THE SPAC REPORT

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Year in Review

SPACs Could Revert to Old Structures, Sizes

by Meghan Leerskov

Fueled by the easy availability of capital, the SPAC market grew too large and too fast in 2007 and early 2008, tying up billions of dollars of investors' money in blank check companies that may struggle to find attractive acquisitions.

Bankers and legal advisers to blank check companies now expect a more austere SPAC market to emerge by mid-2009. In place of the SPAC offerings that in some cases topped $800 million may come smaller offerings run by teams that have proven their facility with the SPAC structure in the past. Deals in the future could look more like they did in 2004, when blank check companies emerged onto the capital markets, than in 2007 and 2008 when SPACs dominated the market.

In the meantime, new SPAC offerings have stopped.

"Greed, demand and bigger-is-better attitudes drove up SPAC sizes," said a chairman at a New York boutique investment bank that works with SPACs. "Banks got more fees and management got larger carries, but at the end of the day those SPACs have a small pool of merger partners."

There are still 43 active SPACs with $10 billion in cash in their war chests, however. Some of those companies may be ideally positioned to make acquisitions at reduced valuations. Companies that once might have expected outsized valuations in SPAC transactions are now shut out of the capital markets and may hungrily eye SPACs' billions for funding.

Some market players are hoping for one stellar acquisition to reinvigorate the SPAC market as some say the deal between money management firm GLG **Partners** and **Freedom Acquisition Corp.** did in 2007.

"I have to believe that a SPAC with a trust of millions of dollars will only become more and more attractive as the economic malaise wears on," said David Alan Miller, the managing partner at law firm **Graubard Miller.**

SPACs with less than $100 million and nine to 15 months left in their charters are best situated to make deals, the investment banker said. Just 13 SPACs still seeking a target fit those criteria.

Acquisitions struck last year, as the credit crisis began to drag down the economy, may have a harder time. Deals made at pre-collapse valuations will likely be forced to liquidate, said one long-time SPAC attorney representing about six SPACs working to complete mergers. A total of 26 SPACs with $3.3 billion have agreed to mergers that are not yet complete. About 40 SPACs announced deals in 2008, although some of those have since dissolved or completed their mergers.

"Unless [SPACs] have really enlightened targets willing to take a lesser valuation in order to assure the deal's approval and a premium after the merger, these SPACs are in trouble," Miller said.

There have already been 31 SPACs that have liquidated or announced plans to, so far.

That is one of the reasons why there have been no new SPAC offerings since August, and no new SPACs that have registered shares for an IPO since the third quarter of 2008.

There were 17 SPAC IPOs in all of 2008, raising $3.8 billion. That is 69% less capital than was raised in 2007, when 66 SPACs brought in $12.1 billion.

New public offerings have also stopped because of the low prices that previously issued SPACs are trading at. Few investors will buy units in a new SPAC when so many can currently be bought at a significant discount to their IPO price, said Miller.

In fact, just one SPAC, **Middle Kingdom Acquisition Corp.,** was trading above its IPO price recently — and just by 5 cents. Units in the most recent public offerings, **CS China Acquisition Corp.** and **Chardan 2008 China Acquisition Corp.,** were both trading at about 14% below their IPO prices as of early January.

The entire IPO market didn't do much better. There were 48 IPOs in 2008 that raised about $28.2 billion, according to data from **Renaissance Capital** and DealFlow Media. The number of offerings dropped off by 74% from 2007. SPACs accounted for 14% of all IPO proceeds in 2008, down from 20% in the previous year. In 2008, SPACs made up 35% of all IPOs. They had accounted for about a quarter of the IPOs in 2007.

There were 50 new SPACs that registered shares for IPOs in 2008, a decrease of 38% from the previous year. The fourth quarter was the first period without a new registration since SPACs reemerged in late 2003. The amount that new SPACs registered to raise dropped by 59% to $8.1 billion, compared with the $19.5 billion that could be raised by SPACs that filed to go public in 2007.

The number of SPACs that called it quits before their IPO doubled last year to 14.

More than 80 SPACs remain registered to go public that have not yet done so. But some, like **Pharmamatrix Acquisition Corp.** and **TC Acquisition Corp.,** have been in registration for as long as three-and-a-half years. Few expect SPACs languishing for years in registration to ever go public.

SPACs that withdrew offerings in 2008 had planned to raise $2.8 billion. In 2007, seven SPACs that had registered to raise $520 million called off their IPOs. Already this year, one SPAC, **Greenstreet Acquisition Corp.,** withdrew its $300 million offering.

Next IPO Months Off

Several insiders said that they don't expect that there will be a SPAC IPO for at least three to six months. "Until the supply is absorbed and [a SPAC] makes an announcement that then trades well, then we won't see new IPOs," said the chairman at the New York bank.

One investment banker speculated that money manager Mario Gabelli's SPACs, **Gabelli Entertainment & Telecommunications Acquisition Corp.** and **Greenwich PMV Acquisition Corp.,** might be the first offerings to break the ice. "Mario Gabelli is very aggressive about getting his deals done," said the banker, who is not involved in the offerings.

