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Going Public in the US by Merging into a SPAC: Weighing the Pros & Cons

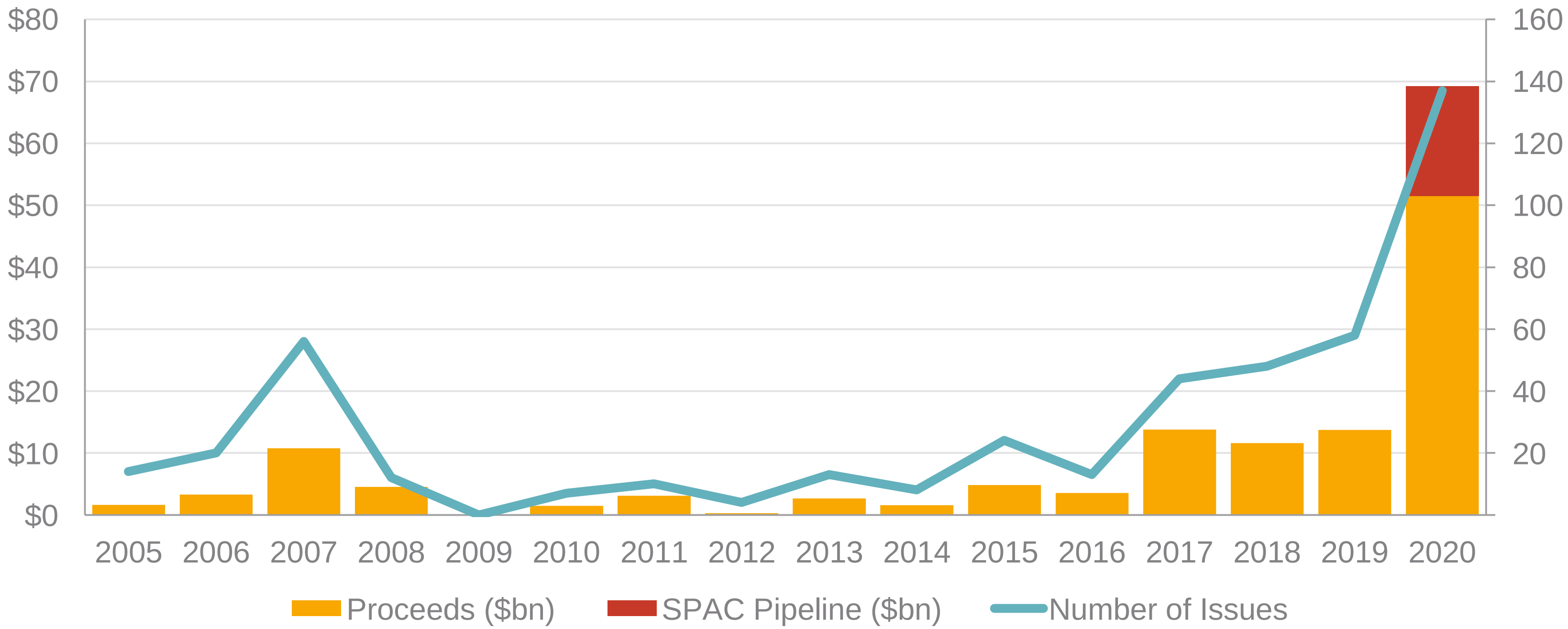
November 2, 2020

SPAC introduction

- What is a Special Purpose Acquisition Company ("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-investors alignment structures

