Professional Perspective

Staying Nimble in the SPAC PIPE Market

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The special purpose acquisition company (SPAC) market has begun to cool, and with that, private investment in public equity (PIPE) transactions, a financing tool used to facilitate de-SPAC transactions, have also encountered some difficulties. A changing landscape for SPACs calls for an extra measure of flexibility and a willingness to consider alternatives in connection with structuring the accompanying SPAC PIPE transaction.

Below, we explore the changing dynamics of the SPAC PIPE market and summarize a number of common structuring alternatives.

The SPAC Market

Since mid-2020, combining with a SPAC became a popular path for a private company seeking to become public. Usually, the initial business combination, or "de-SPAC," transaction was paired with a capital-raising transaction, which often was structured as a PIPE transaction. The SPAC, which was already a public company, offered and sold shares of its common stock to institutional investors in a private placement transaction usually while the SPAC was negotiating the business combination agreement with the private target company.

The entry into the business combination agreement and the entry into definitive securities purchase agreements relating to the PIPE transaction were announced concurrently. The closing of the PIPE transaction was contingent upon the closing of the initial business combination, but the PIPE purchasers were contractually committed, subject to conditions to closing outside of their control, to purchase the offered securities at the agreed purchase price. The PIPE transaction was intended to provide additional growth capital for the target company to pursue its plans and also served to mitigate the possibility that SPAC investor redemptions would deplete the proceeds in the SPAC trust account.

All of this worked quite well through 2020 and even through most of the first half of 2021. In fact, in 2020, there were 64 de-SPAC transactions completed and another 64 de-SPAC transactions were completed in the first half of 2021; in each case, the majority of these included PIPE transactions.

Changing SPAC PIPE Market Dynamics

So what changed? Beginning late in the first quarter of 2021 and continuing through the second half of 2021, market dynamics changed. PIPE investors began to express concerns regarding the illiquidity associated with their positions in these transactions. As noted above, PIPE investors commit to purchase SPAC securities when the business combination agreements are being negotiated even prior to the business combination transactions being announced and agree to a fixed purchase price.

Early in the resurgence of SPACs in 2020, when de-SPAC transactions were being announced, the market prices of SPACs generally reacted positively to announcements of business combinations. But, as the SPAC market became more crowded heading into 2021, and more complicated by regulatory developments, accounting-related issues, aftermarket performance issues from completed transactions, and other factors, every new deal announcement was no longer assured to result in a stock price bump.

Many PIPE securities purchase agreements contained covenants prohibiting PIPE purchasers from shorting or engaging in other hedging activities prior to closing. Even in the absence of such covenants, PIPE purchasers may have been limited in their ability to undertake many transactions in the subject securities in any event given that the securities that they had committed to purchase were "restricted securities" and that there often was not a liquid market for the SPAC's securities. Given that a PIPE purchaser commits to purchase at a fixed price months in advance of actual funding, it is not surprising that the purchaser often seeks to mitigate its risk by engaging in other open market transactions in the same class of securities.

PIPE purchasers also reacted to the perception that, in some cases, perhaps SPAC sponsors may have been incentivized to "overpay" for target companies to complete initial business combinations given that the interests of SPAC sponsors differ from those of other participants in SPAC transactions.

PIPE investors also must earmark a portion of their fund's capital to a transaction, the timing of which is often quite uncertain. Some de-SPAC processes became quite elongated as SPACs faced long SEC review periods, had to contend with restating financial statements due to changes in the accounting treatment of SPAC warrants, and often had to change the terms of the transactions in order to win shareholder support for their deals.

PIPE purchasers came to observe that they could, in some cases, stay on the sidelines of a deal, see how the market reacted to the announcement of a business combination and buy SPAC securities (that were not restricted securities) in the market. None of this should be read to suggest that SPAC PIPE transactions are no longer important tools in the de-SPAC process—quite the contrary, these transactions remain essential to a successful de-SPAC.

Structuring Successful SPAC PIPE Transactions

Now, however, structuring a successful SPAC PIPE transaction requires a willingness to adapt and be creative. Below is an overview of a number of structuring alternatives designed to lead to a successful de-SPAC transaction.

