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# SPAC Market Update: Q1 2021

## Despite a cooling market, SPACs will likely remain a staple public pathway

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## Contents


| | |
|---|---|
| **Introduction** | 1 |
| **SPAC formation** | 2-4 |
| **DeSPAC activity** | 4-7 |
| **Outlook** | 7-8 |


## Introduction

The initial flurry of special purpose acquisition companies (SPACs) in 2020 seemed like a flash in the pan at first, but it looks like these vehicles are here to stay. The unprecedented uptick in SPAC IPO volume in 2020 and the first quarter of 2021 has created a dedicated pool of more than $200 billion to invest in privately owned companies—and that figure does not even include the private investments in public equity (PIPEs) that accompany many of these acquisitions. While we saw a few indicators of waning enthusiasm for SPACs near the end of 2020 with a handful of downsized SPAC IPOs, this development looks to be just a blip. SPAC IPO activity exploded in 2021, with aggregate capital raised already surpassing the total in 2020 by 19.8% in just over one quarter. Recent SEC scrutiny regarding SPACs has led to uncertainty around any potential accounting treatment of warrants, which seems to have caused a temporary halt on new IPOs; however, as it stands now, we believe SPACs still fill a gap in the market, will adapt to any changes, and remain a primary option for companies looking to go public.

In our past research, we have analyzed individual SPACs and more qualitative market dynamics underlying the popularization of the strategy. In this report, now that we have more robust sample sizes in our SPAC data, we will layer our aggregate datasets onto our previous research to gain a sense of the entire market's scale.


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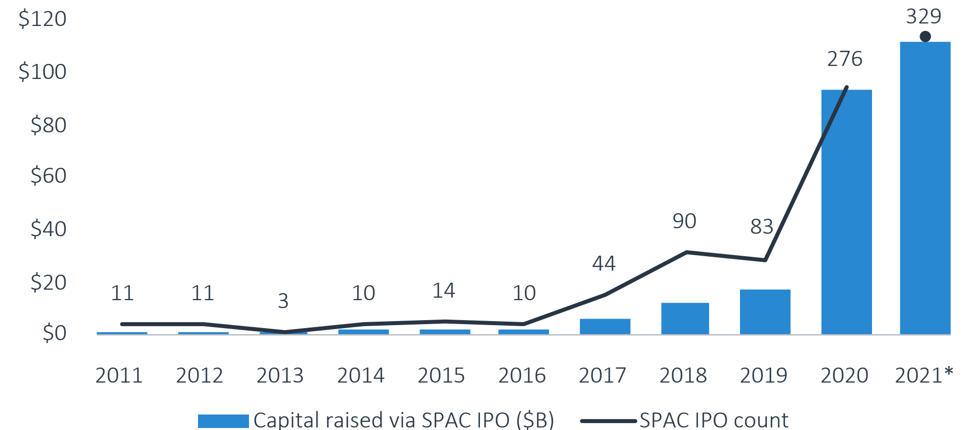
## SPAC formation

