LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
MONDAY, JANUARY 27, 2020

PERSPECTIVE

Two paths to public

IPOs vs SPACs

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Initial public offerings are generally viewed as the option of choice for companies who have reached a critical juncture in their lifecycle and are ready for that next step…the public markets. In addition to liquidity for early investors, founders, employees and management, an IPO is a symbolic event in the evolution of a company's history. It is, of course, not without its drawbacks. Cost, performance pressure, regulatory compliance and the time needed to prepare to go public are all factors that must be evaluated in the context of the IPO decision. While some companies are opting instead to stay private longer and even choosing different exit options, such as a private sale or merger, other companies are also considering other ways to access the public markets and one of the most prevalent of those options is to merge with a special purpose acquisition corporation, or SPAC.

A SPAC is a publicly traded acquisition vehicle whereby a private equity sponsor assembles a management team and raises proceeds through an IPO of a shell company whose sole intention is to acquire an operating company. Most SPACs provide 18-24 months for completion of an acquisition and if no acquisition is consummated, the SPAC is required to liquidate. Private companies who are looking for a way to go public can merge with a SPAC without enduring the initial public offering process required in a typical IPO. With the turmoil in the traditional IPO market in recent years, and certain high-profile IPO failures of late, SPACs are being viewed as a strong alternative to accessing the public market.

A SPAC IS A PUBLICLY TRADED ACQUISITION VEHICLE WHEREBY A PRIVATE EQUITY SPONSOR ASSEMBLES A MANAGEMENT TEAM AND RAISES PROCEEDS THROUGH AN IPO OF A SHELL COMPANY WHOSE SOLE INTENTION IS TO ACQUIRE AN OPERATING COMPANY.

2019 was a big year for both IPOs and SPACs. A large number of unicorn technology companies, including Uber, Lyft, Pinterest and Beyond Meat all went the traditional IPO route, with varying degrees of success. On the SPAC side, Virgin Galactic became public through merger with a SPAC and DraftKings is the latest example of a company taking the SPAC route. Even though both IPOs and SPACs ultimately result in a private company becoming a public company, it can be difficult to make a determination as to which path is right.

What Option Is Best?

Companies may struggle with determining which route is the better option for them. Like any strategic decision, evaluating whether going public through a traditional IPO or a SPAC is all about determining a company's objective and also being able to honestly evaluate a company's resources and its strengths and weaknesses as it relates to its debut on the public market. There is not a one-size fits all direction and there are several factors to consider in making such a decision.

Timing and Cost

The amount of time to undertake a traditional IPO process ranges from 16-19 weeks. Merger with a SPAC may be slightly faster than this timeline but the merger process can also generally require about 14-18 weeks.

A business combination with a SPAC is marginally cheaper than a traditional IPO primarily because of professional fees and underwriting discounts but, from the professional fees standpoint, that is also dependent upon how much time and resources the company may have already committed towards the IPO readiness process. Further, it is important to remember that the work in a SPAC business combination often falls on the target (compared to an acquisition with a strategic) since a SPAC only has a part-time management team who was primarily tasked with just sourcing the deal.

Disclosure

While some companies may think that a business combination with a SPAC is better because they will not have to prepare an S-1/F-1, which is the offering document used in the context of a traditional IPO, it is important to remember that a business combination with a SPAC will require a proxy statement to be filed in connection with the shareholder vote. The proxy statement also contains a significant amount of disclosure regarding the company.

Valuation

Valuation is generally known at the beginning of the business combination process in a SPAC versus at the end in a traditional IPO. In an IPO, the underwriters and the market play a large role in the ultimate valuation of the company. In a SPAC business combination, this is just a typical negotiation between buyer and seller. In both contexts, there is certainly pressure to get a good value so that there is upside but SPACs may experience more valuation pressure as they will be required to obtain a shareholder vote and shareholders of the SPAC may redeem if they do not like the transaction. In an IPO context, since the company has an opportunity to tell their story and stimulate investor interest, there is more flexibility to increase the proceeds to the company if there is significant market demand for the deal.

Market

A SPAC business combination is not dependent on an "IPO Window" but can raise its own challenges. In a traditional IPO, timing is critical and missing the right window can make the difference between success and failure. Failure to raise capital from investors or pricing of offering issues are eliminated in the SPAC context because a SPAC is already capitalized. However, for a SPAC, transitioning to a public operating company with a traditional stockholder base trading on the basis of the target's fundamentals can be a challenge. Post-merger trading can be thin if too many of the pre-acquisition stockholders elect to redeem their stock at closing, which can make it difficult to translate subsequent operational success into increased shareholder value. This challenge is critical to predicting the potential success of a merger with a SPAC. For an IPO, since new shares are sold to a new investor base, there is a greater opportunity for robust trading especially if you can hit the right IPO Window.

Execution Considerations

SPAC management is highly incentivized to complete the business combination as quickly and efficiently as possible given limited window to complete an acquisition. This can bring a feeling of certainty that the transaction will be completed but the post-merger public company can have difficulty getting research coverage. Since no investment banks are typically involved in a SPAC business combination, the company may have to spend time and money to create interest in the company's stock and seek out research analyst coverage. This is often why a simultaneous PIPE transaction is conducted as part of the acquisition financing. For an IPO, there is always a risk that the public will not be receptive to the company and will therefore undervalue the stock. Another execution consideration is that lenders and other financing sources may not want to lend to a SPAC target and may not be as flexible in amending terms and in granting waivers compared to an IPO transaction which can create unnecessary roadblocks to a transaction structure.

Sizing up the Options

While an IPO and a SPAC ultimately both lead to a company becoming public, the journey to that outcome is quite different and several factors weigh into the determination of which option is better depending on the company. Further, it is important to remember that a SPAC exit is only an option to the extent there are viable SPAC vehicles with which companies can merge who have sufficient capital to do an enticing deal. While certainly more companies do take the traditional IPO route, the opportunity to take the SPAC route is increasingly a viable option for companies especially with the growth in the number of SPACs raised. Recent estimates suggest that more than $13 billion in SPAC capital was raised in 2019 through 59 SPACs, providing 59 companies with a possible choice in whether to IPO or SPAC. One thing is clear. Companies and investors benefit from having more options for liquidity. As such, it is likely that the choice between an IPO or a SPAC route will both remain viable paths to the public markets. ■

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