

**PUBLIC FINANCING VEHICLES FOR PRIVATE COMPANIES (Part 1)**

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Many of this column's recent articles have been focused on the private equity and credit markets, partly in response to increased liquidity and deal appetite among these pools of capital. Of late, however, it seems that the public markets – despite restrictive qualifications for IPO's and expenses associated with Sarbanes Oxley compliance – have emerged as a potentially even more attractive source of capital for growing companies. Primarily as a reflection of hedge funds' escalating liquidity, innovative structures are being devised to help these funds expand beyond their core investment strategies. For private companies in need of capital, these structures include funding vehicles such as PIPE's (private investments in public entities), reverse mergers into public shells (followed by PIPE financings), and the recent proliferation of SPAC's (special purpose acquisition companies, otherwise known as “blank check” companies) – which is the topic of this month's column. (Next month, we will provide an overview of recent developments in the more traditional reverse merger arena.)

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A SPAC is a publicly traded shell company managed by a team whose mandate is to identify a private target to merge with or acquire. Unlike a traditional reverse merger into a public shell, a SPAC is specifically created for the purpose of a merger or acquisition, and to that effect has gone through the IPO process and raised money from institutional investors (typically hedge funds). Approximately 85-90% of the cash raised by a SPAC in its IPO is held in escrow and cannot be used by the SPAC until a merger or acquisition transaction is consummated by it. The SPAC typically has a time-limit of 12-18 months to complete a transaction, which limit may be extended if the SPAC has identified a target and is in the process of completing the deal. Any transaction must be approved by the SPAC's shareholders.

A SPAC can usually be flexible in terms of deal structure, and can affect a cash- as well as stock-deal, or variants of both cash and stock. In other words, the SPAC can use stock in a merger transaction and then release the escrow cash to the resulting entity to be used for future growth; or, alternatively, the escrow cash of the SPAC can be used to acquire the stock or assets of the target company. In either case, the SPAC can only consummate one transaction.

*...[public] transaction may be more attractive than raising private equity capital if an industry consolidation opportunity exists and/or the low discount rates in the public markets result in a new valuation premium...*

Upon completion of this transaction, the name of the SPAC and its ticker symbol change to reflect the target's profile or actual name, depending on the situation. The resulting entity's board composition will be driven by the valuation ratios of the two former entities (i.e. the negotiated value of the target to the value of the SPAC, which is typically its cash plus some premium to reflect the value of its public status and any management expertise it may offer). There are typically no set constraints upon these valuation ratios. There are, however, industry-target constraints for most SPAC's, as each one would have had to state its objective and perceived opportunity at the time of its IPO.

As mentioned above, SPAC investors are most commonly hedge funds, and there is an active trading market in SPACs based on a given SPAC's probability of securing a deal, the type of deal anticipated, target valuation, etc. Many SPACs have been structured to include detachable warrants, requiring the SPAC's (not the target's) management team to purchase a significant percentage of these warrants as a show of confidence. The amount of cash raised by individual SPACs to-date has varied between roughly \$20 million and \$200 million, and by latest count there are some 35 (plus or minus) SPACs currently trading. The number of transactions actually consummated or announced by SPACs is in the low single digits, but this may be a reflection of the relative youth of these vehicles in the marketplace.

*...performance of the resulting public shares is an element of potential risk.*

For private companies, a SPAC transaction may be more attractive than raising private equity capital if (a) an industry consolidation opportunity exists, in which the availability of public stock as currency is an advantage, and/or (b) the relatively low discount rates in the liquid public markets result in a net valuation premium, despite the cash drain of Sarbanes Oxley compliance. The post-merger performance of the resulting public shares is an element of potential risk, and a point of further consideration that will be touched upon in next month's column.

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