EVERSHEDS SUTHERLAND

Selling to a SPAC

Key legal considerations for target companies

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Agenda

- What is a SPAC?
- The de-SPAC transaction: Customary deal terms
- The de-SPAC transaction: Getting the deal done
- What a Target Company's shareholders can expect post-acquisition
- Public company preparedness
- Timeline for a SPAC acquisition

What is a SPAC? (General background)

- A SPAC is a “special purpose acquisition company” i.e., a so-called “blank check” company that is organized to raise capital in an IPO in anticipation of identifying and acquiring one or more operating companies through a business combination
- As a blank check company, a SPAC does not have commercial operations until the first business combination (often referred to as the “de-SPAC transaction”) is consummated
- A SPAC is typically formed by sponsors that believe that their experience, reputations and access to proprietary deal flow will allow them to identify and complete a business combination with one or more companies that will be successful as a public company

What is a SPAC? (General background)

– Founders (i.e., the SPAC management team) invest initial capital in the SPAC to commence its operations
  - Founders typically acquire a class of convertible common equity from the SPAC for nominal value, often only $25,000
  - Upon completion of the initial business combination, the Founders' shares are automatically converted into the same class of common equity that is issued to the public
  - The Founders' shares are subject to adjustment such that founders retain a specified percentage (typically 20%) of the outstanding equity of the company following the initial business combination
  - The retention of Founders' equity is akin to the carried interest in a private equity transaction, and incentivizes management to find an attractive target and close a business combination
  - The Founders also typically acquire warrants for $1.00 each (with an exercise price of $11.50) in order to fund certain costs associated with the formation of the SPAC and related IPO; this is their "at risk" capital; warrants can be exercised on a "cashless basis"

What is a SPAC? (General background)

- In its IPO, the SPAC issues “Units,” with each Unit consisting of one share and a warrant (or more often, a fraction of a warrant)
  - IPO price typically set at $10.00 per unit
  - Warrants are typically issued out of the money (115%-120% of unit offering price) and whole warrants are exercisable only following completion of a business combination
  - Units typically separate into shares and warrants and trade separately 52 calendar days after the date that the IPO closes
  - Public warrants can typically only be exercised for cash
- Significant percentage of IPO proceeds, at least 90% and often closer to 100%, are placed in a trust account until a business combination is completed or the SPAC is liquidated

What is a SPAC? (General background)

- From the perspective of a privately held target company (Target), selling to a SPAC (the “de-SPAC transaction”) can have a number of advantages:
  - A de-SPAC transaction can provide a partial or complete exit strategy for founders and early stage investors
  - A de-SPAC transaction is an efficient way to complete a “back door” IPO of Target (similar to a reverse merger), since the Target will be publicly traded following the de-SPAC transaction
  - A de-SPAC transaction can create a publicly traded platform for growth and/or future acquisitions
- A de-SPAC transaction avoids the lengthy and expensive SEC process associated with traditional IPOs
  - A de-SPAC transaction is generally an easier way to go public for pre-revenue or early-stage companies and/or companies focused on unproven or disruptive technologies, such as autonomous vehicles, alternative fuels, or 3d printing, for example
  - A de-SPAC transaction is less dependent on the state of the capital markets generally and the IPO market in particular

Real life example – Accel Entertainment

- Industry
- Stage of growth
- Nature of investors
  - Founders
  - Employees/ESOP?
  - Venture Capital/Private Equity?
- Strategic objectives
- How a SPAC came on the radar

The de-SPAC transaction

- SPACs are subject to restrictions on operations following IPO
  - Operations are limited to searching for de-SPAC Target and related actions; Target company <u>cannot</u> have been identified before IPO is completed
  - Management team cannot receive compensation from the SPAC during the period prior to consummation of the de-SPAC transaction
  - Founders’ equity gets to elect board prior to de-SPAC transaction.
  - Deadline for completing a business combination is typically 18 or 24 months from the date of the IPO; extension may be granted by shareholder vote
  - The transaction size requirement for the business combination must be at least 80% of IPO proceeds
  - However, transaction size can be a multiple of IPO size through the use of a PIPE (private investment in public equity) transaction and/or debt financing

