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A Q&A for Savvy Investors

Pre-Merger SPAC Investment Strategies Uncovered

The following is a collection of frequently asked questions surrounding pre-merger SPACs and how to approach the investment landscape. Dive into expert answers on various aspects of Special Purpose Acquisition Companies (SPACs), including how they work, their potential benefits and risks, strategies for successful SPAC investments, and the current state of the SPAC market.

For seasoned investors and novices alike, this guide provides valuable knowledge to help navigate the rapidly changing SPAC investment market. Discover the intricacies of SPAC investing and empower yourself to make informed decisions on one of the most dynamic and evolving aspects of the financial marketplace.

QUESTION:

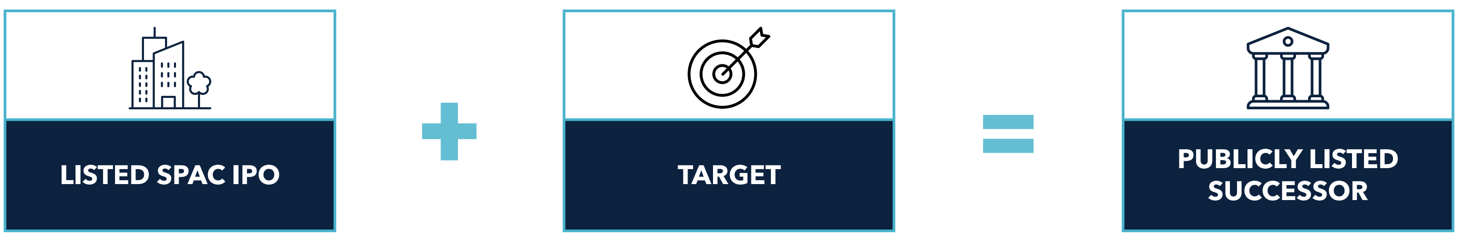
What is a Special Purpose Acquisition Company (SPAC)?

ANSWER:

A Special Purpose Acquisition Company (SPAC), sometimes referred to as a "blank check" company, is a public acquisition vehicle formed by a management sponsor team that raises capital via IPO with the intent to use that capital to merge with an existing private company within a finite period.

The primary stages of a SPAC are the IPO, announcement of a business combination agreement, closing of the business combination and the listing of a new public entity (*at which point the SPAC dissolves*).

SPAC Framework



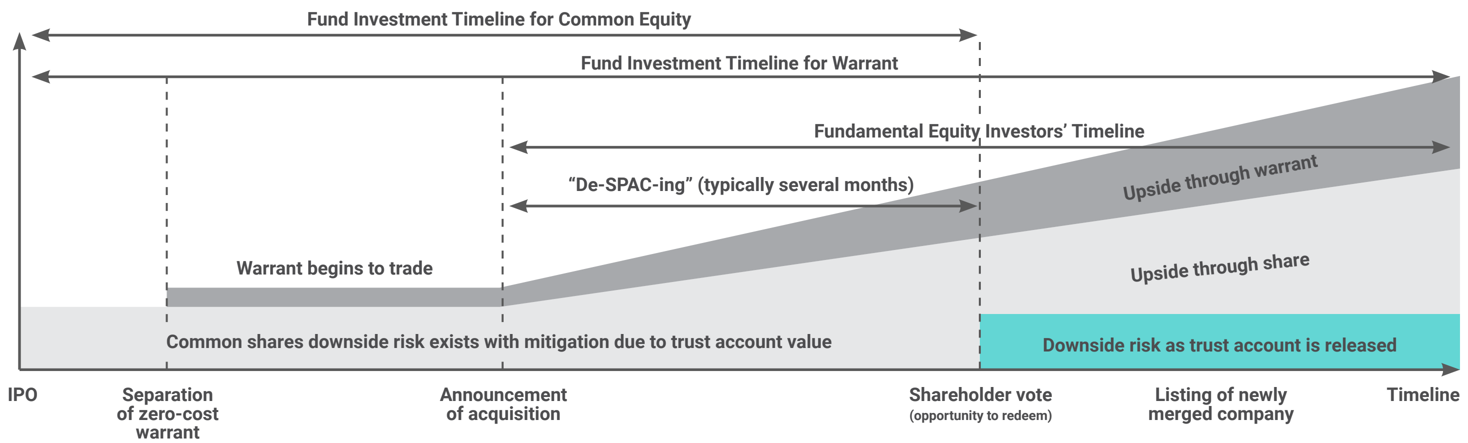
QUESTION:

What are the important events in the life span of a SPAC?

