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# **Special Purpose Acquisition Companies**

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## **Abstract**

Special purpose acquisition companies (SPACs) are blank-check companies that raise funds from investors through a public offering of shares and warrants (known as a Unit IPO) for the purpose of buying a private firm. SPACs have no assets or business plan and their only intent is to acquire an operational business. Because of limited data (SPACs have only gained popularity in the past decade), there has been very little research into the nature of firms that are targeted for SPAC acquisitions, with most research focusing on short-term performance statistics. A SPAC transaction effectively takes an existing private business and makes it publicly traded; it is an alternate way for firms to go public. This paper will examine what differentiates a traditional IPO from a SPAC IPO by exploring the situations that cause a company to pursue a SPAC transaction, and thus shed light on the unique process and structure that these deals offer. This work expands on the current literature, which has examined only the short-term performance statistics of SPAC transactions, by using a case-study method to investigate several deals in detail and examine the environment that spawned these deals. By following the money trail and analyzing the returns, we will see the incentives for the SPAC founder, the investors, and the target acquisition. My research on SPACs will help all parties evaluate the pros and cons of these specialized transactions.

## I. Introduction

Special Purpose Acquisition Companies (SPACs) are publicly traded pools of capital that have been raised for the sole purpose of merging with an operating company (Berger, 2008). Because these pools of capital are publicly traded, when they acquire an operating company, that company becomes publicly traded. In this way, SPACs can be seen as an alternative to standard IPOs for companies.

SPACs offer a very different opportunity to investors than typical IPO purchases. The most obvious difference is the amount of knowledge available to investors at the time of investment. IPO investors have knowledge of the company that is being invested in, whereas SPAC investors have relatively no knowledge of the company at the time of the IPO, investing essentially in the founders' ability to find a profitable acquisition.

The structure of the SPAC transaction provides some protections for investors, due to the blind nature of their investment. Typically, 85 to 100% of the proceeds from the SPAC's IPO are held in a trust until a deal is made or the SPAC is forced to dissolve (Stowell, 2009). This trust is invested in U.S. Treasuries, so there is potential for a small amount of investment income should the fund dissolve (Tran, 2009). This trust benefits investors because of the voting rights investors have. When SPAC founders have found an acquisition target, the non-founder shareholders must vote to approve the transaction. Those who vote against the deal are entitled to a pro-rata share of the trust in exchange for their shares (Lewellen, 2009).

SPAC investors also benefit from their shares being publicly traded. Should an investor not agree with the decisions of the SPAC founders, they are free to sell their shares on the public market. This gives investors freedom to exit their investment both before and after the vote to approve the acquisition.

SPACs are typically priced at \$6 to \$10 per unit at the IPO. These units are made up of one share of common stock and one or two warrants (Stowell, 2009). SPAC founders are typically given 20% of the post-IPO shares for a nominal investment. These shares are held in escrow and are voted with the majority of other shareholders until the transaction is finalized. When the transaction is proposed, no more than 20% of shares can vote against the deal if it is to be completed. The transaction must also be valued at 80% or more of the value of the funds held in the trust. In addition, this deal must be completed within two years from the time of the SPAC IPO, and a definitive

engagement letter must be signed within 18 months; otherwise, the SPAC will be dissolved and the trust disseminated among investors. To help maintain high trust values after the SPAC IPO, a percentage of underwriting fees is deferred and held in the trust until a deal is consummated (Lewellen, 2009). SPACs typically list under the name of the SPAC until a deal is consummated, at which point they usually take the name of their target and re-list under a more appropriate ticker. This process is detailed in Figure 1.

Because of the blind nature of the transaction, founders are typically either very experienced industry professionals or people with a high degree of prominence and investing history. Some examples of professionals who have raised these funds include Roland Berger, Tom Hicks, Joseph Perella, Ronald Perelman, Dan Quayle, George Tenet, Bruce Wasserstein, and Steve Wozniak. Because investors have to invest merely in the ability of the founders, founders must be recognizable and trusted figures.

