SPACs in the Spotlight – Video Transcript

Private companies that want to “go public” and sell their shares on a stock exchange typically do so through an initial public offering, or IPO.

But an IPO isn’t the only way for a company to go public.

Another way is with a SPAC, which stands for “Special Purpose Acquisition Company.”

A SPAC is a shell company — a company with no business operations of its own — that’s created for the sole purpose of raising money through its *own* IPO, with the goal of then buying, or merging with, an existing private company.

A SPAC is often called a “blank-check company” because investors who purchase shares in a SPAC don’t know what the underlying target company will be. Essentially, investors are handing over a blank check to the SPAC for it to use to pursue its goals.

SPACs aren’t new, but economic challenges created by the pandemic have fueled their resurgence. 2020 was a strong year for SPACs, and 2021 has already surpassed that record.

Chart: Number of SPACs 2009 - 2021: 2009 - 1; 2010 – 7; 2011 – 15; 2012 – 9; 2013 – 10; 2014 – 12; 2015 – 20; 2016 – 13; 2017 – 34; 2018 – 46; 2019 – 59; 2020 – 248; 2021 – 345

A SPAC can take a private company public much faster than a traditional IPO — 3 or 4 months compared to up to 1 year — and may allow more control over a target company’s share pricing and other deal terms.

Funds raised in a SPAC IPO are held in a trust until they are used to purchase a company, typically within a two-year time frame.

SPAC managers have a strong incentive to buy a company, even at inflated values, because they can take up to a 20% stake in the target company at what could be a significant discount from the after-market value — a motivation that could create a conflict of interest.

And the time window to complete a deal means that SPAC managers may have less time to conduct due diligence on the target company and negotiate a price. So investors should make sure to consider the SPAC manager’s qualifications and level of experience with completing special purpose acquisitions, along with the target company’s realistic financial prospects.

SPAC investors generally get their full investment back if the SPAC fails to acquire a company within the specified time frame.

Investors can also get their money back if they aren’t happy with the deal and decide against taking shares of the target company.

By investing in a SPAC, investors might get access to shares of a fast-growing start-up or other trending company, allowing them to get in “on the ground floor.”

But potential investors should conduct plenty of research and understand the unique risks before jumping on the SPAC bandwagon.

Investing in a SPAC can present different risks depending on the point at which shares are purchased. These include the risk that the acquisition of the target company may not occur or that the investment may decline in value even if the acquisition is completed.

Investors who purchase shares in the secondary market after an acquisition announcement may suffer a loss if the value of the shares subsequently declines.

And the risk that SPAC managers are inexperienced or unqualified can be more pronounced if the SPAC has a limited operating or performance history.

Disclosure: The return and principal value of all stocks fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Investments offering the potential for higher rates of return also involve a higher degree of risk.