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A Primer on Special Purpose Acquisition Companies

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Current Market for SPACs

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The recent resurgence in SPAC IPOs

- SPACs reached a height in 2007, during which 66 SPACs raised a total $12 billion. However, SPAC IPO activity came to an almost complete halt after the great recession, with only 1 SPAC IPO occurring in 2009, raising $36 million in capital.
- In recent years, SPACs have reemerged and are gaining momentum. In 2015, 19 SPACs completed IPOs raising $3.6 billion in a 120% increase over the amount raised in SPAC IPOs in 2014 and 7 more in registration.
- In 2015, SPACs raised a significant amount of capital. For example, Double Eagle Acquisition Corp completed an IPO that raised $480 million and Pace Holdings Corp completed an IPO that raised $400 million.

Despite their successful marketing, SPACs have had mixed success finding acquisitions

- Of the 235 SPACs that have completed IPOs since 2003, 127 have successfully completed acquisitions, 27 SPACs are looking for an acquisition, and 5 have announced acquisition targets.
- Since 2003, 76 SPACs have been forced into liquidation.

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Increase in Size of SPAC Offerings

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The recent trend is towards larger IPO sizes

- After nearly tripling from the average size of SPAC IPOs jumped again from $145.8 in 2014 to $201.8 in 2015, a 38% increase.
  - In 2013, SPACs raised $1.4 billion and the average IPO size was $144.7 million.
  - In 2014, SPACs raised $1.7 billion and the average IPO size was $145.8 million.
  - In 2015, SPACs raised $3.8 billion and the average IPO size was $201.8 million.
- In 2015, two large deals significantly raised the average for the year
  - Double Eagle Acquisition Corp raised $480 million
  - Pace Holdings Corp raised $400 million

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What is a SPAC?

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- A business entity organized to acquire one or more operating companies through a business combination
- Specified deadline for completion of business combination
- Primary objective of raising funds through a public offering of its securities
- Generally exempt from “Blank-Check Company” Rule 419

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SPAC vs. Blank Check Company

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A SPAC is exempt from regulation as a Blank Check Company under Rule 419 on the basis that its net tangible assets exceed $5 million.

- Rule 419 imposes various onerous requirements on blank check companies, including prohibition on trading of its common equity until an acquisition occurs
- While not required, SPAC offerings generally follow the spirit of Rule 419 offerings with a few significant differences.
  - 95+% of net proceeds deposited in escrow
  - Fair value of first targeted business to represent at least 80% of the amount held in trust
  - Units issued in SPAC offerings begin trading on date of IPO

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SPAC vs. Blank Check Company Cont.

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	SPAC	Blank Check Company
Escrow of offering proceeds	Nasdaq rules dictate at least 90% of proceeds from the offering and private placement are deposited in a trust account	The gross proceeds less allowable underwriting commissions, expenses and company deductions under Rule 419, are deposited into an escrow account
Investment of net proceeds	Net offering proceeds are invested only in securities that are direct obligations of or obligations guaranteed by the United States, with a maturity of 180 days or less or in money market funds meeting conditions under Rule 2a-7 of the Investment Company Act	Proceeds can only be invested in specified securities, such as a money market fund or in securities that are direct obligations of or obligations guaranteed by the United States
Receipt of interest on escrowed funds	Interest on proceeds from the trust account is paid to investors	Interest on funds in escrow is held for the sole benefit of investors
Limitation on fair value or net assets of business	Nasdaq rules dictate the initial business combination must be with one or more target business that together have a fair market value equal to 80% of the balance in the trust account	The fair value or net assets of a target business must represent at least 80% of the maximum offering proceeds

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SPAC vs. Blank Check Company Cont.

