masuda funai

News & Types: Client Advisories

SPACs – Impact on Strategic Investors

7/27/2021

By: Benjamin F. Gould, Jennifer R.M.C. Watson, Gregory M. Wright

Practices: Corporate, Finance & Acquisitions

A lot has been reported on Special Purpose Acquisition Companies ("SPAC") and their revived use to raise money through an initial public offering ("IPO"). There were 248 SPACs started in 2020 raising approximately $83 billion. As of the beginning of June 2021, approximately 430 additional SPACs were started raising over $100 billion. The use of SPACs does not appear to be slowing down.

However, there are concerns that investors receive less value for their investment that they could make elsewhere and that SPAC sponsors are receiving more profits than are warranted. This article does not take a position on these controversies, instead focusing on consideration of the impact SPACs have on strategic acquirors.

BACKGROUND:

A SPAC is a shell corporation that has no business other than to find a target to acquire and merge taking the target public. Investors in a SPAC do not know what business they will ultimately be investing in.

Sponsors that start the SPAC typically make a nominal investment (typically a combination of stock and warrants) but own about 20% of the SPAC. The funds from the sponsors are used to finance the IPO and for working capital purposes. Sponsors may be private equity or a group of experienced executives.

The investment in the IPO by investors is usually placed in escrow until the target is identified and the merger is approved by stockholders or if liquidation occurs because a merger with a target was not completed in required time frame.

Typical SPACs have 18 to 24 months to locate a target and close the transaction (merge with the target) taking the target public ("DeSPAC").

What makes SPACs attractive is that they provide a route to take the target company public without some of the pricing variations that occur with regular IPOs. The value of the target is agreed upon between the SPAC and the target. Investors in the SPAC that do not agree with the proposed merger may receive their investment back. Investors also have the right to approve or reject the merger with the target.

There are arguments on both sides that SPACs are fair/unfair to investors and sponsors. For some SPACs, the management team sponsors have a track record of success in the industry and bring incredible value to the SPAC resulting in the nominal investment for 20% of the SPAC to be a good deal for investors. However, some SPACs have been scrutinized for the 20% the sponsors receive for their nominal contribution as compared with the investors cash making the DeSPAC possible. As competition of SPACs continue, one could

©2021 Masuda, Funai, Eifert & Mitchell, Ltd. All rights reserved. This publication should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended solely for informational purposes and you should not act or rely upon information contained herein without consulting a lawyer for advice. This publication may constitute Advertising Material.

foresee SPACs competing for investment by reducing the sponsor ownership level or increasing the price paid by sponsors for their 20% in order to attract investors.

Strategic investors, particularly foreign strategic investors, usually have a longer timeline for due diligence and tighter valuations for a target than private equity. Strategics usually know the business inside and out and want to really evaluate if the target will fit within their organization. This results in longer due diligence timelines. With the onslaught of SPACs, strategic investors will have even more competition for targets. Thus, strategic investors will need to revise their timeline for due diligence, bidding and closing on a transaction. Valuations may differ between bidders for a target, but the biggest issue we see is the ability of private equity and SPACs to move quickly on a transaction that their management deems a good investment compared to strategic investors that take more time to conduct due diligence. Price can usually be agreed upon, but the timeline, particularly if the target is a United States business, will need to move quickly.

Foreign strategic buyers should understand that most sellers, private equity and SPACs at the negotiation table will have broad authority and be able to make decisions on the spot. To increase the likelihood of a successful purchase, strategic investors need to pick a team of their top management to conduct the transaction and empower the team, up to a certain financial amount, to make decisions without needing to go back for approval for various stages of the negotiations. Closing the transaction can be conditioned on final board or stockholder approval just as SPACs need to obtain. However, strategic investors must be prepared to call a special meeting of the board of directors or stockholders to vote on the approval of the closing of the transaction.

For additional information, please contact one of the authors or a member of Masuda Funai's Corporate, Finance & Acquisitions Practice Group.

©2021 Masuda, Funai, Eifert & Mitchell, Ltd. All rights reserved. This publication should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended solely for informational purposes and you should not act or rely upon information contained herein without consulting a lawyer for advice. This publication may constitute Advertising Material.