

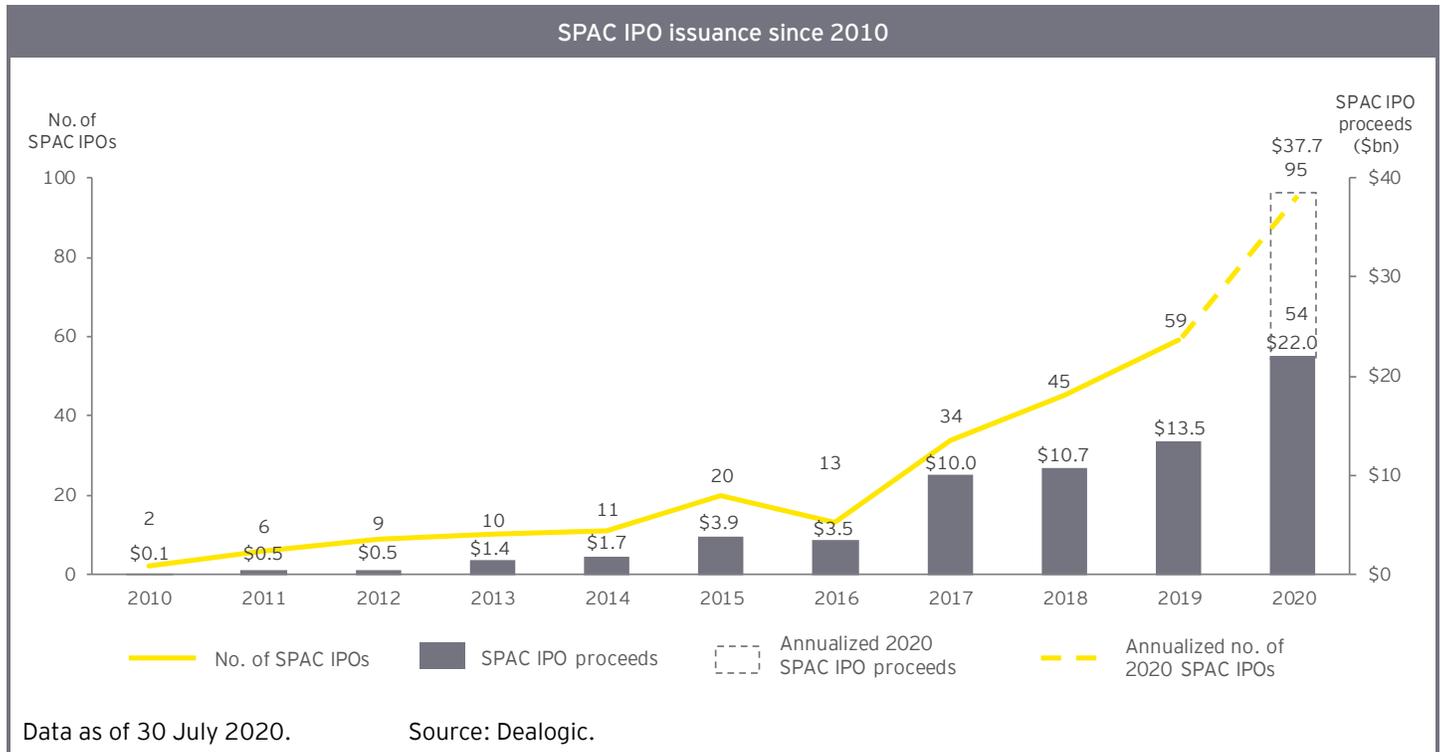
# Equity capital markets update

SPAC market expansion: why more  
private companies are electing the  
SPAC path

August 14, 2020

# SPAC market expansion

Over the last several years, the market for special purpose acquisition companies (SPACs) has experienced significant growth and maturation, opening a viable alternative path to the public markets for more private companies than ever before. SPAC IPOs have generated more than \$10 billion of proceeds each year since 2017, a milestone not previously seen since before the financial crisis of 2007 and 2008.