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	SPAC	Blank Check Company
Trading of securities issued	The units may trade before the initial business combination so long as the SPAC files a Form8-K including updated financial information	No trading of the units or the underlying ordinary shares and warrants is permitted until the completion of a business combination
Exercise of the warrants	Warrants cannot be exercised until the later of 30 days after the completion of the initial business combination or 12 months from the closing of this offering	Warrants could be exercised prior to the completion of a business combination but securities received and cash paid would be deposited into the escrow account
Election to remain an investor	A shareholder vote may not be required. If there is a shareholder vote, a SPAC may offer to redeem shares.	A prospectus regarding the business combination would go to each investor, who would have the opportunity to decide if he or she elects to remain a shareholder or require the return of his or her investment
Business combination deadline	An acquisition must be completed within 24 months.	An acquisition must be completed within 18 months
Release of funds	The proceeds will not be released until the earliest of the completion of the initial business combination , the redemption of any shares in connection with a shareholder vote, the redemption of shares if unable to complete a business combination within 24 months.	The proceeds held in escrow are not released until the earlier of the completion of a business combination or the failure to effect a business combination within the allotted time

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How SPACs are Structured

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- Founders (i.e., the SPAC management team) invest initial capital to form SPAC
  - Founders' shares typically sold for nominal value
  - Designed to ensure founders retain 20% of equity after IPO
- IPO consists of units, composed of shares and warrants
- SPACs are subject to restrictions on operations
  - Deadline for business combination (e.g., 18-24 months)
  - Size requirement for business combination (e.g., 80% of net assets)
  - No compensation to founders
- SPACs have Audit Committee and corporate governance structures similar to other operating companies
- Underwriters play a large role in pre-IPO structuring of SPAC
- Significant percentage of IPO proceeds, at least 90%, are placed in a trust account until business combination or liquidation

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How SPACs are Structured (cont'd)

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Founders and Management Team

- Well known private equity and hedge fund operators
- Current and former mutual fund managers
- Assorted politicians and corporate executives
- Notable officers include:
  - Former counterterrorism official Richard Clarke
  - Former Apple executives Steve Wozniak, Gilbert Amelio, and Ellen Hancock
  - Former Congressman Thomas McMillen
  - Former undersecretary for federal Department of Homeland Security Asa Hutchinson
  - Former CEO of Apollo Investment Corp. Michael Gross
  - Former oil executive Tony Hayward

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How SPACs are Structured (cont'd)

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Securities Offered

- Units offered in IPO consist of:
  - One share of common stock
  - One to two warrants exercisable for one share of common stock
- IPO price typically set at $10.00 per unit
- Units typically separate on a voluntary basis into components 52 calendar days after the date that the offering commences
- Warrants not exercisable until consummation of a business combination or liquidation
  - Exercise price varies based upon IPO price ($5.00 to $12.00) depending on the exercise ratio from warrants to common stock, which can range from 3:1 to 1:1.
  - Redeemable for nominal value if SPAC shares trade above set market price

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How SPACs are Structured (cont'd)

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Trust Account

- Most offerings include terms requiring a greater percentage of IPO proceeds (up to 100%) held in trust account
  - Fund additional amounts through private placement by insiders concurrent with IPO
  - Use of deferred underwriting discounts
  - Provides greater protection for investors, coupled with greater risk for insiders/underwriters
- IPO proceeds are invested either in U.S. treasury bills with a maturity of 180 days or less or money-market funds
- Some disbursement of interest permitted to pay income taxes and for use as working capital
  - Counters high percentage of IPO proceeds held in trust account
  - However, some deals limit the amount of interest that can be used as working capital and the circumstances in which interest on IPO proceeds can be disbursed.

