# CAPITALIZING ON CONTROVERSY: DEMYSTIFYING SPACS AND PIPES

*NOVEMBER 11, 2021*

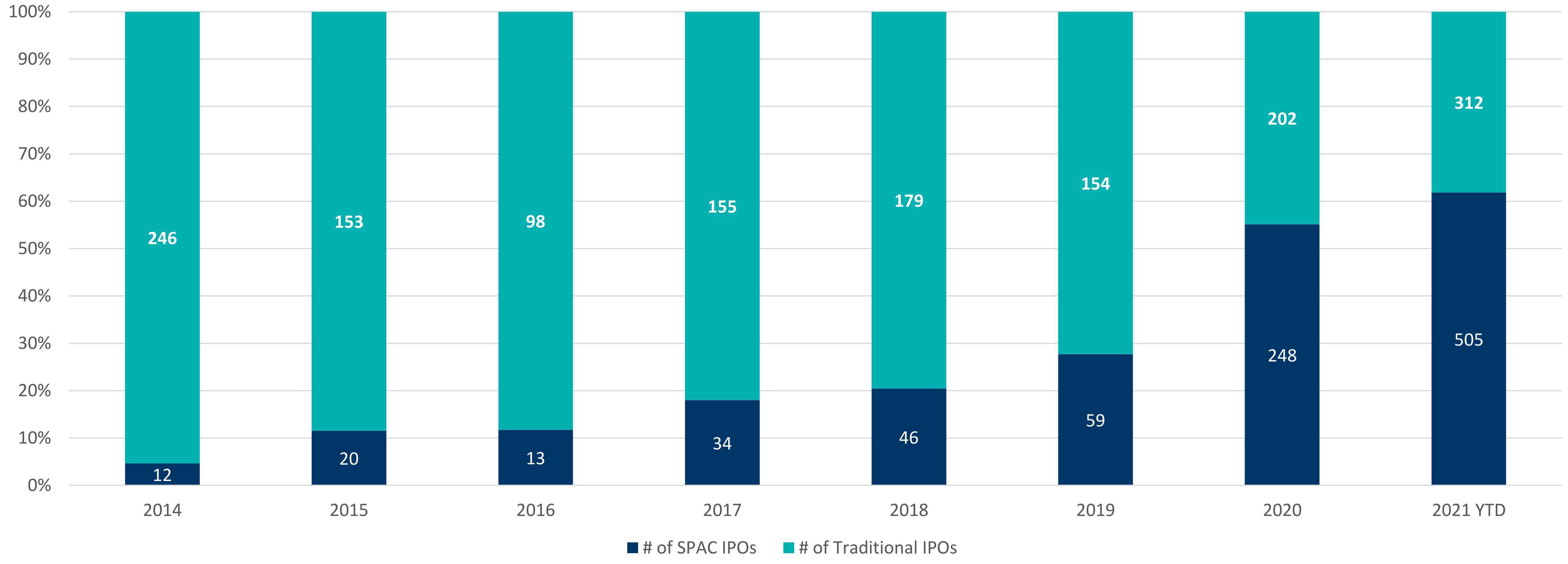
**Ronald Temple, CFA**
Managing Director, Co-Head of Multi-Asset and Head of US Equity



LAZARD
ASSET MANAGEMENT

# SPAC IPOS NOW COMPRISE A MAJORITY OF ALL IPOS

## Since 2020, SPACs Have Outpaced Traditional IPOs in both Quantity and Capital Raised




As of October 31, 2021
Source: SPAC Analytics.

# WHAT IS A SPAC?

- A SPAC (special purpose acquisition company) is a “blank-check” company
  - founded by a sponsor,
  - with no initial operations or assets,
  - that raises investor capital through an IPO,
  - with the goal of acquiring a private target company
- IPO proceeds are held in a trust for a predetermined period (typically no more than 24 months), during which the SPAC management team pursues an acquisition target
- The target business is acquired in a transaction referred to as “de-SPACing”
- After the de-SPAC, the SPAC sponsor and SPAC investors own a material stake in the target company, which then trades under its own name and ticker

# WHAT IS A PIPE?

- A PIPE (private investment in public equity) is a critical source of funding of a de-SPACing
- Prospective PIPE investors are brought “over the wall” to conduct due diligence on the target company
- PIPE investors get to participate in the de-SPACing at an agreed-upon, private price
- Allocations are concentrated amongst “anchor” institutional PIPE investors
- PIPE investors have the opportunity to profit from the difference between the private placement price and any appreciation thereafter

# STRATEGIC OPTIONS FOR PRIVATE COMPANIES

| | SPAC | LBO | IPO |
|---|---|---|---|
| **Upfront Proceeds** | -No prescribed limit<br>-Ability to raise incremental capital via PIPE | -Monetization of full value | -~20-25% of value of company |
| **Synergies** | -Validation from PIPE investors | -Potential operational and/or financial benefits from sponsor | -None |
| **Valuation** | -Public market valuation, net of dilution | -Private market valuation, based on sponsor IRR targets | -Public market valuation, net of IPO discount and underwriters' spread |
| **Execution Risk** | -Market risk between signing and closing, but ability to execute even when IPO market is "closed" | -Closing contingent on raising of debt at maximum leverage | -Requires "open" IPO market at closing |
| **Capital Structure** | -Public company-appropriate leverage | -Maximum supportable leverage | -Public company |
| **Exit** | -Ability to sell-down/spin as desired | -Complete exit at time of transaction | -Ability to sell-down/spin as desired |

Source: Goldman Sachs. Scenarios above are not exhaustive and are subject to change.

# PROS AND CONS OF GOING PUBLIC VIA SPAC

| | SPAC | Traditional IPO |
|---|---|---|
| Valuation and Funding | Pre-determined | Subject to market conditions |
| Speed to Market | Accelerated timeline | Extended timeline |
| Financial Projections | Provided as part of marketing efforts | Prohibited |
| Ability to Reduce Leverage | Able to raise more capital with pre-determined pricing | Size of capital raise might be constrained |
| Expenses | Dilution from sponsor promote, SPAC warrants and operational costs | IPO discount and underwriters' spread |

Scenarios above are not exhaustive and are subject to change.