There are currently more than 100 active SPACs with approximately \$30 billion of equity held in trust seeking acquisitions. Along with this unprecedented depth of capital, several other factors have contributed to the increased viability of the SPAC path to the public markets, including:

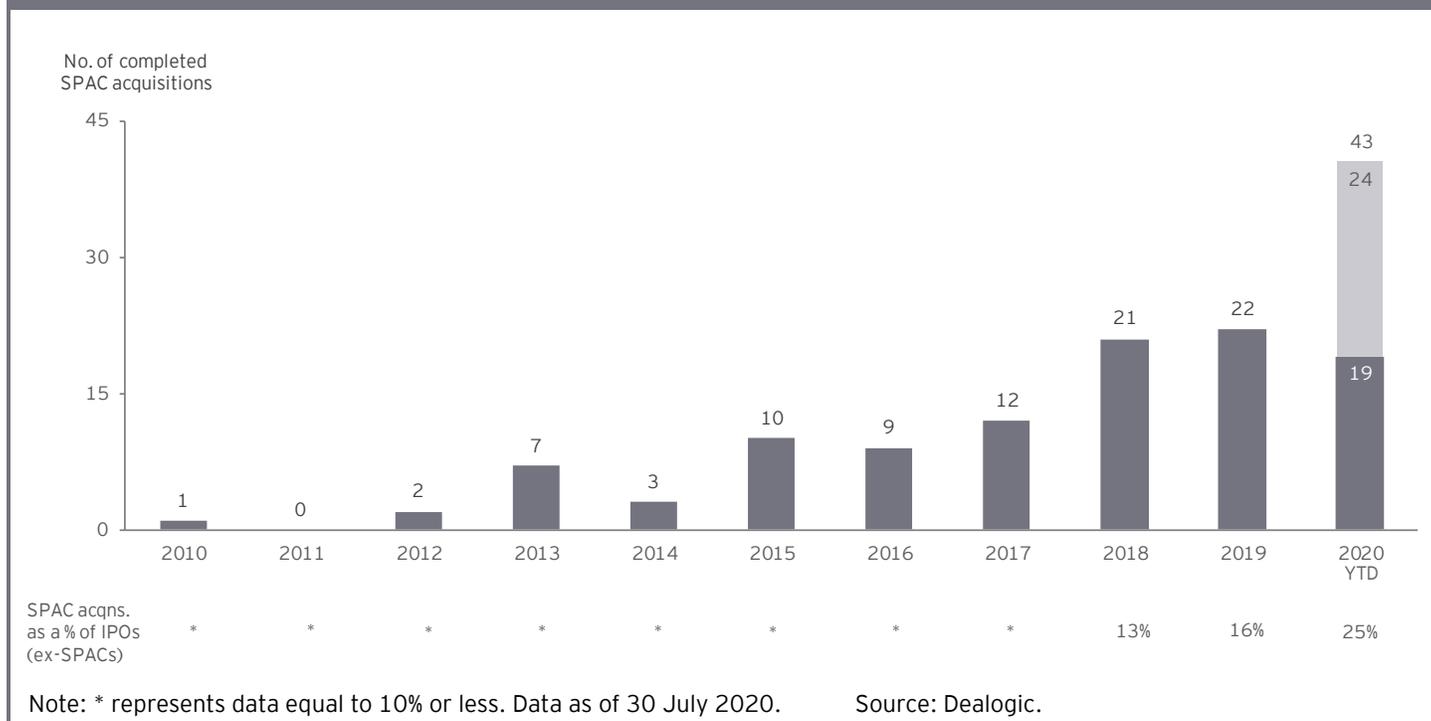
- ▶ Meaningful “acquisition-friendly” structural modifications appearing in some recent SPAC IPOs
- ▶ “Higher-profile” SPAC sponsors entering the arena, providing brand credibility to the SPAC product
- ▶ Strong aftermarket performance capturing considerable media attention for some of the recent larger SPAC mergers and merger announcements

As a result, company owners, boards and management teams that had typically focused their analysis of strategic alternatives on the traditional IPO path or an outright sale are now routinely evaluating SPAC mergers as part of these discussions.

## Could merging with a SPAC be a viable strategic alternative?

The evolution of the SPAC path can be seen in the recent uptick of SPAC acquisition activity. Since the beginning of 2019, 41 SPAC mergers have been completed and 24 have been announced (through July 30, 2020). Assuming these announced acquisitions are consummated, the SPAC path to the public markets would represent more than 30% of IPOs over that period.