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How SPACs are Structured (cont'd)

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Optional Structural Elements

- Additional features either to satisfy market expectations or as a result of agreements involving the Founders and underwriters:
  - Lock-up agreements
  - Pre-IPO sponsor warrant purchase commitment agreements
    - Purchase of warrants occurs concurrent with IPO closing
  - Redemption rights for public shareholders upon completion of the initial business combination.
  - Registration rights agreements

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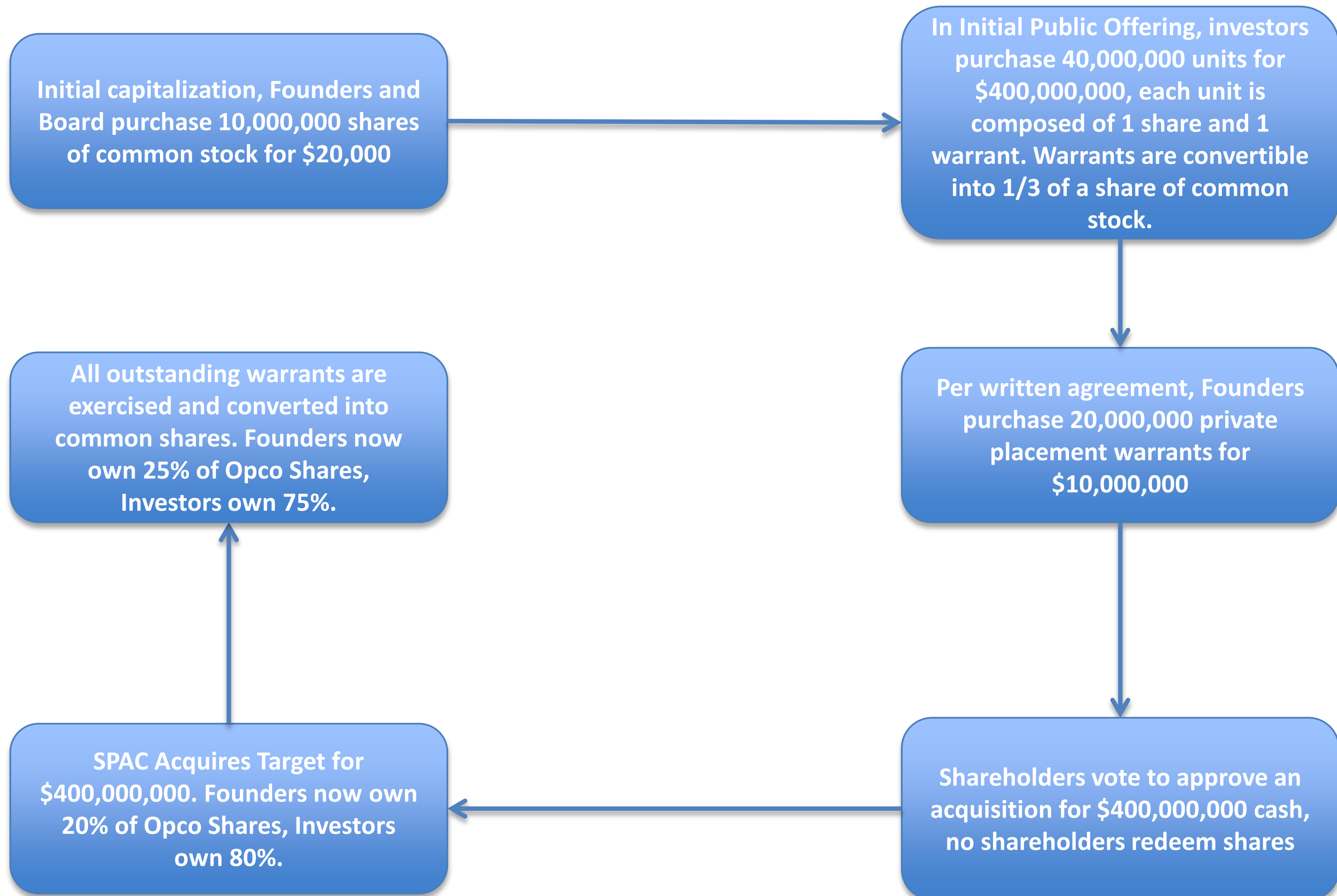
SPAC Dealflow Scenario 1



