SPAC Transaction FAQs

Over the last several months, we have seen a dramatic interest among successful venture-backed companies in pursuing an exit with SPACs (Special Purpose Acquisition Companies).

An exit via a SPAC entity may be the right option for companies looking to raise capital and obtain access to the public markets in lieu of a traditional IPO. The FAQs below draw on our team's experience with recent high profile SPAC deals – including a currently-pending announced SPAC transaction with a market value in excess of $1.8 billion – as well as decades of experience working with venture-backed companies in M&A and IPOs.

THE BASICS

1. What is a SPAC (Special Purpose Acquisition Company)?

- A SPAC is an entity formed for the purpose of finding and completing a business combination. It offers an alternative method for a "target" private company to go public and raise capital.

- SPACs are formed by sponsors with the experience and network allowing them to raise money in an IPO that can be used to acquire a business that can be run as a public company. The SPAC may have an industry focus. Typically, the SPAC will own approximately 20% of the acquired company post-closing.

- A SPAC has a pool of cash available in a Trust Account and a public listing on a stock exchange and will look for a "Business Combination" with a private company that has a real operating business. The target company shareholders will ultimately hold a majority of the post-combination entity – often in excess of 80%.

- The Trust Account cash is only available to the SPAC upon the consummation of the Business Combination. If it doesn't consummate a deal within during the 2-3 years the SPAC typically has to find a combination partner, the Trust Account cash will revert to the SPAC stockholders. If a Business Combination is consummated, but an individual stockholder does not like the deal, the holder has the right to elect to have its shares redeemed for its pro rata share of the Trust Account at the time the transaction closes.

2. What is the SPAC's lifecycle?

- There are four stages to the SPAC lifecycle. Note that step 4 is effectively an IPO for the Target company, so there is sometimes some confusion in discussions of "the IPO" in a SPAC context.

- At Stage 1, when the SPAC launches its IPO, public investors purchase a unit in the SPAC (comprised of one share and a warrant or a fraction of a warrant) for $10 per unit. The SPAC sponsor also receives shares and purchases warrants in connection with the IPO.

- Post-IPO, at Stage 2, the SPAC is essentially an empty shell with the sole aim of seeking out Target companies to acquire, in a similar manner to Private Equity firms searching for target deals.

- The last two stages are negotiating and consummating the Business Combination and the associated PIPE transaction, each as described below.

PLANNING FOR THE SPAC BUSINESS COMBINATION (aka, the "de-SPACing")

3. How should companies view an offer from a SPAC? Should you do the deal?

- Sometimes the relative unfamiliarity of the SPAC structure can distract from the fact that these deals are essentially another way to do an IPO. The first question for any company presented with a SPAC term sheet shouldn't be "are these good terms?," but rather, "is now the right time to transition to life as a public company"?

- If the company is ready to go public – both from a business life-cycle / valuation perspective and from an operational readiness perspective – then the next question is whether to go the SPAC route or a traditional IPO.

- If a SPAC transaction is the right path, the next question is which SPAC? There are a lot of SPACs in the market, which have been formed at a blistering pace, so there is typically not a reason to engage with the first SPAC term sheet received on the fear that this will be the company's only opportunity.

4. Once a SPAC finds a target to acquire, what happens next?

- Like a private M&A deal, the parties will negotiate a non-disclosure agreement, a term sheet/letter of intent/exclusivity agreement, and then a definitive Merger Agreement together with ancillary documentation.

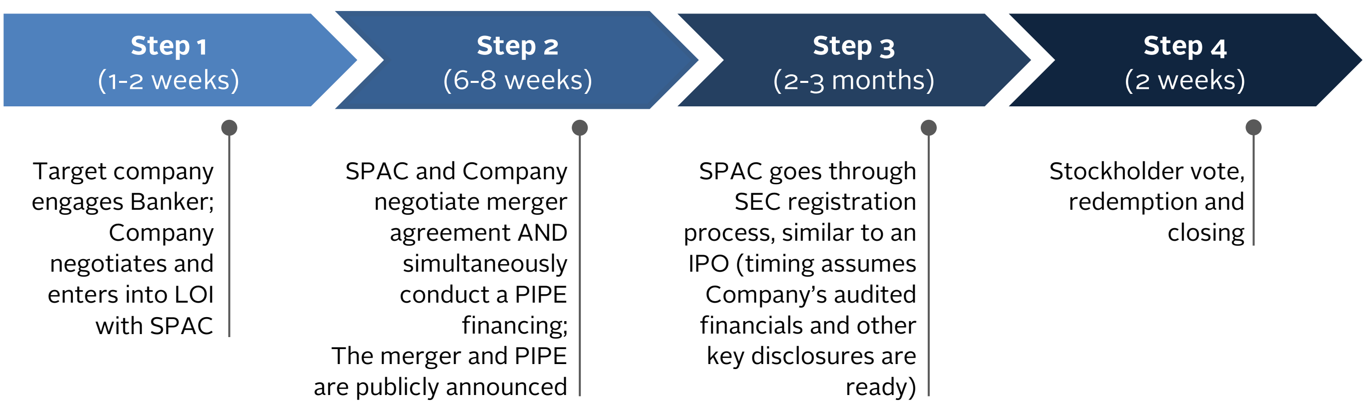
- The SPAC term sheet shares some features with an M&A term sheet, but differs substantially, as the focus is on the post-closing capitalization of the company, which can be fairly complex and customizable.

