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SPAC-and-Span: A Clean Exit?

SPACs can present an appealing alternative exit for sellers, especially those for whom a traditional sale or IPO proves challenging.

While robust M&A and IPO markets have given investors solid liquidity options, in some cases selling a company to a publicly traded special purpose acquisition company, or SPAC, can be an appealing alternative. Recent examples in the United States include the $500 million acquisition by Levy Acquisition Corp. of Del Taco in June 2015 and the pending $879 million acquisition by Boulevard Acquisition Corp. of AgroFresh Inc., a subsidiary of The Dow Chemical Company. In the UK, notable examples include Burger King going public in 2012 through a $1.4 billion merger with a UK SPAC.

SPAC Basics

A SPAC, which is typically sponsored by an experienced investor and/or management team, raises money in an IPO in anticipation of completing an unidentified acquisition. The IPO proceeds are held in a trust account that can be accessed only to complete such an acquisition, and if the SPAC does not complete an acquisition within a specified timeframe (e.g., 21 months), it must liquidate and return the trust proceeds to its stockholders. The sponsor generally receives common stock equal to 20 percent of the SPAC's pre-business combination common stock as compensation for finding and completing a deal — similar to the carried interest in a private equity fund — for which it receives no proceeds from the trust account if the SPAC liquidates.

While earlier SPACs required stockholder approval before completing an acquisition, thus creating delay and uncertainty, more recent U.S. SPAC structures provide that upon the closing of a SPAC's first acquisition its public stockholders can elect to have their shares redeemed for cash without a stockholder vote, unless such a vote is required by law or by stock exchange rules (e.g., issuance of more than 20 percent of the SPAC shares as merger consideration).

Pros and Cons

IPO Alternative — A traditional IPO can be challenging or impossible for certain companies, e.g., because a company is too small or its business is in a down cycle, the equity markets are not open to IPOs or the IPO process is simply too burdensome. In such cases, merging with an already-public SPAC can be an alternative to a traditional IPO. Merging with a SPAC also offers structuring flexibility not available in a traditional IPO, such as utilizing earn-outs, escrows and other private M&A methods of allocating risk and upside. In addition, a SPAC merger can be structured so that the seller retains varying degrees of post-closing control, as well as some upside through partial stock consideration.

Post-Transaction Trading — Transitioning to a normal operating company with a traditional stockholder base trading on the basis of the target's fundamentals — a/k/a "de-SPACing" — can be a challenge. Post-merger trading can be thin if too many of the pre-acquisition stockholders elect to redeem their stock at closing, which can make it difficult to translate subsequent operational success into increased shareholder value. Because having the target's stock trade on NYSE or Nasdaq can be key to a successful exit, some sellers require a closing condition that the SPAC meet stock exchange listing requirements at closing.

No Reverse Break Fees — Unlike a traditional acquisition agreement, however, the potential to receive deal protection in the form of a reverse break-up fee from the SPAC (e.g., in cases of failure to raise financing) can be limited because of the inability to access the trust account cash other than post-business combination.

Uncertainty About Available Cash — Because a SPAC's public stockholders can elect to have their shares redeeemed for cash in connection with the business combination, the amount of cash available to pay target stockholders and for post-closing operations is inherently uncertain. As a result, the target may require a "minimum cash" closing condition or, perhaps more importantly, that the SPAC have committed acquisition financing. For this reason, many SPAC acquisitions include a simultaneous PIPE investment.

Motivated Buyer — Because SPACs are required to liquidate if they do not complete a business combination and the SPAC sponsor receives no proceeds from the trust account upon liquidation, SPAC sponsors are highly incentivized to find and complete a transaction before their deadline. While this time pressure can provide negotiating leverage for a seller, this dynamic is offset at least in part by the reality that if the SPAC stockholders do not view the target as appropriately valued, they will vote with their feet by choosing to redeem their stock, thereby putting significant stress on the capitalization of the post-combination company and, in some cases, causing "minimum cash" or other closing conditions not to be satisfied.

Timeline and SEC Filings — The elimination of the historical automatic SPAC stockholder vote requirement does not fully avoid the SEC filing requirements. Because the SPAC is a public company and the SPAC's terms require that a redemption option be provided to the SPAC stockholders — essentially a self-tender offer — an acquisition will still involve SEC filings. The SPAC's tender offer documents (and its proxy statement, if a vote is also required) must include audited financials and full business description of the target, meaning that the target has to be "IPO-ready" to avoid significant incremental delay. As a result, a SPAC transaction will take three to five months to complete, generally comparable to a traditional IPO, but likely longer than a private sale.

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While the recent improved track record for SPACs has eliminated much of the reputational taint associated with earlier "shell company" structures, some dealmakers remain wary of merging with a SPAC because of the associated complexities compared to more traditional market exits. Nevertheless, SPACs present an interesting alternative exit for sellers, especially during periods of choppiness in the IPO market or where lack of acquistion capital for buyers makes the traditional M&A market comparatively less attractive.

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

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