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SPAC Dealflow Scenario 2

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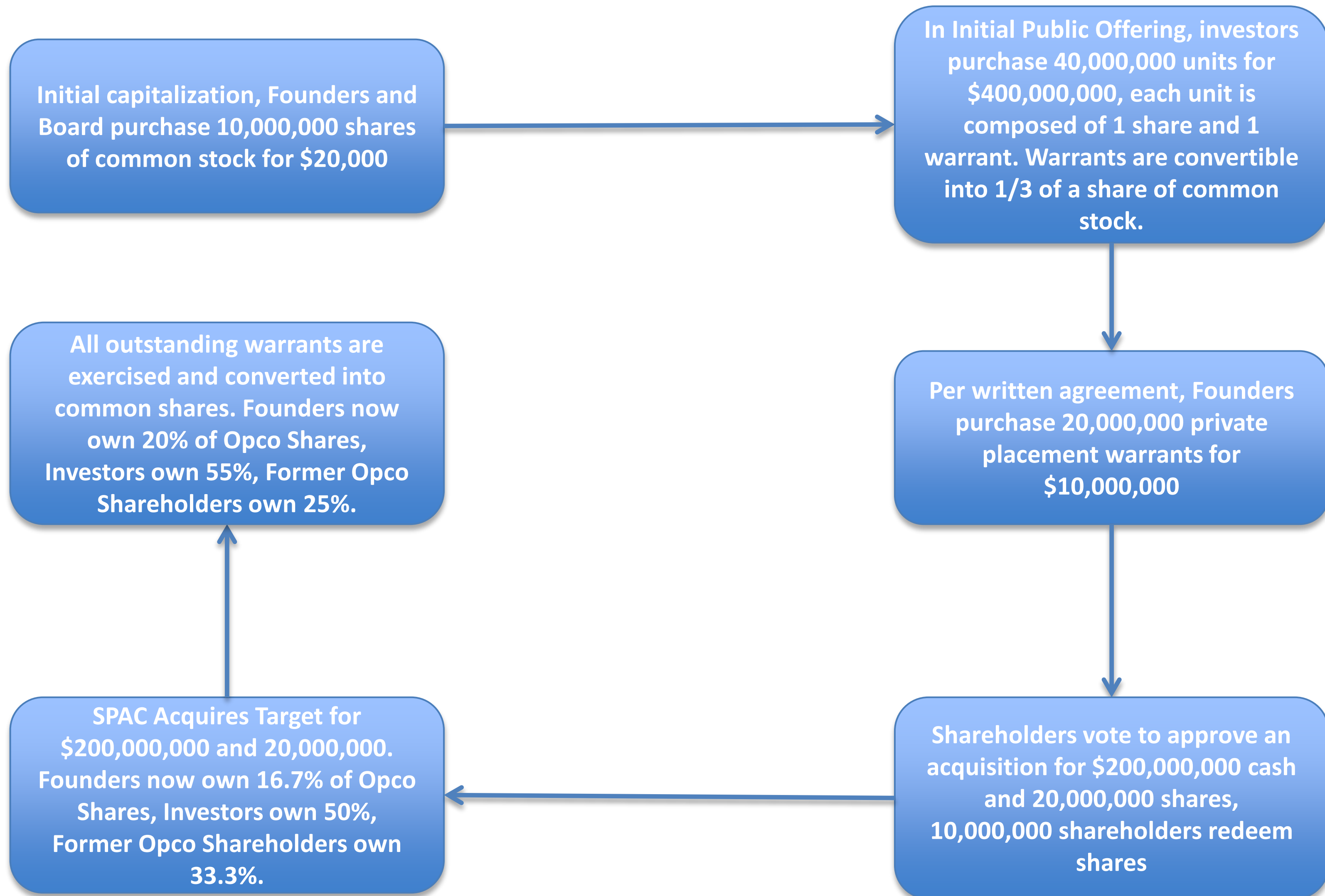

