

Financial sponsors go on a SPAC attack

Once a shaky alternative to conventional IPOs, these special-purpose acquisition companies are being used by private equity firms to buy and exit portfolio holdings.

By Bill Meagher Updated on August 12, 2016, 11:31 AM ET

Over the last year, more than half of the initial public offerings and registrations tied to special-purpose acquisition plays have been led by private equity players. And while PE investors have always had a connection to this quirky corner of Wall Street, the bond has never been this pronounced.

According to **PrivateRaise**, a service of The Deal LLC, nine SPACs since August 2015 have raised almost \$3.8 billion in IPOs led by PE-related entities. That total includes a \$510 million private-equity-in-public-equity, or PIPE, transaction prior to the \$690 million May 2016 IPO of CF Corp. (CFCO), a blank check company led by former **Blackstone Group LP** dealmaker **Chinh Chu** and Fidelity National Financial Inc. Chairman **William Foley**. The CF deal was the largest transaction in the past year, but it certainly wasn't the only transaction that included marquee private equity investors.

July, for example, saw Conyers Park Acquisition Corp. (CPAAU) sponsor Centerview Capital Holdings debut its \$402.5 million IPO, and TPG Capital LP is behind the \$450 million IPO of Pace Holdings Corp. (**PACE**). **Riverstone Holdings LLC**, a PE firm focused on the energy sector, priced its \$500 million **Silver Run Acquisition Corp.** (SRAQ) **SPAC** in February. Fellow energy player KLR Holdings raised \$85 million with its KLR Acquisition Corp. (KLRE) in March.

Marc Lasry of Amroc Investments LP and others brought **Boulevard Acquisition Corp. II** (BLVD) public last September in a \$370 million transaction and the Gores Group checked in with **Gores Holdings Inc.** (GRSH), an August 2015 IPO of \$375 million. **Easterly Acquisition Corp.** (EACQ) came public last August, raising \$200 million and already closed its merger, grabbing up solar company **Sungevity Inc.** Global Partner Acquisition (GPAC) raised \$155 million in August 2015, as well.

And of the nine SPACs that have registered but not yet priced an IPO in the last year, five of them—Colony Global Acquisition, Dundon Capital Acquisition Corp., NB Capital Acquisition Corp., PMV Acquisition Corp. and Highland Acquisition Corp.—all have PE ties.

SPACs are investment vehicles created for the purpose of bringing private companies public, raising capital for the transactions via IPOs, with the proceeds placed in a trust designated for the transaction costs. The vehicles have a specific time period, generally 18 months to 24 months in which to close a merger. Should the SPAC fail to complete a transaction, the IPO revenues are returned to investors, who also generally have the option of voting against deals that don't make their grade, and have their investments returned.

Sponsors generally receive common stock equal to 20% as compensation for putting the deal together, similar to the carried interest in a PE deal, and those shares are locked up for a period of at least 12 months.

Sometimes referred to as the "poor man's private equity fund," SPAC's have never gained the full respect of Wall Street or regulators, in part because the vehicles were targets of fraud in the 1980s. After a hiatus, new SPACs began forming in the early 2000s. In 2007, 81 SPACs went public raising \$19.6 billion, but just two years later, with the economy in tatters and Wall Street still trying to find its way, just three SPACs went public, raising a mere \$118 million, according to PrivateRaise.

And though the current IPO market is challenging—just 56 deals priced this year, according to **Renaissance Capital**—SPACs are pricing regularly.

"It's the golden age of SPACs," said **Doug Ellenoff**, a founding member of the New York firm of **Ellenoff Grossman & Schole LLP**, which does a lot of work in the SPAC sector. "It is a combination of factors. The IPO market is down, private companies are now more comfortable with the SPAC program, and the sponsors who are involved in deals are stronger."

David Miller, managing partner with **Graubard Miller**, which has a solid SPAC practice, has a more PE-centric explanation.

"I think SPACs are perfect vehicles for PE sponsors for a couple reasons," he said via email. "First, PE guys are experts at finding solid target companies at a pre-IPO stage, so it stands to reason that they will also be discovering some interesting IPO-ready targets. Secondly, if for some reason their SPAC fails to locate an appropriate target business within a reasonable period of time, they will likely have a number of their own portfolio companies which could make suitable SPAC targets."

Skadden, Arps Slate, Meagher & Flom LLP Partner **Gregg Noel** also thinks there is another factor that helps explain the bump in PE SPAC plays. "I think the prominence of some of the recent PE players doing SPACs has had an impact. If it's working for them, it makes other market players willing to consider SPACs."

Among those buyout gurus is **Wilbur Ross**, once a workout artist for **Rothschild** who made his fortune in restructuring and distressed asset deals. Ross' PE firm rolled out a SPAC raising \$500 million in a June 2014 IPO. WL Ross Holding Corp. (WLRH) wound up buying chemical maker Nexco Solutions Holdings LLC (NXEO) from Fort Worth, Texas, PE firm **TPG** in June, with private equity on both sides of the same deal.