Minimize Redemptions

An initial area of focus often relates to minimizing redemptions, a process that allows investors to get back their money at the SPAC IPO price. The SPAC sponsor or its affiliates may consider offering a portion of their common stock or warrants to the SPAC's existing shareholders to obtain a commitment from them to refrain from exercising their redemption right.

Alternatively, the SPAC sponsor might consider offering a cash payment to the SPAC shareholders as an inducement in exchange for a non-redemption guarantee. The offer could be made to SPAC shareholders or may be limited to holders that own at least a certain number of shares, holders that accept the offer by a certain date or on a “first come, first served” basis—up to a certain number of shares or up to a specified dollar amount.

Reverse Redemption Decisions

If the redemption rights have already been exercised, the SPAC sponsor may instead offer the cash payment to the SPAC's redeeming shareholders in exchange for an agreement to reverse their redemption decision. This option may be difficult to implement as the redemption elections will need to have been made within a narrow window and that leaves the parties with limited time to pursue a reversal.

However, this option does allow the parties to know the exact number of redeeming shareholders to pursue, and therefore, to make a more targeted offer. Importantly, the SPAC is unable to issue additional securities that would vote on the business combination and the holder of the securities cannot receive a cash payment from the SPAC's trust account. Any cash payment made to the SPAC's shareholders must come directly from the SPAC sponsor or its affiliates.

Obtain a Backstop Commitment

Another option to mitigate the risk of shareholder redemptions would be for the SPAC sponsor to enter into a backstop agreement to support the overall transaction. The agreement commits the sponsor to a financial backstop against some or all shareholder redemptions.

Alternatively, the SPAC itself could obtain a loan commitment that functions as a financial backstop to offset a significant number of redemptions. For example, as part of the Aurora Acquisition/Better initial business combination, the SPAC's sponsor not only provided a financial backstop to shareholder redemptions, but also provided a financial backstop to a portion of the SPAC PIPE transaction.

The financial backstop is often structured to allow the provider the option to purchase shares in the open market or in private transactions at a price per share that is lower than the redemption price. The backstop provider is often also given the opportunity to purchase shares directly from the SPAC if the SPAC shareholders have already elected to redeem.

Recently, certain unaffiliated financial intermediaries have agreed to act as backstop providers and take principal risk resulting from their direct share purchases in exchange for a fee. The company would be obligated to register the purchased shares for resale following the consummation of the de-SPAC transaction. The backstop provider would then have the option of either reselling the shares into the public market or continuing to hold the shares for a longer period of time.

Target Shareholders Reduce Cash Consideration

Another alternative would be for the target company's shareholders to reduce their cash consideration in an amount that equals the shortfall resulting from the SPAC shareholder redemptions. The ownership percentage of the target company's shareholders in the combined company would proportionally increase as a consequence. This adjustment could be made mandatory and incorporated into the business combination agreement or the adjustment be made at the discretion of both parties following the announcement of the initial business combination.

Target Conducts Private Placement

Another alternative gaining popularity is for the target company to conduct its own private placement. This is not a PIPE transaction, but rather a mezzanine or late-stage pre-IPO private placement, or a “bring your own private placement” in effect. The target company completes a private placement with institutional investors, while negotiating the initial business combination agreement with the SPAC, but the private placement is not contingent on the de-SPAC. Given it is a private placement undertaken by a private company, it is not a “PIPE” transaction.

Presumably, institutional investors and cross-over investors are interested in the target company on its own, whether or not it pursues the SPAC, and are willing to bear the risk that the business combination with the SPAC may not come to fruition. However, the private placement does provide additional capital for the target company to pursue its growth strategy should the de-SPAC transaction proceed, regardless of SPAC shareholder redemptions.

Reprice or Restructure SPAC PIPE Transactions

Beginning in late 2021, a significant number of SPAC PIPE transactions have been either repriced or restructured. Pursuing the repricing option often requires the SPAC sponsor and its affiliates to forfeit a portion of its equity position. Additionally, the participation of SPAC sponsors, affiliated entities, directors, and officers in SPAC PIPE transactions has increased significantly. Commitments by these related parties have been made to help bolster confidence in the overall transaction and to signal an alignment of interests between the related parties and the PIPE investors.

A restructuring of traditional SPAC PIPE transactions typically involves the issuance of warrants or of a convertible security instead of, or as a supplement to, the common stock offered in the SPAC PIPE transaction. Alternatively, certain SPAC initial business combination transactions have been restructured to include a forward purchase agreement.