SPACs surge

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

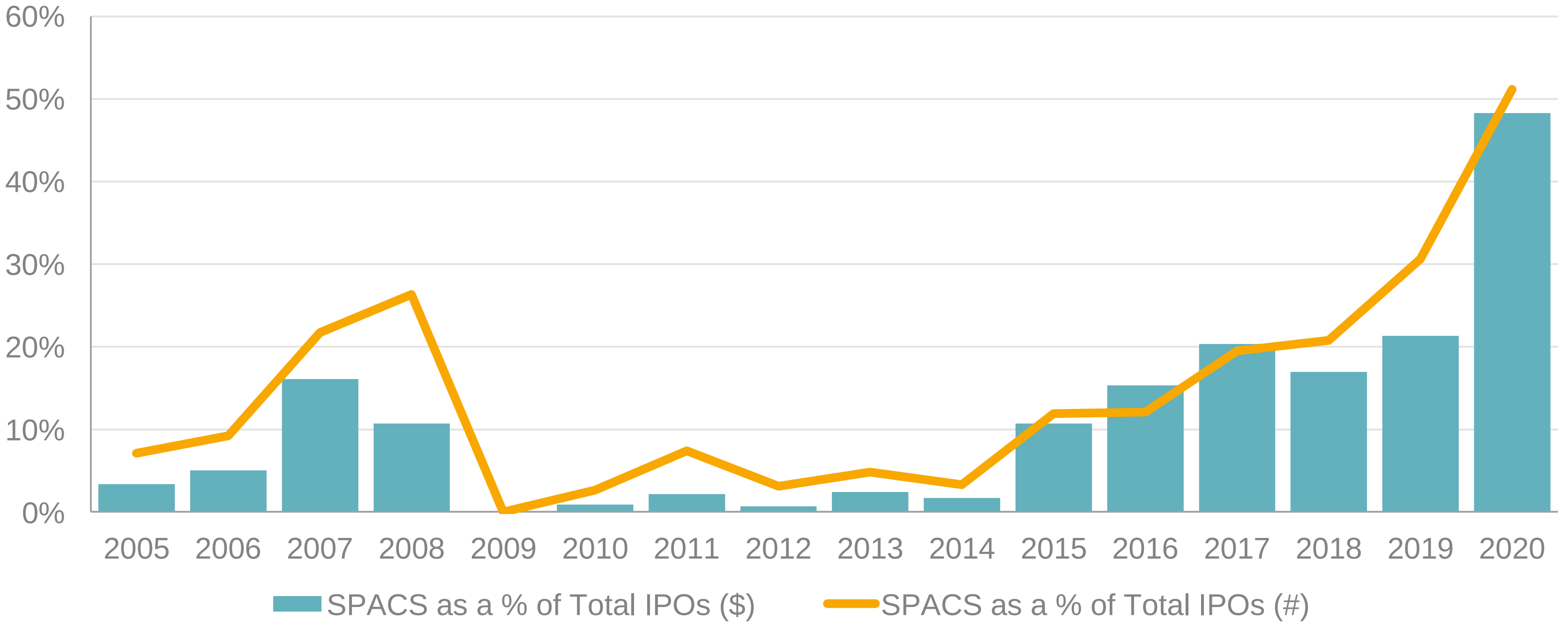


*Excludes deals less than $50m in proceeds

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)*

- Not all SPACs are the same
  - Some are focused on a particular geography or industry
  - Others have no such mandate
- 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"
  - Sponsor receives 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 warrants to fund IPO costs in private placement
  - This is commonly referred to as the "at risk capital"
  - Occurs in conjunction with IPO
- Sponsor generally receives management fees after initial business combination
- SPACs must acquire target within specified timeframe
- Timeframe is typically 18-24 months
- Some SPACs may include an option to extend this deadline

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"
- 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

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

- Post-merger, the target operating company is the surviving entity, and will be a 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

Merging into a SPAC

What are the advantages of merging with a SPAC?

- Merging with and into a 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 required proxy or proxy/prospectus disclosures (similar to what is required for a traditional IPO)
- 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
  - A SPAC may be willing to undertake a transaction with a company that is earlier stage than the typical IPO candidate
- May provide flexibility regarding content and timing of communication
  - Fewer restrictions on business combination discussions than 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 foregoing 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 of securities
  - Investor outreach may not translate into institutional investor familiarity
  - IPOs (and private placements pre-IPO) usually create such relationships
- SPACs incur significant costs and the process for the operating company is no cheaper than an IPO

