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Special Purpose Acquisition Companies ("SPACs")

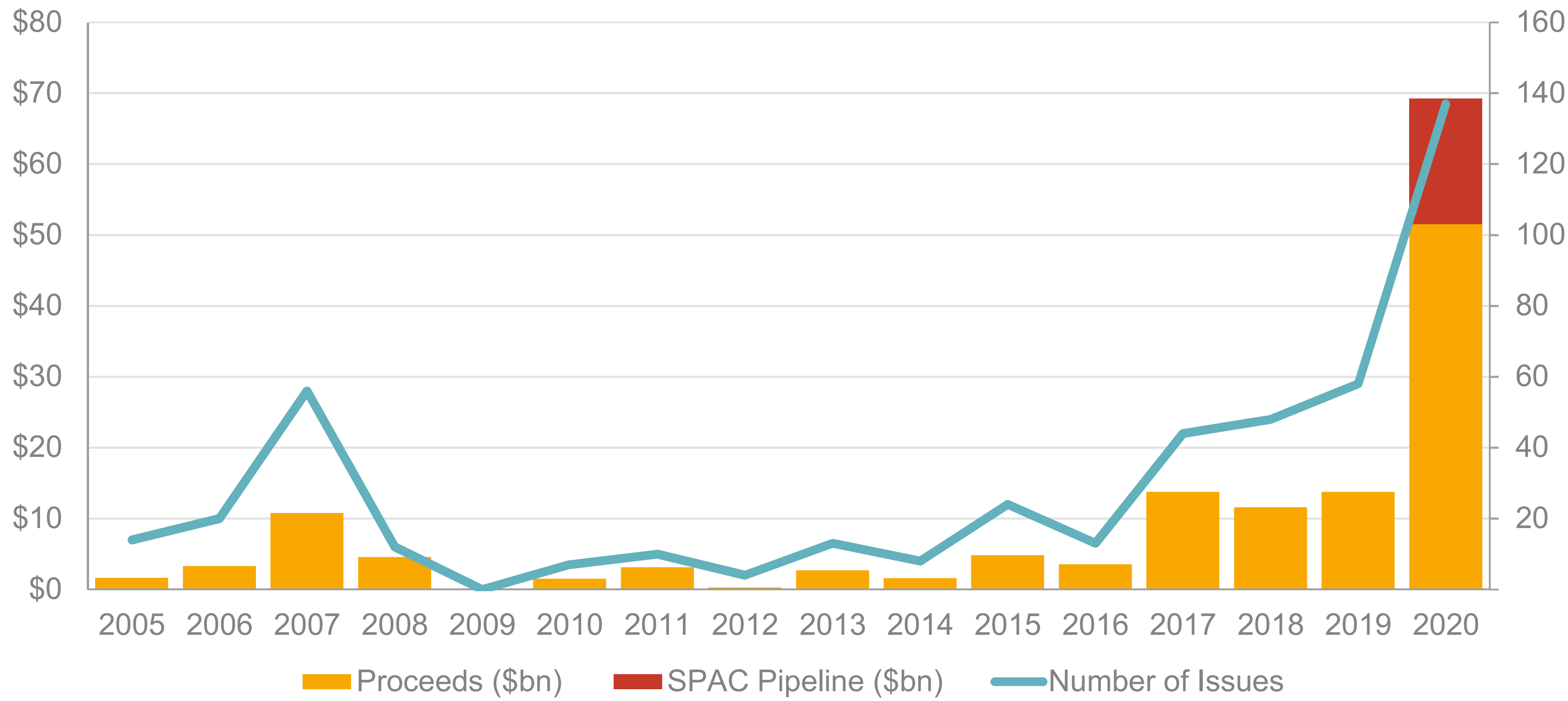
November 2020

SPAC introduction

- What is a SPAC?
  - Newly formed company with no assets or operations
  - Registers with U.S. Securities & Exchange Commission ("SEC") the offer and sale of stock and warrants
  - Business plan: find an operating company to buy using IPO proceeds
  - May or may not specify industry or geographic focus
  - Must identify a target company to acquire within a specified time frame
- For an operating company merging with and into a SPAC is an alternative to a traditional IPO
- SPACs have existed for many years, but there has been a recent surge in popularity—this may be explained by several changes:
  - Higher quality sponsors
  - More blue-chip investors
  - Bulge bracket underwriters
  - Better sponsor-investor alignment structures