But even Gabelli's SPACs, which would raise $125 million and $200 million, are larger than what many dealmakers expect in the next generation of blank checks. Bankers and attorneys said that the largest SPACs will likely not be bigger than $100 million and that $20 million to $50 million deals will dominate the landscape. SPACs that filed to go public in 2008 planned to raise an average of $161.3 million. That was one-third less than the average SPAC in 2007.

Originally, the standard strategy for a SPAC was to go public with a savvy management team to acquire smaller companies in a business that the managers were familiar with, said Peter Weprin, who specializes in SPAC deals for investment bank **Cowen and Co**. But then SPAC offerings grew. And grew. "All of a sudden the management teams are $500 million buyout guys," Weprin said. "That's not their expertise and that's not their comfort zone."

In fact, the average size of a SPAC IPO has grown every year since 2003. A SPAC IPO in 2008 brought in an average of $226 million, 19% more than in 2007. The average deal in 2007, at $183.5 million, was 96% larger than in 2006.

It remains to be seen if smaller offerings will right the market. Former SPACs that raised $50 million or less in their IPOs were recently trading about 63% below their offering price, according to data from investment bank **Morgan Joseph & Co.** SPACs that raised more than $50 million are only faring slightly worse, off 64% from their IPO prices.

Large Banks Getting Out?

If SPACs begin to make smaller offerings, it is likely that the flood of larger underwriters that entered the market in 2007 will disband their SPAC teams, many say.

In the meantime, however, firms including **Deutsche Bank** and Citi that have been hard hit by the credit crisis have reportedly spared these teams in recent layoffs.

"Certainly they need the SPAC teams to wrap up these funded deals, so I don't see them getting laid off until the SPACs go through the cycle," said the chairman of the boutique investment bank. "And if they do good deals, they won't get laid off."

Large banks "are not cutting a lot of heads in their SPAC capabilities," said Weprin. "There are hundreds of millions of deferred fees still outstanding."

In fact, if bankers deferred 3.5% of their fees until a SPAC completes a business combination, and there are about $13.5 billion still held by active SPACs, that is potentially $472.5 million in uncollected fees.

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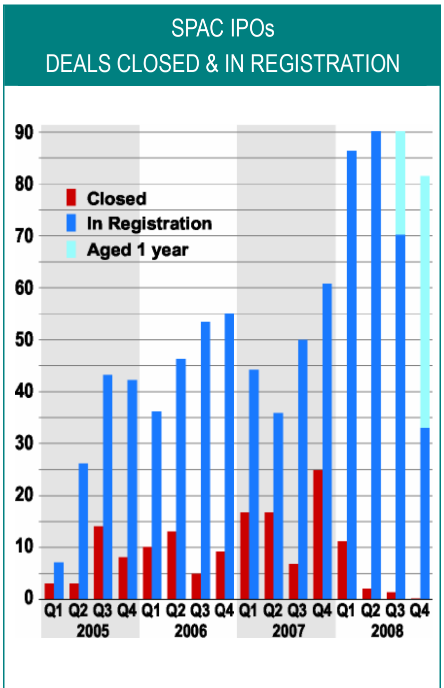
Graubard Miller

The chairman of the bank expects that bulge-bracket firms won't underwrite any new SPACs, however. The firms that are comfortable with smaller deals, like **Ladenburg Thalmann & Co., Morgan Joseph, Maxim Group, EarlyBird Capital** and **Rodman & Renshaw,** will likely remain in the market.



Source: *DealFlow Media*

Tapping Endowments for Cash

Some dealmakers disagree over whether it's the economy at large or the SPAC structure itself that has backed the market into a corner. But most are in agreement that changes must come, especially in regards to which investors are routinely targeted by underwriters.

"There will be a different audience," said Miller. "The buyers of SPAC IPOs will change and it won't be the typical hedge fund buyers from before."

Hedge funds, which have historically been the largest buyers of SPAC shares, have developed a tenuous relationship with the companies. SPACs have relied on the firms to buy into IPOs and approve mergers. But some hedge funds, facing redemptions, have liquidated SPAC holdings, contributing to depressed share prices. The low prices have in turn made it difficult to get mergers completed. With SPACs trading below their trust value, many shareholders opt for the cash and vote down mergers.

Despite these difficulties, SPACs did manage to complete 20 mergers in 2008 valued at more than $5.1 billion.

Weprin believes that high-networth investors and endowments may be an untapped resource for IPO dollars. These investors and institutions were burned by hedge funds and may be looking for more liquid and transparent investments, he said. "I see SPACs as giving them an opportunity to participate in non-public opportunities, to pick the team and the deal, and if you don't like it, you put in a sell order and you're out that day," Weprin said.

Harvard Management Co., which manages assets for the university, has invested in as many as 10 SPACs recently.

But in the mean time, the investment banker says that hedge funds aren't necessarily looking to give up on SPACs. "Hedge funds are alive and well," he said. "They tell me, `[SPACs] outperformed every sector in my universe.' They are down 6% in their SPAC portfolios, but being down 6% is the new up. They are very happy."

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