- It is highly recommended for a target company to engage a financial advisor no later than the negotiation of the term sheet. Bankers will be able to advise a company on valuation and other key economic terms like how to evaluate dilution from warrants and Sponsor equity, and then will be able to help structure investor engagement.

- It is important to understand that while the target typically (although not always) receives shareholder approval at the time of signing the Merger Agreement, the SPAC's obligations are subject to SPAC shareholder approval which will occur at a stockholder meeting after the disclosure document (proxy statement and/or registration statement) is cleared by the SEC and mailed to stockholders – similar to the approval process in a public company target M&A deal. Even more critically, even if the shareholders approve, a high-level of redemptions can reduce the amount of cash available in the trust account substantially – because of this risk, target companies will almost always insist on a closing condition that a certain minimum amount of cash (whether from the trust account or the PIPE transaction) be available at closing. This "minimum cash" condition should be negotiated at the time of the term sheet discussions.

- Once the term sheet discussions are complete, the parties will proceed to the negotiation of the Merger Agreement and ancillary agreements (including confidential disclosure schedules), the launch of the PIPE process, and preparing the public disclosure document (proxy statement / registration statement).

5. What is the typical process and timeline for a SPAC transaction?



A note about timing. While some sources suggest a SPAC transaction can be faster than an IPO (i.e., 4-5 months instead of 5-6 months), in our view, companies should really plan on a 6-month process under either path unless the company is already far along the IPO preparation path (perhaps having already prepared disclosure and filed an S-1 on a confidential basis) at the time of switching over to a SPAC transaction.

The SEC review process for the proxy statement or S-4 is similar in scope and duration to an IPO. Also, the preparation of the required audited public company financial statements can take substantial time, as well as drafting a polished MD&A, Business section, Risk factors and other required disclosures that will present well to investors.

6. In addition to the merger process and the "IPO-like" activities, there is also a PIPE financing. How does that work?

- In the SPAC context, PIPE (Private Investment in Public Equity) commitments are used to reduce the risk of too many redemptions by the SPAC shareholders and to ensure that the combined company will have sufficient cash raised in the transaction.

- Because PIPE investors can be solicited on a confidential basis prior to signing a merger agreement / announcing the deal, PIPEs are also used to "test the waters" in terms of investor sentiment regarding a company's business and the valuation that has been negotiated between the target and the SPAC. That said, companies should be aware of the substantial risks of a leak once the PIPE discussions commence.

- The PIPE subscriptions will close substantially concurrently with the closing of the SPAC Business Combination. Typically PIPE investors purchase their shares at a slight discount to the nominal value ascribed to the target shareholders' shares, or they are given other "sweeteners" like having the Sponsor transfer some of the Sponsor's shares or warrants to the PIPE investors.

GOING PUBLIC: SPACs AND IPOS

7. How is a SPAC transaction like an IPO?

- The process is very similar to an IPO, except without the participation of underwriters, and with more limited "road show" meetings with investors.

- The target company will need to draft disclosures on its business for inclusion in the SPAC's proxy statement or S-4 registration statement, of a similar scope to an S-1 filed in a traditional IPO.

- Two-to-three years of audited financial statements (to a "PCAOB" standard rather than a private company audit) will be filed, along with pro forma financial statements.

- Target companies should carefully evaluate the financial statement requirements before entering into an LOI because an additional year of audited financial statements may be required in the SPAC context when that extra year would not be necessary in a traditional IPO. This will depend on the size of the target company and where the SPAC is in its lifecycle (e.g., if it has filed its first Form 10-K).

- As with a traditional IPO, it is common for some or all target company stockholders to be subject to some form of lock-up agreement or market stand-off after the closing.

- The company will also need to have all of the public company "infrastructure" in place by closing. For example, the finance function will need to be robust enough to prepare guidance and periodic financial disclosure to be filed with the SEC. Board composition, governance policies and procedures, and executive compensation practices will need to be re-vamped for life as a public company. Board independence requirements will apply post-closing and as a result targets interested in SPAC transactions should consider board composition well in advance.

- Lastly, while the headline valuation is critical, the parties need to settle on a value that isn't so high that it won't be attractive to SPAC investors. And because of their incentive structures, SPAC Sponsors are more motivated to find a price that will "sell well" rather than pushing for the last marginal dollar. So the pricing dynamics are more similar to an IPO than they are to an M&A deal.

8. What are the pros and cons of a SPAC transaction compared to a traditional IPO?

Pros

- A SPAC transaction may be available while the traditional IPO market closes or is less available
- Avoids a traditional underwriting process which can take longer and be less flexible
- Potential to structure in earn-outs to provide additional upside for existing Company stockholders if stock consistently performs above priced amount
- Potentially shortens process by 1-2 months, but only if the Company is prepared with all of its requisite disclosures, which are substantially similar to those in an IPO (see Question 5)
- While transaction costs are typically substantial in SPAC deals, the pricing discounts may be more narrow than IPO underwriting discounts

Cons

- A SPAC has a higher risk of not closing after announcement
- The public announcement comes earlier in the process so there is no opportunity to iterate with SEC confidentially
- PIPE and SPAC investors are not necessarily the same as traditional long-term focused IPO investors
- Sharing diligence materials with more than just underwriter counsel (e.g., PIPE investors)
- No underwriters or underwriter counsel to serve as "second set of eyes." SPAC personnel and counsel involvement typically less rigorous.
- Depending on a company's capital structure, the process of obtaining approvals from existing investors can be substantially more complex

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To discuss any of these issues, please feel free to contact your regular Gunderson Dettmer contact, as well as our team leaders involved in SPAC transactions, M&A and IPOs.

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