

## The New Deal Club

As bulge brackets line up behind SPACs, should PE firms start to sweat?

December 17, 2007

By Kelly Holman

Everything old is new again, as the saying goes. On Wall Street, the business of creating special purpose acquisition companies -- known better as SPACs -- has returned, and some of the names behind these companies include old hands such as **Ronald Perelman**, **Thomas Hicks**, **Nelson Peltz** as well as professionals from **Kohlberg Kravis Roberts** and **Apollo Management**.

Nearly one out of four public offerings underwritten this year by brokerage firms — worth some \$12 billion — have been for SPACs. Not only have there been more SPACs being minted by Wall Street's IPO machine, investors are staking larger amounts of money to these companies — first introduced in the early 1990s — which is then used to buy a wide array of companies.

Last week, the stature of SPACs got another lift when one of these so-called blank check companies snapped up the trendy Los Angeles based retailer **American Apparel**, which is probably best known for its racy advertising. Also, billionaire investor and chairman of **Revlon**, Perelman, registered a SPAC with regulators earlier this month.

On Wednesday, Dec. 12, shareholders of the acquisition company managed by entrepreneur **Jonathan Ledecy** and London investor **Eric Watson**, who've staked a combined \$15 million to SPAC **Endeavor Acquisition**, approved its purchase of American Apparel. The American Apparel deal, announced in December 2006, was the latest validation of the SPAC business model even if the deal was completed just before Endeavor was supposed to be wound down. (Most SPACs have a life of two years after they are brought to the public markets.)

Earlier this year, a US SPAC captured the financial market's attention with its \$3 billion-plus bid for a UK hedge fund manager.

Meanwhile, Perelman registered his acquisition company with regulators on Dec. 7 under the name **MAFS Acquisition** (Perelman's investment business operates as **MacAndrews & Forbes Holding**) with the entity seeking to raise \$500 million through an initial public offering managed by **Citigroup**. The renowned investor did not detail exactly what his SPAC will invest in. "Our efforts in identifying prospective target businesses will not be limited to a particular industry or group of industries,"

according to documents filed with regulators that outline the MAFS offering.

Perelman's filing is just one example of how the SPAC has re-emerged after first being introduced roughly 14 years ago. Moreover, the formation of the acquisition companies by high profile, veteran financial managers marks a dramatic shift in the SPAC industry. 14 years ago. Moreover, the formation of the acquisition companies by high profile, veteran financial managers marks a dramatic shift in the SPAC industry.

"I would say it's the rebirth of an asset class where the investment public has a real, opt-out ability to invest with higher end principals in the deal world. Tom Hicks was clearly one of the high-profile successful brand name principals through the 1990's in private equity," says **Mark Klein**, the former chief executive of **Ladenburg Thalmann** and CEO of a SPAC named **Alternative Asset Management Acquisition**. As Klein sees it, Hicks "was somewhat of a pioneer sponsoring a SPAC."

Hicks, of course, is a veteran of the private equity and venture capital set. Hicks, a co-founder of **Hicks, Muse, Tate & Furst**, these days is chairman of **Hicks**

**Holdings**, a holding company for sports, real estate and private equity investments. Hicks, Muse, Tate & Furst raised and managed \$12 billion when Hicks was chairman of the firm between 1989 and 2004. Some of his most notable investments were in soda pop companies **Dr. Pepper** and **Seven Up**, and **Life Partners Group**.

### Under the hood: how SPACs work

Look at the public offering materials for a SPAC and you won't find the typical history of a business, its management or a story about the goods or services that an operating company provides. Instead, SPACs are essentially shell entities without assets that raise money through an IPO -- 90% of which is deposited into a trust and subsequently held in treasuries.

A SPAC's manager generally receives a 20% stake in the company in exchange for investing capital in the business, which they must then put to work in one or more acquisitions within 24 months — offering a hint of why these businesses are also referred to as blank check companies.

In addition to putting the IPO proceeds to work within a two-year period, SPAC managers need to get approval of at least 80% of their shareholders for an acquisition. If an acquisition does not go through, the money stays in the trust. If the IPO proceeds are not used by 24 months, then the money is returned to investors — minus banking-related fees. It's a safeguard for investors who can also get their money back if they do not support a transaction.

Blank check companies are generally structured as unit offerings. A common structure has each unit comprised of one common share and two warrants. Or, a SPAC investor may get one share and one warrant. The warrants allow investors to buy additional shares of stock and the unit price typically has been set at around \$7 per unit. Once a stock trades in the public markets the unit and warrant traded as separate securities.

That structure, though, doesn't always favor the issuer.

**Ken Koch**, a partner at **Mintz, Levin, Cohn, Ferris, Glovsky and Popeo**, says a downside of the outstanding warrants is the overhang that has to be worked through, meaning they can be exercised and dilute a company's regular common shares. "They're either additional sources of capital or a nuisance that keeps your stock price depressed," says Koch.

