THE EXPLOSION OF SPACS – WHAT PRIVATE EQUITY WANTS TO KNOW

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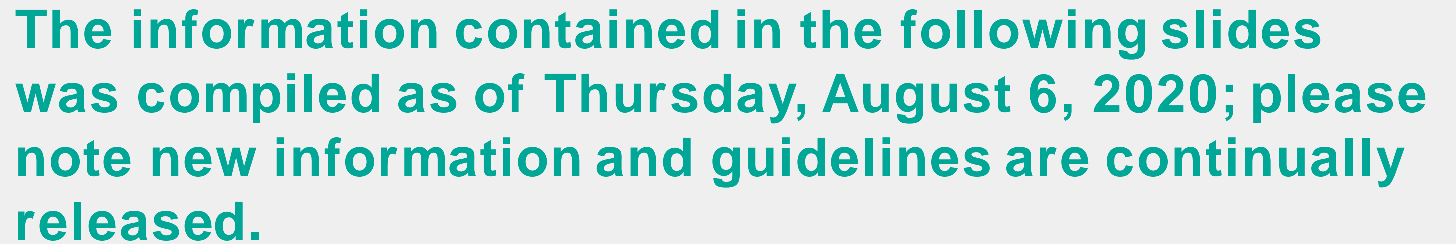

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NOTE REGARDING Q&A

Please use the Q&A feature in the Zoom window to submit questions for the panel. Questions answered during the call will not be attributed to the participant who submitted the question. In the event we are unable to address all questions due to time constraints, we will follow-up with you after the webinar.

Thank you for attending today's presentation!

AGENDA

- What is a SPAC?
- Capital Structure of a SPAC
- Rising Appeal of SPACs in Today's Volatile Markets
- Challenges to Using SPAC Vehicle
- Today's SPACS Utilize Additional Financing Structures to Increase Success
- Forward Contract Arrangement / Financial Backstop / PIPEs
- Private Equity Involvement with SPACs Increase SPACs' Success
- As a Private Equity Sponsor
- As a Provider of Forward Contract or Financial Backstop Commitment
- As an Investor to Extend the Life of a SPAC
- Exit Opportunities for a PE Portfolio Company Target of a SPAC
- Navigating Potential Conflicts
- SPAC Mechanics
- SPAC IPOs in 2019 and 2020

WHAT IS A SPAC?

- Blank-check company formed to acquire a business.
- Formed by “sponsor teams” with target industry experience or private equity shop demonstrating success in identifying, acquiring and operating growth businesses in that industry.
- SPAC raises money through public IPO with the proceeds placed in trust only to be used for an acquisition.
- SPAC has generally up to 2 years to complete business combination, which allows SPACs time to identify targets.
- If public investors don’t like an acquisition target, public investor shares in SPAC are redeemed from the trust.

CAPITAL STRUCTURE OF A SPAC

- Sponsor purchases “founder shares” representing 100% of the total SPAC equity prior to an IPO for a nominal amount (typically between $25,000 and $50,000). This results in the Sponsor having 20% of total issued and outstanding shares following the IPO.

- Sponsor also purchases “founder warrants” which represent the “at risk capital” of Sponsor: typically equal to the upfront underwriting discount (2% of gross IPO proceeds) generally approximately $1 million to cover offering expenses and post-IPO working capital.

- SPAC IPO investors purchase units comprised of one share of common stock and a generally a fraction to one whole warrant to purchase a share of common stock in the future. After the IPO, the units split and the stock and warrants trade separately. Some recent SPACs have no warrant coverage.

RISING APPEAL OF SPACS IN TODAY'S VOLATILE MARKETS

- Minimal downside risk for SPAC public investors
  - Investment redeemed if SPAC fails to complete an acquisition or investor elects to redeem if they do not like the business combination.
  - SPAC investor also receives warrant coverage so has increased upside potential.
  - Target timeline of a SPAC allows investors to wait out a correction in the public markets without risk.
- Attractive to targets who want to go public but prevented due to market conditions.
  - Allows rollover sellers.
  - Permits capital infusion in the company along with potential exit strategy for target investors.
  - Emerging growth company status—less disclosure obligations.
  - Opportunity to go public faster versus the traditional IPO path.
- Market conditions could lower valuations of private companies creating acquisitions opportunities.