The de-SPAC transaction

- Not your typical sale of private company to public company
- Consideration
  - Consideration payable to Target’s shareholders can be all cash or all stock, but is often a combination of stock and cash
  - Where the target company itself has multiple classes of equity holders and other stakeholders (e.g., multiple venture capital rounds), the allocation of the SPAC merger consideration can be complex and the subject of significant negotiation
  - PIPE transactions often close concurrent with the de-SPAC transaction to provide additional liquidity for the SPAC to pay merger consideration or operating expenses
  - Significant target company shareholders (in addition to SPAC sponsors) are often subject to lock-ups with respect to their SPAC equity for a certain period of time (6-12 months) after closing
  - SPAC equity issued to target company shareholders in a de-SPAC transaction is usually registered with the SEC. However, if a target company shareholder would be deemed an “affiliate” of the SPAC after the merger, the shareholder’s SPAC equity would be “control securities,” and registration rights would be required for the resale of these securities prior to the expiration of a holding period
  - Sometimes a portion of the equity consideration payable to target shareholders is subject to an earn out based on the public company’s stock price post-acquisition

The de-SPAC transaction

- Notwithstanding the closing certainty issues, SPACs usually are not subject to reverse break fees, due to the unavailability of pre-closing assets to backstop such obligations (the trust account is not available to compensate the target company or its shareholders)
- De-SPAC transactions do not typically permit post-closing indemnification to the selling shareholders, due in large part to the use of stock consideration and the difficulty in obtaining agreement of Target shareholder base
- Target companies are frequently able to negotiate for "fiduciary out" protections

Real life example – Accel Entertainment

- Consideration
  - Stock versus cash?
  - Rollover of Management Equity?
- Unique terms?
  - Indemnification?
  - Rep and warranty insurance?
  - Earn-Out?
  - PIPE transaction?
  - Debt financing?
  - Termination or reverse termination fees?

Getting the de-SPAC transaction done

- Closing conditions
  - SPAC shareholder approval requirement
    - If the transaction is not approved, the SPAC can re-commence its search for a Target if there is time remaining
    - Alternatively, if no time remains in which to realistically find a new Target, the IPO proceeds are released from escrow and returned to investors
    - Typically, the Founders are obligated to vote in favor of the de-SPAC transaction
  - Potential need for Target shareholder approval
    - Depends upon the nature of Target stockholder base
  - Governmental and other approvals
    - S-4 registration statement if SPAC shares will be issued to Target Shareholders
    - Hart Scott Rodino antitrust filing
    - CFIUS (Committee on Foreign Investment in the United States) filing/review, if applicable
    - Other regulatory filings/approvals, depending on industries in which Target operates

Getting the de-SPAC transaction done

- Redemption condition: Investors can reject business combination and redeem shares for pro rata portion of IPO proceeds that are held in a trust account
    - Even if de-SPAC transaction is approved, shareholders can redeem
        - Shareholders can vote in favor of deal but redeem shares
        - Shareholders always get to hold on to warrants
    - In certain cases, a maximum redemption condition is imposed as a closing condition
    - In other cases, cash from PIPE investors and/or debt financing can cover the required cash component
    - Founders typically agree to not redeem their equity
- Minimum cash condition
    - Due to the redemption option, prior to the redemption vote a SPAC will not know the amount of cash in its trust account
    - PIPEs can offer the benefit of cash certainty

Real life example – Accel Entertainment

- How far into life of SPAC was deal?
- Concerns obtaining the SPAC vote?
- Accel Entertainment shareholder vote required?
  - Controlling stockholders?
  - Drag-along/Tag-along rights?
- Governmental approval concerns (e.g., gaming commissions?)
- Redemption concerns?
  - What level of redemptions?
- Was PIPE/debt financing necessary to keep deal together?

