

# A guide to investing in Special Purpose Acquisition Companies

What you should know before you invest

Wells Fargo Advisors wants to help you invest in Special Purpose Acquisition Companies that are appropriate for you based on your investment objectives, risk tolerance, time horizon, and diversification needs. This guide will help you better understand the features, characteristics, risks, and costs associated with the various Special Purpose Acquisition Companies offered by Wells Fargo Advisors, as well as how your financial advisor and the firm are compensated.

## What are Special Purpose Acquisition Companies?

Special Purpose Acquisition Companies (“SPACs”) are shell companies with no operating history that are designed to raise funds in the public equity markets through an initial public offering (“IPO”). The IPO is completed in order to acquire or merge with an existing operating company, usually within a specified industry or geographic region. SPACs are usually sponsored by small management teams with investment and/or industry specific operational experience (“Founders”).

The Founders typically pay a nominal amount and acquire privately placed common stock or units that give the Founders a 20% ownership interest immediately after the IPO. Although SPACs have existed since the 1990s, SPACs in their current form are a relatively new investment vehicle with the vast majority of SPAC IPOs occurring since 2004.

## Features and characteristics

SPAC IPOs involve the issuance of units, usually at a price of \$10.00 per unit, with each unit consisting of one share of common stock, as well as a fractional detachable warrant (giving the holder the option to acquire one share of the company at a future date for a price that is typically higher than the unit IPO price). Upon completion of the IPO, the proceeds are placed into a trust account and usually invested in short-term government securities until the SPAC commences an acquisition. The management team of the SPAC generally has 18 months to sign a letter of intent and 24 months to close an acquisition after the consummation of the IPO. If these time limits are not met, the funds in the trust plus accrued interest are returned on a pro-rata basis to the non-Founder public shareholders.

### Investment and Insurance Products are:

- Not Insured by the FDIC or Any Federal Government Agency
- Not a Deposit or Other Obligation of, or Guaranteed by, the Bank or Any Bank Affiliate
- Subject to Investment Risks, Including Possible Loss of the Principal Amount Invested

Once an acquisition is sourced, it typically may only proceed if (i) a majority of shares voted by public stockholders are voted in favor of the acquisition and (ii) public shareholders owning less than 30% (or some other percentage as set forth in the SPAC organizational documents) of the shares sold in the IPO exercise their right to exchange their common stock for a pro-rata share in the Trust account as described below. Within a short time after signing a definitive agreement, the management team sends a proxy to shareholders. Shareholders have the option to (i) vote for the acquisition, (ii) vote against the acquisition, or (iii) vote against the acquisition and ask for their pro-rata share of the trust to be returned. Even if the acquisition is approved, public shareholders that vote for option three will have their pro-rata share of the trust returned. Greater than 80% of the funds in the trust must be used to acquire the target company (stock for stock deals and debt financing is typically permitted).

For equity investors, the primary benefit of a SPAC is that it acts as a “more liquid” private-equity investment and allows investors to participate in the potential benefits of investing in privately held companies while potentially maintaining the liquidity of a publicly traded entity. Investors also have the option to receive back their pro-rata share of the trust’s net assets at the time of proxy voting. Once the transaction is approved, the investor owns the stock in the underlying company and is subject to all the risks associated with the operation of that company. The exercise of the warrants by public shareholders also provides an additional source of capital for the SPAC to use for growing the Company and/or reducing debt.

Once an acquisition purchase agreement is signed, the SPAC will issue a press release which describes the proposed transaction. The Company will also file a Form 8-K with the SEC that contains the press release. At announcement or shortly thereafter, the SPAC will file an investor presentation on Form 8-K that describes the deal and transaction merits to shareholders. The Company will also go on an investor roadshow and present the deal and target company to shareholders. Under Regulation FD, any information or communication to one shareholder must be filed on Form 8-K.

Shareholders will receive a complete SEC merger proxy typically between 10 and 60 days before the scheduled shareholder vote.

### **Warrants**

As mentioned earlier, SPAC IPOs are often structured to offer investors a unit of securities consisting of shares of common stock and warrants. A warrant is a contract that gives the holder the right to purchase from the company a certain number of additional shares of common stock in the future at a certain price, often a premium to the current stock price at the time the warrant is issued.

