Market Trends 2017/18: Special Purpose Acquisition Companies (SPACs)

A Lexis Practice Advisor® Practice Note by
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OVERVIEW

The market for initial public offerings (IPOs) of SPACs experienced significant growth in 2017. According to research and analysis tool IPO Vital Signs, 34 SPAC IPOs raised over $9 billion in the U.S. markets in 2017, more than double the activity from 2016. In connection with an accelerating market, there was significantly increased participation in the SPAC market from well-established private equity firms as SPAC sponsors and the largest investment banks (so-called bulge-bracket banks) as their underwriters.

SPACs raise funds through an IPO and, in turn, use the capital they raise to seek to acquire one or more businesses in the future. A SPAC is typically marketed to focus on potential acquisitions in a particular industry or geography, although at the time of the IPO a SPAC will not have identified a particular target. A SPAC normally offers units comprised of shares of common stock and warrants to purchase common stock with a strike price higher than the offering price of the unit. In recent deals the unit has consisted of a share of common stock and a fraction of a warrant, typically one-half or one-third, where each whole warrant entitles the holder to purchase one share of common stock. 52 days following the pricing of the IPO, holders can usually separate the units into the underlying common stock and warrants, allowing the warrants and common stock to trade separately. The funds raised by the SPAC in the IPO are placed in an interest-bearing trust account which generally cannot be disbursed other than (i) for the closing of an acquisition or (ii) to redeem shares that investors have elected to have redeemed upon an acquisition or extension of the life of the SPAC. In some SPACs, a portion of the interest earned on the trust account can be used to fund the working capital of the SPAC. A SPAC typically has two years beginning on the IPO pricing date to consummate an initial business combination before its formation documents require the SPAC to liquidate and return the funds in the trust account to investors. For additional information on SPACs, see Special Purpose Acquisition Company Offerings and Transactions.

NOTABLE TRANSACTIONS

The SPAC IPO market had several notable transactions in 2017, including Social Capital Hedospohia Holdings Corp. (Social Capital), the much-discussed technology focused SPAC planning to bring one or more “unicorns” (i.e., private companies valued at $1 billion or more) into the public markets; Silver Run Acquisition Corp. II (Silver Run II), the largest SPAC of the year that raised $900 million; and Vista Oil & Gas, S.A.B. de C.V., the Riverstone Holdings, LLC sponsored SPAC that marked the first Mexican-listed SPAC IPO. In addition to the strong SPAC IPO market, a number of SPAC initial business combinations (often referred to as de-SPACing transactions) took place in 2017, including the simultaneous acquisition by Quinpario Acquisition Corp. 2 (Quinpario) of SourceHOV Holdings, Inc. (SourceHOV) and Novitex Holdings, Inc. (Novitex) to form Exela Technologies, Inc. (Exela) and the acquisition of Atkins Nutritionals, Inc. by Conyers Park Acquisition Corp. to form The Simply Good Foods Company.

Social Capital

In a deal that attracted significant media attention, in September 2017, Social Capital consummated an IPO raising gross proceeds of $690 million to acquire a technology unicorn. Led by Chamath Palihapitiya, a former Facebook executive, Social Capital intends to target the estimated 150 venture-backed, private technology companies valued at over $1.0 billion to “create an alternative path to a traditional IPO for disruptive and agile technology companies to achieve their long-term objectives and overcome key deterrents to becoming public.”

Social Capital offered 60,000,000 units for $10.00 per unit. Each unit included one Class A ordinary share and one third of one warrant, with each whole warrant exercisable for one Class A ordinary share at an exercise price of $11.50 per share. Credit Suisse, as sole representative for the two underwriters, quickly exercised its option to purchase an additional 9,000,000 million units, bringing the total offering to $690 million of gross proceeds. Social Capital’s units trade on the New York Stock Exchange (NYSE).

As unicorns have chosen to remain in the private markets longer, Social Capital aims to utilize the SPAC model to provide a more attractive path to the public markets, a model which, if successful, could provide significant future opportunities for SPACs to follow.