# COMMON TYPES OF COMPANIES GOING PUBLIC THROUGH DE-SPACS

| PE Exits |
|---|
| Cano Health |
| Hostess Brands |
| Paysafe |
| Simply Good Foods |

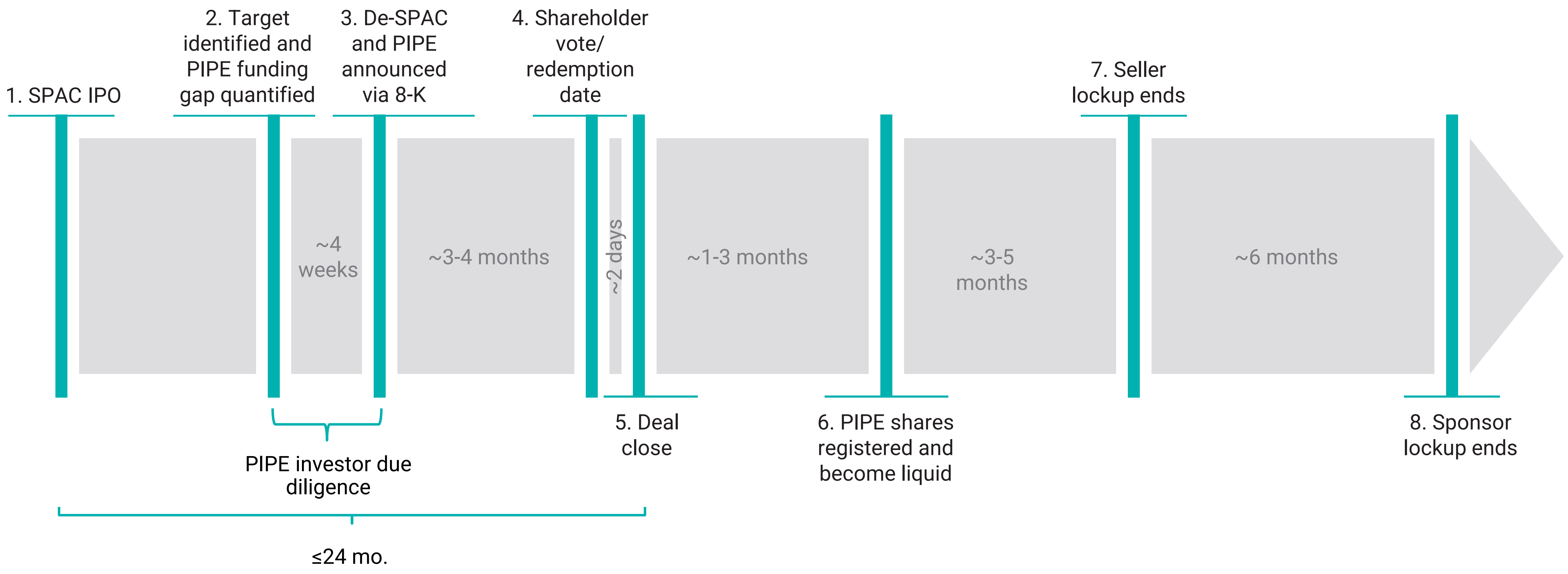
| Family/Founder-Controlled |
|---|
| UTZ Brands |
| Billtrust |
| United Wholesale Mortgage |

| Spinoffs |
|---|
| Bakkt |
| Cerevel |
| Ardagh Metal Packaging |
| ChampionX |

| Growth Capital | |
|---|---|
| *Established* | *Pre-Revenue* |
| Proterra | Archer |
| Benson Hill | Lordstown |
| SoFi | Virgin Galactic |
| Open Lending | AEye |

For illustrative purposes only. The securities mentioned should not be considered a recommendation or solicitation to purchase or sell these securities. It should not be assumed that any investment in these securities was, or will prove to be, profitable, or that the investment decisions we make in the future will be profitable or equal to the investment performance of securities referenced herein. There is no assurance that any securities referenced herein are currently held by Lazard.

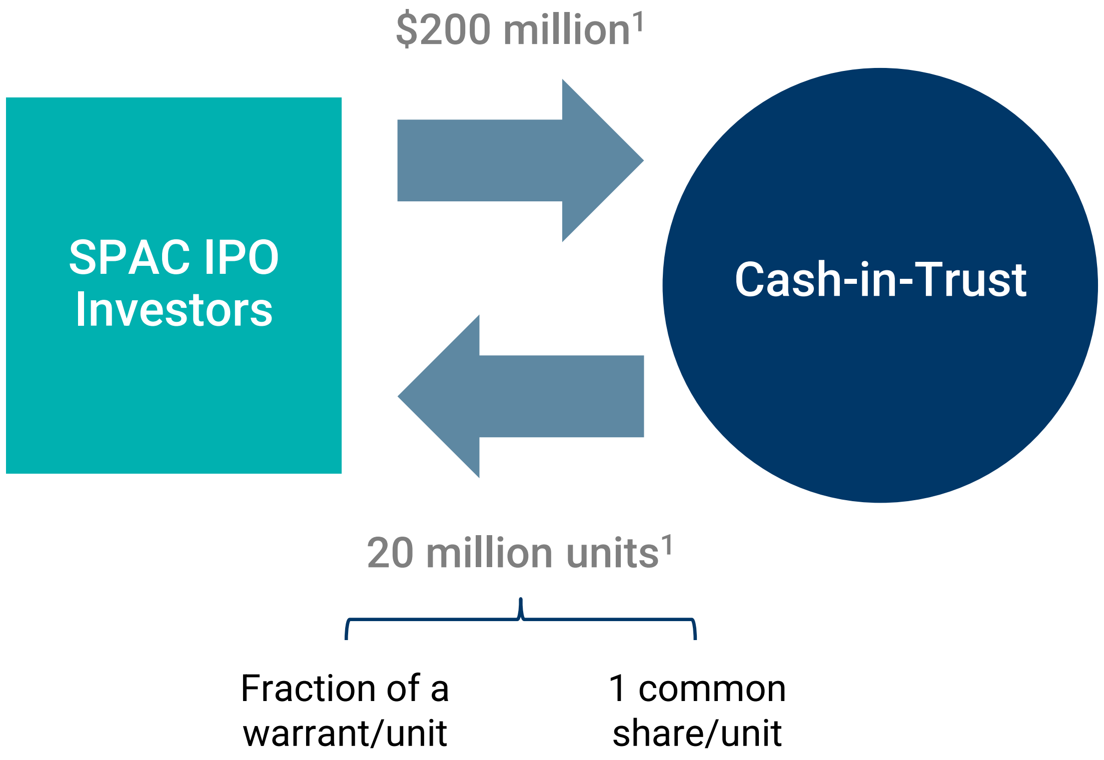
# THE SPAC LIFECYCLE – A HYPOTHETICAL EXAMPLE




For illustrative purposes only.
Lockup periods reflect common industry standard. However, lockup terms for each deal are defined pursuant to a merger agreement and proxy, and therefore may vary.

