

SPACs – Exit Opportunities for Private Equity Sponsors?

*By Sachin Kohli**

Over the past few years, Special Purpose Acquisition Companies (SPACs), also known as “blank check” companies, have raised significant amounts of capital through the public equity markets. Since January 2007, over \$14 billion has been raised through SPAC public offerings. Recent high profile offerings have brought new legitimacy to this market, including Thomas O. Hick’s SPAC, Hicks Acquisition Co. I, which raised over \$530 million, and Goldman Sachs’ underwriting Liberty Lane Acquisition Corp., a \$350 million SPAC organized by former Fisher Scientific CEO Paul Montrone.

In today’s deal environment, where credit is scarce and exit opportunities for sponsors are more limited, sales to SPACs have become a more attractive exit opportunity for private equity sponsors. Traditionally, selling to a SPAC may have been less attractive to private equity sponsors because they were not well positioned to participate in, and often explicitly avoided, competitive auctions. This is because the consummation of any acquisition by a SPAC is conditioned upon receipt of stockholder approval, which puts SPACs at a significant disadvantage when compared to other bidders that do not have such conditionality associated with their bid. Certain private equity firms, including Madison Dearborn Partners and Kohlberg & Co., have begun to utilize SPACs as a way to monetize their investments. Madison Dearborn has completed two sale transactions with SPACs, including the \$1.6 billion sale of the paper and packaging assets of Boise Cascade, L.L.C. to Aldabra 2 Acquisition Corp., a SPAC that was formed by the founders of Terrapin Partners, LLC.

While SPACs present an interesting opportunity for private equity sponsors to monetize their investments in today’s deal environment, there are certain aspects of SPACs that sponsors should take into account when deciding whether to do such a deal:

- **Stockholder Approval Required:** The consummation of an acquisition by a SPAC is conditioned upon the receipt of stockholder approval, even if such approval is not required under state law. Typically, the SPAC’s organizational documents will require that a majority of its stockholders approve the acquisition. The founders of the SPAC are usually required to vote their shares in accordance with the public stockholders to avoid any influence they may have over the vote by way of their significant equity ownership. The threat of stockholders voting against a deal presents an element of deal risk that a private equity sponsor will have to take into consideration when deciding to sell to a SPAC. In addition, if stockholders threaten to vote against a deal, it may require the private equity sponsor and the SPAC’s founders to provide an incentive to the SPAC’s stockholders to vote for the deal. In the sale of the paper and packaging assets of Boise Cascade to Aldabra, Terrapin Partners Venture Partnership and Boise Cascade (which consists of the remaining assets of the Madison Dearborn portfolio company) agreed to provide approximately 40 institutional stockholders with contingent value rights (CVRs). These CVRs provide the Aldabra investors, who purchased their shares at a price of \$10.00 per

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share, with some downside protection. The CVRs work as follows: if one year from the date of the approval of the transaction the 30-day average of the trading price of Aldabra (the Anniversary Price) is less than \$10.50, then Terrapin and Boise Cascade are to pay each stockholder holding a CVR an amount equal to \$10.50 minus the Anniversary Price, up to a maximum of \$1.00 (on a per share basis). The payments are to be split equally by Terrapin and Boise Cascade, and paid in cash, stock, or a combination of cash and stock. In exchange for these CVRs, those stockholders agreed to vote in support of the acquisition.

- **Stockholder Conversion Rights:** SPAC stockholders that oppose a transaction typically have the right to exercise “conversion rights.” Conversion rights provide SPAC stockholders with the right to convert their shares into their pro rata portion of the IPO proceeds that are being held in escrow in the event they oppose the proposed transaction. If more than a specified percentage of stockholders exercise their conversion rights (generally in the range of 20% to 40%), the SPAC is prohibited from consummating the transaction. While essentially a put right, these conversion rights present another element of deal risk to private equity sponsors as they may incentivize stockholders to vote against the transaction.
- **Timing Considerations:** SPACs have limited life spans (typically 18 to 24 months) that may sometimes be extended if the SPAC enters into a letter of intent or definitive agreement with a target company. If a transaction is not consummated within that time frame, the SPAC must liquidate and return its IPO proceeds that are being held in escrow to its stockholders. Depending on one’s perspective, this could provide private equity sponsors with additional leverage when negotiating with a SPAC that is working on a tight time frame to wrap up a deal.
- **Rollover Opportunity:** SPACs also provide private equity sponsors with an opportunity to realize a liquidity event while continuing to maintain equity in a public company. In Madison Dearborn’s sale of the paper and packaging assets of Boise Cascade, Madison Dearborn, through various entities, retained approximately 49% of the equity of the publicly-traded company. The opportunity to participate in additional upside may be tempting to some private equity sponsors, particularly given the liquidity of the investment.

Given the amount of capital that has recently been raised by SPACs and their relatively short investment time frames, one can expect that over the next few years SPACs may play a more prominent role in providing exit opportunities to sponsors. However, sponsors need to be aware of the unique characteristics of SPACs in evaluating those exit opportunities.