Exela

One recent trend is that SPACs are increasingly pursuing more complex deSPACing transactions, including transactions which involve acquiring two target companies at once. In February 2017, Quinpario, a SPAC sponsored by Jeffry Quinn’s investment firm, announced a combination with both Novitex (backed by Apollo Global Management, LLC) and SourceHOV (backed by HandsOn Global Management, LLC) to form Exela, a leading global information and transaction processing company. The complex, three-way transaction was supported by new debt financing led by the Royal Bank of Canada and Credit Suisse and a significant private investment in public equity (PIPE) investment from outside investors to backstop redemptions from the trust account. The $2.8 billion merger consummated in July resulted in a delevered combined company that is traded on The Nasdaq Stock Market (Nasdaq). Another example of this trend is National Energy Services Reunited Corp.’s proposed concurrent acquisition of Gulf Energy SAOC and National Petroleum Services for an aggregate purchase price of approximately $1.1 billion.

DEAL STRUCTURE AND PROCESS

Initial Public Offering

A sponsor typically forms the SPAC entity prior to making an initial filing of a registration statement—usually on Form S-1. A SPAC is most often sponsored by either (i) well known professionals in the specific industry or geography of focus for the SPAC or (ii) private equity funds seeking acquisitions outside the focus of their general funds.

The registration statement for a SPAC follows the same form requirements as any other IPO. However, since the SPAC has no operations to describe, the disclosure is relatively simple. The registration statement includes current financial information of the SPAC, including audited financial statements, and a detailed description of the SPAC structure. In addition, although the SPAC will not have identified a target, the registration statement will describe the expertise of the sponsor and generally describe the industry or geography on which the SPAC will focus. For further information on IPOs in general, see Initial Public Offering Process , Registration Statement and Preliminary Prospectus Preparations for an IPO, Going Public: Client Preparations, Top 10 Practice Tips: Initial Public Offerings, and Initial Public Offerings Resource Kit.

Upon consummation of an IPO, the typical capitalization of a SPAC is as follows:

- 20% of the outstanding shares are issued for a nominal amount to the sponsor(s) in what is referred to as the "sponsor promote" or the "founders shares."
- 80% of the outstanding shares are issued to the public in the IPO as part of a unit that also contains a warrant or a fraction thereof. The proceeds of the IPO, after paying part of the underwriting discount and other expenses, are placed in a trust account. The remaining part of the underwriting discount is only paid upon the consummation of an initial business combination.
- The sponsor also purchases warrants to fund the difference between the offering price to the public and the commissions and expenses paid by the SPAC such that there are enough funds in the trust to repurchase shares at the offering price of a unit upon redemption. The proceeds received by the SPAC from the privately placed warrants are referred to as the sponsor's "at risk capital" because upon a liquidation, these amounts are paid out to the public shareholders and the warrants purchased would not have any value and would not receive any distributions.

Business Combination

After the IPO, the SPAC is typically listed on either Nasdaq or the NYSE, and management of the SPAC turns its attention to seeking an existing business to acquire in the SPAC's initial business combination. For additional information on listing on Nasdaq or NYSE, see Nasdaq Initial Listing Requirements Table and NASDAQ Continued Listing Requirements Table. Management of the SPAC is typically a group of people affiliated with or on loan from the sponsor who dedicate part of their time to seeking an initial business combination. Pursuant to stock exchange rules, the initial business combination must occur with one or more target businesses that together have an aggregate fair market value of at least 80% of the assets held in the trust account (excluding the deferred underwriting commissions and other items) at the time of the definitive transaction agreement.

