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(Excerpted)

SPAC Attack Specified Purpose Acquisition Companies Gain Favor

A handful of investment banks and merger experts are transforming the traditional “blank check company” into a favored vehicle to launch small but promising private concerns into the public sector. Blank check companies, which are essentially blind pools, have been long considered a sideshow of the capital markets due to past abuses. But the latest incarnations of the concept, which are commonly referred to as “SPACs” (specified purpose acquisition companies) or “TACs” (target acquisition companies), are enticing conventional investors in emerging growth companies seeking structured investment products that combine principal protection with upside opportunity.

What’s the attraction? SPACs give investors an efficient vehicle, from a time and money standpoint, to assess and invest in companies that are entering the public markets and thus offer an exit strategy, experts say. At the same time, they add, the structure minimizes investor downside compared with the inherent risks of investing in a true operating company’s initial public offering.

A SPAC is a cross between an IPO and a reverse merger: Individuals, who generally possess merger and acquisition experience and specialize in a particular industry, form a management team and hire an investment bank to underwrite an IPO to form a shell company. The SPAC then hunts down a merger candidate that wants a public listing, and the two businesses pursue what essentially amounts to a reverse merger.

In fact, a recent spate of SPACs parallels the rash of reverse mergers that have occurred over the last 18 months. Both ideas are reactions to the soft IPO market and the lack of investment banks willing to underwrite companies looking to raise \$20 million to \$35 million through a public offering, says David Nussbaum, chairman of EarlyBirdCapital.

Yet, while reverse mergers rarely provide private firms with immediate capital, SPACs infuse their target companies with cash raised through the IPO. Thus, during the IPO phase, these renovated blank check companies directly compete with PIPE issuers for capital. But SPACs that pull off mergers could very well increase private placement activity in the future. For instance, GraphOn Corp., which merged with the

blank check company Unity First Acquisition Corp. in 1999, issued a \$1.15 million common stock PIPE in February 2004, demonstrating the feasibility of combining a SPAC offering with follow-on PIPE financing.

“At the end of the day, SPACs are a structured financing product,” says Robert Moreyra, executive vice president and a director of CEA Acquisition Corp., a SPAC that completed an IPO in early 2004. “It’s like a tranching offering or a securitization where you break up the pieces and the pieces end up bigger than the whole.”

New Structure Blank check companies are hardly new – investors launched a flurry of vehicles similar to today’s SPACs in the mid-1990s before an insatiable IPO market gobbled up every deal in sight. But for nearly 15 years, the vast number of blank check companies have operated under Rule 419 of the Securities

Act of 1933 and the Penny Stock Reform Act of 1990, which provide certain protections to investors. Those include escrowing the gross IPO proceeds into an insured depository account or a separate bank account established by a registered broker-dealer until after a merger is completed.

The most recent SPACs, however, are exempt from Rule 419 and the penny stock rules because they have more than \$5 million in net tangible assets after their IPOs, and the SPAC units are selling at \$6 each, instead of \$5 or less. Still, advocates of the structure say SPACs align the interests of management and investors nearly perfectly, which provides shareholders with greater comfort than Rule 419. “The market recognizes there are measures built in to protect investors,” says **Mitchell Littman**, a securities attorney with Littman Krooks. “But what this really boils down to is the pressure on the management team.”

No Lack of SPACs Certainly the safeguards built into the latest SPAC structure have won over some investors. Since January 2004, 16 SPACs have raised over \$486 million through IPOs, according to information filed with the Securities and Exchange Commission [see “SPAC Tracker,” p. 22]. In the first four months of this year 12 more SPAC offerings have been filed, seeking to

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