A Sober Look at SPACs

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This Paper

- SPACs that successfully acquired a target between Jan 2019 and June 2020
- Four main findings:
  - Transaction costs are higher than previously recognized (larger than those of IPOs)
  - High dilution of SPAC shares due to:
    - Sponsor's promote of 20% of SPAC post-IPO shares
    - Underwriter's fee 5.5% of proceeds
    - IPO investors' free warrants attached to redeemable shares
    - Of $10 per SPAC share, only $6.40 left in cash after dilution
  - Dilution correlated negatively to post-merger performance
  - Losses absorbed by SPAC shareholders rather than targets

WHAT'S NEW?

- **Past wave:** SPACs perform badly because of poor incentives defined in the contract
  - Sponsor's compensation: not conditional on merger quality
  - Limited time to do a deal: maximum 2 years
  - Underwriter's deferred fees: not conditional on merger quality
  - At least 80% need to be spend on target

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  - High dilution of SPAC shares due to:
    - Sponsor's compensation
    - Underwriter's fees
    - IPO investors' free warrants

REDEEM VS. SELL SHARES

- "Nearly 100% of IPO investors redeem or sell their shares before the merger"
  - Can you differentiate between redeem and sell? Does it matter?
    - Keep warrants vs. lose warrants?!
- In the past, SPACs will be liquidated if too many shareholders redeem?
- **Now, it appears that SPAC shareholders do not vote to approve the merger**
  - This is something new
  - If too many IPO shareholders redeem
  - This explains the need for more cash and PIPE investment
  - Or, SPACs are buying larger targets now?!

WHY/WHEN DO THEY REDEEM?

- Isn't dilution going to be there only if the warrants are exercised?
  - How do "SPAC Mafia" make money?
  - Only by keeping/exercising the warrants?
- In the past it was suggested that their strategy was to short sell the SPAC, vote against the merger, and redeem their shares
  - SPAC merger success rate was low
  - What is the success rate now?

PROVIDE MORE DETAILS

- Successful SPACs
  - When was the IPO done?
  - How long time it took to find a target?
  - Time affects SPAC performance, as it reflects sponsors' incentives to close a deal
- Unsuccessful SPACs
  - How many SPACs fail to complete a deal? (You mention 6, but when were they created)?
  - Why not examine unsuccessful SPACs as well?
  - Are they any different from successful SPACs?

WHY SPAC RATHER THAN IPO?

- Costs, at least as high as those for an IPO
- Time, it may not take less than for an IPO
- **SPACs offer more price discovery and reduce the information asymmetry of IPOs**
  - Safe harbor against liability under securities laws
  - PIPE investments (needs more elaboration)
  - Earnouts for target shareholders (don't they make the dilution worse?)
- Are SPAC targets different from firms that file for an IPO?
  - Were they always private, or these are reverse leveraged buyouts?

Other comments

- Isn't the sponsors' promote of 20% conditional on closing a deal? How can they transfer some of their shares to other parties?
- High-quality sponsors may do better because of selection (better at finding undervalued targets), rather than treatment (better at bargain and expectations for further involvement).
- T1: show also means (as you do in the other tables) and number of observations
- T4: there might be some outliers because the mean of "Underwriting fee as % cash delivered in merger" is very high

CONCLUSION

Very nice and interesting paper!

- History has a tendency to repeat itself.