De-SPACing

De-SPACing

- Process of SPAC acquiring a private company target called "de-SPACing"
- In many respects, similar requirements and processes to a public company merger
  - Letter of Intent ("LoI")
  - Due diligence
  - Merger agreement
- However, there are key differences, such as:
  - Shareholder approval required through proxy statement or proxy/prospectus
  - Redemption opportunity for SPAC shareholders, potentially through tender offer
  - Restrictions post-merger on SPAC holders under securities laws and regulations
  - Greater flexibility (and uncertainty) in purchase consideration
  - Limited recourse if de-SPACing fails

Process overview

- The process from announcement of a definitive agreement (and proxy filing) to close, with multiple rounds of investor outreach, may take between two and five months (*not all that different from an IPO process*)

Step 1: Preparation

- Negotiate LoI
- Draft merger agreement
- Develop investor outreach plan
- Wall cross investors
- Conduct testing the waters
- Initiate private investment in public equity ("PIPE") *(if applicable)*
- Begin proxy preparation

Step 2: Public process

- Execute merger agreement and announce transaction
- Conduct announcement conference call and investor meetings
- File proxy statement with audited financials

Step 3: SEC review and marketing

- Receive and respond to SEC comments
- Continue selective (or broad) investor outreach
- Hold analyst day
- Retain proxy solicitor
- Set shareholder record and vote date
- Mail final proxy (~3 weeks prior to vote)

Step 4: Closing process

- Conduct final roadshow
- Regular calls with underwriters and advisors to track large shareholders
- Tabulate redemption requests (two days prior to vote)
- Hold vote
- Close transaction

Process overview *(cont'd)*

- Timing will depend on the preparation of the proxy statement, the SEC review of the proxy statement, and the response to those comments
- Best practice is to file proxy statement and release investor presentation as soon as possible after announcing the entry into the definitive agreement
- IPO-style roadshow, including the target company's management

Letter of Intent

- Similar to a public merger, first step is typically letter of intent
- The LoI describes the most important elements of the transaction, including:
  - The structure of transaction
  - Price and consideration (earn out or not)
  - Confidentiality and exclusivity provisions
- The LoI is non-binding, but will include some binding terms, such as:
  - Exclusivity agreements, in which the seller agrees not to negotiate a sale with third parties for an agreed period of time
  - Confidentiality agreements
  - Agreements that each party will be responsible for its own transaction expenses

Due diligence

- After LoI, detailed due diligence begins, including but not limited to:
  - Valuation
  - Accounting
  - Legal
  - Tax
- Similar to any acquisition, buyer (*i.e.*, SPAC) usually conducts more due diligence
- Target company should also conduct due diligence on SPAC's sponsor, investors, and potential management structure post-merger

Deal terms

- Because of possible shareholder redemptions, amount available to the SPAC is uncertain
  - Therefore, transaction agreement usually provides flexibility in terms of consideration
  - Purchase price generally calculated on "cash free/debt free" basis with post-closing true-up, rather than fixed purchase price per share
  - Escrow arrangements and earnouts are also common
- Target shareholder consideration usually is a combination of cash and "rollover" equity
  - SPAC sponsors often negotiate for greater "rollover" equity to hedge against cash shortfall due to redemptions
  - Target typically requires "minimum cash" condition and committed additional financing

Deal terms *(cont'd)*

- SPAC transaction agreements generally do not have "fiduciary out" if board of directors changes its recommendation
- Market practice varies with respect to post-closing survival of representations and warranties
  - Some do not survive closing, similar to public company transactions
  - Some deals provide for survival periods for some or all representations and warranties, with recourse to an escrow
  - Representation and warranty insurance becoming more common
- Very limited deal protection
  - Reverse break-up fee from SPAC rare
  - Reimbursement of target's fees and expenses inconsistent