SPACs surge

- US-listed SPAC volumes rise 275% YOY to all-time high $51.5bn

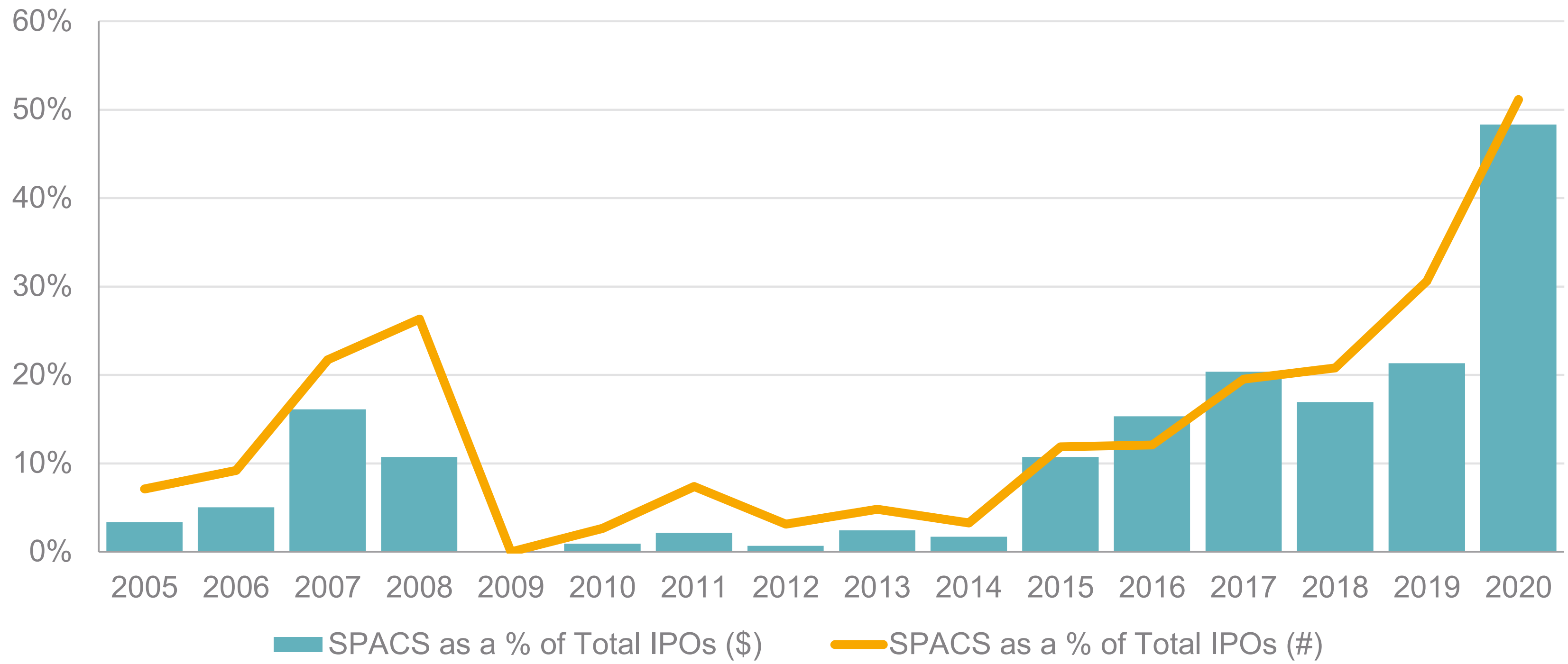


*Excludes deals less than $50m in proceeds

Data from Refinitiv

US listed SPAC IPO activity

- By volume, US-listed SPAC IPOs account for more than half of overall US-listed IPOs this year and 48% of proceeds raised



