Buyouts
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SPACs Are Back, And With Friendlier Terms

With an innovative set of terms designed to be friendlier to investors and target companies, a group of investors—including a former partner at Hicks, Muse, Tate & Furst Inc.—is hoping to revive the tarnished reputation of special purpose acquisition companies.

A group that did one of the last SPAC deals under conventional rules has put together a vehicle that its sponsors believe could be a pioneer for renewing the SPAC, which can be an exit vehicle for buyout shops.

The new SPAC, 57th Street General Acquisition Corp. (OTC bulletin board: SQTCU), has a shorter investment horizon than conventional SPACs, smaller payouts for the sponsors, and, perhaps most controversially, a new way for investors to express their displeasure with the deal that the sponsors of the blank-check company ultimately come up with.

“I think the market is going to be looking at this to see how it plays out,” said Joel L. Rubinstein, an attorney with the New York law firm McDermott Will & Emery LLP, who helped structure the terms of the vehicle, which went effective in May. “It hopefully will lead to higher quality transactions, because higher quality companies will feel comfortable going forward with the process.”

All told, 57th Street raised $54.6 million, including $1.85 million invested by the sponsors, through the sale of investment units, Rubinstein said. The company has no geographic or sector restrictions related to where it can invest. The public vehicle's investment units can be split into their constituent components: a $10 share of stock and a warrant for an additional share, which becomes exercisable when the deal closes with a target company.

Many of the terms of the offering were designed to appeal more to potential sellers than those of past SPACs.

In conventional SPACs, for example, the strike price of the warrants has typically been priced at a discount to the nominal value of shares, so that the warrants are “in the money” when the acquisition closes, making them immediately dilutive to the newly public company.

But the organizers of 57th Street put the SPAC's strike price at $11.50, so the company must increase in value before the warrants become exercisable, taking some of the sting out of the dilution, Rubinstein said. “In the end you want the SPAC to be something that target companies want to sell to.”

Tina Pappas, a managing director at the New York investment bank **Morgan Joseph & Co. Inc.** and its head of SPAC capital markets, who worked with Rubinstein and the founders to structure the new SPAC, said that the terms of the 57th Street SPAC also give target companies more certainty of close.

In a conventional deal, a SPAC is required to hold a shareholder meeting to approve the acquisition. This in turn requires a proxy solicitation, the meeting itself, and considerable time and expense. It also raises the risk that shareholders could scuttle management's deal. "Especially in the first half of last year when market conditions were so bad, a lot of SPACs had difficulty closing their transactions," Pappas said.

By contrast, 57th Street will have no shareholder vote, but instead will provide a tender offer to give investors a way to opt out of the acquisition by letting them sell shares back to the company. This provision received the greatest scrutiny by the Securities and Exchange Commission, Rubinstein and Pappas said, but regulators eventually were persuaded that the tender offer documents provided adequate disclosure to protect the interests of shareholders, who are primarily hedge funds and other institutional investors. "The uncertainty surrounding the shareholder vote turned off a lot of potential target companies," Pappas said.

The terms of the 57th Street SPAC are also more shareholder-friendly than those of past SPACs. "We tried to address several things we thought were deficiencies in the product," Pappas said. Unlike conventional SPACs, where the sponsors receive 20 percent of the stock in the SPAC for their role as promoters—similar to the carried interest take for private equity fund sponsors—this one provides only 10 percent "ownership promote." In addition, rather than a 24-month to 30-month investment period, which stretched to 36 months for some SPACs, this one gives management only 15 months to find a company to acquire.

Still, it was a measure of the SEC's caution that the review of 57th Street took more than eight months, rather than the four to five weeks to get approval of a conventional SPAC.

The backers of 57th Street are veterans of the SPAC business. Mark D. Klein, its chairman, president and chief executive officer, is a former CEO and chairman of the investment bank Ladenburg Thalmann & Co., which was a leader in doing SPAC deals in the middle years of the past decade.

The company also has the backing of Stone Tower Capital, a $4 billion New York hedge fund headed since 2001 by Michael J. Levitt, who helped lead Hicks Muse's ill-timed foray into telecom and venture capital in the bubble years, and Jonathan Berger, a co-founder and partner of buyout firm Pegasus Capital Advisors LP.

Klein declined to comment for this article. Stone Tower Capital did not respond to a request for comment.

The same group was previously involved in Alternative Asset Management Acquisition Corp., a $414 million SPAC that became the go-public vehicle for the appraisal and auction firm Great American Group Inc. (OTC bulletin board: GAMR), of Woodland Hills, Calif., in a $60 million deal last July. (The unused money was returned to investors.)

SPACs have had a speckled history. Originally launched in the 1990s as a way for smaller companies to go public without the expense of a conventional IPO, the vehicle lost favor during the dot-com bubble of the late 1990s, when the market seemed awash in money.

After that bubble collapsed, SPACs staged a resurgence, beginning in 2004. By the time the market peaked in 2008, the largest SPAC, organized by Michael Gross, a founder of Apollo Management, raised $500 million from investors and produced a $1 billion deal.

When the market for IPOs dried up in the credit crisis of 2008, so did the market for SPACs. More than half such companies organized since 2006 failed to find deals within their investment period and had to return investors' money.

By Steve Bills