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Underwriters

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- I-Bankers Securities, Incorporated
  - A boutique firm focusing on $70 million to $200 million offerings
  - Led $480 million Double Eagle IPO
- Cantor Fitzgerald & Co
  - A newer firm to the SPAC space, in 2015, Cantor Fitzgerald participated in 7 offerings ranging from $40 million to $175 million.
- Citigroup
  - In 2015 Citigroup participated in six SPAC offerings ranging from $75 million to Pace Holding's $400 million IPO.
- Deutsche Bank
  - In 2015, Deutsche Bank raised over $2 billion in proceeds in only six SPAC offerings.
- EarlyBirdCapital, Inc.
  - As one of the first securities firms offering SPACs, EarlyBirdCapital still plays an important role in the industry, participating in 4 offerings in 2015.

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Founder Warrant Purchase Commitments

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- Historically, management obligated to buy warrants in the aftermarket after the IPO
  - Served to align management and investor interests
  - Arguably provided increased liquidity for warrants

- The current practice is for founders to acquire warrants directly from the SPAC
  - Purchase occurs concurrently with the closing of IPO
  - Proceeds are generally placed in trust account

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Selection of Prospective Target Operating Companies

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- Some SPACs have limited their scope of prospective operating companies to focused market segments
- However, SPACs do not have to limit their scope but can choose to target a company in any field or any market
  - E.g., Marathon Acquisition Corp.; Harbor Acquisition Corporation
- Completed deals occurred in the following market segments:
  - Real estate, entertainment/media, technology, energy, and water
- Specific investments include:
  - Chinese men's fashion
  - Mexican fast food
  - Truck accessories
  - Agricultural innovations
  - International fishing fleet
  - School buses

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Business Combination Restrictions

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- Fair market value of target business must exceed 80% of a SPAC’s trust account assets per listing standards

- Strict deadline for business combination
  - Must consummate a business combination within 18-24 months of IPO
  - Extensions may be granted (e.g., Great Wall Acquisition and China Mineral Acquisition)

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Primary Regulatory Steps in the IPO Process

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- Prepare and file Form S-1 registration statement with SEC
- Select and file listing application with a trading market
- Make filing with FINRA regarding underwriting compensation and arrangements

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SEC Review of the IPO Process

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- Review and comment on Form S-1
  - Focus on disclosure
  - Not merit-based evaluation of offering
- Form S-1 assigned to one of the Disclosure Operations section of the SEC's Division of Corporation Finance
- Disclosure Operation is divided into 11 groups, organized by industry type. SPACs, however, may be assigned to any group.
- Long-standing Division of Corporation practice to provide comments within 30 days of filing of Form S-1 and within 5 days of filing subsequent pre-effective amendments

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A SPAC promoter can facilitate a smoother SEC review

- Avoid taking any steps to search for or locate a target business before and during IPO
- Avoid any contacts, preliminary or otherwise, with potential target businesses before and during IPO
- To the extent possible, limit conflict of interest-related relationships and transactions, and provide detailed disclosure to extent there are any conflicts

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Main Factors to Consider

- Historically, most SPACs had their securities quoted on the OTC-Bulletin Board
  - Securities quoted on OTC-BB are not “covered securities” under federal securities laws and therefore subject to blue sky regulation
  - Limits investor pool largely to institutional investors because of state blue sky exemptions for offerings to such investors
  - Costs associated with “blue-sky” compliance
- Currently, both Nasdaq and the NYSE permit SPAC listings
  - Listed SPACs are exempt from “blue sky” regulation
  - Listing fees and officer annual affirmation requirements apply
  - Additionally, listed SPACs must comply with listing standards

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Exchange or Trading Market

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- In 2008, both Nasdaq and NYSE filed proposed rule changes with the SEC to permit SPAC listings.
- Many of the listing requirements are the same.
- Since 2011, in order to eventually list on a national exchange as the acquisition company, the SPAC's shares must previously be listed on the exchange to fit into a carve out from the definition of "reverse merger."

