WHAT IS A SPAC AND HOW DOES IT FIT IN THE WEALTH ENTERPRISE INVESTMENT PROGRAM?

A BRIEF OVERVIEW

As a family office company, we are often mandated to create customized investment strategies for families and family offices. Part of this includes evaluating investment strategies that, like many other things, gain popularity in the media due to certain market conditions. With equity valuations at an all-time high, investors are looking for ways to generate yield, and SPACs have gained in popularity in recent months as an alternative to traditional equity markets. But first, a little bit of background.

SPAC stands for Special Purpose Acquisition Company. SPACs are basically shell companies specifically created by investors with the purpose of raising money through an IPO with the intent to eventually purchase another company. SPACs are publicly listed, with no operations and only hold cash - essentially a blank check with a stock ticker.

Typically, the "management" of a SPAC is the sponsor – or a team of sponsors – usually Wall Street investors. A SPAC raises capital through an initial public offering (IPO) and:

- Has a ticker like any stock
- Holds capital in a trust for two years or until the acquisition is made
- Can only be used to make an acquisition; if no acquisition is made within two years, the funds are returned to investors
- Post-acquisition of the target company, SPAC shareholders become the owners of the company, as the SPAC assumes the identity of the company it has acquired

Here is the kicker – the investors have no knowledge of what company the SPAC will eventually purchase. This is why SPACs are often called "blank check companies." There are many benefits of SPACs, including the opportunity for a fast exit by private equity and venture capital managers, and a lower cost of IPO. In addition, SPACs can boost the sale price of the IPO, benefiting the LP investors.

ROLE IN A PORTFOLIO

With a firm understanding of what a SPAC is, now we can discuss what role they have in an investment portfolio. There are several ways to invest in SPACs: as a sponsor, through a private manager, and as a public market investor.

SPACs may offer a way for a family business to go public and therefore generate a liquidity event. When a family sets up a SPAC, it becomes the sponsor. The SPAC will effectively purchase the family's business. As a result, the business becomes public much faster, cheaper and with less disclosure than through a traditional IPO. SPACs are also profitable to the sponsor who receives 20% of the shares as a fee ("promote").

As a portfolio investment, investing in SPACs is best executed through astute private market managers—venture capital and private equity managers that utilize SPACs to effectively exit portfolio positions through the IPO process and hedge fund managers who can exploit the volatility and inefficiency through trading. These managers are well-positioned to extract the complexity premium that SPACs can offer.

The market environment for SPACs has been extremely active. The reason is that liquidity is plentiful and inexpensive. In such environments, money is "looking for a home." Combined with extremely high investor sentiment, ease of trading, and low opportunity costs (due to low bond yields), public market investors are willing to reach out of the risk spectrum. As a result, they are willing to buy recently listed SPACs with little information. As higher liquidity and sentiment (i.e. "froth") leads to higher prices, both SPAC sponsors and private managers can take advantage of public market investors' high-risk appetite.

Given this transfer of value, we caution against investing in SPACs through the public markets and find private markets to be the better opportunity.

INCREASE OF SPAC IPO ACTIVITY

SPAC activity has grown rapidly since last year: [1]

	2016	2017	2018	2019	2020
No. of SPAC IPOs	13	34	46	59	237
Proceeds Raised ($bn)	3.5	10.0	10.8	13.6	79.9

Sources: CapitalIQ, data as of 8/5/2020; NASDAQ data as of 12/28/2020

- As shown above, 237 U.S. SPACs raised $79.9 billion in 2020, which was dubbed the "year of the SPAC."
- 128 SPAC IPOs have already been completed in 2021, raising $38 billion (as of early February 2021)[2]

RISKS

Like any investment, SPACs come with a set of risks. Because they are pre-acquisition, SPACs should trade at cash value. Since it has no operations, the SPAC should trade at roughly the value of the cash in the bank. In addition, there is inherent risk because the acquisition (assuming it occurs) is unknown. Also, and importantly:

- The SPAC process circumvents the rigorous due diligence of the normal IPO process.
- Investors viewing SPACs as a way to gain access to IPO "jumps" are likely to be disappointed.
- There is potentially high opportunity cost if no acquisition is made and capital is returned.