While the Ross SPAC didn't break brand new ground, it did serve as a signal to PE investors and others that SPACs were back as viable investment vehicles, and, in 2014, according to PrivateRaise, 36% of the SPACs that went public had PE backing,

raising a little over \$1 billion. (Last year, that figure for PE-backed SPACs dropped to 25%, but the volume rose to almost \$1.5 billion.)

While PE investors clearly find SPACs attractive vehicles, they don't want to talk about their investments or the strategies behind them. Just one investor contacted for this story was willing to talk, but not be identified.

He said that 10 years ago, SPACs were sponsored by management teams who were short on expertise and the vehicle suffered from a poor reputation among investors. But that reputation has slowly improved to the point where private equity firms and players consider the vehicle a legitimate investment.

"It is an interesting form of liquidity and given our expertise at funding companies and deals, it now makes sense to be involved," this person said.

The source also said that with the difficulties facing the IPO market, SPACs make more sense.

A chicken-and-egg question has also been hatched in the sector, as larger investment banks get into the deal mix. Traditionally, smaller investment banks such as **EarlyBirdCapital Inc.** I-Bankers Securities Inc. and **Chardan Capital Markets LLC** have done the majority of the heavy lifting in terms of underwriting. But larger banks such as **Deutsche Bank Securities Inc.**, **Citigroup Global Markets Inc.** and **Bank of America Corp.** are now edging higher in the SPAC league tables. And for the first time in memory, **Goldman, Sachs & Co.** underwrote a SPAC IPO, signing onto Silver Run Acquisition Corp.'s \$450 million offering, which was upsized to \$500 million.

Is it the size of the deals, a bad IPO market or the fact that some of the PE players have strong working relationships with the banks that are getting larger, better known financial institutions involved with SPACs? Perhaps all those things are in play, according to the security lawyers who talked to The Deal for this story.

"If you are already doing business with them (PE firms), why wouldn't you pitch them a different product?" Noel asked.

The SPAC product itself may also be morphing a bit. In the past, each unit sold in a SPAC IPO included one common share and a warrant to purchase another common share at a specific price. Now most offerings include a warrant to buy half-a-share, showing SPACs don't have to put so much on the table to bring investors in.

In another possible tweak in SPAC strategy, CF, the blank check company led by Chu and Foley, is said to have anchor investors which include Blackstone as well as Singapore's sovereign-wealth fund **GIC**, **Corvex Management LP** and **George Soros' Soros Fund Management LLC**. Those investors are projected to hold their shares regardless of the investment that Chu and Foley bring home. That stability can ease cash concerns for CF as it hunts for a merger.

Since SPAC investors can vote with their feet, trading their shares in for cash if they don't like the deal presented by sponsors, PE firms can face a cash crunch when closing time arrives.

This is especially true given the popularity of SPACs as investments with hedge funds. Given low interest rates, a choppy IPO market and the fact that the funds can park their capital in SPACs for a relatively short period of time—and pull their cash back out if they don't like the deal — hedge funds such as **AQR Capital Management LLC**, **Davidson Kempner Capital Management LP** and **Polar Asset Management Inc.** are among the most active SPAC investors. Since 2014, those three funds alone have invested in 46 SPACs, according to PrivateRaise.

Conversely, SPACs another buying option for PE players. While few companies are going public, that doesn't mean that there are fewer candidates. Private companies that might have looked to IPO are now in the mix as merger targets for blank check companies sponsored by private equity interests. The deal announced last month in which Silver Run said it will acquire Denver-based Centennial Resource Production LLC is one example, given that Centennial had filed a registration statement in June for its own \$100 million IPO.

A fluid SPAC market also provides PE firms with an exit option or an opportunity to thin their portfolios by recruiting a SPAC as a deal partner.

With PE players involved in more SPACs, buyers may view the vehicles differently. In the past, when blank check backers were coming from a variety of business and sector backgrounds, private companies weighing SPAC-induced mergers had to evaluate the likelihood of the deal closing and whether enough shareholders would stay on board. With SPACs backed by the likes of TPG and Centerview, the deals are more likely to close and be viewed in a positive light by private companies.

"From a seller's perspective, it is important to have a sophisticated buyer who 'knows the drill,'" said Graubard Miller's Miller. "Clearly a PE sponsor fits that bill."

The acquisition of **Nexeo Solutions Holdings LLC** (from TPC) by WL Ross Holdings and **Hostess Brands LLC** by Gores Holdings (with Hostess parent Apollo Global Management (APO) on the other side of the table), certainly speaks to how PE-backed SPACs are viewed.

While there are several components that are leading PE players to sponsor SPACs, their presence is still not enough to keep the market rolling.

"I don't think larger underwriters and PE players necessarily bode well for SPACs as a vehicle, unless those PE-sponsored SPACs make excellent acquisitions that trade well after consummation," Miller said. "That's what it is all about. The SPAC marketplace improves when the business combinations perform well."