### SPAC IPO activity



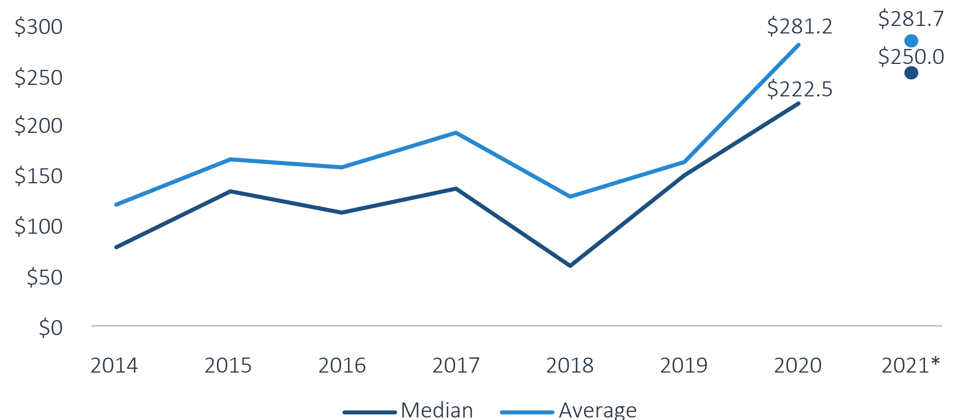

**Source:** PitchBook | **Geography:** Global
*As of April 15, 2021

The SPAC formation process must start with the SPAC management team, which needs to have a demonstrated record of dealmaking prowess or industry expertise to engender confidence from public market investors. This team can form out of existing entities such as PE firms, hedge funds, and VC firms, or the team can just be a new venture started by individuals with industry experience or an extensive investment track record. These qualified individuals and firms are now committing the time to forming and running SPACs because the economics from the founder shares or "promote" are extremely attractive to the sponsors. This incentive structure grants sponsors 20% of the SPAC equity, which essentially serves as a finder's fee for identifying a target, doing the due diligence, and closing the acquisition while having to invest only 2%-5% of IPO proceeds in at-risk capital. This asymmetric payoff, in which sponsors receive 20% of the upside for minimal upfront capital investment, paints a clear picture of the strategy's attractiveness but can create some tension if the SPAC is part of a larger organization. For instance, if the SPAC is formed by a PE or VC firm, and if key dealmakers at those firms begin to focus on the SPAC over the firm's existing private funds or prioritize a deal for the SPAC instead of investing out of the fund, those dealmakers could cause some friction with LPs invested in those funds.

Longer-term underlying trends, such as the precipitous decline in the number of public companies and the extended low-interest rate environment, have pushed investors to growth and alternative investments, adding to the SPAC strategy's momentum. That said, direct incentives to the sponsors remain the primary motivator. For instance, since investors receive such little interest on deposits, the opportunity cost is minimal if they choose to park capital in a SPAC for nearly two years for the potential upside of a compelling acquisition.

The final catalyst to push SPACs into the spotlight in 2020 was the onset of the pandemic, which all but closed the IPO window for at least a full quarter. The lack of new investment opportunities for IPO investors created an opportunity for dealmakers to pre-sell IPOs via a SPAC structure and eliminate that risk for target companies. After the pandemic opened the floodgates for SPAC IPOs, the acceleration of activity from big name sponsors such as Pershing Square, Social Capital, and Churchill Capital also fed into what essentially became a momentum trade within the community of potential SPAC sponsors. This activity has now spread from hedge fund, PE, and former industry operators as sponsors to a group that now includes a handful of VC firms, as well as some athletes and politicians.

**Median and average SPAC IPO size ($M)**




**Source:** PitchBook | **Geography:** Global
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Regardless of how many new SPACs sponsors supply, there has to be matching demand from public market investors to fill out the IPOs. While incentives can be slightly cloudier for these IPO investors, the warrants accompanying the SPAC units deliver some immediate value to the buyer. Given this relationship, we have seen sponsors pull warrant coverage as a negotiation lever to provide more favorable terms to the investors in addition to potential concessions on the SPAC timeline.