SPACs originated at Earlybird Capital under David Nussbaum, with the most recent incarnation coming in 2003 with the Millstream Acquisition Corp. In this first year, only one SPAC completed an IPO, raising \$24 million. The market grew rapidly until 2007, when 66 SPACs conducted their IPOs, for gross proceeds of \$12.1 billion (SPAC Analytics). At the peak of the SPAC market, in 2008, SPACs represented a third of the U.S. IPO market in number of deals and funds raised (Tran, 2009). As with many investments, SPACs saw a dramatic downturn in 2008, with only 25 SPACs conducting their IPO over the next three years (2008, 2009, and 2010). As the U.S. economy has begun to pick up, SPACs have begun to come back, with 16 IPOs raising more than \$1 billion in 2011. This represented approximately 12% of the U.S. IPO market, a diminished share of the market from the 2008 peak (Renaissance Capital, SPAC Analytics). In total, 185 SPAC funds have raised \$23.6 billion since 2003. Of these, 98 have successfully completed an acquisition, while 65 have been forced to liquidate. There are currently 22 SPACs with gross proceeds of \$1.6 billion searching for an acquisition target.

Before the modern incarnation of SPACs, blank-check companies existed under similar premises, but were often corrupted in pump-and-dump scandals. This was originally addressed and defined in the Securities Act of 1933, which empowered the SEC to “prescribe special rules with respect to registration statements filed by any issuer that is a blank-check company” (15 U.S.C. § 77g(b)(1)) (Tran, 2009). The resurgence and continued abuse of these companies in the 1980s

resulted in the Penny Stock Reform Act of 1990 and SEC Rule 419. SPACs were then able to distinguish themselves from blind pools and penny stocks by listing on exchanges (rather than pink sheets) and increasing disclosure, as well as raising at least \$5 million for the fund (Heyman, 2007).

SPAC acquisitions are often seen as single-acquisition private equity firms, as both generally aim to acquire companies for investor return. While SPACs generally take private companies public, private equity funds take either public or private companies private. Private equity funds also lack many investor protection features found in SPACs. Investors in a private equity fund have no voting control over the companies that private equity managers choose to invest in. They also usually lack liquidity—investments usually are locked up for at least a few years, and there is no public market on which to sell the investment. Most importantly, the payment structure for the managers of these funds is very different. While private equity executives generally make 20% of the profits of the fund, SPAC managers take home 20% of the equity in the investment, meaning they can profit even with fund losses (Jenkinson, 2010). This is discussed in greater detail in section II.

This research aims to show why companies have chosen this alternative route to the capital markets. There must be a differentiating feature that SPACs offer to companies for them to choose a SPAC offering rather than a more traditional IPO. Possible reasons for companies to choose a SPAC might include pending lawsuits or weak public markets—unique situations where an average investor may not see the value that management does. What are the motivations for companies, and why do investors and founders choose this investment vehicle? This research aims to follow the entire deal process to see the motives and decision-making process at every level—for SPAC founders, investors, and acquisition management.

## II. Literature Review

Only a few studies of Special Purpose Acquisition Companies have been published. The primary initial research was performed by Jog and Sun (2007), who explain the basic structure of a blank-check company and how it was formed and executed on a very basic level. Most importantly, Jog and Sun investigate the returns to investors and founders from the blank-check company. They find that while SPAC

investors usually lose money in the period from the second day to announcement day, and continue to lose more from announcement to “outcome,” when shareholder vote on the deal is announced.

The study concludes: “It looks like the investors wrote a blank check to management.” (Jog and Sun, 2007). This is supported by their findings that management yielded a median return of 1900%, while investors saw a -3% return to deal completion. The conclusion of these authors seems to match their data, but it may be misleading to compute management’s return as a percentage. Because SPAC founders do not take a salary and pay only a token amount for their shares (median 1.4 cents, Jog and Sun, 2007), their take might better be seen as a substitute salary for their efforts in completing a deal, and should be measured in absolute terms.