## Completed SPAC acquisitions since 2010



Post-acquisition public market performance of SPAC mergers varies widely and has historically trailed IPOs. However, included within the recent class of SPAC acquisitions are several high-profile companies and sponsors, some of which have achieved outsized aftermarket performance and garnered significant media attention, including:

- ▶ **Virgin Galactic Holdings, Inc.**, an aerospace company founded by Sir Richard Branson that is pioneering human spaceflight for private individuals and researchers, completed its merger with Social Capital Hedosophia Holdings Corp. in October 2019. The stock has traded up nearly 150% through July 30, 2020, and the company currently has a market capitalization exceeding \$5 billion.
- ▶ **DraftKings Inc.**, a daily fantasy sports contest and betting provider, completed its merger with Diamond Eagle Acquisition Corp. in April 2020. The stock has traded up over 275% through July 30, 2020, and the company currently has a market capitalization exceeding \$13 billion.
- ▶ **Nikola Corporation**, a designer and manufacturer of battery-electric and hydrogen-electric vehicles, completed its merger with VectoIQ Acquisition Corp. in June 2020. The stock has traded up nearly 300% through July 30, 2020, and the company currently has a market capitalization exceeding \$14 billion.

## Recent changes that have enhanced the SPAC path to the public markets

Key recent developments in the SPAC IPO market are driving more private companies to pay attention to the SPAC path to the public markets, including:

- ▶ **Emergence of higher-profile sponsors.** Higher-profile sponsors are increasingly entering the SPAC arena and, in many cases, they are returning to create multiple SPACs by leveraging their reputation and prior successes. These “brand-name” sponsors appear to have not only elevated the perception of the SPAC path by lending credibility to the product, but they also bring an established reputation with the buy-side that can often enhance investor receptivity. Some notable examples include:
  - ▶ Bill Ackman, founder of hedge fund Pershing Square, sponsored Pershing Square Tontine Holdings, Ltd., which raised \$4 billion in July 2020 to pursue a merger with a “mature unicorn.”
  - ▶ Bill Foley, chairman of Fidelity National Financial and Black Knight Financial and owner of the Vegas Golden Knights, sponsored Foley Trasimene Acquisition Corp., which raised \$1 billion in May 2020 to pursue a merger with a FinTech or business process outsourcing company.

- ▶ Chamath Palihapitiya, an early Facebook executive and founder and CEO of venture capital firm Social Capital, has sponsored three SPACs.
  - ▶ Social Capital Hedosophia raised nearly \$700 million in September 2017 and merged with Virgin Galactic in October 2019.
  - ▶ Social Capital Hedosophia II raised over \$400 million in April 2020 to pursue a merger with a US technology company.
  - ▶ Social Capital Hedosophia III raised over \$800 million in April 2020 to pursue a merger with a non-US technology company.
- ▶ Michael Klein, former vice chairman of Citigroup and current board member of Credit Suisse, has sponsored four SPACs.
  - ▶ Churchill Capital Corp raised nearly \$700 million in September 2018 and merged with Clarivate Analytics, an information services and analytics company, in May 2019.
  - ▶ Churchill Capital II raised \$600 million in June 2019 to pursue a merger in an unspecified industry.
  - ▶ Churchill Capital III raised \$1 billion in February 2020 and announced an \$11 billion merger with MultiPlan, Inc., a healthcare cost management company, in July 2020.
  - ▶ Churchill Capital IV filed to raise \$1 billion in July 2020 and weeks later upsized its IPO to \$1.8 billion despite only including one-fifth of a warrant in its units.
- ▶ Goldman Sachs has sponsored two SPACs.
  - ▶ GS Acquisition Holdings Corp raised \$600 million in June 2018 and merged with Vertiv Holdings, a digital infrastructure management company, in February 2020.
  - ▶ GS Acquisition II raised \$750 million in July 2020 to pursue a company in the diversified industrial, healthcare, technology, media and telecom, or alternative asset management industry.
- ▶ Jeff Sagansky and Harry Sloan, established media and entertainment executives, have partnered on six SPACs, including Diamond Eagle Acquisition Corp (which merged with DraftKings - see above) and Double Eagle Acquisition Corp, which raised \$500 million in September 2015 and merged with Williams Scotsman, a specialty rental modular space and portable storage provider, in November 2017.