The SPAC unit will trade for some time after the IPO. Sometime after the IPO, the SPAC common stock and warrants may begin trading on an exchange separately with their own unique trading symbols. Often, the SPAC will file a current report on Form 8-K and issue a press release letting investors know when separate trading may commence. Investors who purchase SPAC securities after the IPO on the open market should be aware of whether they are purchasing units, common stock or warrants.

*The terms of warrants may vary greatly across different SPACs, and it is important to understand the terms when investing. Terms of the warrants can include how many shares the investor has the right to purchase, the price at which and period during which shares may be purchased, the circumstances under which the SPAC may be able to redeem the warrants, and when the warrants will expire. To learn more about the specific terms, investors should review the prospectus of the particular SPAC.*

### **Anchor investors**

During the SPAC IPO process, sponsors may line up a select group of investors to help support the offering. These stakeholders, called anchor investors, may be brought in by the sponsor to reduce risk, improve demand, and help fund the forthcoming offering. Anchor orders, which generally come from private equity sponsors, also help to stabilize the SPAC IPO and the subsequent trading environment in the secondary market. SPAC sponsors may seek to reduce overall exposure by bringing on institutional investors to purchase a portion of the at-risk capital. Although the commitments are not necessarily binding, having support from these investors could help attract other investors while also reducing the amount of shares the SPAC will need to sell during its marketing road show. In some instances, the commitments raised from anchor orders may account for more than half of the funds the SPAC intends to raise during the offering period. However, retail orders may be relied upon to fulfill listing requirements, specifically the minimum number of round lot orders required to list on an exchange.

Nevertheless, sponsors often sweeten the terms of the offering for this select group of potential stakeholders. Anchor investors generally have the opportunity to purchase Founder shares at a nominal cost from the sponsor in exchange for participating in the offering. Further, these anchor investors may not be required to hold any of the public units through the offering (common stock or warrants) and often may be able to sell any of the acquired units at any time. Consequently, this could reduce the initial public float for the securities. However, more importantly, it may create a conflict of interest, as the offering could be materially different between retail and anchor investors. Further, the ability to purchase Founder shares at a nominal cost may cause dilution for retail investors participating in the offering.

## Risks

SPACs are unique investment vehicles, and thus come with unique and inherent qualities and risks. There are a number of risks in investing in SPACs, some more significant than others. This guide attempts to capture a number of potential risks, however this list should not be considered exhaustive of all potential risks in investing in SPACs. In addition, each SPAC may have its own unique risks that are outlined in the prospectus. These securities are not appropriate for all investors, and the market price of these securities may decline.

### **Newly formed company with no operating and financial history and provide limited information**

SPACs are newly formed development stage companies with no operating results, and will not commence operations until obtaining funding through the offering. Because the SPAC lacks an operating history, there is limited information available and investors have no basis upon which to evaluate the company's ability to achieve the objective of completing a business combination with one or more target businesses. Prior to an IPO, SPACs may not enter into any arrangements or understandings with any prospective target entity concerning a business combination and may be unable to complete a business combination. If the SPAC fails to complete a business combination, the SPAC will never generate any operating revenues.

### **Risks related to acquisitions**

In identifying, evaluating, and selecting a target company for a business combination, SPACs are expected to face intense competition from other entities that have a business objective similar to the SPACs. These entities include other blank check companies, private equity groups, venture capital funds, leverage buyout funds, and operating businesses seeking strategic acquisitions. Many of these entities are well established and have extensive experience identifying and effecting business combinations directly or through affiliates. Moreover, many of these competitors possess greater financial, technical, human, and other resources than SPACs which will give the competitor an advantage in pursuing the acquisition. SPACs may be more likely to invest in trendy sectors or industries without the more stringent scrutiny than if the target companies went through an IPO and, as such, may be more speculative investments.