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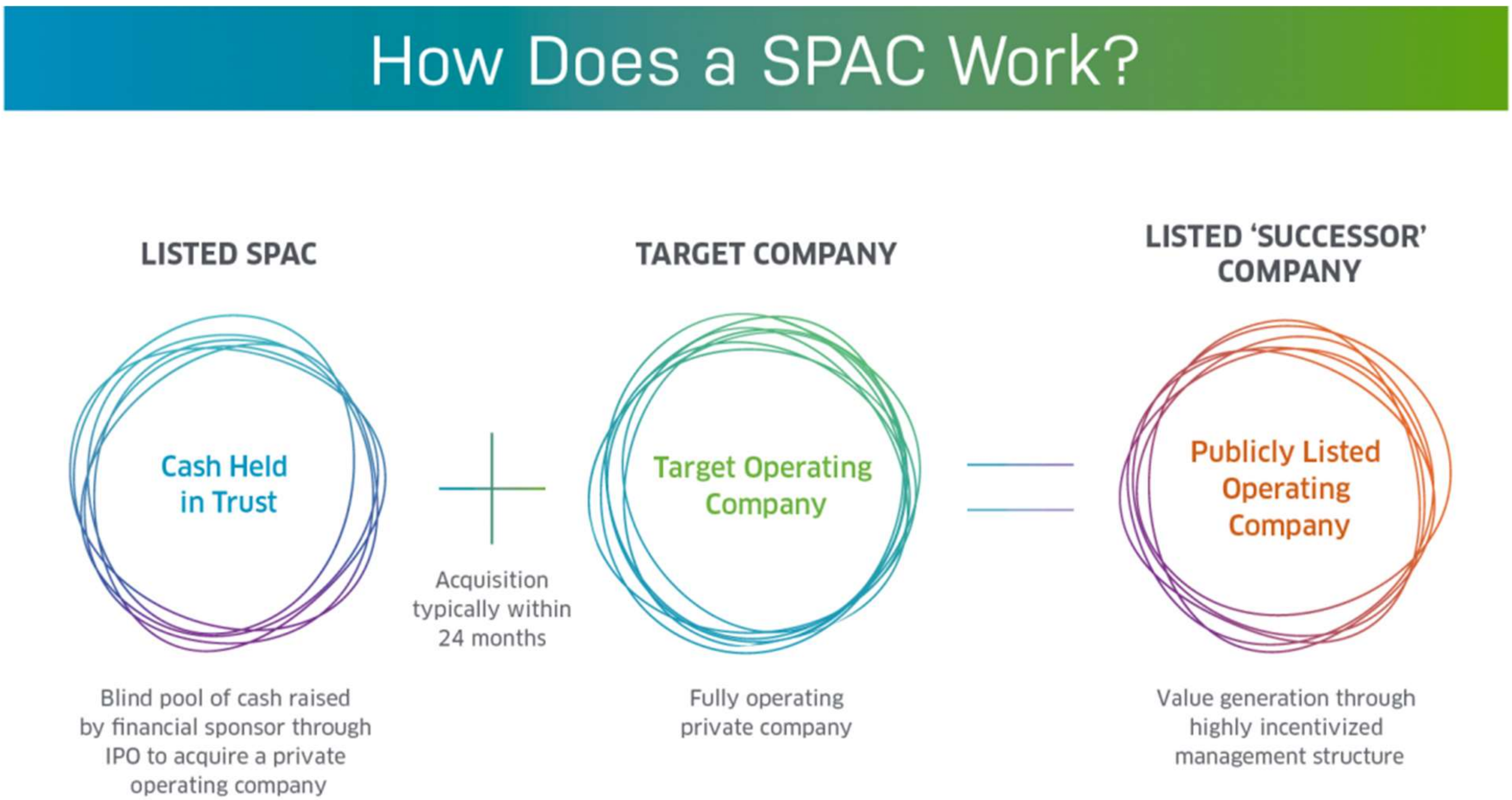
SPAC basics

How does a SPAC work



SPACs: Special Purpose Acquisition Companies
Listing a SPAC on Nasdaq, Nasdaq (June 2020)

How does a SPAC work *(cont'd)*

- Post IPO, SPACs place 100% of IPO proceeds in an interest-bearing trust account
  - Complete an acquisition (an "initial business combination")
  - Redeem investors under certain conditions
- To compensate for illiquidity, SPACs offer investors units
  - Units consist of common stock and whole or fractional warrants
  - Warrants typically priced "out of the money" (*i.e.*, higher than IPO price)
  - Shortly following IPO, common stock and warrants trade separately

How does a SPAC work *(cont'd)*

- Sponsor often receives 20% of SPAC's common stock as compensation
  - This 20% is commonly referred to as the "founder's shares" for nominal consideration
  - Nominal consideration not placed in the interest-bearing trust account
  - Founder's shares are locked up for one year following the merger
- Sponsor purchases in private placement warrants to fund IPO costs
  - This is commonly referred to as the "at risk capital"
  - Occurs in conjunction with IPO
- Sponsor generally receives management fees after initial business combination