### A retreat of an investment idea

These blank check companies, of course, aren't entirely a new concept. Industry observers say **David Nussbaum**, chairman of **EarlyBird Capital**, and **David Miller**, a partner at the law firm of **Graubard Miller**, first introduced the SPAC concept used today in 1993.

EarlyBird Capital, a broker and an asset manager which claims to have trademarked the SPAC acronym, underwrote 13 public offerings of SPACs from 1993 to 1994. But, the dotcom boom of the mid-1990s eclipsed the SPAC market. The underwriting of SPACs remained as dormant as a bear in winter until 2003, when EarlyBird brought to mar-

ket a \$24.2 million IPO of **Millstream Acquisition**, a SPAC that bought **NationsHealth**, a Sunrise Fla.-based medical products supplier, for \$20 million in 2004.

EarlyBird has since underwritten 39 blank check company public offerings.

Bulge bracket investment firms — like Citigroup, **Bank of America** and **Deutsche Bank** have not let this lucrative source of underwriting fees slip by. In 2005, Deutsche Bank arranged the \$120 million IPO of **Cold Spring Capital** on the American Stock Exchange — the first SPAC IPO underwritten by a bulge bracket bank, according to industry observers.

### Are SPACs akin to PE funds?

SPACs, to a degree, have certain parallels with private equity funds. These companies are formed for the express purpose of making acquisitions and the premise for investors is similar at the most fundamental level: they are betting on the SPAC's management team. But, unlike a private equity fund where limited partners of the fund rely solely on the discretion of general partner managers to determine the viability of an investment, investors get a say in what a SPAC buys.

"If I were to compare this to a private equity fund I would come out favorably on the SPAC," says Mintz Levin's Koch. "A SPAC is very liquid, you can get out, and you have a vote on every deal," he says.

Koch says, however, the blank check companies do present certain disadvantages when compared to leveraged buyout funds.

A SPAC has to issue a proxy with the **Securities and Exchange Commission** so it takes more time for a SPAC to complete an acquisition. In the case of an investment banking auction a private equity firm's management can act more quickly when buying a privately-held company because they do not require approval from their limited partners.

SPACs, meanwhile, present challenges as well as opportunities for private equity fund managers. These companies present additional competition for companies that are for sale, but these very same blank check companies may end up buying businesses from buyout funds. Take, for example, the cases of Chicago's **Madison Dearborn Partners** and Cambridge, Mass.-based **Monitor Clipper Partners**.

In January 2007, Madison Dearborn completed the sale of its Oak Brook, Ill.-based dredging services portfolio company **Great Lakes Dredge & Dock** to **Aldabra Acquisition**, a blank check company established by **Terrapin Partners** executives **Nathan Leight** and **Jason Weiss**. Aldabra raised \$55.2 million with its February 2005 IPO. Separately, Monitor Clipper sold **TPI** to **Information Services Group**, a SPAC that raised \$258.7 million in February of this year. Information Services Group, run by former VNU media executive **Michael Connors**, paid \$230 million for TPI in November.

**Ed Glotzbach**, the former president and chief executive of TPI, says the sale to ISG was more appealing than being assimilated into a strategic buyer's organization or being purchased by a financial sponsor. "The private

equity path was not a preferred one for us because it was an impermanent structure. [Now] there's a more permanent base of capital," says Glotzbach.

Glotzbach, who is now vice chairman at ISG, says the corporate governance and auditing aspects of the now-public business don't worry him, noting that he has experience in the public oversight arena and that **PricewaterhouseCoopers** has served as the Stamford, Conn.-based company's auditor all along.

For Connors, ISG itself offered the seasoned corporate executive a career path other than the route CEOs often take these days when looking for their next job assignment: managing a private equity portfolio company. The executive, says he had been talking with Boston buyout house **Thomas H. Lee Partners** and New York's **New Mountain Partners** about the possibility of launching a \$1 billion information services-oriented business before he learned much about the SPAC business. "I thought I was going to do it with private equity but once I was told about the SPAC I realized all I needed was the capital," says Connors.

SPACs have emerged as the darlings of the IPO market and the American Stock Exchange in 2007, marking one of the Street's brighter spots in the otherwise credit-blighted year. In 2007, the blank-check offerings generated 24% of the total number of US-listed IPO's and 19% share of the new issue market volume, according to **Dealogic**. The 66 new blank check issuances accounted for \$12 billion worth of offerings on a year-to-date basis, compared with 40 offerings of \$3.3 billion for 2006. And, the blank-check business isn't expected to

slow any time soon since there's \$6.7 billion of SPACs in the IPO pipeline.

