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MONEY

Shaq, Ciara and A-Rod have one. But are SPACs, the latest investment craze, right for you?

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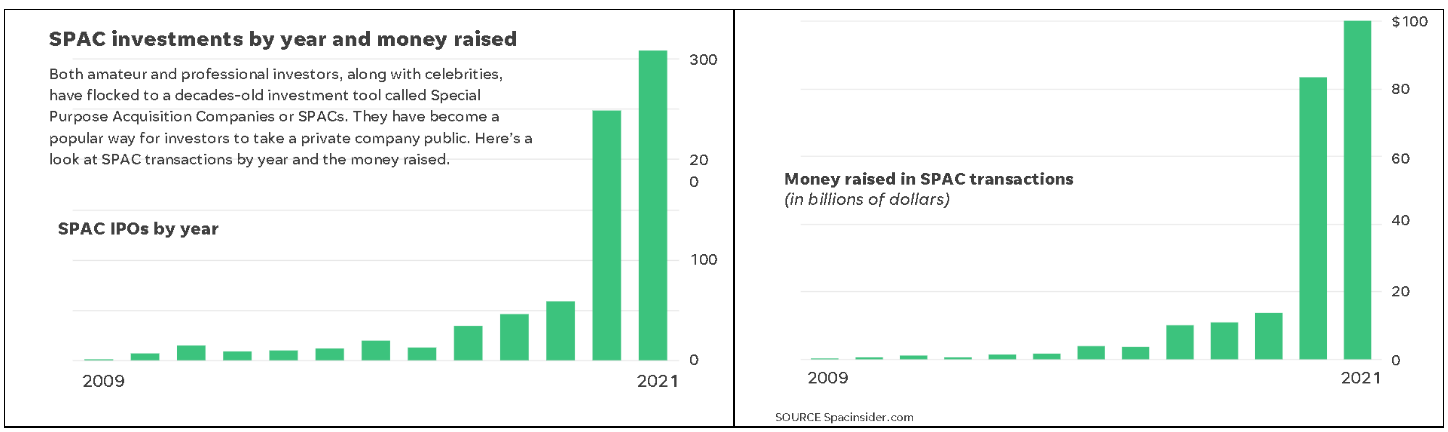
NBA great Shaquille O'Neal is part of one. So are superstar singer Ciara, lifestyle guru Martha Stewart, rocker Sammy Hagar and retired baseball slugger Alex Rodriguez.

These celebrities and many others have become the public faces, part owners and in the case of A-Rod, the chief executive, of special purpose acquisition companies or SPACs — one of the hottest trends on Wall Street and an investment that has grown popular with the general public. SPACs, created to raise money in an initial public offering (IPO) to buy another company, are also drawing scrutiny from government regulators. They worry that all the buzz around SPACs is blinding people to their risks.

Access to SPACS has become easy. Mom-and-pop investors can buy them through online trading sites like Robinhood and Charles Schwab. And at the relatively inexpensive cost of $10 a share, they have attracted tens of thousands of individuals who belong to online SPAC groups, including about a half dozen on Facebook.

"SPACs for once allow the retail investor to feel like they have a chance to invest like an angel investor," says Travis Mrkvicka, a doctor in Minneapolis, Minnesota, who is part of the 21,500-member SPAC Investing 2021 Facebook group.



Mrkvicka says that SPACs allow people like him to "invest in companies they see promise in at the very earliest stages of their going public — before the IPO runs up like crazy and they're left, as retail investors so often are, to pick up the leftover pennies."

SPACs, once a vehicle for mostly institutional investors like big mutual funds, became a popular option for amateur investors roughly six months ago.

Some, like Bill Lyons of Saratoga Springs, New York, jumped into SPAC investing in summer 2020.

"The luster is perhaps starting to fade as the market is pretty flooded," says Lyons, who invested through his Schwab account and claims to have done well. "Last summer, you could pick a decent SPAC, and it could be up within a month or two at 100% or 200% ... which was wild. Now, it's really under attack."

SPACs, also called blank check companies, have less detailed information for investors than a traditional IPO, while both are used to convert a private business into publicly traded companies.

With a SPAC, an investor is relying upon the expertise of a sponsor or management team, which sometimes includes celebrity partners for publicity, to raise the funds and then merge with a private firm that then "goes public" which means its stock can trade on exchanges, where anyone can buy and sell it.

With a traditional IPO, a company takes itself public by hiring an investment bank that pitches it to potential investors like mutual funds and hedge funds through a series of presentations called roadshows. By the time a company is ready to go public, it has filed a comprehensive public document with the Securities and Exchange Commission that gives anyone a detailed look at its books and potential risks.

SPACs have become wildly popular, and there are at least 308 on the market with $100 billion in proceeds looking to invest in private companies, according to spacinsider.com, a New York-based subscription site that tracks them. That's a more than nine-fold increase in proceeds from just three years ago. Southeast Asia's Grab, a ride-hailing giant, made history in mid-April with the world's largest SPAC merger at $40 billion.

SEC warnings

The investment frenzy has caught the attention of the SEC, and a former economist with the regulatory agency told USA TODAY that nonprofessional investors should stick with diversified index funds and avoid SPACs because of their risks and historical poor investment returns.

"One of the problems in the SPAC space is the fees can be pretty high and often it's not clear what the investments will be," says Chester Spatt, the former SEC economist who now is a professor at Carnegie Mellon University in Pittsburgh.

Spatt adds that just because some high-profile SPACS have included celebrity partners that "doesn't give me a lot of reassurance or confidence" that they are a good investment.