### **Liquidation of trust account before a business combination**

If the SPAC is unable to complete a business combination prior to the 18 or 24 month anniversary of the offering date and is forced to liquidate its assets, the per-share liquidation distribution to investors may be less than the offering price due to the expense incurred for the offering, general and administrative expenses, and the anticipated costs of seeking a business combination. Furthermore, there will be no distribution with respect to outstanding warrants (which will expire worthless) if the SPAC liquidates before the completion of a business combination.

### **Sensitivity to declining interest rates**

SPACs depend on sufficient interest being earned on the proceeds held in their trust accounts to provide additional capital, which may be used to identify one or more target businesses and to complete initial business combinations, as well as to pay any taxes owed. A substantial decline in interest rates may result in the SPAC having insufficient funds available with which to structure, negotiate, or close an initial business combination. In such event, the Company would need to borrow funds from its Founders to operate, or it may be forced to liquidate. The Founders are under no obligation to advance funds in such circumstances.

### **Industry risks associated with acquisition targets**

SPACs may enter into a business combination with a company in any industry and are not limited to any particular type of business unless specified in its prospectus. Accordingly, there is no current basis for an investor to evaluate the possible merits or risks of the particular industry in which the SPAC may ultimately operate or the target business which it may ultimately acquire. If the SPAC completes a business combination with an entity in an industry characterized by a high level of risk, the company may be affected by the risks of that industry. SPACs cannot assure investors that they will properly ascertain or assess all of the significant risk factors in a particular industry, geography, or target business.

### **Dependency on the efforts of the management team**

The success of the SPAC ultimately depends on its management team's ability to effect an acquisition at a fair purchase price. Therefore, SPACs rely heavily on the continued service and time commitments of their management personnel. Investors cannot be assured that these individuals will remain with, or devote sufficient time to, the company for the immediate or foreseeable future. In addition, these individuals are, or may become, engaged in several other business endeavors and none of these individuals are required to commit any specified amount of time to the SPACs affairs. If the other business endeavors of these individuals require them to devote substantial amounts of time, this could limit their ability to devote time to the SPACs business objectives, including the time necessary to identify potential business combinations and monitor related due diligence. This could have a negative impact on the SPACs ability to consummate a business combination. Although some of the SPAC's key personnel may remain with the target business in senior management or advisory roles following a business combination, not all will remain with the business. Similarly, some or all of the management personnel of the target business will not remain with the business after the business combination.

### **The interests of the sponsor**

SPAC Founders generally purchase equity in the SPAC at more favorable terms than investors in the IPO or subsequent investors on the open market. As a result, you should be aware that although most of the SPAC's capital has been provided by IPO investors, the Founders 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. Specifically the Founders may profit from the completion of a business combination even if the acquisition is unsuccessful for investors on a longer term basis. The Founders' divergent interests and access to additional information about the target company may also raise the potential risk of misuse of funds, fraud through the misrepresentation or omission of information with respect to the target company or improper trading.

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

# Additional considerations for secondary market purchases

## **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.

Secondary trading can be speculative, especially before a merger is announced. This could lead to volatility and greater price movement resulting in potential losses. There will be dilution to SPAC investors post-merger. The dilution can be attributed to existing investors in the combining company, private investors, SPAC sponsors, and exercised warrants. The degree of dilution will vary from SPAC to SPAC.

## **Forward-looking projections**

Because a SPAC combination is considered a merger and not an initial public offering, the target of the SPAC is not subject to the projection rules the Securities and Exchange Commission has for other newly public companies. While companies going public via an IPO are typically prohibited from providing forward-looking projections in their prospectuses and during the quiet period, SPAC targets are not typically subject to any meaningful restrictions with regards to what they can publish. This difference could allow a SPAC target to issue a very optimistic financial projection that causes a SPAC to pay an excessive price for the target company.

# Tax treatment

SPAC shareholders are subject to income taxes on the interest, dividends, and/or capital gains distributed to them. However, in retirement accounts such as individual retirement accounts (IRAs), taxes are deferred until distributions are taken from the account. Also, when an investor sells the SPAC position, he or she will generally realize a taxable gain or loss that should be reported on their income tax returns.