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Nasdaq vs. NYSE Listing Standards

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	Nasdaq	NYSE
Issuer Requirements	Securities listed on Nasdaq must have at least 300 round lot shareholders upon listing and at least 300 public shareholders for continued listing.	Securities listed on NYSE must demonstrate 400 holders of round lots and 1,100,000 publicly held shares. SPACs must demonstrate an aggregate market value of $250,000,000, a market value of publicly-held shares of $200,000,000, and have a closing price or an IPO price per share of at least $4 at the time of initial listing.
Corporate Governance Requirements	SPACs must generally meet all corporate governance requirements.	SPACs must generally meet all corporate governance requirements.
Trust Account	At least 90% of the proceeds raised in the IPO and any concurrent sale of equity securities must be placed in a trust account.	SPACs are required to keep at least 90% of the proceeds, together with the proceeds of any other concurrent sales of the SPACs' equity securities, in a trust account.
Deadline for Completing Business Acquisition		Within 36 months the SPAC must complete one or more business combinations with an aggregative fair market value of at least 80% of the value of the trust account.
Shareholder Approval	Each business combination must be approved by to a majority of the SPAC's Independent Directors. If the SPAC submits the combination to a shareholder vote, then it must file a proxy statement or information statement if not subject to shareholder approval.	Each business combination must be approved by to a majority of the SPAC's public shareholders.
Redemption Rights	Any public shareholders who vote against the business combination must have a right to convert their shares of common stock into a pro rata share of the aggregate amount then in the trust account, if the business combination is approved and consummated.	Any public shareholders who vote against the business combination must have a right to convert their shares of common stock into a pro rata share of the aggregate amount then in the trust account, if the business combination is approved and consummated.

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FINRA's Role in the IPO Process

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- FINRA, a self-governing body of which the underwriters are member firms, will review the proposed offering arrangements to determine whether the underwriters' compensation for the offering is "fair and equitable" to the SPAC
- Prior to commencing IPO, the underwriters must receive a "no-objection letter" from FINRA
- Underwriting compensation is broadly defined and may include
  - "Purchase options" issued to underwriters
  - Fees received both for IPO and for subsequent advisory work (e.g., for aftermarket warrant solicitations and evaluation of potential acquisition candidates)
- FINRA set forth guidance on SPACs in 2008

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Regulatory Obligations of SPACs after an IPO

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- SPACs must file Form 10-Ks, Form 10-Qs, Form 8-Ks and proxy statements with the SEC
  - Their executive officers and directors must file Section 16 reports with the SEC
- SPACs must comply with Sarbanes-Oxley Act of 2002, including Section 302 and 906 certifications
- Corporate governance listing standards of Nasdaq or NYSE, including regarding director independence
- SPACs may take advantage of Emerging Growth Company Status of the 2012 JOBS Act
- SPACs must comply with the Dodd-Frank Act of 2012 to the extent applicable

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Operating Concerns of SPACs after an IPO

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- Investing proceeds held in the trust account so as to avoid being deemed to be an "investment company" under the 1940 Act
- Finding a suitable acquisition candidate
- Ensuring that the proceeds held outside of trust account <u>or</u> interest generated thereon (depending on how the IPO was structured) are sufficient to pay operating expenses, including those expenses necessary to consummate a business combination

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Important Steps in Consummating a Business Combination Transaction

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- Conducing due diligence
- Negotiations/break-up fees
- Proxy/registration statement
  - Subject to full review by the SEC

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What is next for SPACs?

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- Will SPACs be able to take advantage of a robust M&A market and achieve greater success levels than in the past?
- Will investors demand more specific industry or geographic targets?

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