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De-SPAC Transactions: Considerations and Risks

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With the accelerated rise of special purpose acquisition companies (SPACs) in 2020 and 2021, business combinations with SPACs, known as de-SPAC transactions, have quickly become a popular alternative to a traditional IPO for private companies to go public.

However, de-SPAC transactions are not without risks. Why have de-SPACs become so popular and what are the key considerations for both SPAC acquirers and target companies entering into a de-SPAC transaction?

Why is a de-SPAC transaction attractive?

What are the key factors to consider in a de-SPAC transaction?

Some characteristics of a de-SPAC transaction

What are some of the key risks related to de-SPAC transactions?

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Useful Resources:

- Global SPACs Guide
- SPACs: Challenges and Opportunities
- Cross-Border Listings Guide
- Global Public M&A Guide
- Global PIPE Guide
- SPACs: What private equity needs to know
- SPACs cross the Atlantic
- Top Tips for Financial Sponsors on Public Transactions
- United States: SPAC litigation gains momentum
- United States: Breaking the bubble - Top risks to the SPAC surge

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Key Experience & Contacts

Why is a de-SPAC transaction attractive?

A de-SPAC transaction has quickly emerged as an attractive alternative to a traditional IPO for a private company to go public. This is typically due to a number of reasons:

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1. Faster, More Efficient, and Less Costly

Going public by a sale to a SPAC is generally faster and more efficient than the traditional IPO route (typically 3 to 6 months as opposed to the 12 to 18 months for an IPO). For the target company, the acquisition by a SPAC may allow it to go public at a lower cost and with less effort and disruption to the company and employees than the relevant IPO process.

2. Negotiating the Valuation Early On

The target company and its shareholders negotiate the share price directly with the SPAC early on in the process. This is in contrast to an IPO, in which issuance price is determined upon commencing the IPO after an oftentimes lengthy review by the US Securities and Exchange Commission (SEC) or other relevant regulator.

3. Absence of Market Volatility and Investor Sentiment

Market volatility is a major factor in an IPO and can have a profound impact on IPO activity and pricing, as was evident during the first months of the coronavirus pandemic. Given that the SPAC is already listed and has typically raised much of the cash required to fund the acquisition at the time of the closing, market volatility and investor sentiment on the valuation of the target are decreased in a de-SPAC transaction. The target may still be able to go public when the listing window may be closed or quite narrow, thereby providing more certainty around valuation and deal execution.

4. Human Capital Matters Too

SPACs generally have experienced management teams and/or quality investment sponsors backing them, with some tangible benefits for the newly public company. The SPAC's sponsors will often take a minority role on the target company's board, providing valuable public company board experience. The SPAC will also take an active role in leveraging its relationships to raise further capital for the target company, enhancing its profile among prospective investors.

What are the key factors to consider in a de-SPAC transaction?

There are several key factors which both the target company and the SPAC will need to carefully consider in relation to a de-SPAC transaction:

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1. Alignment of Strategic Interests

A SPAC will typically include in its IPO Registration Statement the type of industry of the target company it is looking to acquire. As such, ideally the strategic interests between the SPAC and the target company align. The closer the alignment, the more likely it is that the acquisition will make sense to the SPAC shareholders (thereby reducing the risk of redemptions in the SPAC) and to the wider investment community. Further, the SPAC's management team typically will be able to contribute the most in an industry where they have experience and connections. Given the rise in SPACs and the competition for targets, that alignment may not always occur.

2. Understand Remuneration Structures

Understanding how the SPAC sponsors will be remunerated is also an important consideration. Traditionally, SPAC sponsors are remunerated through the ability to acquire shares in the SPAC at nominal value. This can result in sponsors obtaining a return in circumstances where the other shareholders will not. In current de-SPAC transactions, target companies oftentimes discuss restructuring portions of the sponsor's promote, e.g., via additional vesting or forfeiture - to ensure improved long-term alignment.

3. Market Risk Has Not Disappeared

In de-SPAC transactions, the market risk of pricing the IPO has shifted to two crucial points in the de-SPAC process: i) the marketing of so-called "PIPE" financing, often prior to announcement, and ii) the redemption right that the SPAC's original investors hold. In both cases, the target company and the SPAC still have to make the case to the market that the target company is attractive and also priced attractively. The failure to attract PIPE financing, in particular, can be a harbinger of a lack of general market interest, since it occurs relatively early in the process.