# 1. SPAC IPO

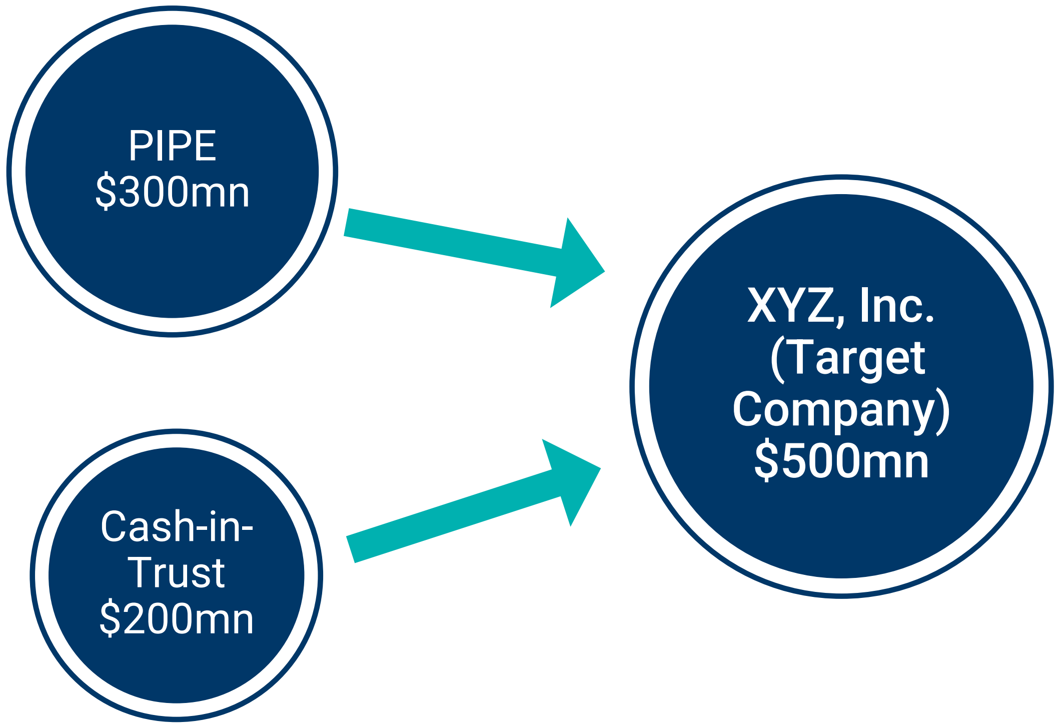
- At IPO, SPAC "ABC" has no operations
- ABC's sponsor launches IPO to raise capital to take a company public
- Proceeds from the IPO placed as cash-in-trust with a custodian
- **IPO investors receive units of SPAC ABC (each unit consists of one common share + a fractional warrant)**
- **All SPAC investors have the right to redeem their shares at par shortly before the acquisition closes while retaining their warrants**




For illustrative purposes only.
1 SPAC unit typically IPO at $10/unit

# 2. TARGET IDENTIFIED AND FUNDING GAP QUANTIFIED

- Target (XYZ, Inc.) is identified, and XYZ management agrees deal price with ABC's sponsor:
  - XYZ's equity is valued at $2.5 billion
  - XYZ floats 20% of the equity = $500 million in equity capital required to complete deal…
  - …but the SPAC IPO only generated $200 million of cash in trust
  - **<u>PIPE required to fund the remaining $300 million</u>**




## Function of the PIPE:

- Provide equity capital
- Validate transaction

For illustrative purposes only.

# 2. KEY ELEMENTS OF PIPE INVESTMENT PROCESS

Potential PIPE investors receive access to:

- The data room, which can include:
  - Detailed company/product presentations
  - Financial projections
  - Financial models, in some cases
- Management team from the target company (XYZ, Inc.)
- The sponsors of ABC SPAC

SPAC sponsors select potential PIPE investors based on:

- Market reputation – strong preference for fundamental, institutional managers with top-tier brands
- Due diligence resources
- Industry and underwriter relationships
- Financial resources to commit necessary equity capital

For illustrative purposes only.

# 3. DEAL ANNOUNCED AFTER PIPE FUNDING SECURED

Press Release:

**XYZ to Go Public Via Merger With ABC SPAC; Combined Firm to Have $2.5B Equity Value**

March 10, 2021 – New York

ABC SPAC, Inc. (“ABC”), a blank check company, announced today that it had entered into an Agreement and Plan of Merger with XYZ, Inc. (“XYZ”), at an equity value of $2.5 billion.

Concurrently with the execution of the Merger Agreement, ABC entered into subscription agreements with certain investors (collectively, the “PIPE Investors”) for 30,000,000 shares of XYZ common stock, for an aggregate purchase price equal to $300,000,000, which, coupled with the $200,000,000 in proceeds from ABC’s initial public offering, will result in equity financings totaling $500,000,000.

The fully-secured PIPE investment was funded by top-tier, institutional anchor investors including Alpha Capital, Beta Investments, and Delta Asset Management. The deal is expected to close in May.

For illustrative purposes only.

