetite for new growth companies has driven SPAC IPOs to new heights, raising a total of \$64.8 billion—as of mid-November, handily shattering last year’s record of \$13.6 billion.¹

SPACs, though, are only the lead driver in an IPO market where, as of mid-November, the number of IPOs reached 369—a 73% increase over the same time last year.² Moreover, SPACs are not the only “alternative” to traditional IPOs making news: direct listings (DL), whereby a company’s existing shares are listed on a stock exchange, giving

founders, employee shareholders, and early backers a path to liquidity, are also gaining some traction with two such offerings completed in September.

For CFOs, these trends mean that the future offers distinct choices for going public. Even though many of these options are not new—SPACs, for example, have existed in various forms since the 1990s—the opportunity to go public quickly and at potentially less expense has acquired new appeal in the era of COVID-19. And in this issue of *CFO Insights*, we’ll outline some of the options for finance executives, helping them parse their choices. Will SPACs, now a growing sub-asset class within IPOs, maintain their momentum? [▶](#)

Has the pandemic driven traditional IPOs the way of the firm handshake? Why take an alternative route when public companies all reach the same destination? And what additional options might emerge?

The emergence of new traditions

The economic dislocation triggered by the pandemic has reshaped the IPO landscape. In April, the spreading pandemic thumped the IPO window closed. But as the stock market began shaking off the initial blow, in June, fast-growing tech companies started peeling off the sidelines, and flexing their money-raising muscle. That was especially true for companies in industries that appeared less susceptible to the impact of COVID, such as grocery delivery, health care, gaming, and enterprise software that supported remote work.

The enthusiasm of investors coincided with the urgency CFOs and their boards felt to act fast, steering clear of the volatility likely to accompany both an election year and a resurgence of the pandemic. The prospect of spending months of preparation, only to

have the company issue shares at precisely the wrong time, heightened the appeal of upfront pricing, which reduces the uncertainty involved in going public.

The pandemic has also driven the existing IPO process to reinvent itself. The mechanics of the process have changed: the roadshow, formerly a weeklong blur of in-person meetings with potential investors across the country, is now conducted in half as many days on a computer screen. The emblematic practice of having the members of a newly minted IPO crowd swarm the NYSE bell-ringing platform is relegated to a pre-pandemic relic.

Sensing a narrow window of opportunity, many CFOs, who may have traditionally wrestled with *when* to take their companies public, now are spending time considering *how*. Their main options include:

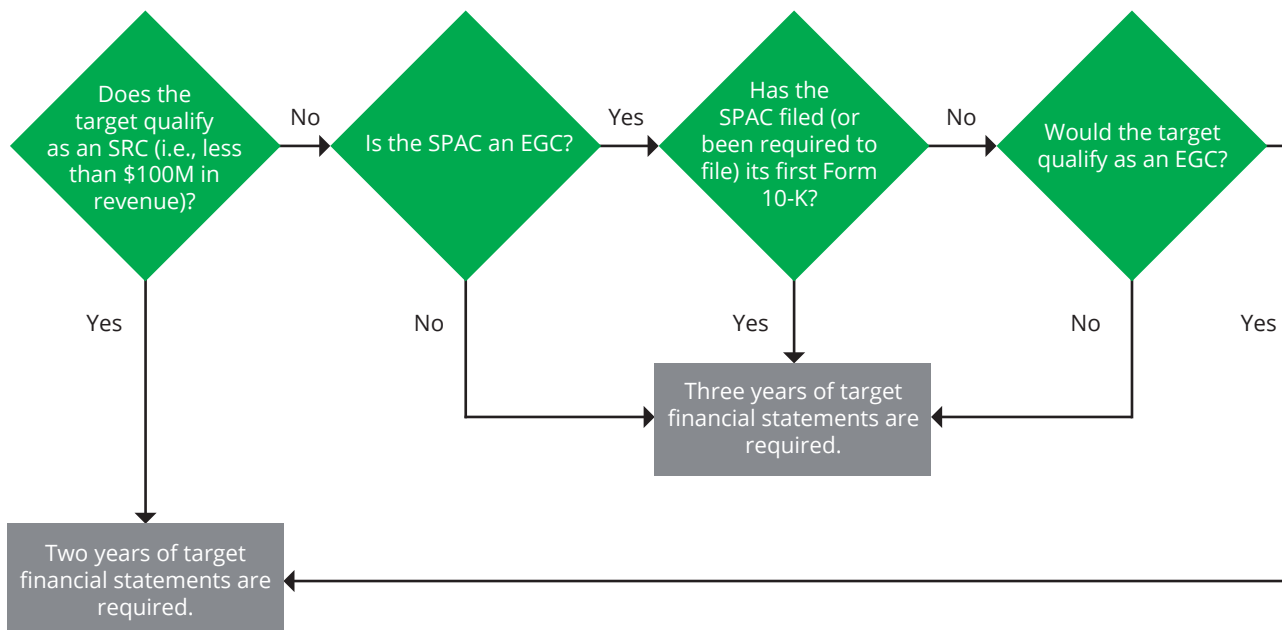
- **Traditional IPOs.** For all their safeguards, traditional IPOs are hardly built for speed. Offerings typically represent the most well-orchestrated event in a company's

financial history. CFOs and boards select an underwriter. Investment banks then shepherd businesses through the process, identifying institutional and retail investors who are philosophically aligned with the business—in it for the long term, in other words. They also help line up research to support the stock. On the day the stock opens, the “pop” in value, which now averages about 36%,³ elicits both euphoria and concerns that the offering was underpriced.