In a forward purchase agreement, affiliates of the SPAC sponsor or institutional investors commit to purchase the SPAC's shares at the closing of the business combination to the extent additional funds are necessary to meet the transaction's minimum cash condition. The forward purchase commitment is often subject to approval by the forward purchaser or structured to be exercised at the forward purchaser's option.

SPAC Issues Convertible Debt Securities

Lately many SPACs have chosen to issue convertible debt in order to provide investors with both a certain defined return and some upside from the equity conversion feature. Conditioned on the combined company having a certain minimum amount of cash at the business combination's closing, convertible debt is typically issued with a five-year term. Convertible debt has interest ranging from 6% to 7%—frequently payable in-kind or in cash at the company's option, a conversion price of $11 to $12.50 per share—or an adjustable conversion price based upon the trading price of the company's common stock, and an interest make-whole payment in cash—providing the holder with a specified guaranteed return.

The convertible notes issued in the 890 Fifth Avenue/BuzzFeed business combination also included a step-up rate of 8.5% if the amount in the SPAC's trust account fell below a certain minimum dollar amount at closing of the initial business combination. The terms of the convertible debt often also limit the ability of the company to issue additional debt following the consummation of the business combination.

Offer of Perpetual Convertible Preferred Stock

Instead of issuing convertible debt, the SPAC may offer investors an option to purchase perpetual convertible preferred stock in addition to the common stock issued as part of the PIPE transaction. Compared to convertible debt, the preferred stock typically bears a lower dividend rate, a higher conversion price and a mandatory conversion requirement. The preferred stock is mandatorily convertible into common stock after a certain period of time assuming the trading price of the company's common stock reaches a certain price threshold.

Issue Warrants, Shorten Lock-Up Restrictions & Other Options

Other SPACs have chosen to issue warrants, together with the common stock sold as part of the PIPE transaction, to provide investors with additional equity upside. For example, warrants with an exercise price of $20 per share were issued in the CF Acquisition/Satellogic business combination for each share of common stock purchased in the PIPE transaction at no additional consideration so long as the recipient agreed to a two-year lock-up restriction.

In other recent transactions the length of the lock-up restriction has been as short as 90 days following the business combination's closing. Some SPACs have issued warrants with minimal or no additional consideration to provide the recipient with downside protection in the event that the common stock trades below the $10 per share purchase price prior to the effectiveness of the PIPE investor's resale registration statement. The terms of the warrants typically follow those of the SPAC's outstanding publicly issued warrants and include an option for the company to redeem the warrants for a nominal amount so long as the trading price of the company's common stock exceeds a certain price threshold.

Instead of issuing additional securities to the PIPE investor, the SPAC may choose to offer the PIPE investor the option to offset its purchase obligation against shares that such investor acquires in the open market assuming the investor also makes a non-redemption commitment with respect to those shares. This may be a particularly attractive option for those investors in SPACs that have common stock trading below the $10 purchase price as it would partially mitigate the investor's price risk between the transaction's public announcement and the initial business combination's closing.

The SPAC sponsor and target company shareholders may consider contributing shares in order to provide some assurance to PIPE investors. For example, in the InterPrivate/Aspiration Partners business combination, PIPE investors were given the option to receive temporary post-closing price protection from pre-existing target company shareholders in exchange for a commitment to extended anti-hedging covenants. This protection, if effected, would be fulfilled by a reallocation of escrowed secondary shares from target company shareholders and would result in a change to the company's pro forma share count.

Lastly, SPAC PIPE investors are often focused on the timeline to liquidity. In the PIPE transaction's subscription agreement, the SPAC agrees to file a registration statement that will cover the resale of the PIPE investor's shares within a month of the initial business combination's closing. To expedite the SEC review process, the SPAC may consider filing the PIPE investor's resale registration statement to address SEC comments in advance of the business combination's closing. Moving this timeline up would allow the company to be in a position to obtain effectiveness of the resale registration statement on behalf of the PIPE investors as soon as possible following the transaction's closing.

Conclusion

Given the recent market volatility, the changes to the economic terms for SPAC sponsors in recent SPAC IPOs, and the likelihood of regulatory change related to SPACs, we can be certain that we will continue to see evolution in the terms of SPAC PIPE transactions in the months ahead.