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Liquidations Bring About New Terms

Deal Structure No Substitute for Strong Targets

by Paul Springer

Dealmakers are working hard to change deal structures and attract fundamental investors at the IPO stage in order to improve the dormant SPAC market. **Heckmann Corp.'s** $625 million purchase of **China Water and Drinks** could free up investor capital to catalyze these developments.

Heckmann announced on May 20 plans to use $455 million in stock and $170 million in cash to acquire the China-based bottled water company. Several people at investment banks active in the SPAC market are hopeful that the Heckmann purchase will put much-needed capital back in the hands of investors.

In contrast, there's been plenty of grim news involving SPACs, whose hedge fund buyers are overbooked and thus unlikely to fuel SPAC IPOs in the near future.

Nine SPACs have liquidated this year, almost twice as many as last year, **while JK Acquisition Corp**. and several others are attempting to prolong their life after failed acquisitions caused them to return capital to investors recently.

And returns for post-acquisition SPACs have been negative on the whole. SPACs that have closed deals are down an average of 30% over their lifespans and only eight can boast positive returns, according to a report by SPAC Research Partners published May 20. On the same day, **Jamba Juice**, which had been acquired in 2006 by **Services Acquisition Corp. International**, announced plans to close stores and restructure. The California drink seller's stock is down more than 75% from the time of its acquisition.

According to Mark Nordlicht, chief investment officer of hedge fund **Platinum Partners**, older SPACs need to close successful acquisitions to put capital back in the hands of potential buyers. Platinum manages structured yield funds as well as long-term long/short funds.

"There was just an unprecedented amount of deals that came out," Nordlicht said, "and I think that the market may have gotten a little ahead of itself in terms of what it could absorb. The SPAC market's not going to shut down. It's really a matter of absorbing the old deals."

The 80% year-over-year increase in SPAC liquidations – from five last year to nine so far this year – may not be as ominous as it first appears. Some of the liquidations involved SPACs that did not find a deal at all during their lifecycles, so shareholder approval never became an issue.

Others fell prey to events of a macro-economic nature. **Cold Spring Capital** and **Grubb & Ellis Realty Advisors** both ran aground whenattempts to acquire real estate companies became abhorrent to shareholders as the sub-prime lending mess cast a grisly shadow over all the financial markets.

But as the prospect of marketing deals becomes harder, SPAC designers are trying to entice prospective investors by reducing their promote, which in the past typically involved 20% equity retained by management.

The prospect of dilution and warrant overhang is not a pleasant one. **Goldman Sachs** is trying to mitigate the problem with its new **Liberty Lane Acquisition Corp.** SPAC, which features a 7.5% promote and units that match a share of stock with a half-share warrant. Liberty Lane is expected to price this week.

Aside from cutting back on dilution, the reduced promote and Goldman's distribution prowess may help to bring in more fundamental investors at the onset, along with the yield players less likely to have long-term interests in the SPAC.

Along similar lines, **JPMorgan** is underwriting **Angelo, Gordon Acquisition Corp.'s** $300 million IPO that is employing a 10% promote and units consisting of one share of stock and a three-quarter-share warrant.

The fate of these new structures will not be determined for some time given the length of the SPAC lifecycle, but there are already divergent opinions about the new strategies' prospects for success.

More dealmakers are likely to alter the terms of the promote, according to SPAC Research Partners' senior analyst Michael Tew.

"That is the trend," Tew said, "and the purpose is to align the interests of management, the sponsors, and the investors in a much more equal way, in a much more relevant way. You'd want to bring in fundamentalbuyers at the SPAC IPO and not wait to recycle those shares at the acquisition. We're not quite there in the marketplace, but that's the ideal situation."

Others are uncertain about how soon reducing management's interest –

and the dilution that goes with it –will help SPACs get off the ground in the early stages.

Joel Rubinstein, a partner with New York law firm of **McDermott Will & Emory**, likes the idea of the reduced promote, but still sees related problems. "People have to feel confident that the dilution can be overcome," Rubinstein said. "And to the extent you have a deal structure where there's less dilution in the form of fewer warrants and a lower promote, then those people who would be buying at the time of the deal potentially feel more comfortable about not suffering the dilution."

At the same time, reducing the dimensions of management dilution can also reduce the upside for fundamental investors who value a unit containing a whole-share warrant. "What I'm hearing is that Goldman's deal may well be able to price," Rubinstein said, "but I don't think most people are thinking that that structure's going to be the wave of the future in SPACs because there aren't enough buyers interested in buying into a structure where they only get half a warrant.

"People think that Goldman with its distribution abilities may well be able to get this one through, but most underwriters I've spoken to who've spoken with their accounts ultimately feel that the market is not there to get the deal through with only half a warrant."

Bankers at active SPAC firms also say that Liberty's half-share warrant and its pricing at $7.50 could make it less attractive than other SPACs of simi¬lar size.

And regardless of how much reduced dilution may encourage early-stage fundamental investors, the SPAC can't have a specific target at the IPO, so investors have no prospective business to analyze.

The reduced promote could also backfire in the case of a deal that is close to attaining adequate shareholder approval but can't quite make it. In such a situation, the typical 20% promote may benefit management, who can appease shareholders by giving back some equity.

"Let's say you're Goldman and you're the SPAC management," explains **David Miller**, the managing partner with the New York law firm of **Graubard Miller**. "If you're a guy with a 20% promote and the Street doesn't think it's as good a deal as you thought, you could always go to the Street and say, 'We're giving back 10% of our stock, we're giving back 12.5% of our stock.'"

But there might not be enough left on the table with the reduced promote, **Miller** said.

"With 7.5%, you sign your definitive merger agreement, you announce your deal, and for whatever reason the Street doesn't think it's that great a deal: Your goose is cooked."

Clearly, investors are scrutinizing deals more closely than ever, and no amount of tinkering with deal structure will make up for a marginal target. This brings in one important deal feature that isn't new – old fashioned hard work to find a target with strong enough financials to impress fundamental investors disgusted with the negative returns posted by the majority of post-acquisition SPACs.

Miller and others think this key ingredient remains constant. "The secret is – and it's been the same since 1993 when we did the first SPAC –you've got to find a good deal," Miller said.

"And it's got to be a good deal at good valuations. Whether the insiders have a 20% promote or, as in the Goldman case, a 7.5% promote, they still have to negotiate a great deal to acquire a target at a valua¬tion that will result in the stock price climbing above trust value."

This sentiment is echoed by Rubinstein, who said, "It's got to be a very solid company that's profitable or somehow in a sector or a geographic region that's perceived as having a lot of growth."

"For example, there are some of the China deals, or some sector-specific deals where people are willing to take a risk, where people feel there is a lot of upside," he said. "But a regular company that doesn't have some particular sex appeal has a high bar to get over in order to demonstrate that it's a good candidate for a fundamental buyer to put their money into."

Those fundamental buyers and SPAC shareholders alike will pass judgment quickly, and they want to see immediate upward movement in the SPAC stock as soon as an intended acquisition is announced.

Bulldog Investors founder Phillip Goldstein puts it very concisely. "If shareholders don't see the stock go up on the announcement, the deal isn't likely to happen."

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