After signing a definitive agreement for the initial business combination, the SPAC must either (i) seek stockholder approval of the initial business combination at a meeting called for such purpose in connection with which stockholders may seek to have their shares redeemed (regardless of whether they vote for or against the initial business combination) or (ii) provide stockholders with the opportunity to sell their public shares to the SPAC by means of a tender offer. For additional information on seeking shareholder approval under Nasdaq or NYSE rules, see 20% Rule and Other NYSE and NASDAQ Shareholder Approval Requirements. Whether through redemption or a tender offer, the price paid for the shares is an amount in cash equal to the holder's pro rata share of the aggregate amount then on deposit in the trust account, including interest but less taxes payable and amounts permitted to be withdrawn for working capital purposes. Many SPACs restrict holders (together with others they are acting in concert with) from redeeming more than a certain percentage—generally 10% to 20%—of the outstanding public shares in order to discourage holders from accumulating large blocks of shares. This is often referred to as the "Bulldog provision" (named after an activist investment fund that in 2008 accumulated a large stake in TM Entertainment and Media, a SPAC, and attempted to replace the board of directors and force an early liquidation of the SPAC).

The choice to seek stockholder approval of the initial business combination or to conduct a tender offer for its shares is in the discretion of the SPAC, generally in consultation with the counterparties to the business combination. The decision is based on a variety of factors, including whether the transaction otherwise requires approval of the SPAC's stockholders (such as authorization to amend the formation documents or to issue 20% or more of the outstanding shares) and the timing of the transaction. In addition, a business combination is often structured to supplement the trust account (or to backstop any redemptions) through issuance of new equity in the combined company at closing through a PIPE investment. The PIPE, the terms of which may vary widely,

may be committed at signing or marketed to potential PIPE investors between signing and closing. Some recent SPACs have signed equity commitments with their sponsor, its affiliates, and other investors at the time of the IPO to provide additional equity financing in connection with the initial business combination, providing the SPAC with greater certainty that any equity funding necessary to complete the transaction will be available. The transactions also often include committed debt financing, either to refinance existing debt of the target company subject to acceleration upon the completion of the transaction or as consideration to purchase the target company. The process from signing to closing typically takes two to five months, depending on the stockholder and regulatory approvals necessary to complete the transaction.

Proxy

If the SPAC submits the combination to a shareholder vote, it will typically prepare and file a proxy statement with the SEC on Schedule 14A to be mailed to shareholders. The SPAC proxy contains all the information that is typical for a large merger, including the target's current and historical audited and interim financial statements as well as other detailed disclosure about the target company or companies. Often targets in initial business combinations are not regularly preparing financial statements that meet SEC filing requirements or being audited under the standards of the Public Company Accounting Oversight Board. In that case, preparing the information can be a significant impediment to timely filing the proxy statement, which affects the timing of closing the transaction. The proxy will also contain a complete description of the post-transaction company and its management, directors, governance structure, and material contracts (including debt financing agreements related to the de-SPACing transaction). If the transaction structure contemplates an entity other than the SPAC as the surviving public company, the proxy could be combined with a prospectus and filed as a registration statement on Form S-4 to register new shares in the surviving company. The proxy is also used to offer the shareholders their redemption rights pursuant to the SPAC's charter documents. For additional information on proxy statements, see Proxy Statement and Annual Report Drafting, Proxy Statement and Annual Meeting: Creating a Timeline and Checklist, Top 10 Practice Tips: Proxy Statement and Annual Meeting, and Proxy Statement and Annual Meeting Resource Kit.

If the business combination contemplates a tender offer in lieu of a proxy/redemption, the SPAC will prepare a Schedule TO which includes a similar level of disclosure about the target company or companies and the terms of the transaction as the proxy statement.

Liquidation

Pursuant to its formation documents, if a SPAC is unable to complete the initial business combination within a set time period (usually 24 months from the IPO closing date), the SPAC will (i) cease all operations except for the purpose of winding up, (ii) redeem the then outstanding public shares for cash at a per-share price equal to the aggregate amount then on deposit in the trust account, including any earned interest, divided by the number of then outstanding public shares, and (iii) as promptly as reasonably possible following such redemption, dissolve and liquidate, subject in each case to the SPAC's obligations under applicable law, including to provide for claims of creditors. A SPAC can also seek to have the initial time period to seek a business combination extended, so long as it concurrently offers holders of the outstanding public shares the redemption rights they would have upon liquidation. The SPAC's officers and directors waive their rights to liquidating distributions from the trust account with respect to any shares held by them prior to the IPO, but not with respect to any public shares they acquire in or following the IPO.