- **Direct listing.** Since streamer Spotify (2018) and communication platform Slack (2019) have gone the direct listing route, a couple of others have followed suit, both this past September. The direct listing path to going public tends to be quickest because moving existing shares to a stock exchange requires much less regulatory scrutiny. And the absence of any primary or secondary underwriter, and any associated fees, lowers costs. Both Spotify and Slack were ahead of their time in that they replaced a traditional toe-to-toe roadshow with streamed investor presentations.

Figure 1: Paper trail: The amount of paperwork required to launch a SPAC may differ, but is still substantial.

The decision tree below summarizes how entities can determine the number of annual audited years to include in the proxy/registration statement. That determination, as well as the determination of the age of the financial statements, must be reassessed (1) each time an amendment to the proxy/registration statement is filed and (2) when the Super 8-K is filed or amended.



Source: Deloitte analysis

- **SPACs.** The abundance of funds held in trusts and the increased appetite for private investment in public equity (PIPE) transactions have thrust SPACs beyond the fringe of capital markets and into the mainstream as significant players for potential sponsors, investors, and target operating companies.

What route works for you?

Deciding which route to take depends on a number of factors. While CFOs who have begun working with an underwriter to file an S-1 should probably continue on the path to a traditional offering, others might start with the following questions to understand the main differences between the options:

1. **Do you value the flexibility to negotiate?** In the traditional IPO process, the underwriter has the upper hand, including setting the stock price. But in SPACs, nearly all aspects can be negotiable—from the opening stock price to the make-up of the board and, in some cases, even the sponsor's ownership stake.
2. **Are you in a hurry?** SPACs are typically faster than traditional IPOs. While a traditional IPO can typically consume more than six months, SPACs have been known to make the transition within four months—but the required paperwork, including both the financial statements and prospectus, is not always less burdensome (see Figure 1).
3. **Is raising capital a primary motivation?** Companies, such as Spotify, can choose the DL route in part because they are well-capitalized. In a DL, a block of shares is sold without any new capital being raised—so far, at least. An NYSE plan that would allow DL companies to simultaneously raise capital was approved by the SEC staff in August, but is currently under review by SEC commissioners.⁴
4. **Who wants a lock-up period?** You, or your board, may decide that a 180-day lock-up period—preventing large shareholders from flooding the market with an oversupply—is prudent.

That's usually the length associated with a traditional IPO, while a SPAC's lock-up typically lasts for a year.⁵ DLs, by contrast, require no lock-up period.

5. Is cost savings a priority?

Underwriting fees typically amount to 7% of a traditional IPO, plus there's the inefficiency embodied in a stock's first-day pop. DLs can access the public float without paying those fees. But that also means their stock price can sink on opening day. In a SPAC, underwriter fees and upfront cash outlays are lower than in a traditional IPO. Still, CFOs of SPAC targets need to be aware that the "sponsor promote," which typically gives sponsors control of 20% of the initial IPO shares, effectively dilutes public shareholders. They should also be cognizant of potential PIPE discounting and discounting in backstop agreements.

SPAC attack

While CFOs and boards may have a choice in how to go public, they do seem to be acquiring a growing interest in SPACs, which is why their unique challenges and risks bear a closer look.

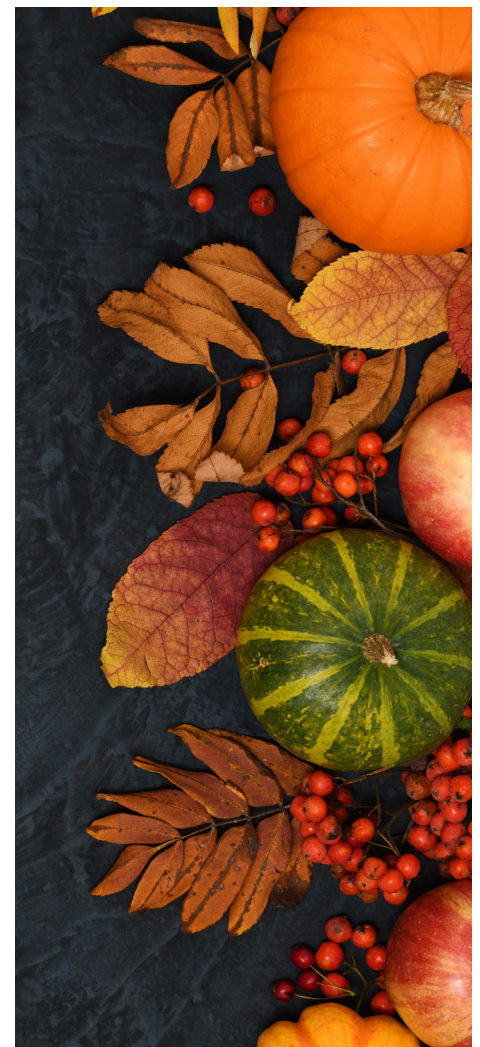
The number of well-known investors and hedge-fund managers entering the space has served to accelerate the momentum, lending credibility to the structure. The influx of seasoned managers with proven track records, coupled with better alignment of sponsor incentives with investor returns, has similarly boosted investor confidence, enabling SPACs to raise significant capital to be used in targeting larger and more mature companies. In addition, the SPAC market has benefitted from the entrance of retail investors who have looked toward post-IPO SPACs as a means of finding suitable returns in the recently volatile market.

