Favorable Market Conditions Lead to Renewed Interest in SPACs

Prepared by:
Howard Jiang and Lori Smith
White and Williams LLP

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Special purpose acquisition companies (SPACs) have experienced a renewed popularity over the past couple of years due to favorable capital markets conditions. A SPAC is a publicly traded acquisition and investment vehicle which is sponsored by an experienced team of investors or parties with significant operating experience who invest the seed capital for the SPAC. The SPAC has no current business operations and has gone public through an initial public offering to raise a desired amount of investment capital for the purpose of doing an acquisition or merger. A SPAC is in some ways similar to the use of a reverse merger to take a private company public in that its ultimate goal is the same – at the end of the day, the acquisition target becomes a publicly traded company through acquisition by, or merger with, the SPAC.

Often, a SPAC will have a specific industry or geographic focus based on the expertise and experience of the sponsoring team, but others may take a broader approach to selecting an acquisition target. The securities offered by a SPAC usually are comprised of a unit consisting of both common stock and warrants to provide added incentive to investors. The warrant can vary in length of exercise period and usually has a strike price set at approximately 15% above the IPO price.

A SPAC is distinguished from a typical public company in several respects:

1. It is a public blind pool investment and acquisition vehicle – namely, it is a public company with no operations other than the cash capital raised for the purpose of identifying and acquiring an acquisition target. However, most current SPACs are not blank check companies subject to Rule 419 of the Securities Act of 1933, as most current SPACs are targeting much larger capital raises exceeding $5 million. A SPAC cannot have a pre-determined acquisition target.

2. It has a finite life span, typically 18-24 months within which a combination transaction is expected to be consummated, or the raised funds must be returned to the investors and the SPAC will be dissolved. After a successful combination or investment transaction, it changes into a typical public company with underlying operations.

3. Its capital structure is similar to the typical PE or VC fund structure, allowing the risk-taking sponsors to keep a certain amount of incentive equity in terms of a percentage of the overall equity of a SPAC. However, if no combination transaction is consummated, the sponsors will be still responsible for all associated costs, including guaranteed interest payments to the investors. The sponsors' funds are at risk.

4. Unlike any PE or VC funds, other than in-kind stock incentives, its management typically does not receive any cash compensation until after the consummation of a merger, upon which most of them may not stay on as the management as the merger target with operations will most likely take over those positions.

5. Nearly all of the funds raised in the public offering are put into a "risk free" and liability remote escrow account to protect the

> investors’ funds until a combination transaction is consummated, whereupon the escrowed funds are released for use by the management of the combined company or for acquisition purposes subject to the shareholders’ approval.

Since the 1990’s when the SPAC first experienced widespread use, the SPAC’s governance and deal-making mechanism has undergone significant changes. Initially, the shareholders only had one bite at the apple. Their “yes” or “no” vote covered both the approval of the transaction and the associated automatic release of the funds from the escrow. The financial crisis in 2008 exposed major drawbacks in such a unitary decision mechanism. At that time, with prevailing market interest rate being close to zero as compared to what the SPAC sponsors promised (typically around or above 5% at that time) and the very uncertain prevailing economic condition, the guaranteed interest payment to the investors made the decision to vote “no” more attractive. Thus, many SPACs failed to do any combination and returned the funds back to the investors after the depletion of the pool of interest payments funds put up by sponsors. Later on, this unitary decision making has been reformed into a bifurcated decision making process, where the shareholders can vote “yes” for the combination transaction but “no” for their funds release and ask their funds to be returned to them. This allows the shareholders two votes, which permits them to keep the potential upside value represented by the warrant portion of their investment and salvages the value of the SPAC as a public company. As a result, the guaranteed interest payments to the shareholders by the sponsors have also been greatly reduced to around 1% per annum.

Over the years, the advantages of the SPAC have become more obvious. It offers a company that is ready for the public market and access to public capital a quicker and safer process as compared to an IPO, which can take a much longer period and is subject to volatile market conditions. It offers more flexibility in structuring a transaction, making many issues negotiable between the two companies and their shareholders including deal and exchange payment method and the regulation of the release of shares into the market, the purchase price adjustment and other matters. The combination transaction or acquisition transaction is subject to a shareholders vote through proxy solicitation on Schedule 14A of the Securities Exchange Act of 1934 that includes the up-to-date financials of both the SPAC and the target company, a discussion of the target company's operations and its prospects. The turnaround time for a Schedule 14A is much shorter, usually around three months as compared to typically a four to nine month period for an IPO. A key timing factor for a successful combination transaction is the audit of the financials of the target company, whether the target company's financials are auditable and/or can be audited in a timely fashion.

The public offering process of a SPAC follows the typical IPO process. It starts with the filing of an S-1 registration statement if it is a domestic company in the U.S. or an F-1 registration statement if it is a foreign issuer. Confidential filing is available as the SPAC does not have much assets or revenue to begin with. Depending on the desires of the sponsors, a SPAC can now be listed on NASDAQ, NYSE or the OTC market. Historically, the New York Stock Exchange did not permit listing of SPACs but this has recently changed, while NASDAQ has listed over 100 SPAC IPOs. Most SPACS elect to be traded on a main board exchange as opposed to the OTC market as OTC markets tend to be more thinly traded.

In view of the bifurcated voting mechanism, a SPAC may have to go through the process of replacing some existing shareholders who vote “no” with respect to their funds being used for the targeted transaction with new investors. In this process, the SPAC needs to find more permanent capital to replace the shareholders withdrawing their funds.

As bigger and more established players such as Blackstone and Goldman Sachs get into the SPAC space, the sizes of SPACs have also increased from tens of millions to hundreds of millions or even around $1 billion in funds raised. Various mechanisms have also sprung up such as the forward purchase commitment, associated private placement in conjunction with the combination transaction as well as warrant call and put rights. One can expect further innovation in the future as this space continues to attract investors and companies.