And two recent academic studies, including one from Stanford and New York University's law school, found that the price of shares typically falls the first year after a merger.

The SEC has issued at least four "statements" or "investor alerts" since December, including one on April 8 in which it warned about sponsor or management compensation, celebrity involvement and "the potential for retail participation drawn by baseless hype."

A call and email seeking comment from the SEC were not returned.

The SEC warnings are just fine with David Alan Miller, the managing partner at Graubard Miller in New York who invented SPACs in the early 1990s.

"Now that SPACs are in the mainstream, many more people are trying to invest in them," he says. "It is important that investors be educated about the product. The SEC is trying to do that."

Miller says he and fellow former NYU School of Law classmate David Nussbaum created the first SPAC IPO in 1993 and they came about to provide investor protections following problems with the 1980s version of "shell" investment companies that defrauded investors.

"There was a need to provide the typical retail investor with the ability to invest in venture capital type deals," Miller says. "The SPAC provides a way for them to participate."

U.S. SPACs have raised $100.3 billion so far in 2021, already exceeding last year's total issuance of $83.4 billion, according to data from SPAC Research. But that has waned recently, with just 10 SPAC IPOs in April, down from 109 in March.

SPAC 101

Jay Ritter, a University of Florida finance professor who specializes in IPOs, was a one-time skeptic of SPACs but has become an investor in them after learning more about the process, he says.

According to Ritter, a typical SPACs work like this:

A sponsor or management team forms a SPAC or a shell company and begins selling investments at about $10 a share, which has become a market norm with some selling slightly lower or higher.

The investment pools can total tens or hundreds of millions of dollars, but a typical size is about $200 million, and the sponsor looks for a private company to take public.

The process can take up to two years, and the investment money is placed into an interest-bearing account during that time.

Once a merger is announced, non-management investors vote on whether to consummate the deal. At that point, an investor can either get the money back with interest or become an investor in the company that merges with the SPAC. The company then goes public and has a market ticker, with the stock price ultimately moving up or down based upon a company's projections or performance.

Most SPACs also grant warrants that are issued in fractions to investors, who may then purchase additional stock down the road. They are similar to employee stock options, which allow workers to purchase shares at a certain price and redeem them later.

Lyons, the Saratoga Springs investor who works as a school bus sales representative, says warrants are a way for average investors to make large sums of money. He says some warrants can be purchased for about $1 a share, and he's seen some warrants from SPAC deals increase to $42 a share since last summer.

Lyons says SPAC investing has been similar to the cryptocurrency trend or the tech boom that occurred in the early 2000s.

"This has been crazy. Hopefully, we will get another year out of it," he says.

Lyons says the downside is that a SPAC investment, like a traditional IPO, can go underwater if a SPAC merges with a company that has poor financial results, causing the share price to plummet.

Ritter and others who monitor SPACs say the biggest winners are the sponsors who create the SPACs and typically awards themselves 20% of the shares but invest only a portion of the cost of those shares.

For example, in a $200 million deal, a sponsor may award itself $50 million worth of shares but only invest $7 million, Ritter says.

"This is great for the sponsor, and this is why celebrities are getting involved. For the celebrity, this is a great opportunity for them to make money," says Ritter, noting they could be part of the sponsorship group. Others say celebrities could get a flat fee like getting paid to pitch a product in a commercial.

Ritter added that private companies can be big winners. They can increase the price of their firm because there are so many SPACs looking to invest in a small number of available targets.

They "have good bargaining power," he says.

COVID-fueled SPACs

While SPACs have been around for a few decades, their popularity began to grow again around 2016 , according to Kristi Marvin, chief executive and founder of spacinsider.com.

By late 2019, Richard Branson's Virgin Galactic space company made headlines by going public through a SPAC.

"That captured people's attention," says Doug Ellenoff, a partner at Ellenoff Grossman & Schole in New York who has done SPAC deals for 20 years.

Marvin, a former banker who lives in Manhattan, says there were 59 SPAC IPOs in 2019 with $13.6 billion in proceeds. But they really took off during the COVID-19 pandemic, with 248 SPAC IPOs last year raising $83 billion in proceeds.

Tyler McClure, a former farm manager from Sunnyside in central Washington, says he wasn't really familiar with SPACs until he lost his job last year during the pandemic and became a day trader.

He says he dabbled in about 10 SPAC stocks but gave up on them because he doesn't play the long-investment game.

He says SPACs are popular with amateur investors because it's relatively cheap to buy in and if an investor picks a good management group that merges with a solid company then the shares have the potential to skyrocket.

Marvin of spacinsider.com says the pandemic, which caused the market to plunge last spring, made it difficult for some private companies to get access to cash. So, she says, if a company wanted to tap the public markets, then SPACs became a less risky way to raise funds.

"It has grown so quickly and the worry is there will be some failures, but I don't think anyone will deny there will be failures," she says. "It's no different than a traditional IPO."

Marvin says traditional IPOs are inherently risky and flawed because a firm could take up to nine months to prepare to go public and then a major event could spook the market and derail the process. Plus, in a traditional IPO, a company doesn't know how much money it will be able to raise until the night of pricing.

Yet, Marvin says there also is a risk for a sponsor if the management group can't find a company to invest the funds and has to return cash to investors because they have lost their ability to make money.

Mohammed Elayan, an Irvine, California lawyer who specializes in mergers and acquisitions, says he's made some small SPAC investments based upon the reputation of the sponsor.

"It's not like I have invested my life savings," Elayan says. "I just put in a little to see what's going on because it's interesting. It's definitely hot, but when it's hot it's inevitable a correction is coming."