- ▶ *Larger deal sizes.* In the past, private companies needed to be the “right” size to consider becoming a public company through a SPAC merger. Small companies would be disproportionately impacted by the dilution inherent in a SPAC transaction. And large companies could quickly “outgrow” the SPAC alternative at a certain point in their development. However, the recent proliferation of larger SPACs, as well as the increased availability of additional equity capital through private investments in public equity (PIPEs), forward purchase agreements and credit facilities, have begun to mitigate these issues.

The average SPAC IPO has grown to nearly \$400 million in 2020, up from approximately \$50 million in 2010. Since the beginning of 2019, there have been 12 SPAC IPOs that have raised over \$500 million and four that have raised more than \$1 billion, compared to five and zero, respectively, for the preceding 18-month period. The largest SPAC merger ever was announced in July 2020 when MultiPlan announced its \$11 billion merger with Michael Klein’s Churchill Capital III.

- ▶ *Greater backstop funding.* In addition to the considerable rise in SPAC IPO proceeds, SPACs are often supported by additional capital in the form of forward purchase commitments and credit lines. These funds are used to cover SPAC shareholder redemptions, and provide cash to pre-merger owners and the post-merger company. In recent years, we have seen a rise in this backstop funding, including:
  - ▶ Pershing Square Tontine (\$4 billion in trust): Pershing Square, the SPAC’s hedge fund sponsor, committed to invest an additional \$1 billion alongside the SPAC and was granted the right to purchase up to an additional \$2 billion of equity units.
  - ▶ Foley Trasimene (\$1 billion in trust): Cannae Holdings, Inc. and an affiliate of Thomas H. Lee Partners committed to purchase an aggregate of up to \$300 million of equity units to support a merger.
  - ▶ Spartan Energy Acquisition Corp. (\$575 million in trust): an affiliate of Apollo Global Management, LLC, committed to purchase up to \$300 million of equity units in a private placement to support a merger. In July 2020, Spartan executed a merger agreement with Fisker Inc., a pre-production electric SUV designer, and announced a \$500 million committed private placement.
  - ▶ Mosaic Acquisition Corp. (\$300 million in trust): an affiliate of Fortress Investment Group LLC, and certain other investors, committed to purchase \$150 million of ordinary shares in a private placement to support a merger. Mosaic’s January 2020 merger with Vivint was funded in part through this private placement.

- ▶ *Reduction in warrant coverage.* Warrants have long been included in the SPAC units sold at IPO as an inducement to attract investors, but they can become highly dilutive for companies whose share prices perform after the merger. As the SPAC IPO market has evolved in recent years, the magnitude of warrant coverage has generally decreased, reflecting greater confidence from SPAC IPO investors that successful mergers will be consummated. There have been several notable SPAC IPOs in the last two years with units containing less than one-third of a warrant, including Churchill Capital III, GS Acquisition II and Flying Eagle (sponsored by Eagle Equity Partners). In addition, in July 2020 the first two SPAC IPOs (greater than \$50 million) without any warrants came to market – Therapeutics Acquisition Corp. sponsored by RA Capital Management, L.P. and Mountain Crest Acquisition Corp. sponsored by Sunlight Global Investment LLC. In addition, SPACs are continuing to find other creative ways to facilitate acquisitions by addressing some of the traditional sticking points for attractive private targets. For example, Pershing Square Tontine Holdings, Ltd. replaced the traditional, highly dilutive founders shares with an option for Pershing Square Funds to buy up to 5.95% of the target company, but only at a price that exceeds 120% of the SPAC IPO price.

## Key issues for private companies to consider

Companies contemplating a transition to the public markets often consider the following key issues as they evaluate their strategic alternatives.