Renegotiation of deal terms

- Despite flexibility of SPAC transaction agreements, closing conditions may not be met. This may occur due to:
  - High redemption levels
  - Inability to obtain alternative financing within permitted parameters
- Parties have two choices in this situation:
  - Terminate agreement
  - Renegotiate transaction terms
- Because SPAC sponsors have a strong incentive to complete deals, renegotiation is more common
- Transaction renegotiation generally takes two forms:
  - Deal made more attractive to certain or all public shareholders to decrease redemptions
    - *Example*: Sponsor may agree to forfeit some founder's shares
  - Target company may agree to waive minimum cash closing condition or accept equity instead of cash, in exchange for target-friendly amendment

Proxy statement or proxy/prospectus

- SPAC must file proxy statement on Schedule 14A
  - If SPAC intends to register new securities as part of transaction, SPAC must also file a proxy/prospectus on Form S-4 (or F-4)
  - The continuing company may be able to qualify as a foreign private issuer (FPI)
- Proxy statement or proxy/prospectus statement must contain:
  - Financial statements of SPAC, target, and any businesses, if any, acquired by target
  - Description of post-transaction company and its management, directors, governance structure, and material contracts
  - Pro forma financial information reflecting proposed business combination
  - Management's discussion and analysis for the SPAC and for target
  - Selected historical data of SPAC and target, including pro forma financial data
  - Comparative per share information, including pro forma per share data
- The type of information that is required of a target company is the same as what would be required if target company were to do an IPO
- The SEC review of the proxy statement and the comment letter process also will be similar to that of an IPO

Proxy statement or proxy/prospectus *(cont'd)*

- There are several aspects of the proxy/prospectus that require close review:
  - The financial presentation for the SPAC target. Often, ascertaining the financial statement presentation requirements may involve judgment, as it may be possible that the target is deemed the predecessor company.
  - For pro forma financials, an assessment also will be required as to which entity is the acquirer, which also requires analysis and judgment.
- The proxy/prospectus will usually contain a discussion of the background of the merger
  - Among other things, this section will provide a discussion of valuation for the target
  - In presenting the valuation, projections will be included
    - These projections should be diligenced; the projections usually also will be shared in a data room or in investor materials with PIPE investors

Indicative timeline: SPAC merger vs. a traditional IPO

	Weeks 1-4	Weeks 5-7	Weeks 8-10	Weeks 11-12	Weeks 13-16	Weeks 17-19
			SPAC merger completed *(week 10)*			**Traditional IPO completed** *(week 19)*
SPAC Merger	• Finalize diligence and negotiations of identified target • Draft merger proxy document • Announce transaction • Conduct deal announcement investor presentation • Finalize merger proxy • File proxy/prospectus with SEC • Valuation established	• Obtain initial investor feedback • Monitor trading dynamics • Receive and respond to SEC comments • Determine transaction timeline • Develop marketing plan	• Perform detailed investor targeting • Begin roadshow • Set record date for shareholder vote • Complete SEC review • Continue investor roadshow • Mail definitive proxy and hold shareholder vote • Tabulate votes and redemption requests • Complete SPAC merger			
Traditional IPO	• Hold org. meeting • Prepare due diligence presentations • Conduct due diligence • Begin S-1/F-1 drafting • Distribute draft legal documents and S-1/F-1 • Draft legal documents	• File S-1/F-1 confidentially with FYE financials • Begin drafting roadshow, analyst presentation and analyst financial model • Finalize legal documents for first filing	• Receive first round SEC comments • Continue drafting roadshow and analyst financial model • Invite bookrunners and co-managers • Host research analyst due diligence session • Bookrunner and co-manager due diligence (with projections) • Refile S-1/F-1 confidentially	• Receive second round SEC comments • Refile S-1/F-1 confidentially • Analysts draft IPO model • Continue drafting roadshow presentation	• Receive third round SEC comments • Finalize S-1F-1/legal documents • Refile S-1/F-1 publicly 15 days prior to launch • Research analyst provides final models • Continue drafting roadshow presentation	• Evaluate market conditions/filing range • Finalize roadshow • Receive SEC clearance and file/print preliminary prospectus • Launch transaction and roadshow • Continue roadshow • Valuation established • Price offering • Closing and settlement

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Are you ready to be a public company?