# 4. SHAREHOLDER VOTE/REDEMPTION DATE

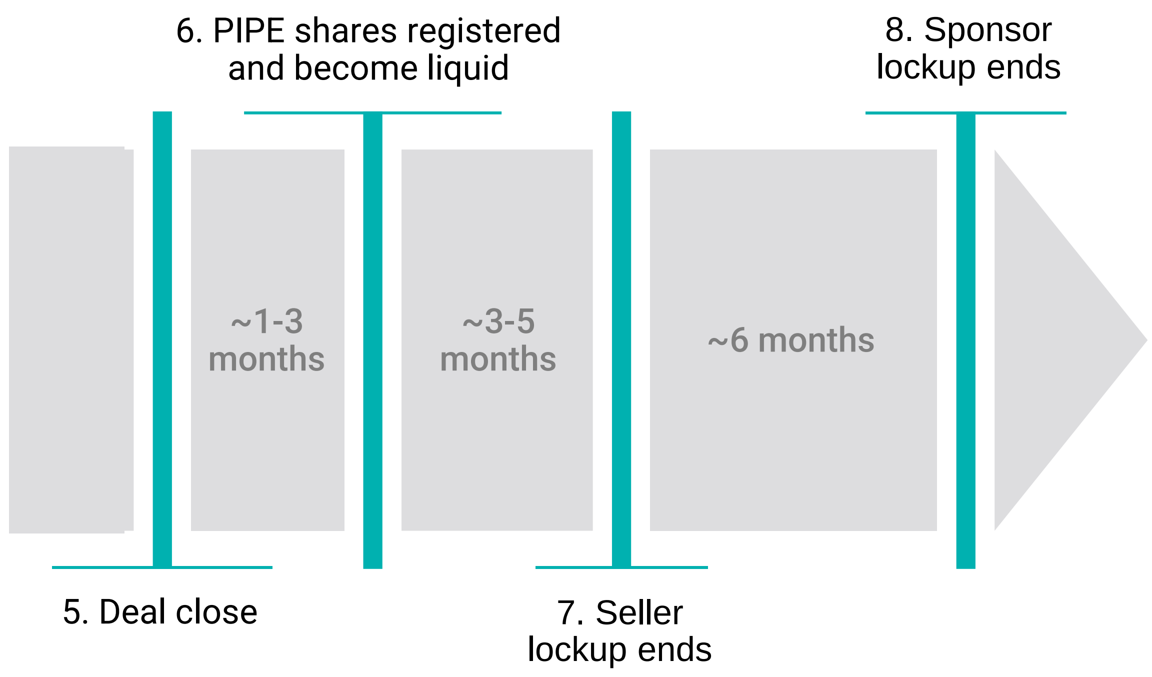
## Shareholder Vote:

| NO | YES |
|---|---|
| **Acquisition Not Approved** | **Acquisition Approved** |
| ▪ Proposed transaction rejected if a simple majority of shareholders vote "No" | ▪ Proposed transaction approved if simple majority of shareholders vote "Yes" |
| **Trust Liquidation** | **Acquisition Completed** |
| ▪ All funds returned to public shareholders pro rata<br>▪ Sponsor does not have right to liquidation proceeds<br>▪ Also occurs if transaction is not consummated within ~24-month acquisition deadline | ▪ Company becomes public<br>▪ Shareholders have the right to redeem their investment, converting their shares into pro rata portion of cash-in-trust |

For illustrative purposes only

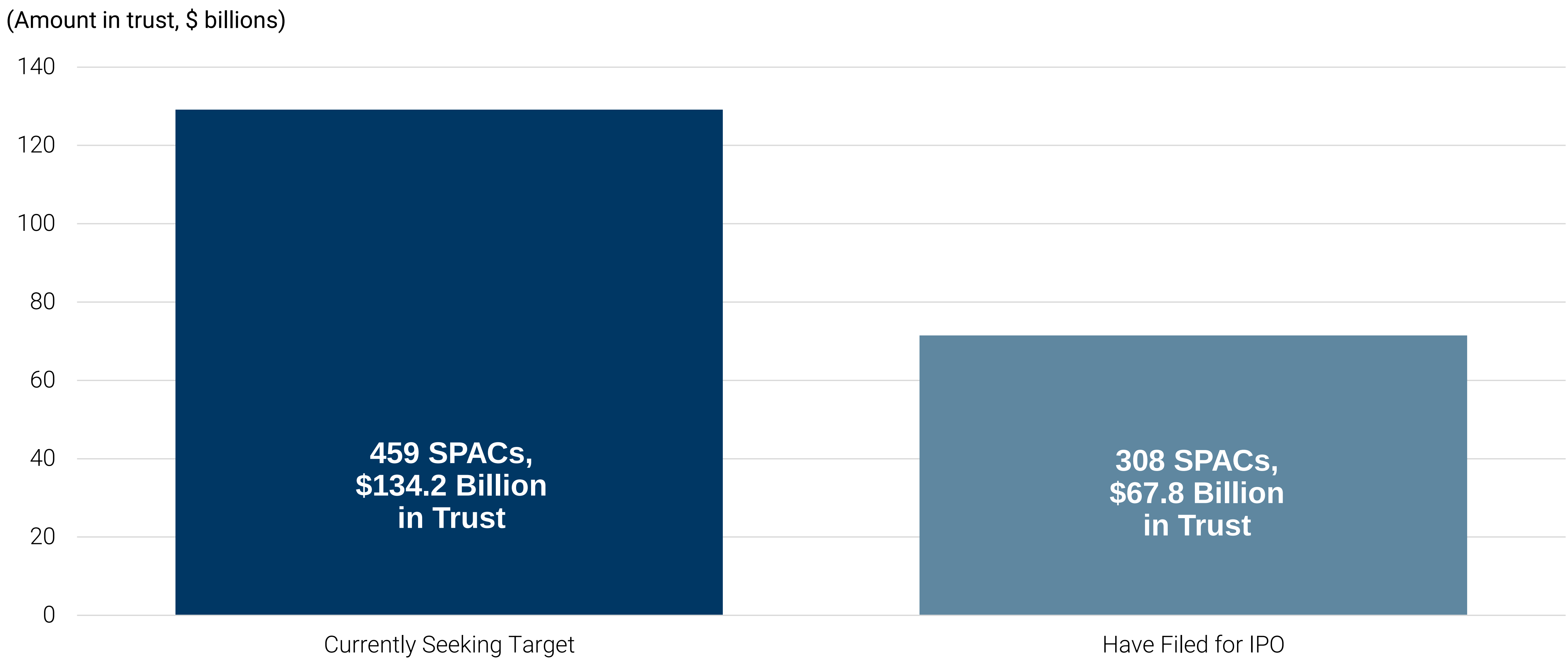
# 5-8: DEAL CLOSES, SHARES REGISTERED, AND LOCKUPS END

- ~2 days after shareholder vote and redemption date, the deal closes and ticker changes to reflect target company
- PIPE shares typically take ≤3 months to be registered, after which they become fully liquid
- Sponsor lockup ends ~6 months from deal close, target lockup ends ~12 months after deal close




For illustrative purposes only.
Lockup periods reflect common industry standard. However, lockup terms for each deal are defined pursuant to a merger agreement and proxy, and therefore may vary.

