PEHUB

New SPAC Structure Holds Promise for Private Equity Exits

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Private equity funds considering exit alternatives for their portfolio companies may want to take a close look at the structure of 57th Street General Acquisition Corp., a new special purpose acquisition company that went public at the end of May.

This new SPAC includes a number of changes to the traditional SPAC structure designed to address concerns expressed by potential sellers of companies or assets to SPACs. As a result, it may offer a desirable exit strategy for PE funds and other sellers. (*Full disclosure: I'm an attorney who represented 57th Street's IPO underwriters*)

SPAC History

Between 2003 and 2008, SPACs raised over $20 billion in their initial public offerings in the United States. A SPAC is a blank check company sponsored by a management team which raises capital from the public and places substantially all of this capital into a trust account. It then embarks on a search for a business or assets to acquire. The hallmark of a SPAC is the ability for every public shareholder to obtain their pro rata share of the trust account if the public shareholder wishes to convert its shares into cash at the time the SPAC closes its acquisition or, alternatively, if the SPAC liquidates because it was unable to close an acquisition within a specified period of time following its IPO.

SPACs have been extraordinarily successful in upholding their promise to provide shareholders with their pro rata share of the trust account when required. Their record has been mixed, however, when it comes to the back-end business acquisitions. While the majority of SPACs have successfully closed acquisitions, including a number with private equity sellers, some of these deals were completed in a time-consuming manner and only after the SPACs engaged in a variety of supplemental "side deal" transactions with their shareholders. As a result, sellers of high quality companies were sometimes wary of entering into transactions with SPACs, thereby limiting the pool of desirable targets.

What's The Big Deal?

As the public markets began to thaw in the Fall of 2009, veteran SPAC bankers, sponsors and lawyers decided to take a fresh look at the traditional SPAC structure with a specific view towards improving the business acquisition process.

First, they focused on features which imposed artificial requirements on the transaction unrelated to the actual deal between the SPAC and the target. Most prominently, traditional SPACs provided their public shareholders with the opportunity to convert their shares into cash at the time of an acquisition only in conjunction with a favorable vote on the acquisition by holders of a majority of the SPAC's shares at a special meeting of shareholders.

This vote, which in most cases was not required by law or SEC rules, resulted in significant costs and delays, and also imposed an artificial threshold for closing a deal, which could be exploited by "no voters” to their advantage. It also was eliminated in the 57th Street SPAC.

Instead, public shareholders are offered the opportunity to redeem their shares at the time of an acquisition through a tender offer, which has a 20 business day offer period and whose rules prohibit “side deals” by the SPAC and its sponsor. In addition, traditional SPACs required a minimum value for the target company and provided that no acquisition could be closed if more than a minority of public shareholders, typically between 20% and 40%, requested conversion of their shares into cash. In 57th Street, the minimum value was eliminated, and the conversion threshold was increased to 88%.

Next, they considered the SPAC’s securities. In their IPOs, SPACs typically offer units, consisting of one share of common stock and one warrant to purchase a share of common stock. The warrant strike price typically was set significantly below the IPO price of the units. The significant potential dilution from these “in the money” warrants put significant downward pressure on the trading price of the common stock. The strike price of 57th Street’s warrants were, therefore, set above the IPO price of the units. In addition, the SPAC’s sponsor’s “promote” typically consisted of 20% of the SPAC’s common stock, which often was viewed as “too rich” by potential targets. This was cut to 10% in 57th Street.

While it remains to be seen if the new structure in 57th Street is adopted by other new SPACs, PE firms may wish to take a close look at the improvements in this new structure which may offer an attractive exit alternative in today’s market uncertainty.

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