TRANSITIONS

SPAC-ULATIONS ON SPECIAL PURPOSE ACQUISITION COMPANIES

There is a four-letter word that has gained a significant amount of momentum since the start of 2020. Those letters are S-P-A-C which stands for “Special Purpose Acquisition Company.” These companies are currently all the rage in the media. So far in 2021, there have been roughly 362 SPACs completed, and they’ve raised nearly $105 billion in funding.

SPACs have become the new way to fast track a public listing with less regulatory oversight by the Securities and Exchange Commission. What concerns me about SPACs, is that they have been mostly inactive for several years and have suddenly emerged with immense popularity. This is a reminder for us to proceed with caution. Caution is never an endpoint for information; it is the starting point for building a frame of reference. Being equipped with the right information and implications around SPACs is vital to our understanding of their role and legitimate sustainability in financial markets.

What is a SPAC per se? A SPAC is a publicly listed shell vehicle, or a “blank-check company,” with no operations or assets. A sponsor team raises a pool of cash to be used solely for the acquisition of an operating target company. The only asset of the shell company is cash. They exist for the sole purpose of merging with a target operating company. SPACs skip to the end and then attempt to fill in the beginning. A SPAC goes public only after clearing some very modest regulatory hurdles. The SPAC is required to complete that initial business merger with the target business. After going public, if the SPAC does not take the target business public within twenty-four months, then they are required to liquidate and return the gross proceeds to the shareholder. It is important to understand why over a twelve-month horizon the mean return for post-merger SPAC transactions is an estimated -35% with a median return of

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-65.3 % respectively. The reason for these terrible returns is seen in the way they are created.

To illustrate, a SPAC is being raised by Company A. The terms of the SPAC are that Company A puts in $9 million to receive a 20% ownership of a $600 million SPAC. Company A receives 20% of $600 million, which is $120 million if they complete the acquisition. Not too bad! Even if the company acquired by Company A is a complete failure and drops in value by $250 million on its first day of trading, Company A's 20% share of the remaining $350 million is still worth $70 million. Company A gains $61 million, while investors in the SPAC lose $250 million. In addition, if the SPAC performs well, Company A gets to purchase more shares at an advantaged price which lessens the investors' gains. This is the typical structure for a SPAC; easy to see why SPACs are all the rage. The house wins and the shareholders lose.

Amid today's demanding investing environment, we need to be aware of the risks surrounding SPACs and the volatility that encapsulates these speculative investment vehicles, and their destructive impact of dilution. The key is proper diversification and making sure that you are not taking on excess risk in relation to your financial goals and personal risk tolerance. At the end of the day, I believe that it is important to make investment decisions that are based on a more holistic perspective that goes beyond the latest retail or speculative sentiments in the financial media. This is where the power of information is essential. As with all investments, investors need to understand the details of what they are buying. Investing without consideration of these risks isn't really investing at all.... It's SPAC-ulating.

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