

SPACS, THE "NEW" PRIVATE EQUITY VEHICLE IN CANADA – AN ASSET CLASS OF \$800M AND GROWING

Posted on June 30, 2015

Categories: [Insights](#), [Publications](#)

On June 24, 2015, Acasta Enterprises Inc. announced that it had filed a prospectus for an initial public offering (IPO) of \$275 million. If completed, this would be the largest, and the fourth, special purpose acquisition corporation (SPAC) to go public on the Canadian capital markets – all of this occurring over the past three months. The first three SPACs, Dundee Acquisition Ltd., INFOR Acquisition Corp. and Alignvest Acquisition Corporation, raised \$100 million, \$200 million and \$225 million, respectively. It is now clear that a new asset class is being quickly developed in Canada.

Given the SPAC trajectory, we believe it would be useful to reflect on the historical roots of SPACs in Canada and to summarize the current state of the market. To assist market participants, please see a [summary outline of the rules](#) governing SPACs and a comparison thereto of the structures implemented by the four SPACs that have been announced in Canada.

Background

The first four IPOs for SPACs in Canada no doubt caught some market participants off guard, primarily because the Toronto Stock Exchange (TSX) established the rules allowing for SPACs in December 2008. In fact, SPACs have existed in the United States market since the early 1990s. Since 2003, the use of SPACs as a viable alternative for investors looking to participate in corporate acquisition opportunities traditionally pursued by private equity firms has risen sharply within the American market. Between 2003 and 2008, more than US\$21 billion in gross proceeds were raised through SPAC offerings in the United States.^[1] It was this growing market interest in the United States that led the TSX to adopt SPAC rules in 2008 notwithstanding its initial reluctance to permit SPACs to go public in Canada, largely because SPACs lack an operational history and cannot meet certain financial standards. Since the financial crisis commenced in 2008, US\$9.4 billion in gross proceeds have been raised through SPAC offerings in the United States.^[2]

What are SPACs

A SPAC is a publicly-traded holding company with no operating business at the time of its IPO. Instead, SPACs are marketed on the strength of an experienced management team, sophisticated investors and a sponsor

(Founders). The Founders may be, but are not always, focused on a particular industry, sector or geographical area. SPACs require a minimum IPO of \$30 million and there must be at least one million freely tradable securities held by public holders and at least 300 public holders of securities, holding at least one board lot each. Generally, the proceeds of the IPO (or a significant portion thereof) are held in trust (or escrowed) while management seeks an appropriate target business to effect an undetermined future acquisition (a **qualifying acquisition**), which needs to be completed within 36 months from the date of the IPO. If a qualifying acquisition is not completed prior to the deadline, the escrowed IPO proceeds are returned to shareholders (other than the Founders).

Formation and General Structure

A small group of Founders will establish a SPAC. The Founders purchase common shares of the SPAC at a nominal price, and thereby obtain a significant carried interest. In the Canadian model,^[3] this carried interest is 20% of the issued and outstanding shares, 25% of which is subject to forfeiture if the trading price of the shares does not increase by more than 30% of the IPO price within five years of the IPO. Founders and/or sponsors will generally need to also acquire shares at the IPO price to finance the SPAC's pre-qualifying acquisition expenses.

The SPAC program is primarily governed by the rules of the TSX, and involves a two-stage process:

- the filing and clearing of a SPAC listing application and prospectus (to be prepared in accordance with applicable securities laws), the completion of the IPO and the listing of the SPAC's common shares on the TSX (including obtaining any required regulatory relief); and
- the identification and completion (following shareholder approval by majority vote) of a qualifying acquisition.

The SPAC program is similar to the capital pool companies program of the TSX Venture Exchange that has been available in Canada since 1987. Both programs enable companies with no assets and no commercial operations to enter the Canadian public capital market and later acquire an operating business using the proceeds raised in the IPO. However, the SPAC program operates on a larger scale, contains more stringent investor protections and is generally more attractive to a wider range of investors. However, at least initially, it would appear that investors in SPACs are institutions and high net worth investors, with the retail market primarily on the sidelines.

The SPAC program is not available to issuers that have entered into a written or oral binding acquisition agreement with respect to a potential qualifying acquisition prior to the completion of the IPO. However, a SPAC is permitted to engage in the process of reviewing potential qualifying acquisitions and may enter into

non-binding agreements, including confidentiality agreements and non-binding letters of intent.

Observations

While it is surprising that it has taken six years for the SPAC program to take hold in Canada, the advantages are clear to investors and acquisition candidates:

- A SPAC will have capital readily available to utilize when it identifies a qualifying acquisition, which will allow the SPAC to react quickly to any potential merger transactions and will thus provide an advantage over other competing bidders which may not already have such financing in place.
- A SPAC may also use its securities as currency in an acquisition, thereby allowing it to secure a much larger target while providing potential incentives for owners of prospective targets.
- Multiple acquisitions completed concurrently by a SPAC could provide access to a TSX listing for companies that do not individually satisfy the minimum listing requirements of the exchange.
- Consistent with the US model, investors have come to expect that all of the IPO proceeds will be deposited in escrow. As a result, SPACs' pre-qualifying acquisition costs are funded by the Founders/sponsors, providing greater security to investors and further aligning the interests of the Founders/sponsors with investors.
- The requirement of underwriters to deposit a minimum of 50% of their commissions from the IPO to be held in escrow (in the Canadian model, 58-59% of commissions have been escrowed), helps to motivate underwriters and agents to remain committed to the success of the SPAC following its IPO.
- The right of shareholders in the Canadian model to get 15% of their common share investment back (but still keep all of their warrants) in connection with the vote to approve a qualifying acquisition (conversion right), and the right to be repaid all of their investment if a qualifying acquisition is not completed on a timely basis (liquidation distribution right), help protect investors; and this contributes positively to the IPO marketing process.
- Unlike many private equity vehicles, investors are able to dispose of their interest on an exchange at any time they wish.
- The fees and expenses of SPACs which may be paid prior to completion of the QA have been very limited in the Canadian model – which compares favourably to traditional private equity management fees.
- SPACs that have a strong management team are well-positioned to take advantage of depressed stock prices of operating companies that are experiencing financial difficulties, especially during turbulent economic times.

The development of the SPAC asset class in Canada is new and it will be interesting to see how it develops. While the future of this asset class looks promising, long-term success will no doubt be linked directly to the

achievements of the early market entrants, and more specifically to the quality of the qualifying acquisitions completed by these early market entrants.

by Paul Davis, Hellen Siwanowicz and Marina Tran

1 Raymond D. King, Senior Manager, Global Diversified Investments, Toronto Stock Exchange and TSX Venture Exchange, "[Guide to Special Purpose Acquisition Corporations](#)" (accessed 2015, TSX Inc.).[ps2id id='1' target=""]

2 "[Fundamental Analysis](#)" (5 May 2015). [ps2id id='2' target=""]

3 In referring to the Canadian model, we mean aspects of the structure used in the four Canadian SPAC IPOs which are identical. See [chart](#) for more details.[ps2id id='3' target=""]

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

© McMillan LLP 2015