CHALLENGES TO USING SPAC VEHICLE

- Timing and deal uncertainty.
- Target's desire of certainty of closing.
- Redemptions can lower market float threatening surviving company's ability to continue trading on stock exchange.
- Target transaction with SPAC requires more disclosures and financial information due to SEC process than sale to private equity company.
- The above challenges can cause targets to discount SPAC bids.

TODAY'S SPACS UTILIZE ADDITIONAL FINANCING STRUCTURES TO INCREASE SUCCESS

- Capital infusion or continued investment in the target by the sellers and/or Sponsor show confidence in the valuation of the business combination.
- Cash infusion into target creates certainty of availability of cash consideration and confirms that that the equity value of the SPAC post-business combination will be greater than the redemption price (thus discouraging redemptions).
  - Financial commitments to provide additional cash to cover need for additional funds from reasons including:
    - Capital needed to extend life of SPAC, if necessary
    - To address cash shortfall in trust to address potential stockholder redemptions
    - Target acquisition agreement mandates minimum cash amount to satisfy closing condition

FORWARD CONTRACT ARRANGEMENT / FINANCIAL BACKSTOP / PIPES

- Typically these arrangements provide mechanisms by which the SPAC can require additional capital infusion from the Sponsor or from a third party.
- **Forward contract arrangement:** In a number of SPAC transactions, affiliates of the sponsor or outside investors enter into forward purchase agreements with the SPAC where they commit to purchase equity of the SPAC in the event additional capital is necessary to complete the De-SPAC transaction. These forward purchase commitments are often conditioned upon the De-SPAC transaction satisfying the investment mandate of the investor.
  - Sponsor and/or its affiliates of the SPAC agree on or before the IPO to a forward contract arrangement to commit additional funds. These commitments are generally conditional obligations.
- **Financial backstop:** In order to protect SPACs against redemption risks, many SPACs also receive a “financial backstop”, which can come in the form of sponsor contribution, debt, or outside third-party investor.
  - Sponsor, affiliates, and/or third parties agree post-IPO to a backstop arrangement to commit additional funds. These commitments are generally conditional obligations.
- **PIPEs:** SPACs may also raise additional capital to finance a portion of the purchase price for the business combination through offerings known as private investment in public equity, or PIPEs.
- *Risk*: Forward contracts and backstop obligations are conditional, and therefore provide a lower risk profile than the original sponsor investment.

PRIVATE EQUITY INVOLVEMENT WITH SPACS INCREASE SPACS' SUCCESS

- As a sponsor to SPAC.
- As a provider of a forward contract or financial backstop commitment to SPAC.
- As a lender to extend the life of SPAC.
- As a portfolio company target of SPAC.

AS A PRIVATE EQUITY SPONSOR

- As Sponsor to SPAC:
  - Private Equity obtains access to public markets, allowing Private Equity to go beyond their traditional limited partner base to raise capital.
  - Enables Private Equity sponsor to invest in an industry or type of investment that it would otherwise be restricted or prohibited from under its relevant limited partner agreements.
- Sponsor retains 20% of the post-IPO SPAC providing an outright ownership percentage that increases the potential upside in the post-business combination, which allows Private Equity sponsor the opportunity to achieve Private Equity type returns.
- *Risk*: Sponsor faces risk of losing entire SPAC investment if no transaction is consummated by the deadline (no De-SPAC event), potential reputational damage and diversion of focus.