- In connection with the SPAC process, the management team will need to devote substantial resources to:
  - Negotiating an M&A deal;
  - Diligence related to the SPAC process;
  - Diligence related to the PIPE transaction;
  - Preparing an investor roadshow and doing roadshow meetings for the PIPE first and for the SPAC investors after;
  - Preparing SEC disclosures and financial statements; and
  - Preparing to be a public company
- Immediately upon completion of the SPAC merger, the target will be an SEC-reporting company subject to periodic reporting and corporate governance requirements
  - This means that the target must give thought to corporate governance matters (*i.e.*, composition of board of directors, committees of the board, policies and procedures appropriate for a public company)

Are you going to get the benefits associated with being a public company?

  - The target should consider whether it has undertaken all of the corporate "housekeeping" that is desirable before becoming an SEC-reporting company (*i.e.*, adoption of an adequate stock option plan, formalizing employment agreements, etc.)
  - Finally, if the continuing company qualifies as an FPI, it should consider whether it will rely on home country accommodations available to FPIs
- Consider life post-SPAC
  - Will company have the capital it needs?
  - Can you absorb the costs associated with being a US public company?
  - Is SPAC large enough or is PIPE large enough that the stock will be liquid?
  - Will there be research coverage?
  - The SPAC will have commitments to register the resale of the stock underlying the public warrants, the founder's warrants, the PIPE holders' stock and potentially stock received by target holders. How will it control the volume of stock coming to market?
  - Are you prepared to comply with periodic reporting requirements?

Securities Considerations Specific to SPACs and Former SPACs

Exemption from "blank-check company" status

- SPACs are 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 an escrow account
  - Until the business combination is complete, cannot transfer/trade securities
- Depositing funds into the escrow account is now SPAC market practice
  - However, hindrance to restrict trading, pending transaction completion
  - Documentation for most SPACs allows up to 24 months to complete the initial business combination
- To be deemed a blank-check company, the 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:
  - The SEC requires the issuer to 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.
- It is important to distinguish blank check status from shell company status.

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
    - This is important to consider in connection with the SPAC IPO and also in connection with any PIPE transaction
  - Holders of the SPAC's securities may not rely on Rule 144 for resales until:
    - One year after the SPAC has completed its initial business combination and filed its super 8-K
    - The SPAC files Form 10 information in the super 8-K
    - The SPAC files periodic reports required by Section 13 or 15(d) for the prior 12 months
  - A SPAC cannot become a well-known seasoned issuer (WKSI) until three years have passed since its initial business combination

Emerging Growth Company ("EGC") status

- A SPAC generally will be an EGC as defined in Section 2(a)(19)
- It will remain an EGC until the earlier of:
  - The last day of the fiscal year
    - Following the fifth anniversary of the IPO completion,
    - In which the SPAC has total annual gross revenue of at least $1.07 billion, or
    - In which the 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 the SPAC has issued more than $1 billion in non-convertible debt securities during the prior three-year period
- If, following the initial business combination, the SPAC continues to comply with the above criteria, the SPAC will continue to benefit from EGC status.
- It's important to consider that the private company merging with the SPAC will "lose" some of its time as an EGC by virtue of the SPAC merger since the five-year period will count from the SPAC IPO date.

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 as ineligible issuers
- Therefore, it's important that SPAC roadshow presentations are 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

