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## SPACs rise in popularity, contribute to M&A activity

The Special Purpose Acquisition Company, commonly referred to as a SPAC, has experienced a tremendous rise in popularity over the past year. Wall Street has endorsed these investment vehicles, with major investment banks such as Citigroup and Deutsche Bank beginning to underwrite SPACs over the past year. As SPACs continue to gain traction in the marketplace, they will undoubtedly create increased competition for strategic and financial buyers.



### INSIDER VIEW

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A SPAC is an acquisition vehicle formed by a dedicated management team without an operating business. Management raises money through an IPO and uses the proceeds to fund an acquisition. The emergence of SPACs means that competition within the M&A arena will become tighter as a larger number of buyers compete for acquisition candidates.

SPACs not only provide an alternative source of capital but also afford potential targets and investors a number of advantages over private equity groups. Since a SPAC is a public shell, a private

company achieves public status immediately upon acquisition by a SPAC while avoiding the risk, time, and expense associated with an IPO. Therefore, SPACs offer private companies an important benefit that private equity groups are unable to provide: a direct and immediate path into the public arena. Ideally, the company would be bought at a fraction of what it would be later worth on the public market, resulting in large returns for investors.

Given that SPACs are public companies, the liquidity of the stock allows investors to sell their holdings as they deem appropriate. The management team must also execute an acquisition valued at 80 percent of the capital raised - or more - within a 12-month to 18-month time frame or the invested capital is returned to the shareholders. Unlike private equity groups, SPACs maintain voting requirements that allow investors to veto possible acquisitions with a majority vote.

The prominence of SPACs in the marketplace has also been driven by the potential for significant financial gains by their management teams. SPAC managers are required to purchase warrants on the open market on top of the 20 percent ownership stake they must hold. The stock is purchased at cents on the dollar, creating the potential for large payouts upon a successful acquisition. The ability to achieve large gains from a single transaction has lured the attention of prominent industry players.

In all, more than 50 SPACs filed to go public in 2005. About half of these made it to market, raising approximately \$1.2 billion in capital for acquisitions. That represents a significant growth in SPACs from 2004, when 11 went public, raising a total of \$500 million. This momentum has carried into 2006 with 18 SPACs executing IPOs so far this year and raising more than \$1.13 billion in capital.

While the number of SPACs that filed to go public and raised capital in 2005 was significant, the number of acquisitions completed was minimal. From 2003 until 2005, only 11 transactions were announced by SPACs. But in 2006 SPACs have proven their ability and desire to complete transactions, with 10 companies already announcing acquisitions.

SPACs represent a third tier to the M&A buyer universe, and, while they are relatively new to the arena, they appear to be gaining traction. The proliferation of SPACs coupled with access to larger amounts of capital and increased attention from the business community could engender an M&A environment characterized by intensified competition and higher valuations.

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