AS A PROVIDER OF FORWARD CONTRACT OR FINANCIAL BACKSTOP COMMITMENT

- By entering into a forward purchase agreements or financial backstop commitment, Private Equity funds have the opportunity to participate in the SPAC prior to the business combination without putting its capital or resources at risk upfront. While these roles have historically been filled by SPAC sponsors, the market is starting to see sponsor affiliates or outside third party funds/investors enter into these financing arrangements.
- **Forward Purchase Agreement Example:** Longview Acquisition Corp. entered into a forward purchase agreement with Glenview Capital Management for $150M. Pursuant to the terms of the forward purchase agreement, the $150M commitment is subject to a downward adjustment in the event the total assets of the SPAC fall below a certain threshold.
- **Financial Backstop Example:** Pivotal Acquisition Corp. (PVT) secured $100M backstop commitments from both the Ontario Teachers' Pension Plan and MGG Investment Group, LP to fully secure the SPAC.

AS AN INVESTOR TO EXTEND THE LIFE OF A SPAC

- In the event a business combination is not expected to close prior to the deadline, the SPAC can seek shareholder approval to extend the deadline. The SPAC must determine (with advice from its underwriter) as to the amount of funds needed to offer shareholders in order to minimize the amount of funds redeemed from the trust.

- These extension investors typically receive founder stock from the sponsor team in consideration for their lending funds to the SPAC.

  – Example: Earlier this year, Big Rock Partners Acquisition Corp. filed its fifth extension since its IPO in 2017 to extend its De-SPAC deadline. In connection with the extension, Big Rock will contribute $0.02 to the trust account per month for each public share that did not redeem.

- *Risk*: Acting as a late-stage investor to extend the life of a SPAC can present substantial risk to the extension investor as the shares become worthless and the loan is never repaid if a deal is never consummated. This risk is reduced if there is an actual target transaction announced.

EXIT OPPORTUNITIES FOR A PE PORTFOLIO COMPANY TARGET OF A SPAC

- Allows portfolio companies to achieve cost savings compared to traditional IPO.
- Access to public markets and the ability to go public during periods of market instability.
- Allows for alternative exit opportunity for private equity backed companies.
- Access to capital to fund operations and growth.
- Ability for existing owners of company to share meaningfully in future growth with stock rollover that may not be available in a traditional exit.
- SPACs are a great way to bring in seasoned management teams to growing companies.
- *Risk*: Private Equity sellers face the risk of deal uncertainty resulting from the potential for the SPAC having insufficient funds to meet its purchase price obligations. The target company financials and other confidential information will become public upon initial Form S-4 merger proxy and the target will incur various attorney and legal fees, regardless of whether or not the transaction is consummated. At least two years of audited financials are typically required.

NAVIGATING POTENTIAL CONFLICTS

- Conflicts of interest for private equity funds can arise in several different situations in a SPAC:
  - Fund sponsors face potential conflicts with respect to doing entering into business combinations with affiliates of their existing funds. These potential conflicts are commonly addressed in the SPAC prospectus where the SPAC agrees not to consummate an initial business combination with any entity affiliate with any SPAC sponsors, officers of directors.
  - Fund sponsors face potential conflicts with other existing funds. Partnership agreements will often have limitations around the ability of sponsors to raise successor or competing funds. These potential conflicts are also addressed in the SPAC prospectus where the SPAC commonly discloses that officers and directors of the sponsor have a duty to offer certain acquisition opportunities to other affiliate funds before the SPAC can pursue such opportunity. These potential conflicts of interest are also often times naturally mitigated by the differing nature of acquisition targets considered attractive by a SPACs v. a typically private equity fund transaction.

SPAC MECHANICS

- SPAC conducts typical IPO registration process with the SEC followed by firm commitment underwriting. Timing is typically 45-60 days, substantially shorter than a regular IPO. Also an abbreviated roadshow.
- IPO gross proceeds held in trust account to be released only in business combination or to redeem SPAC investor shares at end of SPAC life.
- SPAC typically has 18-24 months to complete a business combination.
  - Under stock exchange rules, target business or assets must have an aggregate fair market value of at least 80% of the assets held in the trust account.
- Following the execution of a business combination definitive agreement, SPAC shareholders vote on business combination pursuant to a Form S-4 proxy statement.
- If business combination is approved by shareholder vote and all other transaction conditions are met, the SPAC and target business will combine into a publicly traded operating company and SPAC shareholders have right to have their shares redeemed from the trust on a per-share, pro rata basis.
- If SPAC fails to complete business combination by its deadline (and any extension thereof), then the SPAC is liquidated.