How does a SPAC work *(cont'd)*

- If SPACs do not complete initial business combination before deadline:
  - Must liquidate their trusts
  - Redeem their investors (plus interest)
  - Founder's shares not redeemed for cash upon liquidation
- Therefore, sponsors incentivized to find suitable target
- Process of acquiring private company target called "de-SPACing"
- De-SPACing involves similar requirements to those for a public company merger
- Once a target is identified, sponsor conducts preliminary due diligence
- If the sponsor and target company reach an agreement in principle, they execute a letter of intent ("LoI") outlining key terms
  - Although LoI is nonbinding, there may be some binding terms (e.g., exclusivity agreements, confidentiality agreements)
- After LoI is signed, sponsor conducts greater due diligence (e.g., legal, accounting, financial)

How does a SPAC work *(cont'd)*

- During and after the completion of due diligence, sponsor and target execute merger agreement
- SPACs obtain shareholder approval for merger
  - Approval obtained in compliance with SEC proxy rules (i.e., file proxy statement with SEC; review and comment by SEC; mailing of proxy statement to SPAC shareholders; shareholder meeting)
  - Proxy statement must comply with Regulation 14A
  - Must also disclose information about target in compliance with SEC regulations
- SPAC will offer investors the election either:
  - To redeem their common stock for original purchase price and interest; or
  - To sell their public shares to the SPAC in a tender offer
    - If a tender offer occurs, must comply with SEC tender offer rules

How does a SPAC work *(cont'd)*

- Investors may redeem regardless of vote for or against transaction
- Investors may hold warrants even if they redeem common stock
- Unlike traditional mergers, reverse break-up fees are rare
- After merger, target operating company is surviving public company
  - The operating company must therefore be prepared to comply with the rules applicable to US public companies, including the corporate governance, ownership reporting, and related rules
  - The operating company usually will use the period during which the proxy statement is being reviewed to undertake all necessary corporate housekeeping

How does a SPAC work *(cont'd)*

- The stockholders of the operating company should bear in mind that a SPAC or former SPAC is subject to certain securities law requirements that differ from the requirements applicable generally to other SEC reporting companies. For example:
  - SPAC must file a special Form 8-K ("Super 8-K") within four business days after de-SPACing
  - SPAC cannot use Form S-8 to register any management equity plans until 60 days after initial business combination complete
  - SPACs are considered "ineligible issuers." Therefore, cannot use a free writing prospectus in any securities offerings within 3 years of filing Super 8-K
  - SPACs shareholders cannot rely on Rule 144 to sell shares until one year after filing of the Super 8-K, which takes place shortly after merger
  - SPACs must file a resale registration statement for shares underlying warrants

Merging into a SPAC

What are the advantages of merging with a SPAC?

- Merging with and into SPAC may be faster than a traditional IPO
  - However, that will depend on:
    - Nature of negotiations between SPAC and operating company target
    - Shareholder approval process
  - Will also require significant management time and resources
  - Entails negotiation of merger agreement and related ancillary documents
  - Operating company will also be required to prepare IPO-style disclosures for the proxy
- Going public via SPAC may provide greater certainty than IPO
  - Merger consideration and valuation set when merger agreement executed
  - Repricing may be possible due to market volatility or other reasons
- May help flexibility regarding content and timing of communication
  - Fewer restrictions on business combination discussions than on IPO discussions

What are some disadvantages of merging with a SPAC?

- Historically, concern with SPAC sponsor-stockholder interest alignment
- Sponsors typically receive founder’s shares for nominal consideration
  - Sponsors may profit even if future acquisition proves unsuccessful
  - Recently, some changes in SPAC structure; for example, Bill Ackman forgoing all founder’s shares
- SPACs create short-term arbitrage opportunities
  - SPACs allow investors to keep warrants even if they redeem shares
  - May impede long-term investing
  - SPACs traditionally attract hedge fund investors
- Redemption rights create inherent uncertainty about available funds
  - May mitigate this via issuing additional equity or equity-linked securities
  - Capital-raising transaction may also provide additional capital to grow

What are some disadvantages of merging with a SPAC? *(cont'd)*

- The market may not like the proposed initial business combination
  - Post-merger, over 50% of SPACs experienced poor aftermarket performance
  - Over time, this trend may reverse itself, especially with better sponsors
- SPACs may lack investment bank and institutional investor relationships
  - This may hinder equity research coverage and market making
  - Investor outreach may not translate into institutional investor familiarity
  - IPOs (and pre-IPO private placements) usually create such relationships
- SPACs incur significant costs and the process for the operating company is no cheaper than an IPO