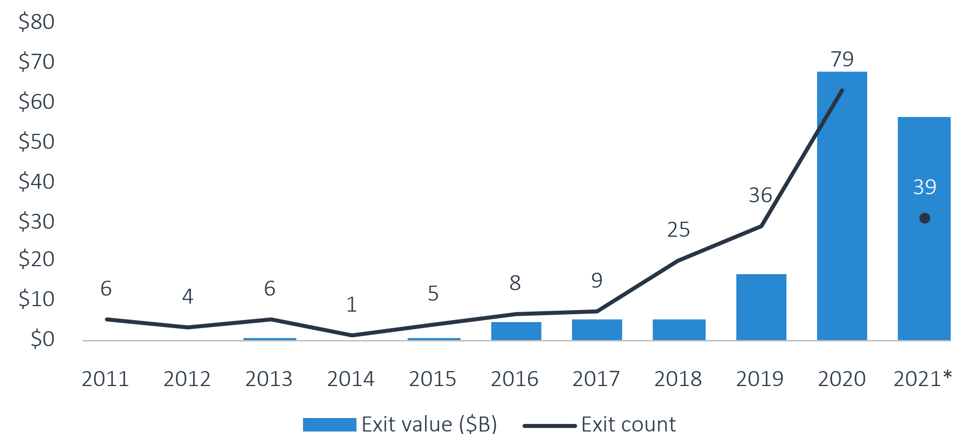
We think it is also important to note that there have been some recent developments regarding the SEC's treatment of SPACs that seem to have already strangled new SPAC IPOs over the first few weeks of April and may possibly hamstring the market in the future. The rumored change has to do with the accounting treatment of the warrants on a SPAC's financial statements wherein these instruments would be recategorized as a liability rather than equity. The main issue seems to be that the changes in the warrants' fair market value would now flow through as accounting earnings for the SPAC, complicating the once-simple SPAC financial statements. This adjustment may disincentivize the inclusion of warrants in new SPAC IPOs which, as noted earlier, are a critical benefit to the SPAC IPO investors. Without a concrete rule, it is tough to tell if this revision will apply to all SPAC warrants or if there will continue to be ways to maintain the status quo. We think retaining warrants in the SPAC structure will likely just require wording changes on the warrant agreements. The regulator is

reportedly working to understand the product better and slowing down new issuance until it comes to a final decision.

Outside the immediacy of the warrants, there is also existing demand from investors for growth opportunities amid the low-interest rate environment, which SPACs have been able to satisfy. We believe this incentive is particularly relevant to retail investor interest in the space, as this group is mainly shut out of the private markets and even IPO allocations, especially for the most in-demand deals.

## DeSPAC activity

### SPAC acquisition activity

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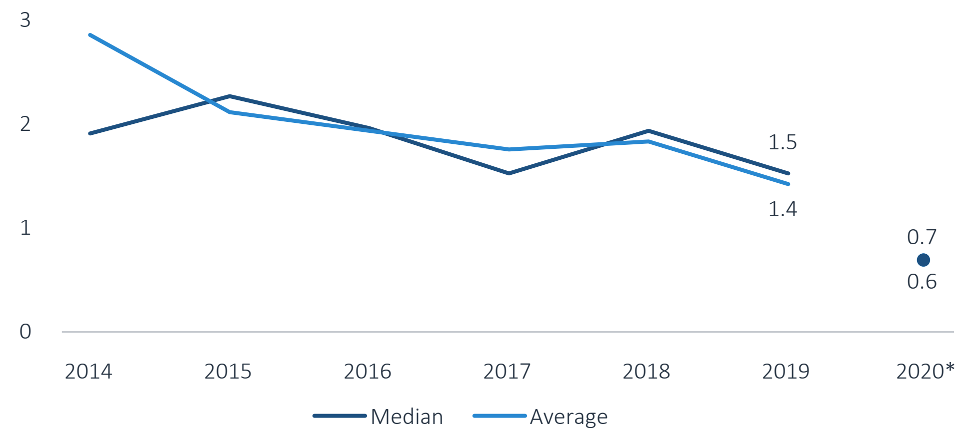
With another quarter of data, we also finally see some momentum building in SPAC acquisitions. Since the beginning of 2020, 118 SPACs have closed on an acquisition, representing over $120 billion of value that is now public. Even with this explosion in activity, these deSPAC deals still lag the pace of new SPAC IPOs, confirming that there remains a multitude of SPACs still actively looking for a target. SPACs are becoming more aggressive in finding deals quickly, with the median time between SPAC IPO and completion of reverse merger for SPACs raised in 2020 falling significantly to 0.64 of a year (or around 7.5 months). This figure will likely rise as more 2020 SPACs complete their deals, but the current figure suggests that there are still ideal target companies out in the market and that SPACs are capitalizing on the opportunity.

