SPACs Resurface in a Volatile Market

As the IPO window closes, SPACs offer an alternative option

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Key takeaways

- The public market volatility brought on by the COVID-19 pandemic has decimated the flow of companies choosing to go forward with an IPO. However, SPACs have maintained some success during this period given their deferred nature, which allows them to wait out a correction in the public market. As experienced SPAC players, both Social Capital Hedosophia and CC Neuberger returned with new vehicles and were met with upsized offerings, signaling that capital allocators are still searching for places to invest.

- We expect SPACs will continue as some of the few IPOs to go forward during the current period of economic uncertainty, with the success of these listings potentially encouraging more firms to rekindle or implement a SPAC program. While these remain uncommon, we would expect some experimentation with new capital support structures from the sponsors of these vehicles to add extra security to potential buyers of the SPAC IPO. Especially in the current environment, the liquidity offered by these vehicles as an alternative to a strategic acquisition by large private companies should serve to increase the popularity and volume of these transactions.

SPAC definition

The following section is an excerpt from PitchBook Analyst Note: What's Special About a VC SPAC?, written by Cameron Stanfill and released in September 14, 2017.

A blank-check company is an entity formed by financial sponsors for the sole purpose of purchasing one or multiple companies. The SPAC first follows the traditional IPO process, registering with the SEC, filing prospectuses and running investor roadshows. This entity then prices the IPO and raises the funds that will subsequently be deployed to acquire the target business. At this point, the SPAC is a publicly traded shell company and has assumed much of the costs and time commitments usually borne by the target company. The IPOs of SPACs are structured as sales of units that include one share and either a full or partial warrant. Warrants, similar to options but issued by the company itself, give the holder the right—but not the obligation—to buy one share at a set strike price.

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Momentum for change builds

Over the past three years, a more distinct and prevalent desire to innovate on the IPO process has emerged, with direct listings and special purpose acquisition companies (SPACs) emerging as two of the most feasible options. While producing different outcomes, both provide an alternative path to the public market that allows companies to save on fees and avoid certain aspects of the traditional IPO process, including the roadshow. Direct listings more closely resemble the traditional IPO wherein the existing management team transitions to trading on the public market, and they seemed primed to become the preferred method for large technology companies during the bull market. SPACs, on the other hand, function closer to an acquisition as an exit for a private company, with the added result of the target operating as a public company following the deal.

The public market volatility and economic uncertainty of early 2020 have essentially closed the IPO window aside from a few exceptions. The only operating companies to proceed with IPOs have been a handful of biotech startups, which have been joined by some noteworthy SPACs—blank-check companies formed by financial sponsors for the sole purpose of purchasing one or multiple companies. With capital drying up for operating company IPOs, SPACs have regained some of their momentum as a way for companies to find liquidity at a time when many companies are choosing to stay private for longer than ever before. This, combined with the potential for valuation markdowns of the massive inventory of richly valued private companies, has created what some dealmakers may see as an opportunity. We expect SPACs to continue to be one of the only types of IPOs that find success during this crisis.

This type of listing also offers some benefits relative to IPOs to capital allocators during times of uncertainty, which could explain some of the recent success. Once the SPAC is listed, the management team has two years to identify a target, meaning that the SPAC is essentially a deferred IPO. This time lag comes with a distinct advantage in the current climate, as it allows the SPAC to be patient throughout volatility and potentially take advantage of depressed prices and companies that may be in need of a capital infusion. This may have helped these recently listed SPACs raise 20% more than initially sought, although the experience of the managers with the SPAC structure may have also been a factor.

"The traditional technology company IPO process, which has been largely unchanged for decades, has also acted as a driving force to deter private company management teams and their pre-IPO stakeholders from pursuing IPOs. We believe management distraction, a sub-optimal price discovery mechanism and the resultant longer-term aftermarket impact have discouraged private technology companies from pursuing IPOs. This tends to be true even for businesses that are otherwise operationally ready and of appropriate size to access the public markets."

—Chamath Palihapitiya, Social Capital Hedosophia II S-1, February 28, 2020

Recent listings

Fresh on the heels of closing its acquisition of Virgin Galactic in 2019 through its first SPAC, which we have covered previously, Social Capital Hedosophia is back with two more vehicles focusing on the technology sector. The sponsor listed two separate SPACs, Social Capital Hedosophia Holdings II and III, raising $1.1 billion of new capital ($360 million in II and $720 million for III), which was 20% upsized over the initial proposals. The performance of the first SPAC has been volatile, but it has consistently traded above the $10 baseline price in 2020, which has undoubtedly been an effective marketing tool for these subsequent IPOs. This strategy, led by Social Capital's Chamath Palihapitiya, stems from his belief that the current IPO process is deeply broken, especially for high-growth technology businesses. Palihapitiya has been vocal about his pursuit to disrupt the IPO industry, including a lengthy passage in the S-1.[1]

1: "Social Capital Hedosophia Holdings Corp. II S-1," SEC, February 28, 2020

More traditional players are also diving head first into SPACs. A few days after the first Social Capital vehicle went public, a new partnership between CC Capital and Neuberger Berman Investment Advisers completed an IPO of a new SPAC named CC Neuberger Principal Holdings I. This listing, which raised an upsized $360 million in its debut, represents the first in a line of multiple planned SPACs between the two private investment firms. The management team is always important when conducting due diligence on a potential investment, but these teams are even more crucial in a SPAC, which is a pure bet on the management since the operating company will be decided by their eventual acquisition. This new partnership brings a wealth of experience, both in investing in private companies and managing SPACs themselves. Chinh Chu is heading this new vehicle; as a longtime veteran of Blackstone, he was most recent Senior Managing Director before leaving the firm to start CC Capital and the SPAC CF Corporation, which eventually bought Fidelity & Guaranty Life.

"When an acquisition is identified, the SPAC management team only needs shareholder approval if that stipulation is explicitly guaranteed in the SPAC's S-1, or when it is required under applicable law or stock exchange rules. However, shareholders are given a tender offer that affords them the right to redeem their investment if they are displeased with the acquisition target. After receipt of the tender offer, investors in the SPAC have a 20- day window during which they may redeem their shares for their pro rata share of the trust account. The risk the SPAC management bears is that a significant percentage of investors redeem and leave the proposed deal with a large financing gap that must be bridged via further investment by the sponsor or outside financing. This has the potential to distract the SPAC management and could result in the transaction being withdrawn if a large enough portion of shareholders choose to redeem."

—Cameron Stanfill, "PitchBook Analyst Note: What's Special About a VC SPAC?" September 14, 2017

The experience of the team likely gave potential investors more confidence in the SPAC, but the structure of Neuberger's participation also adds some intrigue to this listing. Not only is the firm investing $200 million in a private placement concurrent with the acquisition. (They'll be doing so via a closed-end fund known as Neuberger Berman Opportunistic Capital Solutions Master Fund LP, which should serve a source of long-term capital supporting the vehicle.) The firm has also agreed to provide a backstop of up to $300 million for a single SPAC (and only up to $600 million total until a fourth SPAC in the partnership is co-sponsored) to counteract any redemptions by shareholders in relation to the business combination. This protection is paramount to increasing the surety of the proposed acquisition's completion, given a massive amount of redemptions is one of the few things that could derail a deal or cause an unfavorable capital structure going forward. With these two extra commitments of capital to this venture, Neuberger is flexing its muscles in ensuring a smooth and successful business combination for the SPAC.