ANSWER:

The important events in the life span of a SPAC include:

- IPO (Initial Public Offering)
- Announcement of a business combination agreement – typically 12+ months after the IPO
- Shareholder vote on a business combination – typically around 4 months after the announcement of a business combination agreement
- Closing of the acquisition – typically 1-5 days after the shareholder vote
- Liquidation of the SPAC if an acquisition is not completed – typically 18-24 months after the IPO



QUESTION:

How are the proceeds raised from the IPO invested while the sponsor is seeking an acquisition target?

ANSWER:

The proceeds raised from the IPO are deposited into a trust account that is segregated from funds available to the management team for working capital purposes. Until the time of closing of the business combination or liquidation, the trust account is generally invested in US Treasury bills or US Government Money Market funds.

Lifecycle of a SPAC

	Phase 1 Pre-Acquisition	Phase 2 At Acquisition	Phase 3 Post-Acquisition
Return Profile	Zero coupon bond + warrant.	Zero coupon bond + warrant + equity.	Warrant + equity.
Downside Mitigation	100% of IPO proceeds in trust. Net interest income on cash remains in trust.	Redemption right for value of trust.	None.
Upside Potential	Option to participate in a future acquisition.	Equity upside + warrant through acquiring company at a discount to public market value.	Equity trades on operating company performance with warrants providing additional potential upside.

QUESTION:

Why might investors be interested in a dedicated **pre-merger** SPAC strategy?

ANSWER:

- SPAC market valuations fluctuate frequently. Secondary shares can trade at discounts to trust value which may offer potential benefits to investors participating in an actively managed portfolio.
- Optionality. The SPAC asset class offers equity exposure characterized by the potential for limited downside risk combined with upside optionality.
- In our view, SPACs should continue to be a viable "private to public" option, which offers potential economic and regulatory advantages. SPAC deal combinations are becoming a much more accepted route for well-thought-of-private companies.
- Significant growth in the number of SPAC IPOs, as well as AUM raised, has created a diversified array of opportunities for experienced active managers.
- For some investors, SPAC units or common shares can be inaccessible or difficult to purchase at IPO.

QUESTION:

How can an investor redeem shares? Are mergers always completed?

ANSWER:

Which days can an investor choose to redeem shares?

Shareholders may elect to redeem their shares from the date they receive their proxy until two or three days before the shareholder meeting date. The time interval this covers is usually 20-30 days. Redeeming shareholders typically receive the trust account value back within 10 days of the closing of the business combination.

Are announced mergers always completed?

The merger agreement between a SPAC and a target company will typically contain a minimum cash requirement. If redemptions are too large it could cause a merger agreement to be canceled. In some cases target companies have decided to waive the minimum cash requirement in order to complete a business combination or the SPAC sponsors have been able to raise additional cash outside of the trust account in order to meet the minimum.

Please explain the nature of a warrant: Whole or partial, why is it attached to the unit, cost, exercise prices, maturity terms, etc.)?

Warrants are typically included in a SPAC's units in order to encourage investors to buy shares in the IPO. A standard SPAC IPO sells units consisting of one share of common stock plus ½ warrant for $10.00 per unit. Standard terms for the warrants are an $11.50 exercise price, and an expiration date of 5 years after the completion of a business combination.

QUESTION:

How do sponsors function within a Special Purpose Acquisition Company?

ANSWER:

When a Sponsor receives 20% of total post-IPO shares, is dilution a concern?
The dilution may make it more difficult to complete an acquisition, but it is up to the SPAC sponsor and target company to structure an acquisition that the market will value at $10.00+ per share despite the dilution. Otherwise the SPAC may face high levels of redemptions and have difficulty meeting the requirements to close the acquisition. If a SPAC liquidates the sponsor shares are worth $0, so in order to close an acquisition some sponsors have agreed to forfeit a portion of their promote shares.