The largest SPAC combinations closed to date include United Wholesale Mortgage valued at $16.0 billion, Multiplan at $14.7 billion, Paysafe at $9.0 billion, and of course the just-announced Grab deal, which valued that business at $39.0 billion. (The Grab deal is not reflected in this report's datasets yet since it has not closed.) That deal will be the largest-ever deSPAC transaction by a wide margin, as well as the most recent in the flurry of completed reverse mergers in the mobility technology space.

**Median and average number of years from SPAC IPO to reverse merger by year of SPAC IPO**

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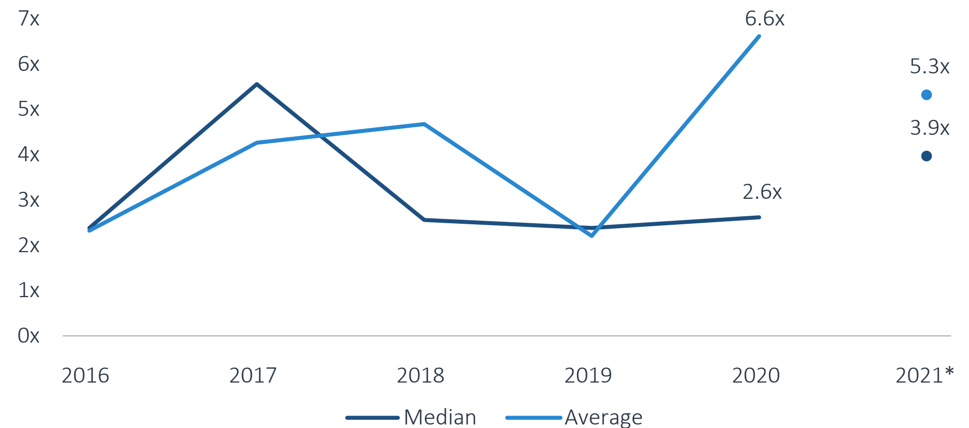
**Median and average ratio of target pre-money valuation to SPAC IPO size**

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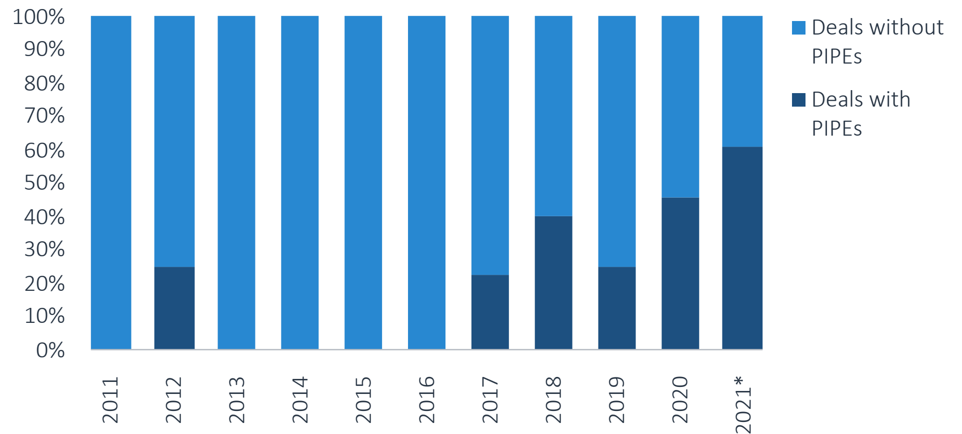
These multibillion-dollar SPAC deals show the evolution of this market over the last few years. We have seen a trend toward smaller portions of equity purchased by the new investors in SPAC combinations, which now more closely parallels the equity sold in a traditional IPO. The ratio between SPAC IPO size and pre-money valuation of the target company has grown to a median of 3.9x and an average of 5.3x in the first few months of 2021. The increase suggests that a newly raised $250.0 million SPAC is typically going to look for a private business valued at or above $1 billion. On the extreme end, we have the Grab deal, which was a $39.0 billion deal completed with a SPAC that raised $450.0 million, accompanied by a $3.5 billion PIPE deal, highlighting the importance of the accompanying PIPE transactions to these massive transactions.