Neither Wells Fargo Advisors nor your financial advisor offer tax, legal, or accounting advice. As a result of complex tax-reporting requirements, investors should consult with their tax advisor or attorney before investing in SPACs.

# Cost of investing in SPACs

You will pay a commission (or sales concession) each time you buy or sell shares in a SPAC. In the primary market, a sales concession is built into the purchase price. When you buy or sell a SPAC in the secondary market, you incur a commission as a cost of processing each transaction.

Advisory accounts are fee-based accounts and include discretionary and nondiscretionary investment advisory programs in which you are charged a fee on the underlying assets. Instead of paying a sales charge or commission on each transaction, you may pay an annual fee, billed quarterly in advance, based on a percentage of the account's value.

## Investor characteristics

SPACs are not appropriate for all investors. Like all investments, SPACs have their own risk/reward propositions. Investors should consider their risk-tolerance level and make investments accordingly. Selecting a SPAC for your investment objectives involves a number of factors unique to each SPAC being considered. You should review the prospectus to fully evaluate your options. You should also talk with your financial advisor, so that together you can make the choices most appropriate for you.

### **Diversification**

Wells Fargo Advisors believes that investors should diversify their investments. Investors should observe an asset allocation strategy and not concentrate their overall portfolio in any one class, or sector of securities. Although asset allocation can be an effective investment strategy, it cannot eliminate the risk of fluctuating prices, yields, and uncertain returns.

### **Reasonable available alternatives**

We have a responsibility to consider reasonably available alternatives in making a recommendation. We do not need to evaluate every possible alternative either within our products or outside the firm in making a recommendation. We are not required to offer the “best” or lowest cost product. While cost is a factor that we take into consideration in making a recommendation, it is not the only factor.

You should consider factors such as those below prior to accepting a recommendation:

- The potential risks, rewards, and costs in purchasing and in the future selling of a security.
- Your age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, and risk tolerance.
- The security's investment objectives, characteristics (including any special or unusual features), liquidity, volatility, and likely performance in a variety of market and economic conditions.
- For complex products, you should consider whether less complex or costly products achieve the same objectives.

By accepting a recommendation, you acknowledge that you have considered the above factors to your satisfaction.

### **Additional resources**

Before investing in Special Purpose Acquisition Companies, it is important for you to read and understand the product prospectus, disclosures, and other offering documents. If you have any questions about a specific product or the information in the product's documents and disclosures, contact your financial advisor.

To learn more about Special Purpose Acquisition Companies, contact your financial advisor or visit the following websites:

**Wells Fargo Advisors**  
wellsfargoadvisors.com

**Investment Company  
Institute**  
ici.org

**Financial Industry  
Regulatory Authority**  
finra.org

**U.S. Securities and  
Exchange Commission**  
sec.gov

**Securities Industry and  
Financial Markets Association**  
sifma.org

## How your financial advisor and Wells Fargo Advisors are compensated on SPACs

For helping you invest in a SPAC, Wells Fargo Advisors and your financial advisor are compensated in ways that vary depending on the selected investment. Your financial advisor will receive compensation in the form of a commission from most transactions.

For most purchases, a financial advisor's compensation is based on the dollar amount purchased or sold in the SPAC transaction. In certain fee-based accounts, a financial advisor's compensation is based on a percentage of assets in the account. The compensation formula that determines the amount of payment to your financial advisor is generally the same for all SPACs.

In addition to receiving compensation, your financial advisor may receive internal credits in the syndicate allocation process for sales in SPACs and other products. Financial advisors may receive allocations of new syndicate deals based on the number of internal credits accumulated. For example, a financial advisor accumulating a large number of internal credits based on past sales of those transactions may receive a greater allocation of a new syndicate issue than a financial advisor with fewer credits.

Within the division that operates in Wells Fargo financial centers and some Wells Fargo stores, a licensed banker may refer you to a financial advisor, as they generally work as a team. In this case, the licensed banker will be compensated through a referral arrangement with the financial advisor.

Wells Fargo Securities, LLC (WFS) may receive compensation for making a market and keeping an inventory in the units and/or common stock of select SPACs. WFS or its affiliates may receive compensation for investment banking services of select SPACs.