# WHERE IS THE CURRENT STATE OF THE SPAC MARKET?




As of September 30, 2021
Source: SPAC Research

# HOW DID WE GET HERE?

- After SPACs raised a record $83bn in 2020, the market raised $97bn more in 1Q2021.
- SPACs broadly trade above par value, even before announcing a deal
- IPOs average 25/week

**March 31, 2021**

- SEC officials cautioned SPACs against misleading forecasts and mandated warrants be reported as liabilities rather than equity
- IPO and deal markets come to an effective standstill as SPACs restate their financials
- 13 IPOs price in all of April

**April 12, 2021**

- SPAC euphoria bursts as pre- and post-announcement SPACs trade down in a highly-correlated manner
- Redemptions rise as more deals trade below par
- Sponsors increasingly concede economics and provide downside protection to attract investors and targets

- More than half of all SPAC IPOs in August and September involve the transfer of sponsor economics and/or overfunded trusts
- Deal announcements decelerate as sponsors struggle to find willing PIPE investors
- IPOs average 7/week during Q3

**September 30, 2021**

**Regulatory scrutiny, which initially gave the market pause in April, is likely to continue, posing uncertainty to sponsors and targets**

*Any simple claim about reduced liability exposure for SPAC participants is overstated at best, and potentially seriously misleading at worst. Indeed, in some ways, liability risks for those involved are higher, not lower, than in conventional IPOs, due in particular to the potential conflicts of interest in the SPAC structure.*

\- **John Coates**
**Acting Director, Division of Corporation Finance, SEC**
*Statement on SPACs, IPOs and Liability Risk under the Securities Laws, April 8, 2021*

As of September 30, 2021
Source: SPAC Research

# WHAT HAPPENS NEXT? SPACS ARE AT A CRITICAL INTERSECTION

**Bull Case**

- Backlog clears as higher-quality SPACs find attractive deals
  - Lower-quality sponsors gradually exit the market, as they find raising money and attracting targets increasingly difficult
- Regulators intensify oversight of SPAC market, increasing investor confidence
- Virtuous cycle of improved investor, sponsor, and target sentiment helps SPACs remain a viable alternative to IPOs

**Bear Case**

- Deteriorating incentives for sponsors reduces future supply of SPACs
- Poor share price performance deters potential SPAC investors
- Elevated SPAC redemption rates increase dilution and dissuade quality targets from pursuing de-SPACs

# THE BEAR CASE

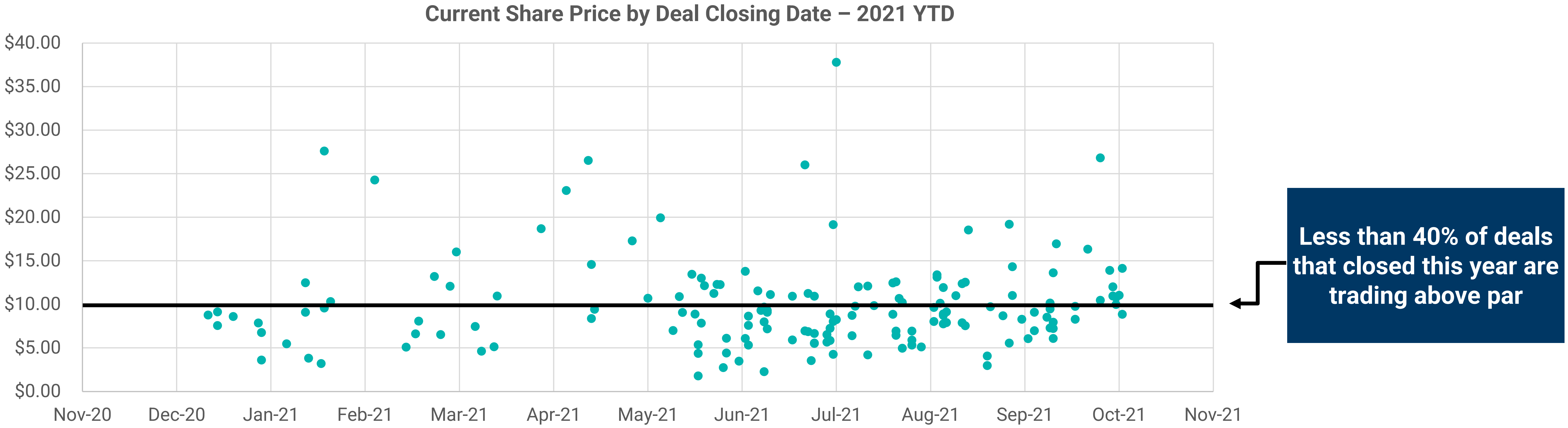
## 1. Diminishing Incentives for Sponsors May Reduce Future Supply

- SPAC sponsors, who traditionally have received a customary promote equal to 20% of trust value, are often sacrificing significant economics in order to consummate deals
- Overfunded trusts are becoming the norm, requiring sponsors to put up more at-risk capital up front
- Wider dispersion of share-price performance post-deal gives less certainty that sponsors' investments will be profitable
- An oversaturated pool of SPACs currently searching for deals is likely to make sponsors hesitant to IPO in the shorter-term