### Share of SPAC acquisition count with accompanying PIPE deal

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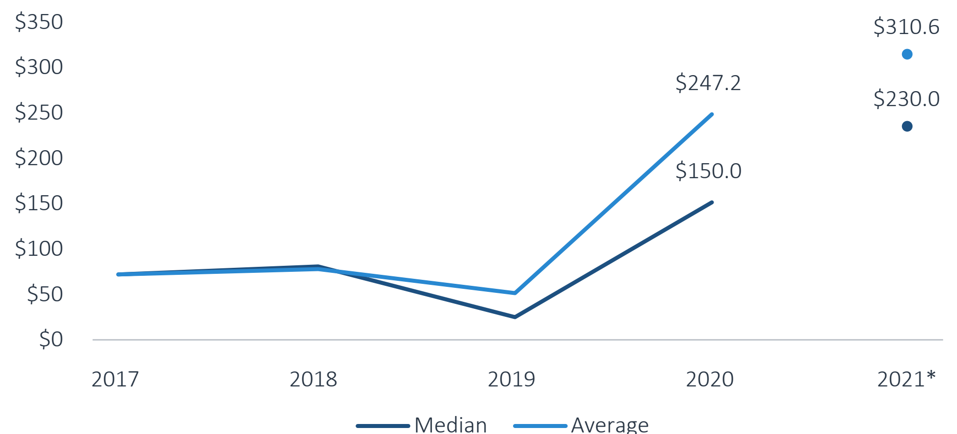
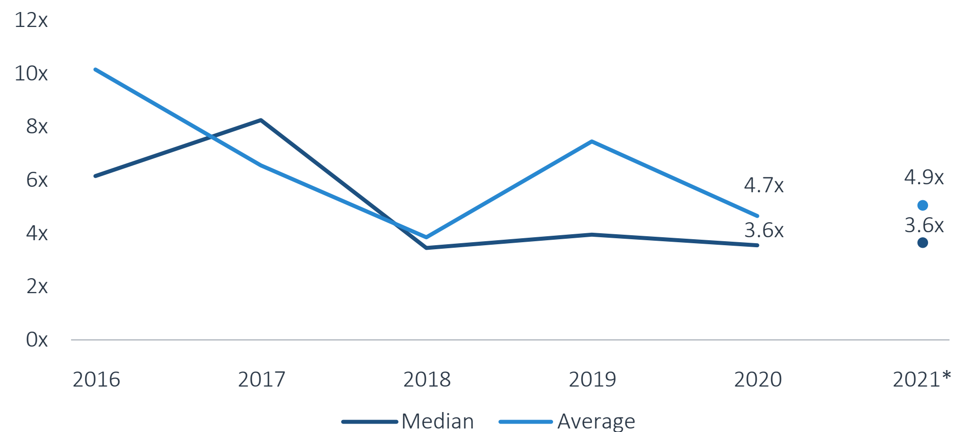
Of all the deSPAC transactions closed in 2021 through April 15, over 60% included concurrent PIPE financing, a distinct growth even relative to 2020 reverse mergers. Of course the Grab deal is an outlier, as the average PIPE size is only $310.0 million in the 2021 deals. However, the transaction displays both the flexibility of the SPAC tool and the current institutional investor demand for these deals given that PIPE size is up 25.6% over 2020. Not only are these PIPEs critical for ensuring the completion of the merger in the case of heavy redemptions, but they also provide third-party validation of the terms and valuation of the agreed-upon reverse merger. As capital availability continues to swell across the private markets with robust fundraising in both PE and VC funds, and as nontraditional investor involvement in VC grows, PIPEs have also become more important so as to match the size of a private round that many of these companies could potentially just raise from traditional private market investors. Furthermore, another positive signal for investors can be cases wherein the sponsor themselves participate in the PIPE transaction, allowing for greater alignment of interests for all parties.