Do sponsors also get any warrants after receiving 20% shares?
In addition to the 20% promote, sponsors typically purchase warrants or units through a private placement at the closing of the IPO in order to pay costs associated with the IPO and to fund working capital. Any securities purchased in the private placement are not eligible to be redeemed.

What happens (and who pays) if expenses and fees end up exceeding a sponsor's initial contribution?
If a SPAC is running low on working capital the sponsor will typically loan the SPAC additional funds so that they can continue working on finding a target and closing an acquisition. Generally, the loan is not repaid if an acquisition is not closed.

Can sponsors trade shares or warrants in the secondary market?
Sponsors are allowed to acquire shares and warrants in the secondary market. Sponsors are not allowed to sell any private placement shares or warrants that they receive at the closing of a SPAC's IPO until after an acquisition has been completed. Shares acquired in the secondary market have the same rights as those of any other shareholder, and could be redeemed.

QUESTION:

Are there any expenses, fees, or taxes paid out from the trust account? Can it become overfunded?

ANSWER:

Are there any expenses, fees, or taxes paid out from the trust account?

Typically funds from the trust account are only released to pay franchise and income taxes, and potentially dissolution expenses if the SPAC liquidates. Occasionally a sponsor is allowed to take a portion of the interest earned out of the trust account for working capital needs. In these cases, the maximum amount the sponsor is allowed to take out is stated up front in SEC filings.

Are there conditions in which the trust account can become overfunded?

Occasionally SPAC sponsors contribute additional cash to the trust account to raise the redemption value over the $10.00 IPO price. This guarantees an investor a positive return if they buy at the IPO price and later redeem their shares or the SPAC liquidates, and is done to encourage investors to participate in an IPO.

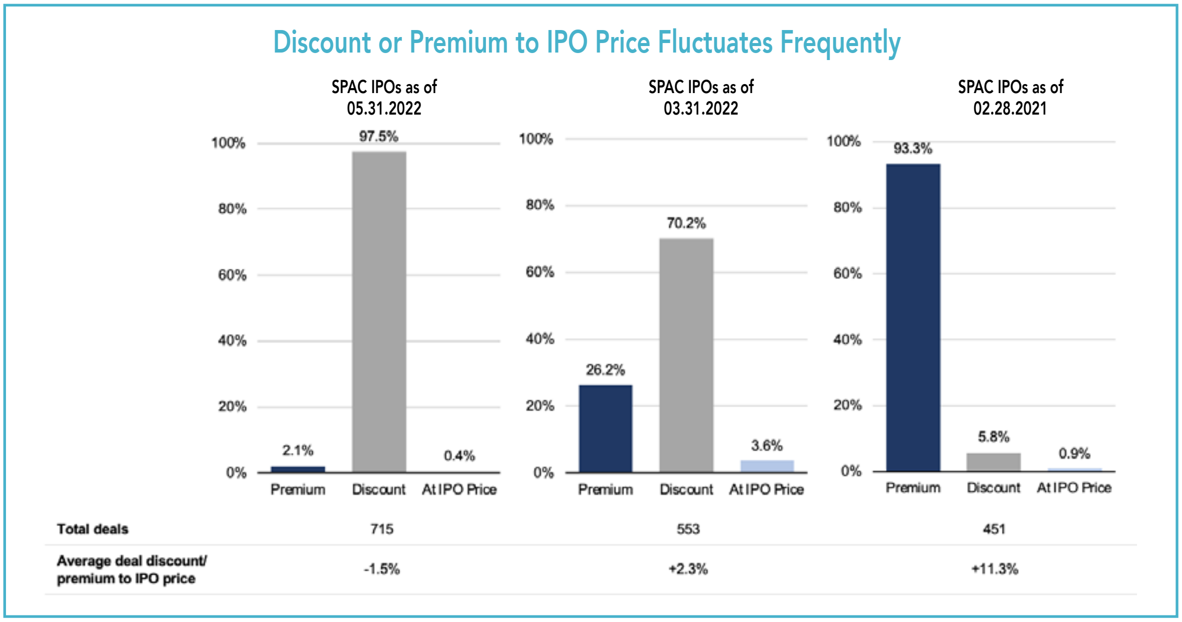
QUESTION:

When the share price is above the warrant exercise price, why are there no active arbitrage activities?

