Investing in SPACs

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Below is the brief overview for investors of important concepts when considering investing in a SPAC, both (1) when the SPAC is in its shell company stage and (2) at the time of and following the initial business combination (i.e., when the SPAC acquires or merges with an operating company). It is important to understand how to evaluate an investment in a SPAC as it moves through these stages.

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What is a SPAC?

“SPAC” stands for Special Purpose Acquisition Company, and is a type of shell company that raises capital in an initial public offering (“IPO”) for the purpose of merging with or acquiring an operating company.

SPACs have become a popular vehicle for various transactions, including transitioning a company from a private company to a publicly traded company. One possible advantage of a SPAC is that a private company can become a publicly traded company with more certainty as to pricing and control over deal terms as compared to traditional initial public offerings.These types of transactions - most commonly where a SPAC acquires or merges with a private company - occur after (often many months or more than a year after) the SPAC has completed its own IPO.
Unlike an operating company that becomes public through a traditional IPO, however, a SPAC is a shell company when it becomes public. This means that it does not have an underlying operating business and does not have assets other than cash and limited investments, including the proceeds from the IPO.

Comparison with a Traditional IPO

Traditionally, a company starts and develops a business. Eventually, that company may grow to a scale that it determines that it has the resources and structures in place for the IPO process and elects to seek to raise capital in the public markets, thereby becoming a public company. Public companies may list their securities on an exchange. In a traditional IPO scenario, the prospectus focuses on historical facts about the issuer and its past performance. Underwriters market the offering after announcing an initial price range. The price at which shares are offered to the public should reflect both demand for the shares and estimates of future performance of the issuer.

If you invest in a SPAC at the IPO stage, you are relying on the management team that formed the SPAC, often referred to as the sponsor(s), as the SPAC looks to acquire or combine with an operating company. That acquisition or combination is known as the initial business combination. A SPAC may identify in its IPO prospectus a specific industry or business that it will target as it seeks to combine with an operating company, but it is not obligated to pursue a target in the identified industry. SPACs do not “pre-identify” possible acquisition targets , but may identify a specific industry or business that it will target , but it is not obligated to pursue a target in the identified industry.

In a traditional IPO, underwriters conduct significant and thorough due diligence on a company and assume liability for the information disclosed in the registration statement. There may be no similar “gatekeeper” function by underwriters in connection with the acquisition target of a SPAC.

Once the SPAC has identified an initial business combination opportunity, its management negotiates with the operating company and, if approved by SPAC shareholders (if a shareholder vote is required), executes the business combination. This transaction is often structured as a reverse merger in which the operating company merges with and into the SPAC or a subsidiary of the SPAC. The combined company following the transaction is a publicly traded company and carries on the target operating company’s business.

In evaluating an investment in a SPAC, there are a number of issues to consider.

What do I need to know before the initial business combination?

Initial information: Prospectus and reports.

When investing in a SPAC by purchasing securities on the eToro trading platform, you should carefully read the SPAC's IPO prospectus as well as its periodic and current reports filed with the SEC pursuant to its ongoing reporting obligations. It is important to understand the terms of your investment in the specific SPAC. It is important to pay attention to disclosures related to the equity interests held by the sponsor and to review the business background of SPAC management team and its sponsors.

You can review a SPAC's IPO prospectus and periodic and current reports in the SEC's EDGAR database https://www.sec.gov/edgar/searchedgar/companysearch.html .

Your investment: Trust account

Typically, SPAC IPO proceeds (minus proceeds used for certain fees and expenses) are held in a trust account. Similar to an escrow arrangement when buying a house, this money is held by a third party until the transaction is completed. A SPAC is liquidated in the event it does not complete an initial business combination within a certain period of time.

SPACs generally invest the proceeds in relatively safe, interest-bearing instruments, but you should carefully review the specific terms of an offering as there is no rule requiring that the proceeds only be invested in those types of instruments. SPACs often use the interest on trust account investments to pay taxes.

In connection with a business combination, a SPAC provides its investors with the opportunity to redeem their shares rather than become a shareholder of the combined company. If the SPAC does not complete a business combination, shareholders are beneficiaries of the trust and are entitled to their pro rata share of the aggregate amount held on deposit in the trust account.

Pro rata share of trust account

One thing to keep in mind is that if you purchased your shares on the open market, you are only entitled to your pro rata share of the trust account and not the price at which you bought the SPAC shares on the market. For example, if a SPAC had an IPO at $10 per share, but you bought 100 SPAC shares on the open market at $12 per share, the shares you purchased are associated with a trust account balance of about $10 per share, so your share of the trust account would be worth about $1,000 (not the $1,200 you paid for your shares).

You should review the IPO prospectus of the SPAC to understand the terms of the trust account, including your redemption rights and the circumstances in which cash may be released from the account.

Trading in SPAC stocks: price formation

In the IPO, SPACs are typically priced at a nominal $10 per unit. Unlike a traditional IPO of an operating company, the SPAC IPO price is not based on a valuation of an existing business. The market prices of SPACs may fluctuate, and these fluctuations may bear little relationship to the ultimate economic success of the SPAC. Hence this can be considered to be a highly speculative trading.