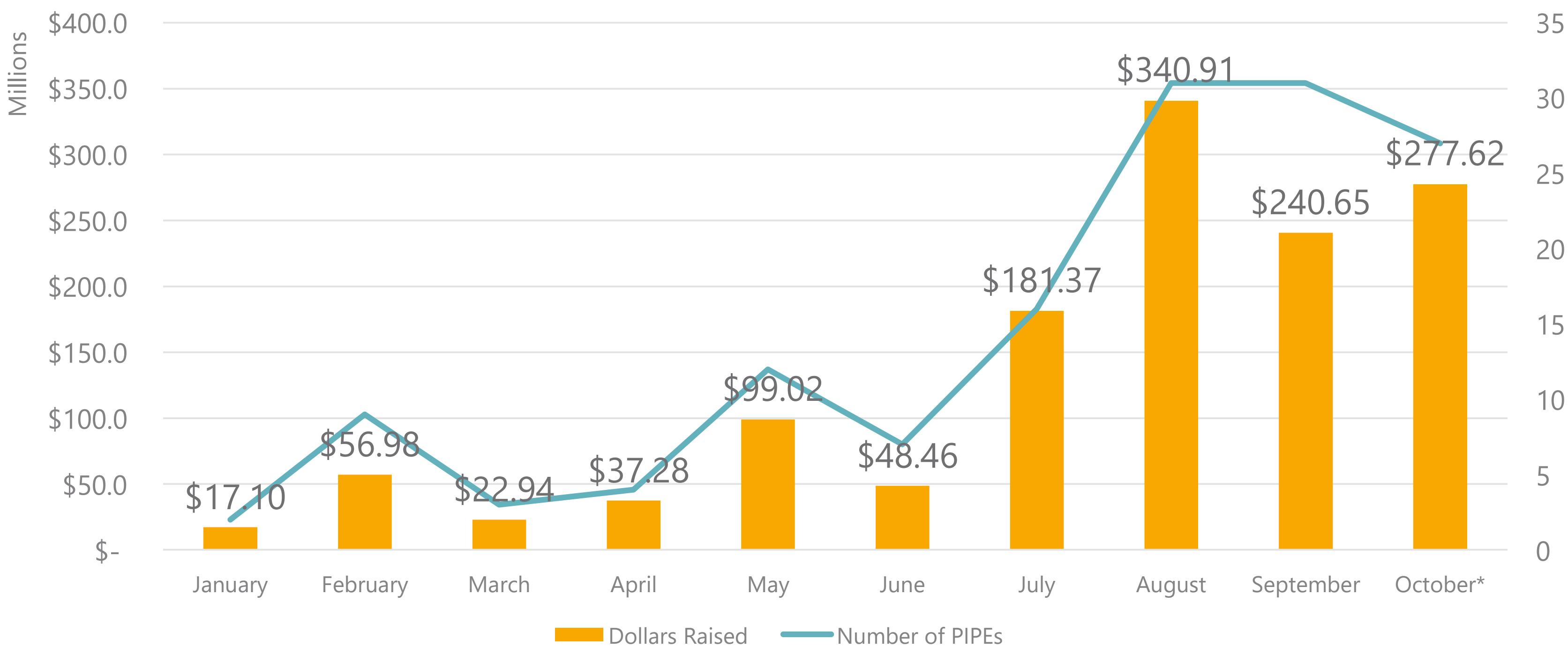
Communications Safe Harbors

- 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 <u>three years</u> after the initial business combination is completed and the super 8-K is filed
- Importantly, SPACs are permitted to rely on Rule 134 for communications announcing an offering

PIPE Transactions

PIPEs issued by SPACs

In 2020, through October 15, there have been 142 PIPE transactions that have raised over $1.3 billion in aggregate.



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Investor outreach

- More often than not, the de-SPAC PIPE transaction will be marketed to prospective investors while the M&A transaction is being negotiated so that both the M&A and PIPE transactions can be announced together
- How will prospective PIPE investors be wall crossed?
  - The "usual" PIPE transaction wall cross script will need to be revised
    - Consider whether the target has any shares that trade, including shares trading on any foreign market or any private secondary market
    - Consider whether trading needs to be restricted in the securities of both the SPAC and the target
    - Consider the length of confidentiality obligation
  - What information will be used to market the deal?
  - Will a cleansing release ever be required?

Investor outreach *(cont'd)*

- Usually, the PIPE transaction will be marketed using an investor presentation that will contain information about the SPAC, information about the proposed M&A transaction and information about target
  - It is essential to consider whether the information that is included in the investor presentation will be either in the proxy/prospectus or whether the investor presentation (or some version of it) will be included in a Form 8-K when the M&A deal is announced
  - Specifically, consider the projections shared in the investor presentation versus the projections disclosure that will be included in the proxy/prospectus

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