# THE BEAR CASE

## 2. Poor Share Price Performance Has Deterred Many Investors

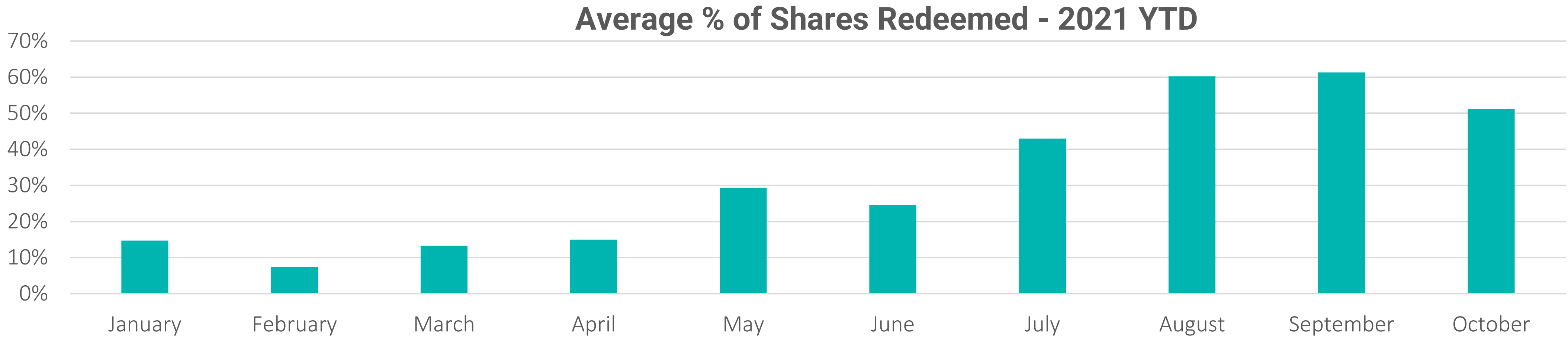
- Since the SPAC euphoria seen in late 2020 into early 2021, deals have rarely "popped" on announcement or closing, while low float has created volatile trading around deal-close
- PIPE investors have been less likely to invest without concessions




As of October 27, 2021. Please refer to the Important Information section for a discussion of risks.

# THE BEAR CASE

## 3. Higher Share Redemption Rates Have Made Capital Less Certain and Target Companies More Skeptical




### Dilution Illustration: SPAC vs. Traditional IPO

| SPAC (No Redemptions) | | | SPAC (60% Redemptions) | | | Traditional IPO | | |
|---|---|---|---|---|---|---|---|---|
| | $B | Shares | | $B | Shares | | $B | Shares |
| Enterprise Value | 2,000 | 200 | Enterprise Value | 2,000 | 200 | Enterprise Value | 2,000 | 200 |
| Amount Sold to Public | 250 | 25 | Amount Sold to Public | 100 | 10 | Amount Sold to Public | 250 | 25 |
| Deferred Fee (3.5%) | 8.75 | | Deferred Fee (3.5%) | 8.75 | | Gross Spread | | 6% |
| PIPEs | 250 | 25 | PIPEs | 250 | 25 | | | |
| PIPE Fee (4%) | 10 | | PIPE Fee (4%) | 10 | | | | |
| Founders Shares | | 6.25 | Founders Shares | | 6.25 | | | |
| Effective Share Sale | | $ 8.56 | Effective Share Sale | | $ 8.03 | Effective Share Sale | | $ 9.40 |
| **Dilution from de-SPAC** | | **-14%** | **Dilution from de-SPAC** | | **-20%** | **Dilution from IPO** | | **-6%** |

- Heightened risk of redemptions threatens to make SPACs more dilutive and less appealing

As of October 27, 2021. Please refer to the Important Information section for a discussion of risks.

# OPPORTUNITIES TO EXPLOIT INEFFICIENCIES ACROSS THE DE-SPAC LIFECYCLE

## Potential Alpha Sources

### IPO Anchor Investment

-Buy SPAC units at $10 in exchange for share of sponsor economics

-Lowers effective SPAC unit cost

### Conditional Forward Purchase Agreement (FPA)

-Sponsor transfers economics to secure FPA

-Lowers effective PIPE price

### Buy SPACs Below Par

-Lock-in upside to par + potential appreciation post-announcement

### PIPE Investment

-Invest in undervalued assets

-Reduce effective PIPE price by negotiating share of sponsor promote and/or valuation

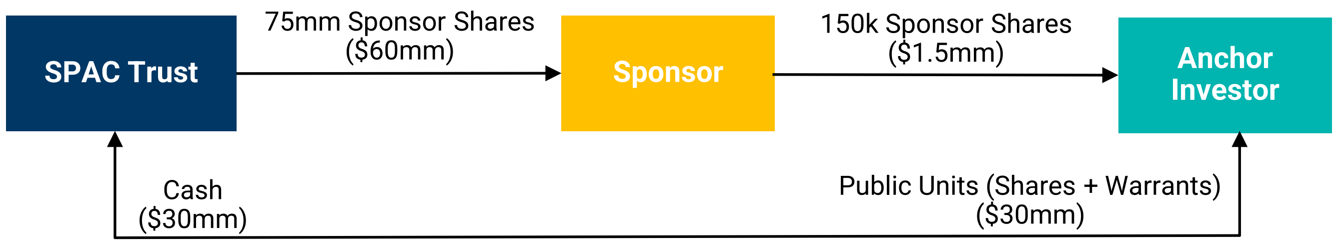
-Negotiate downside-protection features

Source: company filings. Note that the opportunities listed on this slide were not necessarily invested in by Lazard. For illustrative purposes only. There is no assurance an investment will be profitable. Mention of these securities should not be considered a recommendation or solicitation to purchase or sell the securities. It should not be assumed that any investment in these securities was, or will prove to be, profitable, or that the investment decisions we make in the future will be profitable or equal to the investment performance of securities referenced herein.

# POTENTIAL ALPHA SOURCE – IPO ANCHOR INVESTMENT

## Example: TortoiseEcoFin Acquisition Corp.

- In exchange for purchasing 9.9% of the SPAC IPO, the SPAC sponsor transferred 150,000 sponsor shares to each anchor investor for a nominal price of $0.003/share
- The value of the sponsor shares obtained by each anchor investor lowers their effective SPAC purchase price to $9.52
- Importantly, the SPAC shares remain redeemable at $10, while the anchor investor can keep its warrants and sponsor shares
  - Under this scenario, assuming 4x leverage, expected return for this example is 29%




Source: company filings. Note that the opportunities listed on this slide were not necessarily invested in by Lazard. For illustrative purposes only. There is no assurance an investment will be profitable. Mention of these securities should not be considered a recommendation or solicitation to purchase or sell the securities. It should not be assumed that any investment in these securities was, or will prove to be, profitable, or that the investment decisions we make in the future will be profitable or equal to the investment performance of securities referenced herein.

