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The Impact of Recent Market Changes on SPACs

2/23/09 - Special purpose acquisition companies (SPACs) were a mainstay of the IPO market in the years leading up to 2008. Once public, a SPAC has two years to complete an acquisition, which means that some public SPACs must try to complete a transaction in today's very difficult environment. In addition, in 2008 SPACs were approved for listing on Nasdaq and the NYSE, which have stringent corporate governance and other listing requirements. We asked an IPO attorney with extensive experience with SPACs to provide some insight into how the opening of the NYSE and Nasdaq might affect the preparation of SPAC IPOs, and how current market conditions are impacting SPACs now and for the rest of 2009.

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1. There were 65 SPAC IPOs in 2007 that must complete an acquisition within two years of their offering, which means that companies that haven't already done so must effect the purchase some time in 2009. What impact will current market conditions have on these companies' ability to complete their acquisitions?

Overall, I believe the current market conditions will actually have a positive impact on the ability of SPACs to complete business combinations. Because the IPO market for operating companies has dried up and there are fewer opportunities for companies to obtain financing, SPACs should be seen as a very attractive option – as existing public companies, they offer target businesses a viable alternative to the traditional IPO through a merger or other business combination as well as providing a readily available source of funding with the cash held in trust ready to be used by the targets. Of course, SPACs will still have to convince stockholders that their transactions should be approved and not to vote against a transaction solely to get their cash from conversion or liquidation. But as the pedigree of the targets increases, this should be easier to accomplish.

2. After a fast start to 2008—12 SPAC IPOs in the first quarter—SPAC deals dried up along with the rest of the IPO market. What do you foresee for SPACs in 2009?

In general, I think IPOs will be few and far between in 2009 due in large part to the current economic conditions facing the markets. So unfortunately, I think SPACs will have a tough time in 2009. Also, when the IPO market for SPACs does return, I believe the size of those new SPACs will be smaller like what we saw in the 1990s and 2003 and 2004 before the bulge-bracket underwriters became involved in SPACs.

3. When the IPO market eventually comes back, do you expect SPACs to be at the front end of the revival or will it take longer for investors to shake their cautious approach to these companies?

One of the recent problems of SPAC IPOs is that the price for the units offered dropped immediately after the IPO. So an investor could buy a SPAC unit the day after the IPO for less than someone who bought a unit in the IPO. Also, an investor today can buy a unit of a SPAC nearing the end of its life at less than its initial offering price and be guaranteed a quick return on his investment since he will be able to vote no against any proposed transaction and exercise his conversion rights or wait for the SPAC to liquidate. So for SPAC IPOs to be at the front end of the revival, I believe a number of SPAC business combinations must be closed that result in the companies' stock prices subsequently trading up and this supply of "quick return" SPACs must be decreased through completed business combinations or liquidations. Once these two things happen, I believe investors will jump back into SPAC IPOs.

4. In September, the SEC approved a rule allowing SPACs to list on Nasdaq, and they had been approved for listing on the NYSE earlier in 2008. Among those markets' listing requirements is the condition that companies' boards consist of a majority of independent directors. Do you see any particular challenges for SPACs in trying to meet this requirement?

Not really. SPACs actually had been listing on the American Stock Exchange (now the NYSE Alternext US) as early as 2005 and listing on that exchange also required having a board that consisted of a majority of independent directors. Because SPAC officers and directors cannot be compensated in any way for their service to the SPAC, the main challenge in meeting this requirement has always just been finding solid, qualified individuals that will serve on the board of directors of a public company without the promise of being compensated on a regular basis.

5. Should a SPAC decide to list on one these larger exchanges, how will the corporate governance and other listing requirements impact the way the SPAC prepares its IPO? Will the listing requirements determine where a SPAC ultimately lists?

Listing on the exchanges requires companies to have a majority of independent directors and to form audit and nominating committees that must generally be composed entirely of independent directors. So the SPAC will need to make sure it has the necessary number of directors to satisfy those requirements. However, the corporate governance and other listing requirements are generally the same for all three exchanges. So the corporate governance and listing requirements themselves won't necessarily determine which exchange the SPAC seeks to list on. Instead, the size of the IPO and the name-brand recognition that the SPAC is looking for will likely determine which exchange the SPAC ultimately lists on. ■