ANSWER:

SPAC warrants tend to be efficiently priced relative to the common shares. In other words, SPAC warrant prices generally reflect the full intrinsic value of the warrant plus some amount for the time value of the warrant. In cases where warrants have traded at prices below their intrinsic value, it was because the warrants had not reached the point where they could be exercised, and it was not possible to short the common shares or the borrow rate was extremely high.

SPAC Unit and Common Relative Values Change Over Time



Source: RiverNorth Capital Management, Bloomberg. Past performance is not a guarantee of future results.

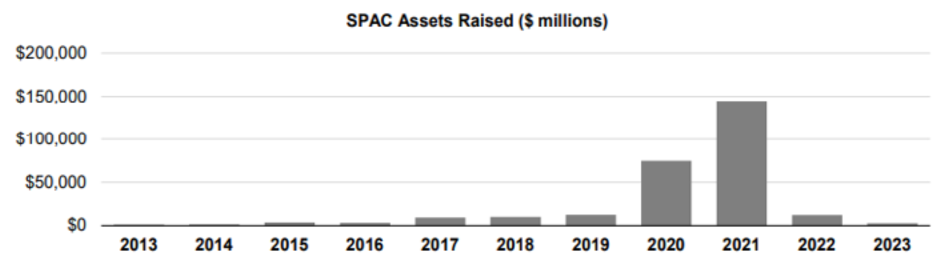
QUESTION:

If the market sees the number of unsuccessful mergers increase, would the popularity of SPACs be sustainable?

ANSWER:

SPACs have been around for decades and serve a useful purpose in the equity markets. While their popularity fluctuates over time, they have constantly evolved to remain relevant to investors and private companies. When there are many well received mergers we tend to see a lot of the return to investors coming from the optionality embedded in SPAC warrants. When it is a difficult environment for SPAC mergers, often the common shares will trade at larger discounts to their trust account values, and investors can benefit from the closing of this discount over time in addition to interest accruing to the trust account. 2020 and 2021 resulted in an abnormal boom of IPOs, whereas the IPO market in 2023 more closely resembles a typical pattern of the years prior.

SPAC Market Statistics (as of 09/30/2023)



	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Total
IPOs	**10**	**11**	**20**	**13**	**34**	**46**	**59**	**248**	**613**	**86**	**22**	**1,162**
Completed Acquisitions	8	8	17	12	31	44	56	174	159	7	0	**516**
Liquidations	2	3	3	1	3	2	3	59	233	7	0	**316**
Announced Targets	0	0	0	0	0	0	0	10	112	35	5	**162**
Seeking Acquisition	0	0	0	0	0	0	0	5	109	37	17	**168**
Completed Acquisitions %	80%	73%	85%	92%	91%	96%	95%	70%	26%	8%	0%	**44%**
Liquidations %	20%	27%	15%	8%	9%	4%	5%	24%	38%	8%	0%	**27%**
Announced Acquisitions %	0%	0%	0%	0%	0%	0%	0%	4%	18%	41%	23%	**14%**
Seeking Acquisition %	0%	0%	0%	0%	0%	0%	0%	2%	18%	43%	77%	**14%**

Source: RiverNorth Capital Management, Bloomberg. Past performance is not a guarantee of future results.

SUMMARY

We believe a diversified and curated portfolio of pre-merger SPACs offers an attractive, asymmetric opportunity with downside mitigation and negligible credit risk or interest rate risk. Holdings are typically purchased at IPO or in the secondary market below trust value, thereby minimizing risk on a per deal basis. By purchasing SPACs in the "Pre-Acquisition" or "At Acquisition" phase of the SPAC life cycle, investments are able to offer downside mitigation due to the redemption value of the SPAC Trust.

Pre-Merger SPACs often have predetermined time frames within which to consummate a Combination (typically two years) or the SPAC will seek to extend the time frame or liquidate. Given the redemption value of their underlying trusts, along with the equity upside they present, these strategies aim to capture the fixed income nature of premerger SPACs.

Looking for a deeper discussion about pre-merger SPACs and the investment landscape?

Contact our team today:

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