The closing by Endeavor, which is changing its name to American Apparel, and Perelman's SPAC registration follow in the wake of several successful blank-check pricings of late including the Citigroup, **Lehman Brothers** and **Merrill Lynch** IPO of **Liberty Acquisition**, which raised \$1.03 billion and represented the year's largest acquisition company offering, **Global Brands Acquisition's** \$250 million IPO run by Citigroup, Lehman and Ladenburg Thalmann, and **Tremis Energy Acquisition's** \$76 million IPO managed by Merrill Lynch and EarlyBird Capital.

One noteworthy feature of the new SPAC wave is the ever-mushrooming size of SPAC offerings over the last three years. The blank check companies had an average size of \$181.8 million in 2007, compared with an average issuance size of \$84.5 million in 2006, \$70.3 million in 2005 and \$37.2 million in 2004, according to Dealogic.

"As the market has grown more accepting of SPACs and the quality and 'name-recognition' of the people managing and associated with the SPACs has improved, the size of SPAC deals has increased," says Aron Izower, a partner at Reed Smith.

Liberty Acquisition, an entity backed by financiers Nicolas Berggruen and Martin Franklin, also carried out the largest SPAC offering of the year with its close on \$1.03 billion this past week following the exercise of an over allotment option by underwriters Citigroup and Lehman Brothers. One of the year's largest SPAC deals was Peltz's Trian

Acquisition which hopes to raise \$750 million. That SPAC registration follows a month after Tom Hicks' Hicks Acquisition raised \$552 million. Investment banks profit nicely from SPAC offerings, taking a 7% upfront underwriting fee and additional fees from the IPO's.

Investor demand for SPACs continues unabated, say equity capital markets professionals like Jeremy Fox, a director at Deutsche Bank, who characterizes it as "extraordinary." Deep-pocketed hedge funds and even mutual funds have purchased the blank-check shares. As evidence of just how strong its business has been, Deutsche Bank announced in late November it had moved to strengthen its SPAC equity platform with the appointment of three senior specialists. At the time of its announcement the investment bank had already brokered \$1.3 billion of blank check offerings.

Citigroup, though, was the unquestionable 800-pound gorilla in acquisition company underwritings in 2007, serving as the book runner on six of the largest SPAC offerings including Liberty Acquisition. In addition to Citigroup and Deutsche Bank, JPMorgan Chase, Lazard and Merrill Lynch have ridden the SPAC train since it took off in

[kelly.holman@sourcemediacom](mailto:kelly.holman@sourcemediacom)

the last few years along with EarlyBird Capital, Ladenburg Thalmann, Jefferies and Morgan Joseph.

Along with the emergence of talented private equity fund managers the SPAC business is undergoing another seismic shift. Historically, SPACs were formed around a team of executives with specialized sector experience to make industry-specific purchases. For instance, Fortress International Group, which appointed former congressman and Undersecretary for Homeland Security official Asa Hutchinson as a board director in January, was formed to acquire homeland security businesses. But, the new trend has veteran finance professionals like Tom Hicks and Nelson Peltz running generalist-oriented SPACs that aren't bent on acquiring a company in just one industry. Hicks Acquisition, for instance, noted in its S-1 filing that it does not seek any "specific attributes or criteria (financial or otherwise) for prospective target businesses."

**Freedom Acquisition Holdings** carried out the year's largest SPAC acquisition — the \$3.1 billion purchase of UK hedge fund manager **GLG Partners** — that closed in November. The deal by the blank check company that raised just over \$500 mil-

lion in December 2006 through an offering price of \$10 a share illustrates the financial clout of SPACs.

"It was the largest business combination ever done by a SPAC," says Alan Annex, a partner at Greenberg Traurig and issuer's counsel. "I think it speaks to the vehicle's ability to take public companies many times the size of dollars raised."

For all the promise the acquisition companies hold it would be incorrect to say that every SPAC IPO has been a resounding success. A handful of SPACs like **China Mineral Acquisition**, for example, have had to liquidate. China Mineral announced its liquidation in September 2006 after exceeding its two-year period to put its IPO proceeds to work. The acquisition company was formed to buy a business in China, following its \$21.3 million IPO in August 2004. China Mineral said it returned the \$20.4 million in proceeds to its investors.

Whether the latest blank-check companies face the same fate as China Mineral isn't certain. The jury is still out, but what is certain is Wall Street has managed to bring back an old idea and attract more investors and greater amounts of money.

©2007 IDDMagazine and SourceMedia, Inc. All rights reserved. SourceMedia is an Investcorp company. Use, duplication, or sale of this service, or data contained herein, is strictly prohibited.



THE CHRYSLER BUILDING  
405 LEXINGTON AVENUE  
19<sup>TH</sup> FLOOR  
NEW YORK, NY 10174-1901  
(212) 818-8800  
[www.graubard.com](http://www.graubard.com)