Securities law considerations

Exemption from "blank-check company" status

- SPACs designed to avoid "blank-check company" classification
- Under Rule 419, a blank-check company must, among other things:
  - Deposit all proceeds and securities in its IPO into escrow account
  - Until business combination complete, cannot transfer/trade securities
- Depositing funds into escrow account now SPAC market practice
  - However, hindrance to restrict trading pending transaction completion
- To be deemed blank-check company, issuer must issue "penny stock"
- Penny stock defined in Rule 3a51
- Rule 3a51-1(g) excludes from the definition of penny stock:
  - Any issuers that have been in operation for less than three years, and
  - Have at least $5 million in net tangible assets

Exemption from "blank-check company" status *(cont'd)*

- In order to benefit from the Rule 3a51-1(g) exclusion:
  - SEC requires issuer file Form 8-K with an audited balance sheet
  - Must file as soon as practicable after the IPO
- It is standard for SPACs to use Rule 3a51-1(g) to avoid Rule 419
- Typically a SPAC's IPO registration statement will state that the SPAC will file such a Form 8-K promptly after consummation of the IPO.
- If the overallotment option is exercised after the filing of this Form 8-K, the SPAC will need to file an additional Form 8-K with an updated audited balance sheet reflecting the overallotment exercise.
- The underwriting agreement also typically contains covenants that require the SPAC to file these Forms 8-K.

Shell company status and ineligible issuer status

- SPACs constitute "shell companies" as defined in Rule 405. Therefore:
  - A SPAC is an "ineligible issuer" and may not use free writing prospectuses
    - Without free writing prospectuses, roadshows are subject to additional limits
  - Holders of the SPAC's securities may not rely on Rule 144 for resales until:
    - One year after SPAC has completed its initial business combination
    - SPAC files current Form 10 information
    - SPAC files periodic reports required by Section 13 or 15(d) for prior 12 months
  - A SPAC cannot become a well-known seasoned issuer (WKSI) until three years have passed since its initial business combination
  - A SPAC cannot use many communications safe harbors under the Securities Act to avoid gun-jumping violations

Emerging growth company status

- SPAC will be an emerging growth company ("EGC") as defined in Section 2(a)(19)
- Will remain an EGC until the earlier of:
  - The last day of the fiscal year
    - Following fifth anniversary of IPO completion
    - In which SPAC has total annual gross revenue of at least $1.07 billion, or
    - In which market value of common equity held by non-affiliates exceeds $700 million as of the prior June 30th (or second fiscal quarter end if not a December 31 fiscal year end company)
  - Date on which SPAC has issued more than $1 billion in non-convertible debt securities during prior three-year period
- If following initial business combination, SPAC continues to comply with above criteria, SPAC will continue to benefit from EGC status.

Marketing considerations

Roadshows

- Under Rule 433, any roadshow that is a "written communication" is a free writing prospectus
- SPACs are not able to use free writing prospectuses
- Therefore, important that SPAC roadshow presentations conducted to avoid being a written communication
- Under Rule 455, a "communication that, at the time of the communication, originates live, in real-time to a live audience and does not originate in recorded form or otherwise as a graphic communication, although it is transmitted through graphic means" does not constitute a written communication.
- In other words, a live, real-time roadshow to a live audience will not be considered a written communication, and therefore not a free writing prospectus

Roadshows *(cont'd)*

- This means that for a SPAC IPO:
  - Traditional roadshow presentations where the SPAC's management and the underwriters meet in person with prospective investors are acceptable; live telephone conference calls are also permissible;
  - A roadshow presentation cannot be recorded using Net Roadshow; though broadcasts of live, real-time presentations allowed
  - Roadshow decks:
    - May be passed out to meeting attendees but must be collected at the end;
    - Attendees may not take the slides with them;
    - Slides can also be broadcast if they are viewable only during the presentation;
    - Roadshow decks may not be emailed to accounts or transmitted in any way that allows the recipient to keep them post-presentation

Communications safe harbors

- As a shell company and an ineligible issuer, the following communications safe harbors are unavailable for SPACs:
  - Research Report Safe Harbors (Rules 137, 138, and 139)
  - Communications more than 30 days before registration statement is on file (Rule 163A)
- Restrictions expire three years after initial business combination complete
- Importantly, SPACs are permitted to rely on Rule 134 for communications announcing an offering

Testing-the-waters communications

- Under Section 5(d) EGCs and persons, and pursuant to Rule 163B other issuers that are not EGCs and persons, authorized to act on their behalf (*e.g.*, underwriters) are permitted to participate in oral or written communications with potential investors that are "qualified institutional buyers" ("QIBs") under Rule 144A or institutions that are accredited investors ("IAIs") under Rule 501 to determine if those investors may be interested in a potential securities offering.
- SEC rules do not require any specific legends on the "testing-the-waters" communications.