# POTENTIAL ALPHA SOURCE – CONDITIONAL FPA

## Example: ISOS Acquisition Corp.

- SPAC ISOS filed to raise $300 million by offering 30 million units at $10 each
  - The sponsor entered into a conditional forward purchase agreement, in which an institutional investor could purchase up to 7.5 million units for $10 each
  - Unlike a traditional PIPE investment, which involves ordinary shares sold for $10, forward purchase units include warrants
  - The value of the warrants attained lowered the effective PIPE purchase price to $9.56, adding to the PIPE investment's potential upside

Source: company filings. Note that the opportunities listed on this slide were not necessarily invested in by Lazard. For illustrative purposes only. There is no assurance an investment will be profitable. Mention of these securities should not be considered a recommendation or solicitation to purchase or sell the securities. It should not be assumed that any investment in these securities was, or will prove to be, profitable, or that the investment decisions we make in the future will be profitable or equal to the investment performance of securities referenced herein.

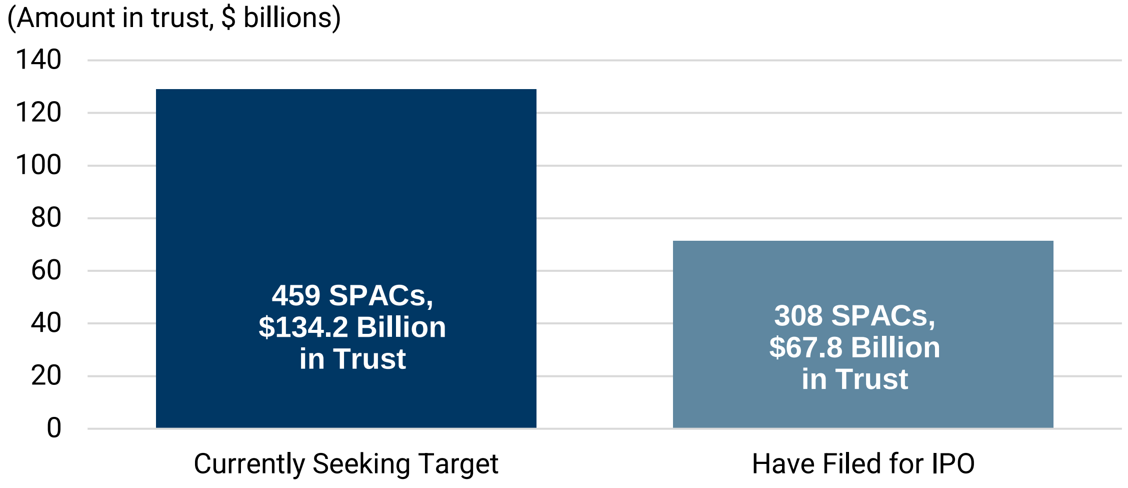
# POTENTIAL ALPHA SOURCE – BUYING SPACS BELOW PAR

- Of the more than 530 SPACs with publicly listed shares that have yet to find and/or close a deal, over 25% trade ≤$9.70, while nearly 90% trade below $10
- SPACs that have announced deals and trade below par are especially attractive, given shorter duration risk (deals typically take ~3.5 months from announcement to close)
- Additionally, SPACs are increasingly overfunding their trusts[1] (i.e., units are offered at $10 but redeemable for $10.10, $10.20, and occasionally as much as $10.30)
- An investor using 4x leverage can redeem shares at $10 with further upside optionality

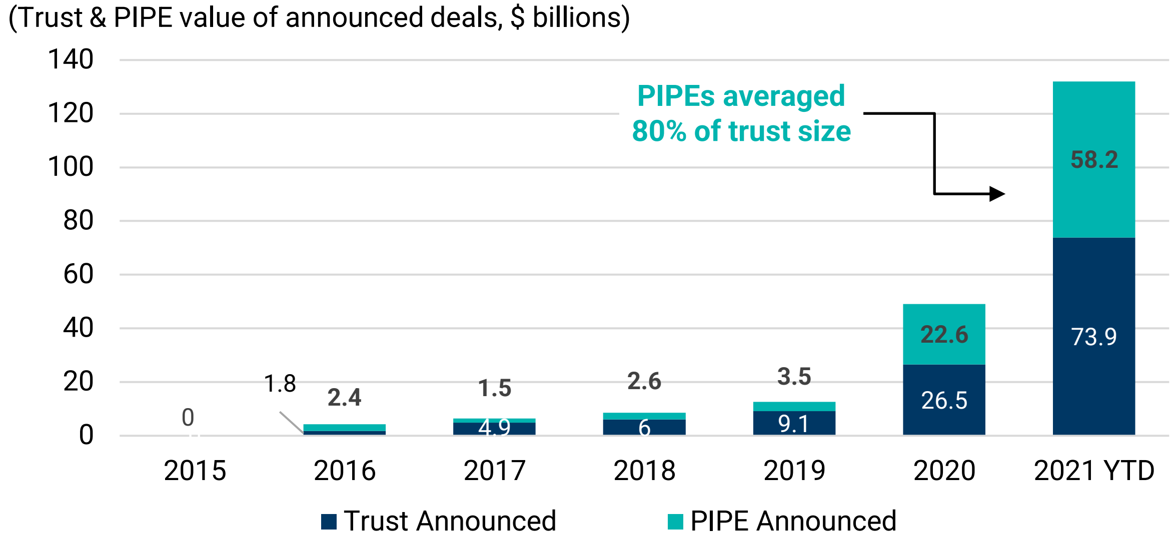
As of September 30, 2021
[1] 5% of SPAC IPOs in 2021 Q1 had overfunded trusts, vs. 50% in August and 69% in September.
Source: SPAC Research, Lazard. There is no assurance an investment will be profitable. Mention of these securities should not be considered a recommendation or solicitation to purchase or sell the securities. It should not be assumed that any investment in these securities was, or will prove to be, profitable, or that the investment decisions we make in the future will be profitable or equal to the investment performance of securities referenced herein.

