SPAC or IPO: Picking the Right Path to Going Public

Yogesh Sharma
Dy.Managing Partner
BDO in India

Anita Somani
Assurance Partner
BDO in India

SPACs (Special Purpose Acquisition Company) have been around for decades as an alternative investment vehicle; however, it has gained immense focus in recent years.

A SPAC is a newly formed company, initially capitalised by sponsors, including the management team, who contribute nominal capital or fund formation and offering costs. The SPAC then conducts its IPO and seeks capital from investors to fund the acquisition of a private operating company. Given this structure, a SPAC is usually referred to as a 'Blank Check' company.

The proceeds raised in the IPO are placed in a trust account while the SPAC's management team seeks to complete an acquisition of an existing operating company (target), generally in a specific industry or geography, within the period stated in the SPAC's governing documents (typically, 18 to 24 months). If the SPAC completes an acquisition successfully, it enters the phase of 'De-SPACing'. The private operating company target succeeds to the SPAC's public filing status and, as a result, the target effectively becomes a public company. If the SPAC is unable to complete an acquisition in the allotted timeframe, the cash held in its trust account is returned to its investors unless the SPAC extends its timeline via a proxy process.

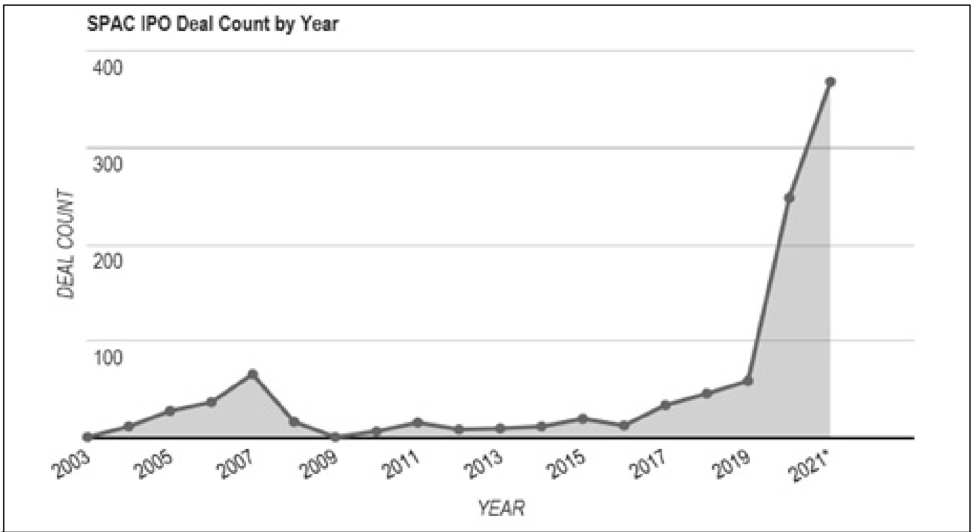
SPACs have seen a resurgence in popularity since becoming all but extinct after the 2007-2008 financial crisis. The first SPACs were established in the early 1990s, but with an increasing number of companies seeking faster ways than an IPO to go public, there has been a sudden spur in SPAC transactions in recent years not only in the US but globally as well.

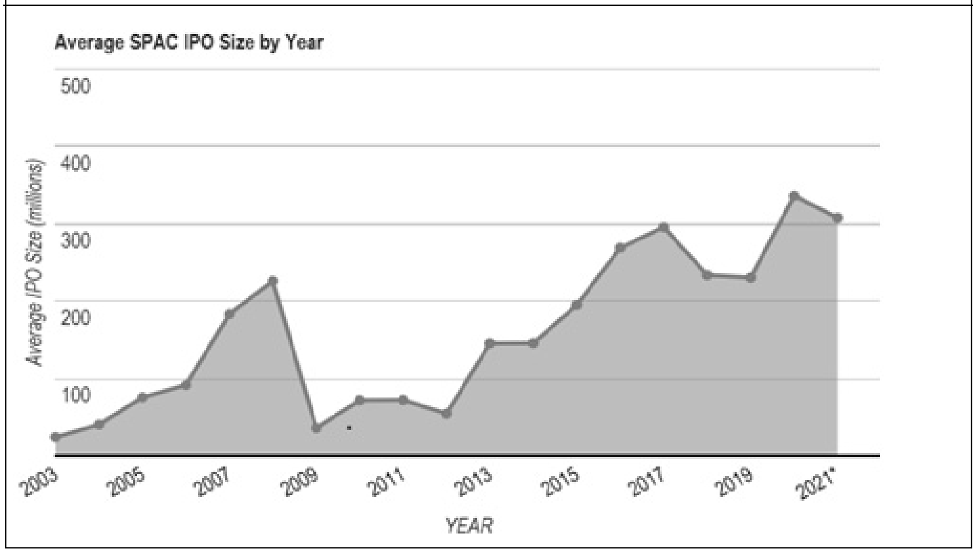
One may ask what has changed in SPACs from then to now? SPACs now appear to be better organised and a more serious investment vehicle, with few notable differences – SPACs now see more closes and less liquidation with a majority of them having successful consummated mergers as against many going to the path of liquidation and returning capital to investors (SPAC closure in the past). The average trust size for the SPAC has increased manyfold over the past few years. SPACs gained momentum with several high-profile investors associating with them and recruiting well known executives from high-profile companies.

However, SPACs at their core, have remained consistent throughout their history. They have a single objective to merge with a company and take it public (de-SPAC).

