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The Proxy Process

Enticing Fundamental Investors Key to Success

by Joshua Sisco

A SPAC can be a highly lucrative endeavor for its management resulting in a stake in a highly profitable and rapidly expanding company. Or, it can equate to two-plus years devoted to a failed acquisition and the loss of millions of dollars. The difference all comes down to the proxy process.

Phil Goldstein, a SPAC investor with Bulldog Investors, summed it up simply: "If the stock trades above cash, then it's good. Investors who would vote no can sell their shares in the open market. If the shares trade down, management is going to have problems."

In order to execute a quality deal, management must "enroll the seller in the SPAC paradigm." David Miller with the law firm Graubard Miller has been a part of this paradigm, and in fact, helped create it, since the blank-check renaissance of the early '90s, and then again during its resurgence several years ago.

According to Miller, a SPAC deal is unique in the M&A arena and is not so much a traditional buyout or merger, but at a most basic level, "a partnership between buyer and seller designed to create a deal at a valuation attractive to shareholders by pushing the common shares to trade at a significant premium above the value of the trust account in the months leading up to the shareholder vote and the deal's close."

The process of completing a blank check deal arrives prepackaged with several prominent hurdles. Among these are signing an agreement, negotiating terms and garnering Securities and Exchange Commission approval within the 24-month time frame. And then there is the required shareholder approval, including cycling the initial risk-arbitrage investors into strategic buyers intent on allowing the resultant company to build value over the long term.

Illustrating these challenges, are the number of SPACs that have recently had to significantly alter deal terms to appease investors, including **Aldabra 2** and **Oracle Healthcare,** or have seen shareholders reject deals outright, like **JK Acquisition, HD Partners and Harbor Acquisition.**

Chief among proxy obstacles is the shareholder conversion. At the time of the IPO, a majority of investors are hedge funds, fixed income, yield-to-cash, and risk arbitragers that are looking to capitalize on a quick increase in the common share price, as well as selling the warrants to longer-term buyers, says Nathan Leight, chairman of the Aldabra SPACs.

These initial buyers, Leight says, are not necessarily inclined to hold stock predicated on fundamentals. The challenge, he says, is turning them over into investors interested in the target company's story and willing to give the company time to grow.

In order to ensure safe passage at the shareholder vote, Aldabra offered contingent value rights to investors, with approximately 40 accepting the offer. The rights offer limited protection against a drop in the share price during the next year.

Joel Kanter, president and secretary of **Echo Acquisition Corp.,** which recently completed a deal with **/LINT Veterinary Care,** felt his deal was a beneficial investment, but in order to consider manning the reigns of a second SPAC, he said there would need to be several fundamental changes in the process, including a greater number of retail investors.

Leight echoes Kanter's sentiments. "I am unsure why most brokerages have not opened up SPACs to retail investors," he said. Leight believes that it would bring in more buyers that were interested in the story of the target company at an earlier stage when they are sorely needed.

"The shares in Echo traded above trust throughout the negotiations and the proxies, however, there were a vast majority of shareholders that had no intention of voting yes on the merger," Kanter said.

In the end, he said, Echo management had to cut its stake in the new public entity by 30% to get a deal done. Echo postponed its meeting several times before a vote took place to continue soliciting favorable proxies.

Kanter said that it came to a situation where 70% of Echo's shareholders needed to be switched out. It was very difficult, he said, especially since a majority of the effort expended on this task, which occurred between Dec. 12 and Jan. 4, was during a downturn in the overall market.

There were a great deal of potential buyers who liked the story, but thought that the SPAC model was overly convoluted, Kanter said. Cycling out those intending to vote no was akin to an additional IPO complete with road show.

The company had to put together investor presentations and hired issuer-paid equity research firm **Dutton Associates** to condense a 700-page proxy filing into a readable, 30-page report.

In both of Aldabra's completed acquisitions, **Great Lakes Dredge & Dock** and **Boise Paper,** Leight favored waiting to announce the target until a definitive merger agreement was reached. "Both companies had publicly traded debt, and we did not want to start a bidding war," he said. With tradable bonds, valuations could be calculated and an unsolicited offer made, explained a second source within Aldabra.

"We believe that the deal must speak for itself," Leight said. "Once a deal is signed, then work to educate investors and tell the story. There are lots and lots of road shows. It would be great if there was more research during this 'twilight zone'."

Tina Pappas, **Morgan Joseph's** lead SPAC banker said that the initial hedge fund investors are pretty upfront about their intentions in looking to profit from the warrants and the cash value of the shares. "We tell managementteams that at least 50% of the investors will need to be replaced." Oracle Healthcare, another SPAC struggling through its proxy process to acquire **Precision Therapeutics,** announced this week that management had cut the sponsor promote by 50% and Precision took a 15% cut in the deal's consideration.

A source close to the Oracle merger said "we very much want [the merger] to close and we made the concessions necessary for that to happen. The question is, at what valuation will the investor pay?" By reducing the sponsor's stake and the shares given to the target, the deal's total consideration dropped from $200 million to $150 million, the source said.

Oracle has hired **Piper Jaffray** to essentially weed out the no votes. If the deal does not go through, Piper does not get paid. The source classified Piper as a liaison between management and the shareholders. Piper has been organizing last-minute road shows.

The source said that the SPAC market has substantially evolved during the past couple of years. "It has become dominated by investors making yield-to-liquidation type calculations, who have no interest in the planned public company."

Miller said that in order for the market to accept a deal, the target company must understand the importance of not "nickle-and-diming the buyers." If they can be persuaded to take a little less upfront and receive target-based compensation down the road, investors will likely be more pleased with a deal's valuation and, in turn, vote their shares in favor of the merger, he said.

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