SPAC IPOS IN 2019 AND 2020

- In 2019, SPACs raised $13.6 billion from 59 IPOs.
  - 23.6% of the 250 U.S. IPOs priced in 2019.
- In 2020, SPACs have raised $21.8 billion from approximately 55 IPOs.
- Majority of SPAC IPOs are in the $200-999M range with top end of range growing.
- Approximately 100 current SPACs seeking acquisitions.
- Across a multitude of industries, including healthcare, technology, cannabis, real estate, biotech, and oil & gas, etc.
- There have been more than 27 SPAC business combinations announced and approximately 55 SPAC IPOs filed in 2020.

MOST RECENT SPAC IPOS

SPAC	Amount Raised	IPO Date	Industry	SPAC Life	Unit	Additional Funding Commitment
Health Sciences Acquisitions Corp. 2 (HSAQ)	$139.2 million	8/4/20	Biopharma & Medical Technology	24 months	Common Share (no Warrant)	None
NewHold Investment Corp. (NHICU)	$150 million	7/31/20	Industrial Technology	24 months	Common Share and 1/2 Warrant	None
E.Merge Technology Acquisition Corp. (ETACU)	$522 million	7/31/20	Software & Internet Technology	24 months	Common Share and 1/3 Warrant	None
Churchill Capital Corp. IV (CCIV.U)	$1.8 billion	7/30/20	General	24 months	Common Share and 1/5 Warrant	None
RedBall Acquisition Corp (RBAC.U)	$500 million	“announced”	Sports, Media & Data Analytics	24 months	Common Share and 1/3 Warrant	Sponsor Affiliates RedBird Series 2019, LP and RedBird Series 2019 GP co-Invest, LP have agreed to purchase an aggregate of $100M of common stock that will close simultaneously with the initial business combination

Note: These transactions all contemplated an upfront discount of 2% and a deferred underwriting commission of 3.5% in the event a business combination is consummated.

ANNOUNCED DE-SPAC TRANSACTIONS

SPAC	Valuation	IPO Date	Target Company	Industry	SPAC Life	Unit	Additional Funding Commitment
CF Finance Acquisition Corp. (CFFA)	$2 billion	12/2018	GCM Grosvenor	Investment/ Advisory	18 months. Extension was approved.	Common Share and 1 Warrant	Sponsor committed to a forward purchase agreement
FinTech Acquisition Corp III (FTAC)	$1.3 billion	11/2018	Paya Inc.	FinTech	24 months.	Common Share and ½ Warrant	SPAC received a backstop commitment and debt financing
DiamondPeak Holdings Corp. (DPHC)	$965 million	3/2019	Lordstown Motors Corp.	Automotive	24 months	Common Share and 1/3 Warrant	$500 million in fully committed PIPE financing
PropTech Acquisition Corp. (PAC)	$523 million	11/2019	Porch.com	Tech/Real Estate	12 months	Common Share and ½ Warrant	$150 million in fully committed PIPE financing
Arya Sciences II (ARYB)	$445 million	6/2020	Cerevel Therapeutics	Neuroscience	24 months	Common Share and 1/3 Warrant	$320 million in fully committed PIPE financing

Note: With the exception of FinTech Acquisition Corp III, which contemplates an upfront discount of 2% and a deferred underwriting commission of 5%, these transactions all contemplated an upfront discount of 2% and a deferred underwriting commission of 3.5%.

QUESTIONS?