SPACs Geographical coverage

With favorable market conditions at play, SPACs grew in popularity in 2020. SPACs remained popular in the US market witnessing 248 SPAC IPOs with SPAC proceeds of USD 83,361mn in the year 2020, as compared to less than 10 SPAC IPOs (each) in the years 2009 and 2010. (Source: https://spacanalytics.com). These numbers are particularly impressive when compared to the traditional IPO market.





Source: spacinsider.com, July 2021

SPAC IPO or Traditional IPO what is the right path for going public?

Companies thinking about going public struggle with the choice of path to go public, while both traditional IPOs and SPAC transactions require extensive due diligence, tax structure decisions, Securities and Exchange Commission disclosures (SEBI equivalent), and governance, policy, and procedure assessments, some notable differences exist. Choosing which option is right for your business depends on a variety of factors, such as – IPO valuation can be volatile and take time to determine while Target valuation in a SPAC IPO is less volatile and is known sooner in the process. IPO can be a time-consuming process; it may take from few months to years depending on the market conditions and company's readiness whereas a SPAC has a defined lifecycle of 18-24 months. In a SPAC IPO, private companies can present forward-looking guidance for revenue and profitability. In a traditional IPO, companies can share their past financials and talk about a total addressable market size but cannot get into detailed financial projections.

The structure of SPAC IPOs offers many advantages and benefits to the investors, sponsors, and the operating companies that are ultimately acquired. As there is no significant operating history, SPAC financial statements in the IPO registration statement are less cumbersome and voluminous and can be prepared in a few weeks as compared to a few months as is common in a traditional IPO. Months of roadshows and marketing the SPAC IPO are not necessary since the primary purpose is to raise funds to acquire a private operating company. SPAC deals typically also require less debt than a private equity deal. The SPAC model provides sponsors great flexibility, with few constraints on the choice of target. The SPAC sponsor typically takes a minority stake in the merged company and may also take a board seat.

While the SPAC IPO has many advantages, the structure is not free from drawbacks: most SPAC criticisms are particularly relevant for retail investors. The fact that at launch SPACs are blank check companies, and that retail investors may be tempted to enter the market based on excess euphoria driven by market rumors or by celebrity involvement, is a key risk that the SEC has recently highlighted. Retail investors do not get the same or all benefits as institutional investors. Unlike retail investors the institutional investors have a say in choosing the start-up to merge with the SPAC, they can opt-out and get all their money back. If they choose to continue with their investment and prices pop, they can double down through warrants. The ability to significantly reduce risk and dramatically raise upside, reside with institutional investors alone.

The SPAC IPO process along with the de-SPAC transaction are highly regulated and complex transactions that require experience and intensive preparation. Also, the investors need to understand how the SPAC IPO and traditional IPO behave at various stages.

SPAC performance after the IPO differs quite significantly from a traditional IPO. SPACs initially trade close to a short-term treasury as the company has not given any detail yet on the possible acquisition. In contrast, a traditional IPO will deliver its performance directly upon listing and may be very volatile just after.

After this initial phase, once the company enters negotiations with a target company, SPAC prices start to rise in the possible acquisition. After the merger is effective, the price will move in line with the company news and the business results announced, as with any traditionally listed company.

Despite the mounting flood of SPAC IPOs, the resilience of traditional IPO markets should continue to present exit and liquidity considerations for PE fund investments, as well as unique tax considerations and potential opportunities to investors and portfolio companies.

Be it a SPAC IPO or a Traditional IPO, the focus is always on protecting investor's wealth and providing them with accurate and reliable information for decision making. Accordingly, SEC has started mounting its focus on disclosure practices by SPACs, including with respect to conflicts of interests and projections (and the liability risk associated therewith).

What Next?

Overall, SPAC IPOs have swamped the US equity market in recent years, but the pendulum may now be swinging in the opposite direction. It will take courage for SPAC investors to stick to their strategies. With a high volume of blank check companies entering the market, many views suggest that the SPAC bubble is about to burst. There are some signs that SPACs have reached a tipping point, particularly when looking at performances. One of the major criticisms recently posed about SPACs relates to their performance being lower in comparison to traditional IPOs. Their recent underperformance is putting pressure on SPACs to deliver on their promises.

SPACs have gained significant popularity as an alternative to IPOs in the US markets. The frenzy of SPACs has begun to gain traction in Asia and is already manifesting its potential this year, as many highly valued tech unicorns in the region mature, spurred by growth in the digital economy as a result of the COVID-19 pandemic. In the recent past, the Indian market has exhibited openness towards new ideas and products, and SPACs could well be right there.

Given Asia's large and mature IPO market, regulators are now considering allowing SPAC listing in various Asian countries. Both Hong Kong and Singapore received increasing market interest to introduce SPACs in their capital markets. Also, there has been increasing demand that SPACs should be regulated and allowed in the Indian market as well to ease the listing of start-ups, which are typically not able to satisfy the profitability criteria for a traditional public listing through an IPO.

India's securities and market regulator the Securities and Exchanges Board of India (SEBI) has reportedly formed a group of experts to examine the feasibility of bringing regulations for SPACs which could boost the prospects of domestic listing of start-ups; a move that will enable new-age firms to list on domestic exchanges and seek investment from equity markets.

While the economic imperative driving the SPAC boom is clear, investors and particularly regulators across the world remain concerned about the quality of information disclosure, the potential for con?icts, and corporate governance.

However, as regulators formalise the regulations and heightened norms around SPAC activities, they need to take a balanced approach by being future-focused and doing their best to attract SPAC listing activity in their countries. As the pool of tech start-ups in Asia have or will likely soon attain unicorn status, stock exchanges may have to join the rush to attract tech-focused SPACs.