4. Is the Investment Deadline Approaching?

Typically, a SPAC has between 18-24 months to complete a de-SPAC transaction (with some listing exchanges prescribing a definite time frame for closing an acquisition). If the SPAC fails to close a business combination within that time frame, the SPAC is liquidated and the SPAC funds held in the trust are returned to the shareholders. As the SPAC sponsor will not receive any of the proceeds from the trust upon liquidation, the sponsor is highly incentivized to complete an acquisition before the time limit expires. If the investment deadline is approaching and the SPAC has still not found a suitable target, it may feel pressure to acquire an otherwise unattractive target or agree to an unattractive valuation in order to avoid liquidation. In that scenario, the risk increases that the shareholders will decide to exercise their redemption rights rather than holding shares in the newly combined company.

5. How Ready is the Target Company to Be a Public Company?

Once the de-SPAC transaction is consummated, the target company becomes a public company and is subject to all of the reporting and disclosure obligations of a public company. A "back door" listing through a SPAC does not reduce the amount of work needed to prepare the target for life as a listed company and so both the SPAC and the target board will need to be sure that the target company will be prepared for these new obligations. Historical financial information on the target will need to be prepared shortly after entering into the acquisition and due diligence conducted to a standard necessary for adequate public disclosure. The SPAC and target company will also need to undertake all other "IPO ready" tasks, including determining the post-IPO board composition, conducting reviews of internal controls and financial reporting procedures appropriate for a public company and putting in place the right governance and other legal and regulatory policies.

Some characteristics of a de-SPAC transaction

While de-SPAC transactions can vary by jurisdiction, there are a few general characteristics that are common to most de-SPACs transactions across the globe:

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1. Shareholder Approval

Depending on how the de-SPAC transaction is structured and what is included in its charter (as well as on which exchange the SPAC is listed), shareholder approval of the de-SPAC target shareholders will likely be required (though the percentage required will vary by jurisdiction). For example, in the United States, the percentage required depends on the state laws that the target entity is organized under, as well as the organizational documents of the target entity. In Germany, the Frankfurt Stock Exchange requires that shareholders vote with a majority of at least 50% in favor of the usage of monies deposited in the trust account, which consequently also applies if the monies are to be used for an acquisition of a target.

2. Transaction Structure

De-SPAC transactions are typically structured as a merger or tender offer. In the United States, the typical structure is an acquisition of the target entity by the SPAC via a reverse triangular merger, while in the Netherlands a de-SPAC transaction is a legal merger. There have also been structures in which a new holding company acquires both the SPAC and the target company.

3. Suspension of SPAC's Shares

While there is generally no suspension of the SPAC's shares on announcement of the de-SPAC transaction (and in fact investors are counting on the post- announcement pop in trading prices), there are exceptions. Such is the case in the United Kingdom, where upon the announcement of the business combination, trading in the shares in the SPAC would generally be suspended as the transaction is treated as a "reverse takeover." However, from 10 August 2021, the UK regulator is changing the rules so that trading in the SPACs shares will not be suspended upon the announcement of a business combination, provided the SPAC and the business combination meet certain requirements that provide increased investor protection.

4. Filing of Disclosure Documents

Following the announcement of a de-SPAC transaction, the SPAC and the target will prepare registration or disclosure documents to be filed with the respective securities regulatory body. For example, in the United States, the SPAC typically files either a registration statement or a proxy statement to solicit SPAC shareholder approval and register the issuance of new shares. And in the United Kingdom, following the announcement of the business combination, the SPAC must prepare the prospectus/ admission document with respect to the enlarged group. This document will contain information concerning the target that must be sourced from the target, and, if a prospectus, drafts must be filed for comment with the relevant financial regulators.

5. Insider Trading and Restrictions on Disclosure of Financial Information

The SPAC will typically be constrained from disclosing certain financial information to potential investors by the securities laws of its respective region. And trading on such information can have significant consequences. In the United States, the SEC has expressed concern regarding the phenomenon of insiders potentially trading on inside information regarding de-SPACs. In the Netherlands, for example, the rules of the Market Abuse Regulation apply to the SPAC and the SPAC may not disclose non-public material information to investors.