Moreover, as increasingly sophisticated players enter the market—such as Ackman—the standard deal terms of SPACs are likely to evolve. Ackman, for instance, priced shares of his Pershing Square Tontine Holdings at \$20 a share, raising \$4 billion. SPACs are usually sold at \$10 a unit, which combine a share with a warrant.

SPACs have also begun targeting a wider range of acquisitions. While historically focused on positive EBITDA companies, 2020 has seen pre-revenue "story-stock" companies entering the fray.

For CFOs whose companies are exploring SPACs, here are some considerations to keep in mind:

- **The top goal isn't to cash out.** Many SPAC sponsors are aiming to use a sizeable portion of the equity raised to fund growth, acquiring additional companies. The teams aren't looking to bankroll a massive cash exit for the current shareholders. Typically, they also scout technologies that are scalable and can be easily integrated with complementary technologies.



- **The timeline can expand.** The timeline to close a SPAC acquisition depends on multiple factors. Given that SPAC shareholders have the right to redeem shares, there can be uncertainty regarding the amount of cash available to pay the shareholders of target companies and to fund post-close operations. Therefore, SPACs and targets often negotiate a “minimum cash” closing condition. In addition, SPAC acquisitions often include a simultaneous PIPE investment upon consummation of the merger in order to amplify deal size (i.e., to acquire target companies with a value that exceeds the amount of cash the SPAC raised through its IPO).
- **The paperwork may differ, but there’s no shortage of it.** In addition, it must be completed in a compressed SPAC merger timeline leading up to the proxy statement or Form S-4 filing. Company bylaws and SEC proxy rules typically require SPAC shareholder approval before the completion of the “de-SPAC” process, whereby the target company is backed into the public vehicle. The completion of a merger typically requires entities to file a proxy with the SEC, obtain and respond

to the SEC’s comments, mail the proxy to the SPAC’s shareholders, and hold a shareholder meeting.

- **The acquisition is not an ending.** Once an affirmative vote is obtained from the proxy process, the target acquisition can close by merging into the SPAC, and the target company becomes a publicly traded entity. A Super 8-K must be filed within four days of the acquisition and must contain substantially the same information that would be required in a registration statement for companies that go through a traditional IPO.
- **Going public means acting public.** The formerly private operating company must be able to meet public company reporting obligations. At that stage, it is imperative that the company make a focused effort to elevate people, processes, and technology to support the demanding reporting schedule of a public company.

SPAC 2.0

Like much of the behavior that has changed during the pandemic, it’s unclear how SPACs will fare in the long term. In the emerging era of “SPAC 2.0,” it’s likely that the offerings will split into different tiers, the highest being those with top-quality sponsors, blue-chip shareholders, and the capability to attract better target companies.

But as the number of SPAC IPOs increases, there may be too many sponsors—confident of their skills at unearthing underappreciated targets—chasing after too few worthy businesses. Investors, who may have jumped in partly because of the lack of other appealing opportunities, may move on. Or a few high-profile SPAC failures—companies blinded by the chance to acquire the cachet of going public, but lacking the necessary infrastructure—could slow the phenomenon, or limit its appeal.

Then again, a more innovative option for going public may arise, combining aspects of both SPACs and DLs. A more efficient electronic system may emerge, or one that rewards long-term performance. Dissatisfaction with traditional means may be short-circuited when rules for IPOs are changed, making them less opaque in the eyes of finance leaders.

But for now, the appetite for alternatives to the traditional IPO process remains hearty: one SPAC leads to another and another. Consider the case of venture capitalist Chamath Palihapitiya, who invested in Slack before turning to SPACs. His first three SPACs identified acquisitions ranging from Virgin Galactic, the space tourism company, to real-estate platform Opendoor to, most recently, insurtech startup Clover Health.⁶ He’s still not done—far from it, in fact. He’s got three new⁷ SPACs in the works. ◀



End notes

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