

## The Question on Everyone's Mind Is there still a SPAC market?

BY DOUGLAS S. ELLENOFF

**D**espite 173 completed SPAC financings and 57 completed SPAC acquisitions over the course of the last five years, the question has arisen: Does a SPAC market remain? This year has certainly been challenging for SPACs, with sponsors and underwriters using creativity and persistence to raise capital or close a proposed business combination. Is the current slowdown a reflection on SPACs as a financing mechanism or a result of the overall condition of the stock market and general decrease in liquidity?

In 2007, more than 70 SPAC financings raised \$10 billion, but there have been only 17 (including two Euronext listings) in 2008. Most have been Asia-focused, with notable exceptions from Germany<sup>1</sup>, a larger Euronext listing (nearly \$400 million), and Navios Maritime (\$253 million), a shipping SPAC.

After the first quarter, the pricing of IPOs was difficult for sponsors, with more money having to be invested in the concurrent private placements. Thus, the capital being held in trust went from around 85% to nearly 100%, and challenges were made to the commonly accepted 20% sponsor promote convention.

Notwithstanding, recently funded SPACs have maintained the conventional approach. This is particularly curious given the critical analysis of the dilutive impact of this structure at the time of the SPAC acquisition and the suggestions that this should delay private business owners from selling to a SPAC. The market response to this concern has been a focus on acquisition candidates that are high-growth opportunities in need of the additional capital afforded by the warrant overhang—and not the more conservative, private equity-like companies promoted earlier in the year.

Of the 173 funded SPACs, 57 have con-

summated their proposed business combinations; 24 have announced their proposed deals and are awaiting stockholder approval; 60 continue to seek appropriate partners (keep in mind that many of these are less than a year into their lifecycles); and 20 have liquidated. Fourteen of the 20 liquidations occurred this year.

The increase in SPAC liquidations is a reflection of many factors, only one of which is whether the proposed business combination is an attractive acquisition candidate. In certain cases, the original SPAC investor simply wants to be cashed out (the fund investor may be under pressure from its own redemptions) and has no interest in supporting even a “good” proposed business combination.

In other cases, particularly since the beginning of the year, sponsors have also been hearing from their investors that their 20% promote must be reduced if the proposed business transaction is going to be approved. Sometime this is justified if the pro forma projections of the proposed business opportunity isn't significant enough to justify the deal's dilution, and in other cases it's simply because the investors believe that the sponsor is obtaining too much of a benefit.

The means by which the sponsor's interest is reduced has changed from a year ago, when certain limited investors would receive the benefits of the sponsor transfer in order to give back to the SPAC itself—indirectly benefiting the remaining investors—or to transfer a portion of the promote to induce new investors to buy out old ones.

Reducing the sponsor's economics in the proposed business combination is just one of several ways in which sponsors have sought to secure the approval of their business combination. Keep in mind, though, that even with the difficulties of the current market and contrary to most SPAC observers' beliefs, several proposed

business combinations have been approved with the sponsors retaining 100% of their original economics.

In situations where the market has not responded positively to the proposed business combination, sponsors have implemented various initiatives to obtain stockholder approval. The most successful of these mechanisms has been the introduction of a self tender offer, whereby the SPAC utilizes either excess trust funds or new capital from a simultaneous financing to re-acquire stockholder shares at a modest premium to the amount held in trust.

The tender offer is specifically conditioned upon the approval and closing of the proposed business combination. This technique has been used successfully in several recent deals and seems to be gaining in popularity, but it does presuppose that there are sufficient excess funds available to accommodate the investors who desire to transition.

Though there has been a dramatic slowdown in IPO activity that has caused many SPACs to liquidate in 2008, we believe that the SPAC market is merely maturing. The stresses that have been emerging in the program since 2003 are becoming more apparent amid unsympathetic market conditions, but it's also fair to say that the nature and objectives of the underlying stockholder base have been equally dynamic.

A deeper look at the underlying data continues to suggest an improving quality of SPAC sponsors, underwriters, and proposed business combinations. Through the difficult lessons of the past 12 months, the class of 2007 and 2008 and their advisors should appreciate the type of transaction and structure that SPAC investors will support and approve.

We are confident that many of the SPAC acquisitions getting completed will perform well and reflect favorably on the SPAC market and program—and yes, it will remain as a viable financing mechanism. **E**

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