### Median and average PIPE deal size accompanying SPAC deals ($M)




**Source:** PitchBook | **Geography:** Global
*As of April 15, 2021

**Median and average ratio of target post-money valuation to combined SPAC and PIPE deal size**

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When looking at the combined deal size of both the SPAC and PIPE relative to the post-money valuation of the target, we see similar trends to the pre-money valuation versus SPAC size that we addressed earlier, with the extra capital from the PIPE lowering these multiples slightly. As of the first few months of 2021, the ratio of post-money valuation to total equity investment sat at 3.6x at the median and 4.9x at the average, both remaining flat to full-year 2020 levels. These figures track with the increased use and size of PIPEs that we have recorded so far this year. This new SPAC market that really began in 2018 and 2019 is still developing and changing drastically, but given all of the activity and now regulatory scrutiny, we expect that this shift toward SPACs may accelerate changes to make the traditional IPO process more company-friendly.

## Outlook

Given the dynamism of the current SPAC landscape, it is difficult to say with certainty what will come of this phenomenon. For now, SPAC sponsors still have incentive to raise more SPACs while the market is receptive and hungry for growth given the clear economic benefits to these sponsors. While potential SEC treatment has currently halted new SPAC registrations, we expect sponsors to adjust as necessary and for new SPACs to continue to list. However, given the pure number of SPACs in the market, we believe new SPAC IPO issuance will likely cool off over the next few months, as sponsors turn to completing deals with their active SPACs rather than raising new pools of capital until more clarity is available. There are still multitudes of capable firms or individuals that have not yet raised a SPAC, which may support some sustained new IPO activity. That said, we believe the majority of activity will come from those sponsors that have already committed significant time to developing this strategy. From the public investor side, we do not anticipate a drop in demand unless there is an external shock to the system such as broader public equity weakness, rising interest rates, or a change in SEC treatment of SPACs that materially distorts the incentives. If SPACs run out of fitting targets for the strategy, we might see more SPACs

dissolve and return capital to shareholders, which may also cool demand for new SPAC IPOs, but the only losers in that situation would be a handful of SPAC sponsors.

This multitude of SPACs will also start to have some side effects. Competition for attractive targets will only intensify over the next few quarters as multiple SPACs compete for a deal but also butt heads with private investors that are looking to invest in late-stage growth rounds or middle-market buyouts. We see SPACs as a financing tool, similar to an IPO, which means it has the ability to fuel bubbles but is not itself a bubble. The $200 billion-plus raised by SPACs in the past 15 months and the 24-month clock on these vehicles may make SPACs more likely to cause sharp expansion of valuation multiples in specific markets that fit the SPAC model, such as those we have witnessed with select businesses in the electric vehicle space. SPACs are highly incentivized to find an acquisition, but shareholders can accept and validate these deals by utilizing their redemption rights, thereby creating a system of checks and balances. While there may be some valuation dislocations as this amount of capital flows through the market, we expect that SPACs will remain a liquidity option for many private companies given they fill a current gap in the landscape created by the arduous traditional IPO process.

Deal terms for SPAC acquisitions have also started to shift as SPACs work to align incentives more clearly with the companies they are competing to buy as well as with public investors. The promote is obviously one of the primary levers the sponsor can use to shift the balance of incentives between the company and themselves. Given the flexibility of the M&A structure, some sponsors have structured their promote shares as an earnout where they earn them in tranches based on stock price milestones, such as the NightDragon Acquisition management team did directly in their SPAC registration documents. The promote has also just been reduced in a handful of SPAC transactions during the negotiation phase of the acquisition, and others have added lock-ups on the sponsor's shares. Another positive behavior from certain sponsors to increase alignment has been participation in the PIPE transaction itself; it allows sponsors to have true skin in the game, signaling a long-term focus on improving the business they are taking public. The SPAC process is not perfect and comes with trade-offs for businesses pursuing this route to the public markets and for investors trying to gain access to exciting opportunities. One thing is certain: This vehicle represents innovation on the IPO process, which we are always enthusiastic to witness.