- ▶ *Achieving valuation goals.* The ability to achieve valuation expectations and the related approaches to valuation can vary widely between SPAC mergers and traditional IPOs, depending on the circumstances. Although SPACs were historically viewed as highly dilutive and expensive “last resorts” to becoming a public company, they have recently become more competitive in terms of valuation. Determining whether an IPO or a SPAC merger will yield competitive valuations relative to a strategic sale largely depends upon the discounts required in each case. In an IPO, discounts to public market peers of approximately 10% to 20% are often expected by investors (the IPO discount). This is typically in addition to haircuts that analysts generally take to company projection models, which themselves can be “intentionally conservative” to position for aftermarket performance and management credibility. In a SPAC merger, realized valuations are analyzed in the context of the dilution from sponsor interests and upside dilution from warrants. Valuations are therefore based on a variety of factors including anticipated receptivity of a company’s equity story in the public markets, volatility and overall market conditions at the time of the IPO pricing or merger negotiation, the warrant coverage and other structural features of the SPAC, as well as a number of other factors.
- ▶ *Speed to market.* The road to an IPO is generally considered to be slower and more methodical than a SPAC merger. While an IPO generally takes five to six months from organizational meeting to pricing, companies often undertake a comprehensive “public-company” transformational process over multiple additional “preparation” quarters ahead of the organizational meeting. In a merger with a SPAC, companies generally sprint to the public markets within a matter of a few months from their initial meetings with the SPAC. For example, VectoIQ’s initial introduction to Nikola was in November 2019, and the merger agreement was signed less than four months later in March 2020 with trading commencing shortly thereafter.
- ▶ *Price and execution certainty.* In an IPO, final pricing is not determined until after the roadshow is complete, which occurs the evening before the shares commence trading in the public markets. Transaction certainty is also not established until the end of the IPO process, as the underwriting agreement is not executed until the eve of trading. In addition, while most of the traditional IPO process can be conducted confidentially, the final three weeks or more play out in the public spotlight while price discovery is occurring. As a result, whether an IPO is consummated and at what price can be influenced by market conditions prevailing right up until the time of pricing. And, since IPO “windows” open and close over time based on prevailing market sentiment, volatility and recent IPO performance trends, private companies are forced to incur significant time and expense well ahead of an intended IPO date to prepare for an uncertain outcome.

In a SPAC merger, the business combination agreement, which contains final pricing and other terms, is negotiated confidentially and executed months ahead of the company’s post-merger trading debut. SPACs generally have up to 24 months to consummate an acquisition or the SPAC IPO funds are returned to investors and the sponsor does not profit from its efforts. This creates a sense of urgency to consummate a merger regardless of fleeting IPO market windows. However, SPACs generally evaluate dozens or more private companies, so any discussions with a SPAC, especially early-stage discussions, may still face substantial execution risk. As a result, private companies often begin preparing for public market life ahead of making a final determination on which specific path it will take to maintain optionality.

- ▶ *Structuring flexibility.* IPOs have historically been more focused on raising growth capital through the sale of primary shares than as mechanisms for shareholder monetization. Since 2017, over 80% of IPO proceeds have been comprised of primary shares. In general, shareholder sell-downs commence only after six-month lockup periods (designed to allow the stock to season in the public markets before secondary sales begin in earnest) expire. Conversely, SPAC mergers have generally permitted greater cash-outs for existing shareholders at the time of the merger, depending on the funds required for the business post-merger and the cash available to the SPAC in trust or through other sources.
- ▶ *Sponsor and investor influence.* In an IPO, private company owners are teamed with largely passive, long-only institutional investors, which generally enables pre-IPO owners to maintain control over the strategic direction of the company. Conversely,

in a SPAC merger, while private companies can benefit from the sponsor's industry experience and connections, the sponsor will generally take a more active role post-merger particularly through board representation, due to its more concentrated ownership and influence.

- ▶ *Branding considerations.* An IPO is generally considered a seminal event in a company's history, marked by a bell-ringing ceremony on the New York Stock Exchange or a Times Square event at the NASDAQ. The publicity of the IPO debut often raises the profile of the company and can enhance its credibility with customers and suppliers. In contrast, SPAC mergers have historically been more of a "back door" route to the public markets with less branding value, though this differentiation may be diminishing over time.

## Looking forward

SPACs have become a more viable path to the public markets and are more often being evaluated by companies considering strategic transactions. The momentum of SPAC IPOs and mergers is undeniable and appears to be accelerating. To the extent that SPAC mergers can deliver strong post-merger performance, SPAC acquisition capacity remains high, and valuations remain competitive, the SPAC path will be a strategic option for private companies to consider, particularly in periods of highly volatile IPO markets.

EY's SPAC coverage involves a cross-functional approach. Please reach out to the EY Equity Capital Markets team or the Americas Transactions Accounting Advisory Services team if a conversation about SPACs would be helpful for your clients.

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