Professional Perspective

Acquisitions of Recent deSPAC'd Companies on the Rise

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Bloomberg Law

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In 2020, the SPAC boom began. Since then, it has resulted in 339 new public companies, according to the ABA's Deal Points Data. A number of these deSPAC'd companies—although only newly minted as public companies—have already agreed to be taken private. Indeed, 17 of them have done so: three in 2021, nine in 2022 and already five in Q1 2023. We expect this trend to continue, even in the face of a down market.

In the past 12 months, many companies have seen their stock price decline—e.g., both the S&P 500 and the Russell 3000 are down ~5%. In addition, the stock price of more than 85% of deSPAC'd companies—which is pegged at $10 per share at the time of deSPAC—is, at the time of this writing, now trading below $10 per share, with more than 65% trading below $5 per share.

While acquirors are often thrilled to acquire assets at lower price levels, targets in turn are not so elated to sell. If a target's stock price is depressed due to general market declines, its board will often see offers received during that period as not reflective of the target's true value. Many choose instead to continue the target's business plan, holding off any transformative deal until the stock price is more reflective of what the board believes is the true value.

This viewpoint, however, appears not to be the case for all deSPAC'd companies. Indeed, according to the ABA's Deal Points Data, 70% of the deSPAC'd companies that have agreed to be acquired agreed to a price per share below $10.

Cash Flow

One reason that these acquisition prices may be acceptable is that many deSPAC'd companies are either pre-revenue or do not generate sufficient cash from their businesses to sustain their operations in the long term. At the same time, many of these companies did not receive sufficient cash in their deSPAC transaction, as significant redemptions resulted in the SPAC delivering less funds and the PIPE market—which had been providing additional financing—effectively disappeared.

This has left many of these companies with an abridged cash runway. In other words, they need, or will soon need, a cash infusion to continue to operate. This issue has been exacerbated by the current challenges in the financing markets. The stock prices of most of these companies are down, in many cases significantly. The recent turmoil in the banking sector has made things worse. And a general dislike of SPACs still taints these companies.

Raising equity financing in this market can prove very challenging or unattractively expensive. In addition, raising traditional debt financing may not be an option, given rising interest rates and the need for sufficient cash flows to support interest or coupon payments. Against this backdrop, the sale of the deSPAC'd company, even at a price level below the deSPAC value, may be attractive—or, at the least, the best alternative—as it locks in value for the stockholders—which may be above many stockholders' cost basis, see next paragraph—ensures the business continues, and protects employee jobs.

Cost Basis

Another reason many deSPAC'd companies may be willing to consider acquisitions at this time is that, although the price may be lower than $10 per share, the cost basis for the vast majority of their stockholders could be well below $10 per share. So, the deal may in fact be quite good for the stockholders. Consider:

- **Stockholders of Target Pre-deSPAC.** The cost basis for stockholders who held shares of the target while it was private—i.e., before the deSPAC—is commonly pretty low, particularly for founders and early and mid-stage investors. Depending on how recent the deSPAC—including the prevalence of any lock-ups—and how frothy the valuation provided by the SPAC, it is likely that this group of stockholders still hold a majority of the deSPAC'd company's shares.

- **SPAC Sponsor.** The SPAC sponsor acquired its shares for a de minimis amount—often $25,000.

- **SPAC Public Stockholders.** These stockholders acquired their shares at $10 per share in the SPAC IPO. That said, significant redemptions—very often in excess of 50% of shares held by SPAC public stockholders—greatly reduce the number of these stockholders holding deSPAC'd company shares.

Although this group would be selling at a loss in a deal where the price per share was below $10, they are likely a small fraction of a deSPAC'd company's stockholder base.

- **PIPE/Other Financing.** At the time of the deSPAC, most companies enter into one or more financing arrangements, including PIPEs and equity support arrangements. Investors in these financing arrangements often acquire shares in the deSPAC'd company around $10 per share. Although this group would likely also be selling at a loss in a deal with a price per share below $10, they similarly represent a small fraction of a deSPAC'd company's stockholder base.

- **Stockholders Who Bought Shares Post-deSPAC.** The cost basis of this group of stockholders may be difficult to ascertain but will at least be correlated with the deSPAC'd company's trading price post-deSPAC. Additionally, the size of this group will likely be dependent upon how soon after the deSPAC the company is acquired—the sooner the acquisition, the smaller the group, and vice versa.

Even when agreeing to sell for less than $10 per share, boards of deSPAC'd companies can still act in the best interest of their stockholders and generally should be able to satisfy their fiduciary duties. When executing a sale transaction of a Delaware incorporated company, the board must satisfy its fiduciary duties of care—i.e., act in an informed manner—and loyalty—i.e., act in the best interest of stockholders—including making a good faith attempt to capture the highest value reasonably available for stockholders if Revlon applies. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1985).

In doing this, directors must consider the facts and circumstances as they present themselves to the board today—including cash runway, business plan execution risk, cost basis of stockholders, financing costs, etc.—and not those of yesterday. Indeed, boards are facing a world that is very different than the one in which the company deSPAC'd.

The board's job is to, in light of present circumstances, compare an acquisition offer against the company's current business plan—or updated business plan—taking into account the board's confidence in the company's management team to execute on that plan, and determine which is in the better interest of the stockholders. As a result, as long as the board satisfies its fiduciary duties in doing so, the board's choosing to pursue the acquisition offer alternative, as opposed to another, should withstand scrutiny.

Conclusion

In the end, although the market is down, and most deSPAC'd companies are trading below $10 per share, deSPAC'd companies have found, and may continue to find, doing a deal now attractive.

With assistance from associate Gargi Bohra, Morrison Foerster (not yet admitted to the bar in the U.S. and only admitted in India)