Other Key Market Trends

As the SPAC IPO market expanded in 2017, we saw more SPACs list on the NYSE than in the past, likely due to a reduction in the NYSE listing fees applicable to SPACs. In addition, both the NYSE and Nasdaq proposed

changes to their listing rules to mitigate obstacles faced by SPACs in listing their shares and keeping their shares listed. The proposed changes by both exchanges, which remain subject to SEC review, include reducing the number of round lot holders (i.e., holders in possession of a number of shares that can be evenly divided by 100) and public holders required prior to an initial business combination and providing a grace period following the initial business combination to comply with the listing standards. These minimum holder requirements prevent listed securities from lacking in sufficient liquidity which could distort the price and trading volume of the stock. Since the share price of a SPAC is effectively supported by the funds from the IPO which are deposited in a trust account and the redemption right of holders in connection with an initial business combination, the price distortion due to a lack of liquidity is less of a concern. SPACs can experience challenges complying with the exchanges' round lot and public holder requirements prior to the consummation of an initial business combination because their shares often trade among a relatively limited number of investors. The proposed rule changes are intended to address the concern by lowering the holder requirements.

MARKET OUTLOOK

SPACs continue to be an attractive vehicle for raising capital and an efficient pathway for privately held businesses to become publicly traded on an expedited timeline compared to a traditional IPO, diverting less of management's time to the transaction process and allowing management to focus on running the business. Market interest remains strong, both in new SPAC IPOs and in de-SPACing transactions. Already in 2018, according to IPO Vital Signs twelve SPAC IPOs have raised over $2.3 billion. While it may be challenging to repeat the robust IPO pace of 2017, the SPAC IPO market should remain strong in 2018 and the market for deSPACing transactions should grow on the heels of a few strong years of SPAC IPO activity.

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Christian Nagler is a partner in the New York office of Kirkland & Ellis LLP. He represents issuers, private equity sponsors, and underwriters in a broad range of complex securities and other transactions including registered offerings, Rule 144A and Regulation S offerings, consent solicitations, acquisition financing, and tender and exchange offers involving convertible securities, trust preferred securities, investment grade and high yield debt, subordinated debt and equity derivatives and securities in acquisition and other financings including involving special purpose acquisition companies.

Christian also represents companies and funds with respect to SEC reporting and compliance, including Section 13 and Section 16 obligations, corporate governance issues, and disclosure obligations.

Christian was named as a leading lawyer in the 2009 to 2016 editions of *The Best Lawyers in America©* and has been named in the capital markets section of *International Financial Law Review 1000*. He has also been recognized in *The Legal 500 U.S.* for his work in Capital Markets.

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David A. Curtiss is a corporate partner in the New York office of Kirkland & Ellis LLP. His practice concentrates in the Capital Markets Practice Group where he regularly represents sponsors, companies and underwriters in equity and debt offerings, including leveraged acquisition financing.

David has worked on a number of significant high-profile corporate matters for marquee clients. Recent SPAC transactions include: advising Quinpario Acquisition Corp. 2 in its pending $2.8 billion combination with SourceHOV, LLC and Novitex Holdings, Inc. to form Exela Technologies Inc and Jason Incorporated in its acquisition by Quinpario Acquisition Corp. David's experience also includes: representing Molson Coors Brewing Company in over $9.0 billion investment grade notes offerings, including those issued in connection with the acquisition of MillerCoors; Acelity L.P., Inc., a portfolio company of Apax Partners, in over $2.0 billion of high yield notes offerings and exchanges; Cerberus Capital Management in its strategic PIPE investment in Avon's international business and carveout of Avon's North American business.

In 2016, David was mentioned in *The Legal 500 U.S.* for Capital Markets: Equity Offerings.

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