Navigating the SPAC Explosion: Target Company Considerations When Contemplating a Sale to a SPAC

When the COVID-19 pandemic hit, the slowdown in mergers and acquisitions (M&A) was widespread. But as deal activity reemerged, one structure saw a resurgence beyond all expectations: special purpose acquisition companies (SPACs).

SPACs, sometimes called "blank check companies," are formed with the goal of raising capital through an initial public offering (IPO) to acquire one or more unspecified businesses. The SPAC sponsor has a deadline by which they must complete a deal—or a de-SPAC transaction—which is typically within two years after the IPO. The capital raised is placed in trust, and if an acquisition is not made by the deadline, capital and interest is returned to investors.

For companies considering going public via an IPO, a SPAC can provide an alternative path that avoids much of the tedious roadshow activity and regulatory hurdles/constraints associated with the IPO process. However, SPACs are generally more dilutive than IPOs due to SPAC sponsor "promote" equity and warrants but can also provide flexibility when it comes to deal structure.

2020 brought 248 SPAC IPOs, 64 de-SPAC business combinations and the largest SPAC M&A deal in history—a record that has since been broken. The momentum is accelerating rapidly, with 258 completed SPAC IPOs raising more than $83 billion in just the first three and a half months of 2021. As of mid-March, more than 500 SPACs with $166 billion in trust are seeking targets. With the two-year investment window looming for each SPAC, this creates a backdrop of an extremely large amount of increasingly impatient capital that is likely to fuel an already strong M&A market in the coming year.

Given the pressure on SPAC sponsors to close a deal, market conditions are favorable for target companies—and their investors—who are looking for an exit opportunity. Increasingly common "SPAC-offs" in which many SPAC suitors compete for one target company can present company owners the chance to secure highly attractive terms and close a deal extremely quickly.

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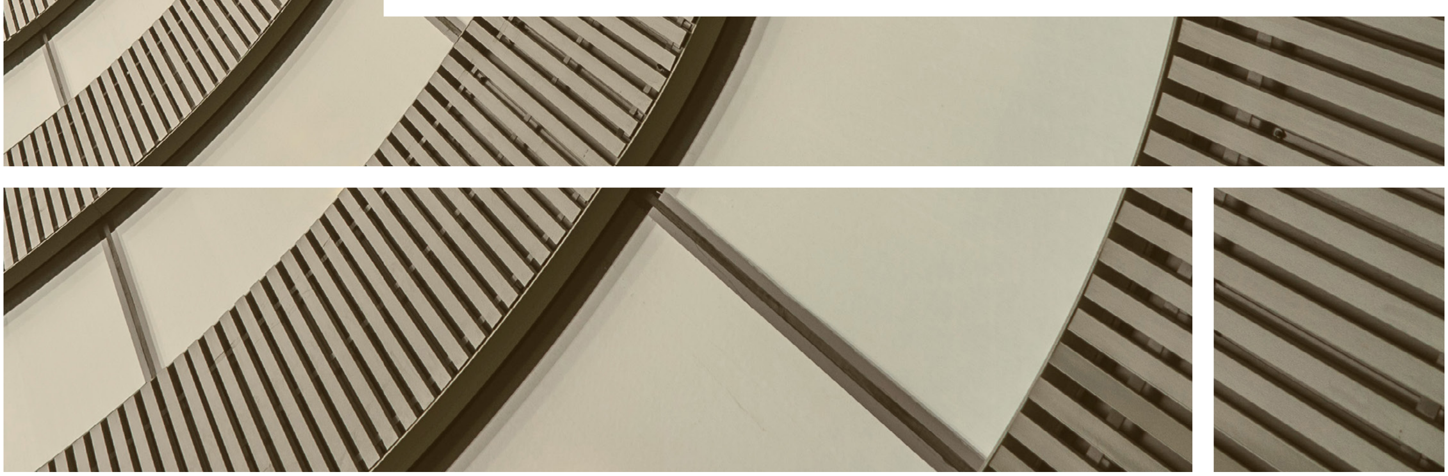

In order to ensure a successful combination, Lincoln International has identified key considerations for private companies, private equity owners and private equity portfolio companies when contemplating a possible sale to a SPAC:

1 **Reputable sponsors and institutional investors bring credibility**
Though SPACs have been around for decades, the vehicle was viewed negatively due to its perceived association with scamming investors in the 1980s and 1990s. Today, a rapidly increasing number of high-profile and respected institutions and individuals have been attached to SPACs, from former Speaker of the House Paul Ryan to Bill Ackman's Pershing Square. As the caliber of participants elevated and success stories emerged, SPACs have overcome past criticism and gained legitimacy—and investor interest has followed.

2 **Conduct careful vetting of potential SPAC acquirers**
In evaluating an offer from a SPAC, several factors shed light on the potential for the company to thrive post-merger. The quality and experience of the sponsor team is of chief importance, followed closely by the expertise of the institutional shareholders in the SPAC. Shareholders and sponsors with a proven track record of success in the company's specific sector often make the best matches.

3 **Evaluate the financials**
The terms of the SPAC IPO and its subsequent success, as well as the amount of cash in trust relative to the expected merger consideration, can be key indicators for future performance. SPAC sponsors are increasingly giving up a portion of their equity in order to close deals quickly. In 2020, 59% of SPAC deals imposed vesting and/or forfeiture requirements with respect to the sponsor's equity. These sacrifices by sponsors indicate the urgency with which they are approaching acquisitions and the room for negotiation in the de-SPAC process.

4 **Early-stage companies take special considerations**
With the growing competition for targets to acquire within their deadlines, many SPAC sponsors are turning to earlier-stage companies as potential targets. However, selling to a SPAC brings the demands of public company reporting and compliance along with it. Before embarking on a SPAC merger, these companies will need to ensure the proper legal and financial processes and mechanisms are in place to successfully function as a public company and perform for shareholders after a deal is completed.

5 **The role of PIPE financing**
PIPE financing, or private investment in public equity, is often used when SPACs need to raise additional capital before making an acquisition. In January, Chamath Palihapitiya's SPAC, Social Capital Hedosophia V, deployed a $1.2 billion PIPE to acquire SoFi. The extremely high levels of PIPE financing involved in recent SPAC deals are another sign that sponsors are using all resources at their disposal to close deals efficiently. PIPE financing is likely to continue to play a part in de-SPAC transactions throughout 2021.

6 **Understand the limitations of the SPAC structure**
While the scales are largely tipped in favor of the seller when it comes to SPAC merger negotiations, they are not without limitations. Selling to a SPAC will not allow for complete shareholder liquidity at closing, but rather a mix of cash and de-SPAC stock. In addition to taking on the burdens of being a public company, targeted selling business owners have limited ability to select a partner or new ownership because the SPAC has already selected investors upon their IPO. Additionally, embarking on a de-SPAC transaction to go public involves a less stable investor base, as investors are not necessarily long-term shareholders. Lastly, closing a SPAC transaction will generally take longer than a sale process and create some additional risk to closing, including SPAC equity shareholders not supporting the deal with the right to redeem their shares.

7 **Global investors get involved**
As more successful combinations close in the U.S., European investors are taking notice. As European capital cities race to become leading financial centers, Amsterdam has positioned itself as a key player in the SPAC market, largely due to flexible listing rules in the Netherlands. In London, a recent government-backed review recommended relaxation of rules around SPACs. As regulation evolves and the U.S. sees more SPAC activity, Lincoln expects European markets and investor appetite to follow.

To discuss the market dynamics impacting SPAC mergers and the opportunity for your company, contact a member of Lincoln's global M&A team at www.lincolninternational.com/services/ma.

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