What a Target's shareholders can expect post-acquisition

– Post-closing equity capitalization

- Following closing, to the extent stock consideration is issued to the target's shareholders, the target's shareholders can expect to share equity ownership of the publicly traded company with three main groups of stockholders:
  - Sponsor
  - Public investors
  - PIPE investors
- Illustrative equity capitalization following IPO:

Holder	Shares	Warrants
Sponsor	7,500,000	6,000,000
Public investors	30,000,000	10,000,000

- Illustrative equity capitalization following de-SPAC transaction:

Holder	Shares	Warrants
Sponsor	7,500,000	6,000,000
Public investors	24,000,000 (20% redemptions)	8,000,000
PIPE investors	20,000,000	0
Target company shareholders	50,000,000	0

What a Target's shareholders can expect post-acquisition

- Transferability of SPAC equity
  - Many target shareholders are freely able to sell the SPAC equity issued to them in the acquisition immediately after the acquisition
  - Some target shareholder may be subject to a lock-up with respect to their SPAC equity
  - Other target shareholders may hold "control securities" which are subject to certain transferability restrictions
- Governance: Typically, the existing directors, officers and management of the target continue in their respective roles in the combined company (subject to any changes to the governance structure required by the purchase agreement)
- Due to securities laws and reporting requirements, many target shareholders will enjoy greater visibility into the company's operations after it becomes publicly traded
- In certain cases tied to SPAC stock performance, warrants may be redeemable by the SPAC

Real life example – Accel Entertainment

- What did the general mix of ownership look like post-de-SPAC transaction?
- Significant lock-ups on stockholders?
- Noticeable impact on trading due to large Founder position?
- Noticeable impact on trading due to warrant overhang?

Target: Public company preparedness

– Financial statements

- Annual financial statements for the required periods in compliance with public company GAAP and SEC rules (Reg S-X, SEC Staff Accounting Bulletins, etc.) and audited under PCAOB standards (rather than AICPA standards commonly used for private companies)
  - Generally, three years of audited financials required, but a target may provide two years under certain circumstances, including if the target would qualify as a "smaller reporting company," or if the SPAC is, and the target would be, an "emerging growth company" and the SPAC as not yet filed a Form 10-K
- Interim financial statements for required periods
- MD&A and market risk disclosures (requires rigorous budgeting and forecasting processes)
- Pro forma financial information giving effect to the business combination (required in the de-SPAC proxy statement)
- Separate financials of businesses recently acquired by the target (if applicable)
- Entities that qualify as "foreign private issuers" benefit from reduced reporting obligations
- **NOTE: SEC's evolving position seems to require warrants to be treated as liabilities versus equity**

– Financial reporting

- Identify and effect the changes needed to report as a public company
- Sarbanes-Oxley requires that the CEO and CFO certify that there are no material misstatements in the financial statements
- Ensure proper financial reporting controls are in place

Target: Public company preparedness

– Governance

- Board compensation
  - Stock exchanges require a majority of independent directors (and proxy advisory firms often look for a high percentage of independent directors)
  - Often the board of the combined company is separated into classes
- Committees
  - Exchanges require audit, compensation and nominating and governance committees, and impose independence and financial sophistication requirements on committee members
- Policies and procedures (insider trading policy, corporate governance guidelines, etc.)

– Human Resources

- Engage compensation consultant
- Adopt public company-style compensation plans for officers, board members and employees
- Understand the extensive compensation related-disclosure required for public filings

– Other

- IT upgrades to streamline the foregoing processes are a must

Real life example – Accel Entertainment

- Describe life as a public company versus a private company
- Was it a significant transition for Accel?
- What governance changes occurred?
- Necessary to hire more employees to operate as a public company?
- Role of outside counsel?

Timeline for a SPAC acquisition

- No discussions may be had with a target prior to a SPAC's IPO
- The amount of time from initial discussions to execution of a definitive agreement varies, but between one and two months is typical
  - During the period between discussions and announcement of a transaction, a target company should assess its public company preparedness and begin preparations to operate as a public company
- An acquisition is typically completed three to five months after a definitive agreement is executed:
  - 1 month after definitive agreement to file preliminary proxy statement / registration statement
  - 1 - 2 months for SEC comments on proxy statement / registration statement and responses
  - 1 month after filing of definitive proxy /registration statement to hold SPAC shareholder meeting
  - Closing promptly after SPAC shareholder meeting
  - Four business days after closing, file "Super 8-K"
- Six months is a typical time period between initial discussions and closing (though the amount of time varies)

Real life example – Accel Entertainment

- Describe the general timeline of the de-SPAC transaction
- Describe the bottleneck areas that required the most focus

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