What is a SPAC? The basics, when you are contemplating going public

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2020 was a record-breaking year for special purpose acquisition companies (SPACs): more than 248 SPACs completed initial public offerings (IPOs) in the United States, raising more than US$83.4 billion, compared to 59 SPAC IPOs raising US$13.6 billion in 2019. Already in the first quarter of 2021, SPAC activity has skyrocketed, with SPAC IPOs raising US$87.9 billion.

For Latin American companies, a business combination with a SPAC may be an attractive alternative to a traditional IPO or direct listing.

What is a SPAC?

A SPAC is an investment vehicle/shell company organized by one or more sponsors to raise capital from the public in an IPO, for the purpose of effecting a business combination with a private operating company to be identified after the SPAC's IPO (a de-SPAC transaction). SPAC IPOs are typically structured as offerings of units comprised of shares and fractional warrants. All proceeds from the SPAC's IPO are deposited into a trust account.

Most SPACs are required to complete a de-SPAC transaction within a certain period of time, typically between 18 to 24 months after the SPAC's IPO. As a result of the de-SPAC transaction, the target company becomes public. If the SPAC fails to close a de-SPAC transaction within the required timeframe (including any extensions), it must redeem the public shares sold in its IPO for each shareholder's pro rata share of the IPO funds held in a trust account, and all of the SPAC's warrants will expire worthless. SPAC investors have the right to have their shares redeemed in connection with an initial business combination.

SPAC goodies

As an IPO alternative, a de-SPAC transaction may provide a target company with the benefit of pricing certainty, because negotiations are conducted directly with the SPAC sponsors and not based on potentially volatile market conditions. Assuming limited redemptions, a SPAC transaction can offer a significant amount of cash to fuel a target's growth or allow sellers to exit. In addition, a de-SPAC transaction can be executed more quickly than most traditional IPOs.

SEC scrutiny

The US Securities and Exchange Commission (the SEC) has recently raised concerns relating to certain disclosure practices by SPACs, including with respect to conflicts of interests and projections (and the liability risk associated therewith).[1] The SEC has also recently challenged the previously accepted accounting treatment of SPAC warrants.[2] The SEC's scrutiny is expected to continue and may intensify.

The SPAC market is open to Latin American companies

Despite mounting SEC focus and a relative slowdown in new issuances and de-SPAC transactions since the first quarter of 2021, current market conditions suggest that the SPAC market will remain popular in the US.

Latin American companies are increasingly turning their attention to this attractive alternative mechanism. If you have any questions on any of the above matters, would like to discuss a potential SPAC issue or investment, or would like to learn more about our extensive experience with SPACS as a means of taking companies public, please contact any of the authors.

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[1] See, “Special Purpose Acquisition Companies” published by the Division of Corporation Finance, Securities and Exchange Commission (CF Disclosure Guidance: Topic No. 11) (available at: https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies) and “Statement by Acting Director Coates on SPACs, IPOs and Liability Risk under the Securities Laws” posted by John C. Coates, US Securities and Exchange Commission, on Friday, April 9, 2021 (available at: https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws).

[2] See, SEC Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies (“SPACs”), published on April 12, 2021 (available at: https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs).