

# TO SPAC OR NOT TO SPAC: A CONTINUING CONVERSATION WITH MID-SIZED PE FUND MANAGERS ABOUT THE SPAC PROCESS (PART II)

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## U.S. Asset Management and Investment Funds Alert

By: Robert S. Matlin, Edward Dartley

### AN INTRODUCTION TO THE SPAC IPO PROCESS:

In our initial alert ([Part I](#)), we provided an overview of key considerations for private equity (PE) mid-sized and emerging managers when deciding whether to launch a SPAC. In this alert, we highlight some practical considerations for mid-sized and emerging managers (together, mid-sized managers) exploring the viability of sponsoring a SPAC, focusing on the early stages of forming the SPAC sponsor, and positioning the SPAC for success in the market. We also provide a sample timeline for the SPAC IPO process. Finally, we highlight certain issues that are impacting the SPAC market based upon the recent pronouncements by the US Securities and Exchange Commission (the “SEC”).

Once the PE sponsor has addressed the viability of launching a SPAC in relation to its existing business, funds and investors (see Part I), there are a number of initial considerations for the sponsor team to consider.

#### **Will the market view your targeted industry or industries with enthusiasm?**

In the SPAC IPO prospectus, you will have the flexibility to pivot to any target that makes commercial sense, but initially, it is important to target an industry or industries where your team has deep domain expertise and will be able to show that you can readily source target companies. In addition, the SPAC targets are usually broader than the traditional PE targets since they may include targets that have no EBITDA or are pre-revenue, but with good growth opportunities in the near term.

#### **Do you have a market-level understanding of the opportunities in your target industries?**

A SPAC sponsor may not have any preexisting form of agreement (oral or written/direct or indirect) with a target company with regard to an acquisition by the SPAC issuer, and there will be representations in the prospectus and the underwriting agreement that the SPAC issuer has no such agreements in place. Immediately following the closing of the SPAC IPO, however, you can and will want to hit the ground running and engage with potential targets. This means that well before the launch of the IPO, the SPAC team should create a list of potential targets and understand the range of their values. Prior to launch, you may inquire of such targets to evaluate their interest in pursuing an IPO through the SPAC process, but such discussions should cease once you have filed your registration statement.

#### **How much do you need to raise in the IPO in order to execute on your plan?**

Typically, a target will be valued at around four to five times your IPO proceeds. Accordingly, if you raise US\$100 million in the IPO, you should target companies with values of US\$400 million to US\$500 million in enterprise value. Of course, you can and will supplement the IPO proceeds with a PIPE (private investment in public equity), and potentially additional financing in the form of debt or convertible debt, as needed.

### **Have you established who will be part of your management/SPAC sponsor team?**

You want people who have a deep understanding of the targeted industry or industries and who have experience in acquiring companies. The team should have operating and public company experience and include someone who can fulfill the chief financial officer function. As noted elsewhere, this is a particular consideration for mid-sized private equity managers with more streamlined investment teams, and may result in a team with a mix of PE employees and outside retained experienced professionals. Bench strength can be augmented through the SPAC issuer's board of directors and through outside advisors. You will also need to determine who will be chairman of the board, CEO and CFO of the SPAC issuer.

### **Have you worked out the economics of your sponsor team?**

The SPAC sponsor will be purchasing 20 percent of the shares issued in the IPO post-closing as founder shares, which will cost an aggregate of US\$25,000. In addition, you will need to invest as "at-risk" capital at least 3.5 percent of the IPO proceeds to pay for the underwriter's commission (usually 2 percent of the IPO proceeds), other fees and expenses associated with the IPO, and for the operation of the SPAC post-closing. This is typically accomplished through a private placement, where the SPAC sponsor purchases warrants at US\$1.00 per warrant, which will be similar to the public warrants with an exercise price of US\$11.50. Often, the investors in the at-risk capital will buy units in the SPAC sponsor, which represent rights with regard to the founder shares and the private warrants. The split between the private placement warrants and the founder shares is subject to negotiations between the sponsor team and the private investors, if there are any. In addition, note that your at-risk capital will need to cover any future upside of the IPO (up to 20 percent) and to cover the underwriter's over-allotment option if exercised (up to 15 percent of the initial closing). Depending on negotiations with the PE limited partners, the necessary at-risk capital can all come from the PE fund, which may also receive up to all of the founder shares.

### **Have you identified a majority of independent directors for the SPAC issuer?**

Typically, you add at least three individuals with impressive backgrounds who will add value to the SPAC issuer and are independent for, a total of at least five board members. These independent directors will be compensated out of the SPAC sponsor shares. One of these independent members will need to be a financial expert to serve as the chair of the audit committee. As with any other publicly traded company, each person on the board and the proposed management of the SPAC issuer will need appropriate vetting to ensure there is nothing that will reflect poorly on them and the SPAC.

### **Have you identified key professionals?**

Professionals include: an investment banking firm to act as the lead underwriter for the transaction, experienced legal counsel, and independent and PCAOB qualified auditors. Also, it is important to have competent financial reporting support either at the sponsor or through an outside provider.

## THE SPAC IPO TIMELINE

Once the decision has been made to move forward and launch a SPAC, time to market becomes important, especially in the current competitive market. The following is a rough guide for the SPAC IPO timeline:

- Weeks One to Two: Prepare your presentation, set up your team and identify your financing sources for the at-risk capital. Hire auditors and counsel. Interview underwriters. Establish your SPAC sponsor entity and SPAC issuer and issue the founder shares to the SPAC sponsor entity.
- Week Three: Hire underwriter and identify board members.
- Weeks Four to Seven: Prepare registration statement and finalize sponsor at-risk financing. Complete audit. Submit confidential registration statement with the SEC. Prepare listing application and file with the Exchange. Obtain CUSIP number and stock symbols. Work on corporate governance policies.
- Weeks Seven to Ten: Finalize investor presentations and respond to SEC comments and file public registration statement. Respond to Exchange comments. Work on underwriting agreement, registration rights agreement for sponsor, and public warrant agreement. File officially with the SEC.
- Weeks Ten to Fourteen: Road Shows. Finalize documentation. Get listing approval and go effective with the SEC and open for trading. Close two days later.

Congratulations, you are now public. Good luck looking for a target and closing your business combination, which will be the topic of our next alert.

Given the level of SPAC activity, it should not be surprising that it has attracted the SEC's attention in recent months. For instance, the SEC recently made clear that the de-SPAC filings which include projections are not immune from securities fraud claims and that the majority of the public and private placement warrants contain terms which require them to be treated as a liability instead of equity throughout their term. To the extent that the SEC is seeking to slow down the pace of both SPAC IPOs and business combinations through the use of existing rules, that goal has had some success. It should be expected that this will give the SEC additional time to assess the market, and potentially determine if new rules or guidance are required with respect to SPAC transactions. Regardless, given the continuing interest in SPACs and their long track record as an established route for capital raising, it is likely that the market will adjust and adapt to any new SEC scrutiny, as it has been doing for over two decades.

## KEY CONTACTS



**ROBERT S. MATLIN**  
PARTNER  
NEW YORK  
+1.212.536.4066  
ROBERT.MATLIN@KLGATES.COM



**EDWARD DARTLEY**  
PARTNER  
NEW YORK  
+1.212.536.4874  
ED.DARTLEY@KLGATES.COM

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