

The resurgence of Special Purpose Acquisition Companies

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Having been written-off by some market commentators following the financial crisis, equity capital markets on either side of the Atlantic are seeing a resurgence in the numbers and size of Special Purpose Acquisition Companies (**SPACs**) coming to market in order to facilitate the participation of investors (principally institutional investors and hedge funds) in private equity investment opportunities.

What is a SPAC?

For the uninitiated, a SPAC is a newly incorporated company which raises money from investors through an initial public offering (**IPO**) of its shares on a stock market (typically in New York or London but also on various other stock exchanges throughout the world) and is established solely for the purpose of acquiring or merging with an existing business (a **Business Combination**) within a prescribed period of time of its IPO (typically 18 months to two years). SPACs are established by one or more individuals or entities (known as sponsors) with experience in acquisitions or company management (typically persons with a private equity and/ or investment banking background) and such sponsors acquire a stake in the SPAC prior to its IPO which will post-IPO generally be equivalent to approximately 20% of the SPAC's equity.

Following the SPAC's IPO, the funds raised, net of the underwriters' compensation and money required for working capital, will be placed in an escrow account to fund the SPAC's eventual Business Combination. This money will be held in the escrow account until such time as the SPAC is ready to implement its Business Combination transaction. At the time of the IPO, the identity of the target business for the Business Combination transaction will not be known (although a target sector or region may have been identified in the prospectus). The practical implication of this is that investors, in deciding whether to invest, must place great faith in the SPAC management team's track record and their ability to identify a suitable Business Combination target.

In seeking out and implementing a Business Combination, the SPAC's management team will be

incentivised by their equity stake in the SPAC (which will often be augmented by the award of warrants or other rights to acquire or receive additional shares in the SPAC at a later date).

The proceeds of the IPO will be released from the escrow account upon the earlier of: (i) the consummation of a Business Combination, in order to fund that transaction; or (ii) if the SPAC fails to complete a Business Combination within the prescribed period, on the expiry of that period, upon which event the money is returned to the investors.

The reason for the resurgence of SPACs?

There are a number of factors which have assisted the resurgence of SPACs in recent years.

Improved market conditions for fund raising in the equity capital markets have certainly been important, together with the return in confidence amongst investors to deploy their capital for investments with investors keen to gain exposure to private equity investment opportunities for their investment portfolios. Additionally, regulatory changes in the United States of America (being the largest market for SPACs) have made SPACs a more attractive investment proposition, with both NASDAQ and NYSE Amex changing their listing rules to remove the requirement for Business Combination transactions to be subject to prior shareholder approval (provided that where the SPAC does not seek shareholder approval for its Business Combination, it conducts a tender offer to its shareholders to enable those who do not wish to participate in an announced Business Combination transaction the opportunity to exit). The immediate effect of these changes has been to remove the uncertainty and risk of the outcome of the shareholder vote. The fact that in many cases shareholder sentiment in relation to a particular acquisition was not known until the vote took place and that shareholders could therefore block a Business Combination at the last had previously deterred potential sellers of high quality companies from accepting bids from SPACs. The renewed investor appetite for SPACs in the United States of America has had a spill-over effect in the UK, with both European based sponsors forming SPACs and listing these on NASDAQ (eg London based Collabrium Investment Advisors LLP and Lepe Partners LLP have both formed and listed SPACs on NASDAQ in recent years, with the IPOs of Collabrium Japan Acquisition Corp and Atlantic Alliance Partnership Corp respectively) and also listing SPACs on the London Stock Exchange. Notably, for SPACs listing in London, class 1 transaction rules under Listing Rule 10 of the London Stock Exchange Rules do not apply as such SPACs have a standard (as opposed to premium) listing. These factors have made SPACs a far more attractive proposition to both investors and potential Business Combination counterparties alike. Amongst noteworthy recent SPACs, Texas Pacific Group recently raised US\$460m on the IPO of Pace Holdings Corp on NASDAQ; Wilber Ross raised US\$460m on the IPO of WL Ross Holding Corp on NASDAQ; Nicolas Berggruen's £900m SPAC, Justice Holdings Limited, which listed in London and subsequently acquired 29% of Burger King Worldwide, Inc.; Bob Diamond's US\$325m SPAC Atlas Mara Co-Nvest Ltd, which listed in London and subsequently acquired banking interests in Africa and Nomad Holdings Limited which raised US\$500m on its IPO in London and subsequently acquired Iglo Food Holdings Limited.

Attractions for Investors and Promoters

One of key attractions for investors investing in SPACs is of course their listed company status. Once listed the SPAC's shares will be freely transferable and liquid, enabling investors to exit their investment at any time by selling their shares in the market. Another attraction is the "money back" feature of SPACs, in that prior to the Business Combination, investors' cash is segregated and held in an escrow account under the control of an independent service provider/ trustee and if not used for a Business Combination before the expiry of the prescribed fixed term of the SPAC, must be returned to investors (also, for US listed SPACs, the requirement that for investors who do not wish to participate in a proposed Business Combination having the right to the return of their cash prior to the completion of the Business Combination). These features enable significantly more liquidity than might otherwise be available to an investor through an investment in a traditional private equity fund. If the Business Combination does not proceed or if an investor does not wish to participate, there are clear mechanisms for the return of the investor's money. The "money back" feature of SPACs is not just an important protection for shareholders; for some investors, particularly hedge funds, it is a clear "win-win". For example, a fund can acquire shares in the IPO and then redeem them for the same price if it does not like the terms of the identified eventual Business Combination transaction. Alternatively, if the fund stays in, it has the potential for receiving upside if the share price rises when the acquisition is announced. Also the fact that most SPAC offerings now comprise warrants or other rights to acquire shares at a later date, as well as shares in a single unit, means that investors may limit their initial outlay whilst providing an opportunity to enhance value at a later date (as the warrants will be listed with the shares, enhancement may also be achieved by selling the warrants in the market).

For promoters and sponsors, using a SPAC has a number of advantages over other forms of private equity investment vehicles. For example, the range of investors able to invest in a listed SPAC will likely be much greater than that available to private equity or other fund structures which are sometimes restricted to professional and institutional investors by law or regulation. Also, the ability to offer sellers of a target business shares in a listed company as part of any consideration package, as well as being able to leverage in funding its subsequent Business Combination, thereby increasing its investment firepower, represent another advantage. Additionally, while SPACs sometimes resemble investment fund structures in certain respects, the costs associated with establishing and maintaining a SPAC structure are generally lower than those applicable to establishing and maintaining a formal private equity fund structure and, aside from needing to comply with the rules of the stock exchange upon which its shares are listed, with the added benefit of the SPAC itself not needing to be regulated as a fund.

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