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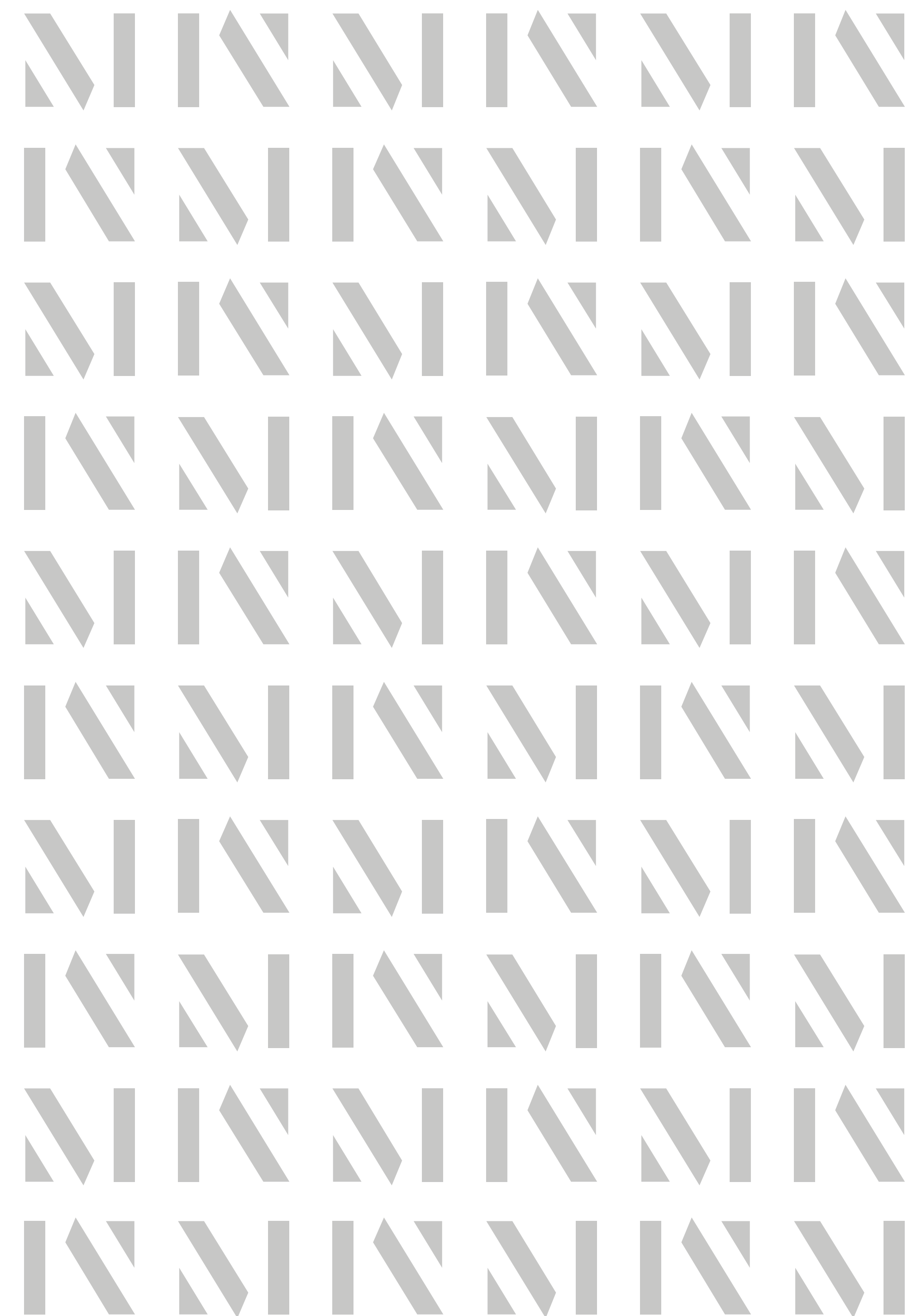

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SAVE THE DATE

What Private Equity Wants to Know About PIPEs

Thursday, August 20, 2020

SURVEY

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