6. Redemption Rights

Generally speaking, shareholders who vote against the business combination transaction are entitled to have their shares in the SPAC redeemed. In some jurisdictions, there may be a threshold redemption amount whereby if investors redeem a specified percentage of their shares, then the acquisition will not proceed and the SPAC will have to be liquidated and trust fund amounts returned to the public shareholders.

What are some of the key risks related to de-SPAC transactions?

The increase in de-SPAC transactions, particularly in the United States, has led to enhanced regulatory scrutiny over these transactions and made them a prime target for shareholder litigation. Below, we summarize some of the major risks facing de-SPAC transactions:

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1. Deal-Related Shareholder Lawsuits

Much like most public M&A deals result in shareholder lawsuits in the United States, there have been a wave of shareholder lawsuits against de-SPAC transactions. These lawsuits fall into essentially two categories: (i) disclosure-based lawsuits, primarily claims of material misstatements or omissions under Section 10(b) of the Securities Exchange Act of 1934 in connection with the SPAC's acquisition (e.g., failure to include financial projections or omitting details relating to negotiations with the target company); and (ii) process-based lawsuits, alleging that the sponsors of the SPAC may have a conflict of interest because they are incentivized to rush into a business combination to avoid liquidation of the SPAC and, therefore, may not adequately diligence a target, or choose an appropriate one.

2. Enhanced Regulatory Scrutiny

De-SPAC transactions are facing enhanced regulatory scrutiny from the SEC, which signaled that these deals will be an enforcement priority for the regulatory agency. The SEC has issued statements on SPACs in which it questioned whether targets in these transactions are ready to go public and also warned that these transactions could be subject to SEC enforcement actions, particularly for material misstatements or omissions in the registration statement in connection with the de-SPAC transaction. The SEC has also issued guidance as to the disclosure considerations that need to be addressed by SPAC sponsors and the target company, including that the SPACs provide "clear disclosure regarding… potential conflicts of interest and the nature of the sponsors', directors', officers' and affiliates' economic interests in the SPAC."

3. Post de-SPAC Shareholder Lawsuits

As many de-SPAC target companies tend to be less mature and have less of a (or no) track record on earnings, their share prices tend to be relatively volatile once public. In the United States, many target companies originally marketed themselves during the de-SPAC on forward projections, which in some cases will turn out to be overly optimistic. Such volatility inevitably attracts shareholder plaintiffs to suits alleging that there were misstatements or omissions during the marketing of the SPAC or afterwards in the company's investor communications.

4. Foreign Investment Control

The de-SPAC transaction may trigger mandatory filings with foreign investment regimes. For example, in the United States, a mandatory filing with the Committee on Foreign Investment in the United States may be triggered if a SPAC that has non-US sponsors is acquiring a US covered target entity, i.e., a company that is involved in critical technologies or infrastructure. As SPACs become more popular in Asia, this increases the risk that a de-SPAC transaction involving a SPAC with Asian-based sponsors may be required to make mandatory CFIUS filings. As such, the SPAC sponsor and target should analyze prior to consummating the de-SPAC whether or not the transaction could be subject to CFIUS review.

Key Experience & Contacts

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Aurora Acquisition Corp.

USD 6.9 billion

Advised Aurora Acquisition Corp. in a USD 6.9 billion de-SPAC transaction to transform Better, one of the fastest- growing digital home ownership companies in the US, into a publicly traded company. This follows our advising in the formation and IPO of Aurora in March 2021.

JHD Holdings (Cayman) Limited

USD 1 billion

Advised JHD Holdings (Cayman) Limited, an innovative merchant enablement services platform in lower-tier cities in China, in the USD 1 billion de-SPAC transaction with East Stone Acquisition Corporation, a publicly traded special purpose acquisition company.

Videocon d2h

USD 325 million

Advised Videocon d2h, one of India's largest pay TV providers, on its initial listing of ADS on the NASDAQ Global Select market as part of a business combination with a SPAC.

Suncorporation

USD Confidential

Advised on the listing of Suncorporation's subsidiary, Celebrite DI Ltd., on the NASDAQ stock exchange via a de-SPAC transaction.

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