Period to complete the initial business combination

A SPAC will typically provide for a two-year period to identify and complete an initial business combination transaction. The SPAC's Prospectus may permit it to extend that time period by approval. If a SPAC lists its securities on an exchange, it is required to complete an initial business combination *within three years of its IPO*. With an increasing number of SPACs seeking to acquire operating businesses, it is important to consider whether attractive initial business combinations will become more scarce.

What do I need to know at the time of the initial business combination?

Redemption and vote

Once the SPAC has identified an initial business combination opportunity, the shareholders of the SPAC will have the opportunity to redeem their shares and, in many cases, vote on the initial business combination transaction. Each SPAC shareholder can either remain a shareholder of the company after the initial business combination or redeem and receive its pro rata amount of the funds held in the trust account.

This is an important investor consideration as the SPAC changes from essentially a trust account into an operating company. As an investor, depending on how you view the prospective initial business combination and its valuation, you can decide whether to redeem your shares for a pro rata share of the aggregate amount held on deposit in the trust account or remain an investor in the combined company moving forward.

Proxy, information or tender offer statement

If the SPAC seeks shareholder approval of the initial business combination, it will provide shareholders with a proxy statement in advance of the shareholder vote. In cases where the SPAC does not solicit the approval of public shareholders, because certain shareholders, such as the sponsor and its affiliates, hold enough votes to approve the transaction, it will provide shareholders with an information statement in advance of the completion of the initial business combination.

The proxy or information statement will contain important information about the business of the company that the SPAC wants to acquire, the financial statements of the company, interests of the parties to the transaction, including the sponsor of the SPAC, and the terms of the initial business combination transaction, including the capital structure of the combined entity.

If the transaction is completed and you decide that you do not want to remain a shareholder, you will be provided with the opportunity to redeem your shares of common stock for your pro rata share of the aggregate amount held on deposit in the trust account by taking the steps outlined in the proxy or information statement.

If a SPAC is not required to provide shareholders with a proxy or information statement (for example, when a SPAC is not required to obtain shareholder approval of the transaction), you will receive a tender offer statement that contains information about the target business and your redemption rights.

You can review a SPAC's proxy, information or tender offer statement in the SEC's EDGAR database.

Conflict of interests: The interests of the sponsor

SPAC sponsors generally purchase equity in the SPAC at more favorable terms than investors on the open market. As a result, investors should be aware that although most of the SPAC's capital has been provided by IPO investors, the sponsors and potentially other initial investors will benefit more than investors from the SPAC's completion of an initial business combination and may have an incentive to complete a transaction on terms that may be less favorable to you.

In addition, the SPAC may require additional financings to fund the initial business combination, and those financings often involve the sponsors. As a result, the interests of the sponsors may further diverge from your interests. For example, additional funding from the sponsors may dilute your interest in the combined company or may be provided in the form of a loan or security that has different rights from your investments.

To learn more about a sponsor's interests in a SPAC, you should review the "Principal Stockholders" and "Certain Relationships and Related Party Transactions" sections of a SPAC's IPO prospectus. You can learn more about an initial business combination and the sponsor's interest in it from the proxy statement, information statement or tender offer statement.

Other SPAC IPOs certain risks

SPAC IPOs may present the following (non-exhaustive list of) risks:

- The risk that SPAC managers are unqualified or incompetent, a risk made more pronounced by lack of any operating history or past performance of the SPAC.

- Risk of failed investment. The risk that no acquisition will occur and the SPAC will be liquidated. The SPAC structure, which requires most of investor's funds to be held in escrow and returned if an acquisition is not completed, does provide some downside protection. Moreover, investors may be able to sell their SPAC units in the secondary market.

- Opportunity costs and long investment horizon.
  Any investor considering a SPAC must be prepared to wait to see a return on investment and potentially not to see one at all as described above. With no guarantees that a suitable target company will be found within that time frame, an investor is exposed to the opportunity costs for their cash deposited with the trust accounts unnecessarily and, in turn, missing out on other opportunities.

- Valuation risk.   The value of the common stock depends on whether the stock is purchased before or after an acquisition target has been announced.

  An investment before the announcement of an acquisition is a bet on whether an acquisition target will be announced and whether it is an attractive investment, hence has high speculative risks of a   "blind" investment .
  After an acquisition target is announced, there typically is a delay, which can be weeks before audited financial statements regarding the acquisition target are available through the preliminary proxy filing and provides transparency .

  In addition, the acquisition terms and arrangements may change during the proxy filing and review period.

  The release of more complete information occasionally leads to a decline in the price of the SPAC's common stock. Investors who purchase in the secondary market after an acquisition announcement may suffer a loss if the value of the shares subsequently declines.

Information is taken from the SEC Investor Alerts and Bulletins
regarding "What You Need to Know About SPACs – Investor Bulletin"