# POTENTIAL ALPHA SOURCE – PIPES

## Record Levels of SPAC Capital Seeking Deals…




## …Will Drive Demand for Vital PIPE Funding…




## …But Traditional Sources of PIPE Capital Fall Far Short of Demand…

- The fundamental, long-only investor community is constrained in its capacity to continue to fund PIPEs
- Meanwhile, recent SPAC skepticism makes deal validation by respected investors even more valuable to sponsors

## …Giving PIPE Investors the Ability to Enhance Risk/Reward by Negotiating:

- Deal valuation
- PIPE structure
- Extraction of sponsor economics

As of September 30, 2021
Source: Dealogic, BofA Securities, SPAC Research

# POTENTIAL BENEFITS OF SPACS

## Benefits for Sponsors

- Potential for strong returns through promote and subsequent appreciation
- Access to a wide pool of prospective investors

## Benefits for Target Companies

- Provide an alternative route to go public while avoiding much of the regulatory and marketing burden associated with traditional IPOs, which can save time and money
- Companies can disclose and advertise financial projections, a practice that is prohibited in a traditional IPO

## Benefits for Investors

- Unique features like redemption rights and warrants offer attractive risk/reward
- Voting rights in the approval of de-SPACing transaction, giving investors a say in the allocation of their capital
- Higher visibility into the companies’ future, given enhanced disclosures

Please refer to the Important Information section for a discussion of risks.

# REMINDER OF CERTAIN RISKS FOR INVESTORS

1. Security Selection Risk
2. Market Risk
3. Liquidity Risk
4. Opportunity Cost / Timing Risk
5. Regulatory Risk
6. Operational Risk
7. Sponsor Risk

The above list is meant to highlight certain identified risks for investors and is not meant to be exhaustive. Subject to change.

# WHERE MIGHT SPACS AND PIPES BELONG WITHIN A PLAN SPONSOR'S ALLOCATION?

We believe they fit best into an opportunistic allocation, but strategies that focus on them may share characteristics with:

**Public Equity: The underlying assets are listed public equities (or derivatives thereof)**

- SPACs have daily liquidity and trade on an exchange
- A SPAC transitions to a publicly-listed operating company at deal completion

**Private Equity: Strategy vehicles in this space tend to have features typical in private equity**

- Some strategies lock-up client capital
- Some structures draw on capital commitments as needed
- De-SPAC investing can offer returns that are competitive with private equity

**Hedge Fund: Some strategies employ hedging tools and leverage**

- Leverage can magnify upside potential from SPACs and hedging may mitigate downside risk

Please refer to the Important Information section for a discussion of risks.

# THE ROAD AHEAD

The de-SPAC market is at a clear crossroads:

- The long-term outlook remains unclear, but there are reasonably probable bull- and bear-case scenarios
- Given the current disconnects in the space, the de-SPAC market appears to present potentially compelling investment opportunities
- If the bull case materializes over the longer-term, understanding the dynamics of the de-SPAC lifecycle could be fortuitous, as it may offer alpha-generating opportunities going forward

Please refer to the Important Information section for a discussion of risks.

# ABOUT THE SPEAKER

**Ronald Temple, CFA**

*Managing Director, Co-Head of Multi-Asset and Head of US Equity*

Ronald Temple is a Managing Director and Co-Head of Multi-Asset and Head of US Equity. In this role, Ron is responsible for overseeing the firm's multi-asset and US equity strategies as well as several global equity strategies. He is also a Portfolio Manager/Analyst on various US and global equity teams. Since joining Lazard in 2001, Ron has leveraged his financial sector, macroeconomic and policy expertise to deliver differentiated insights to Lazard’s clients globally. Beyond his day-to-day responsibilities, Ron engages extensively with a wide range of Lazard's investment professionals across the equity and debt arenas to leverage the firm's insight broadly. Ron speaks frequently on economic and market related topics, offering differentiated analysis and insights. Ron's unique perspectives in part arise from his broad range of previous experiences in financial services. Prior to joining Lazard, Ron was a Director and Buy-Side Equity Analyst at Deutsche Bank AG. In a previous role at Deutsche Bank, he oversaw the implementation of merger related synergies on behalf of Deutsche Bank's CEO of the Americas after Deutsche acquired Bankers Trust. During the Asian debt crisis, Ron served as business manager for Deutsche Bank's CEO and Deputy CEO of Asia/Pacific in Singapore, a position in which he supervised the Investment Banking Division and executed on strategic business changes for the Group. He also held a previous role in a global business manager function for Deutsche Bank's foreign exchange business. Ron has had extensive experience developing and enhancing risk management processes at Deutsche Bank, Bank of America NT&SA, and Fleet Financial. Ron began his career trading cash and derivatives in the interest rate and foreign exchange markets at Fleet Financial Group. Ron earned his Master in Public Policy from Harvard University and his Bachelor of Arts in Economics and Public Policy Studies magna cum laude from Duke University. He is a member of the Council on Foreign Relations, the Economic Club of New York, the CFA Society New York, is the chair of Duke University’s Graduate School Board of Visitors and is Co-Chair of the Duke University Talent Identification Program Advisory Board. He also served as a trustee of the Link Community School in Newark, New Jersey, from 2006-2014, as a member of the Trinity Board of Visitors at Duke University from 2006-2012 and a member of the Financial Accounting Standards Advisory Council from 2013 to 2015.

# IMPORTANT INFORMATION

An investment in any alternative strategy is speculative, involves a high degree of risk, and may lose value. Privately offered investment vehicles are unregistered private investment funds or pools that invest and trade in many different markets, strategies, and instruments. Such funds generally are not subject to regulatory restrictions or oversight. Opportunities for redemptions and transferability of interests in these funds are restricted. The fees imposed, including management and incentive fees/allocations and expenses, may offset trading profits. Investors should not invest in any fund unless they are prepared to lose all or a substantial portion of their investment.

Similarly, investments in unregistered securities such as PIPEs are not subject to the same regulatory restrictions or oversight that registered securities benefit from.  The terms of each PIPE transaction are the subject of individual negotiations and therefore will vary.  Prior to their registration, PIPE securities will not be readily transferrable and likely will be deemed illiquid.  There is no guarantee that PIPE securities will be registered by their issuers in a timely manner, and there is no guarantee that the registered securities can be sold at a gain.