Securities exchange considerations

Nasdaq issues

- One of the requirements of a Nasdaq Capital Market listing is that
  - The securities are held by at least 300 round lot holders (i.e., holders of at least 100 shares) and
  - At least 50% of the 300 required round lot holders must hold unrestricted units with at least $2,500 in value.
- To ensure compliance, Nasdaq typically requires a letter of intent from the managing underwriter of the IPO
- Nasdaq often requests a list of all round lot holders within 15 days after closing of a SPAC's IPO
- In order to provide proper evidence to Nasdaq, the SPAC will have to order non-objecting beneficial holder reports and a share range analysis from Broadridge and Mediant after the closing of the IPO

Nasdaq issues *(cont'd)*

- Nasdaq's position with respect to accepting a share range analysis, without more detailed information, is as follows:
  - If the share range analysis shows 300 round lot holders they will NOT be satisfied, as they will assume that some of the accounts are owned by the same holder
  - If the share range analysis shows 400 or more round lot holders, that is sufficient
  - If the share range analysis shows more than 300 but fewer than 400 round lot holders, that is a judgment call that the examiner will make
- In the event that Nasdaq is not satisfied, it will request that the underwriters provide more information about the investors that bought in the IPO to confirm that 300 different accounts purchased a sufficient number of shares in the IPO. It is unclear that Nasdaq would require this if the information is not available or there are legal or other restrictions on sharing the information.

Nasdaq issues *(cont'd)*

- In counting round lot holders, Nasdaq discounts all accounts related to a household
- For this reason, the syndicate must coordinate book-building efforts so that they avoid duplicate investors and running the risk of not meeting the minimum 300 round lot holder requirement
- As a further precaution, underwriters are advised to aim for a 400 holder count to accommodate inadvertent duplicate accounts

Financial intermediary roles

Multiple roles for financial intermediaries

- The underwriter of a SPAC IPO may have various roles in relation to the SPAC even once the SPAC has completed its IPO, such as
  - Capital markets advisor
  - Private placement agent
  - M&A financial advisor

Capital markets advisor

- The underwriter of a SPAC IPO may assist in various capital markets related activities as the SPAC seeks to identify, and as it negotiates and completes, its initial business combination target
- These activities may include:
  - Wall crossing accounts to discuss their views on a potential qualifying transaction;
  - Arranging meetings with accounts prior to and during the proxy solicitation process;
  - Assisting the SPAC with the preparation of presentation materials
- This role is sometimes described as a "capital markets advisor"
- Assisting the SPAC in its communications with investors may raise potential issues under the proxy solicitation rules
- The capital markets advisor should consider limiting its activities to ministerial functions and avoid attending any meetings with investors to discuss potential targets

Placement agent/initial purchaser/arranger

- The underwriter of a SPAC IPO may be asked to act as a placement agent in a PIPE or in connection with a convert.
- The underwriter should follow its normal practices for an engagement of this type including, if applicable, entering into a separate engagement letter, inclusive of an indemnification agreement.

M&A advisor

- It is common for a former underwriter of a SPAC IPO to
  - Bring potential acquisition opportunities to the SPAC and,
  - Where the former underwriter either brings the potential acquisition opportunity to the SPAC or has relevant sector expertise, to act as financial advisor to the SPAC
- If the former underwriter acts as M&A advisor to the SPAC in its initial business combination, the former underwriter should follow its normal practices for an engagement of this type including, if applicable, entering into a separate engagement letter inclusive of an indemnification agreement
- The former underwriter may not want, or the SPAC may not want, the former underwriter to render a fairness opinion with respect to the initial business combination
- If the underwriter represents the target in the SPAC's initial business combination, the underwriter should follow its normal practices for an engagement of this type including, if applicable, entering into a separate engagement letter inclusive of an indemnification agreement.
- The engagement letter should include language disclosing that the advisor stands to collect its deferred compensation should the SPAC complete its initial business combination.

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