Jog and Sun provide a solid base for further investigation of SPACs, but due to the relatively recent nature of SPACs, their research needs to be updated. Their sample consists of 62 blank-check companies that have raised funds in the years 2003 to 2006. This only encompasses four of the nine years SPACs have been a relevant investment opportunity, and there have been 185 SPACs that have raised funds to date, meaning Jog and Sun only account for one-third of the already small dataset.

Berger (2008) provides an inside look and introduction to SPAC transactions. He uses three case studies to show the different advantages and deal structures that can be achieved through the SPAC investment vehicle, though most of these “positive” examples have soured since his publication. The acquisition of American Apparel in 2007 highlights the way SPACs can be used as alternative routes to capital markets. American Apparel was in non-compliance with its current financing agreements due to high EBITDA to debt ratios, and it was negotiating further waivers of debt covenants for upcoming months. In addition to this, American Apparel was the subject of two different employee lawsuits, and their federal and state taxes were being audited. Since it was unable to fulfill its current debt obligations, the company was unlikely to be able to acquire more debt. This financial distress, coupled with legal troubles, would have made an IPO very difficult, as investors would have been very skeptical. The SPAC was able to negotiate a deal structure that typical IPOs could not and take concessions to make the investment more palatable. By locking up the new shares of American Apparel’s current owner, as well as putting eight million in escrow to cover lawsuits and debt covenant violations, American Apparel was able to obtain the financing it needed.

Berger also discusses Aldabras' acquisition of Great Lakes Dredge and Dock, and Information Services Group's acquisition of TPI. Both are representative of the types of situations that may call for a SPAC acquisition as opposed to a traditional IPO. The Aldabra transaction was complicated by the deferred dredging contracts that destroyed the growth story and a lack of strategic buyers, due to Great Lakes' 40% market share in the dredging industry. The SPAC provided a structure that could realize the value of the company and get some much-needed capital into the business, while the private equity owner maintained a significant equity stake. For TPI, the SPAC provided a flexible deal structure that allowed for a more complicated transaction. TPI management and their private equity investors were able to realize some of their returns, while maintaining a stake in the company through post-profit reinvestment and offered warrants. Both of these examples show the way in which SPACs can be used instead of an IPO or strategic acquisition.

Stefan M. Lewellen (Lewellen, 2009) discusses the predictability of returns from SPAC acquisitions. Most importantly, these returns show SPACs to have a positive return post announcement, but a negative return post transaction. Lewellen notices that SPACs have positive returns after the announcement of a deal, but negative returns at the completion of a deal. This contradicts Jog and Sun (2007), who found that investors lost more from announcement to completion than from IPO to announcement. This may be accounted for by the expanded dataset used by Lewellen. This data is also unusual because the large investor base has the opportunity to vote against value-destroying deals; deals that are approved would be expected to appreciate in value.

Lewellen offers a possible explanation in that the dilution effect of warrants from shareholders and sponsors occurs after a deal is completed. Since all of this knowledge is public, investors might assume that it should be "priced in" during each other stage of trading. Because the SPAC is able to be liquidated for the value of the trust, this dilution effect cannot be priced in until that is no longer an option, because arbitrageurs would take advantage of the discounted shares.

Lewellen is also useful in highlighting the theoretical trading behavior of SPACs by creating three intuitive "rules" by which SPACs should be seen to trade. First, the stock price should always exceed the value of the pro-rata share of the trust, discounted from the SPAC expiration date. Second, if an acquisition is approved, the stock price should be greater than the pro-rata share of the trust. If investors have chosen to stay with the SPAC and not redeem their investment, they

obviously believe there is more value in the shares than in the trust, and this should be reflected in the price of the SPAC. Finally, acquisitions that have been completed should have positive excess returns as long as there is positive market beta. This is because after the deal the stock of a SPAC has no unique features; it is merely another company with shares. Therefore, the SPAC stock should be awarded a market risk premium in its price (as opposed to pre transaction, when the riskless nature of the investment would not dictate such a premium). These rules make intuitive sense, but are often not observed in the actual trading of SPAC shares.

Lewellen's third rule is most often in conflict with the reality of SPAC performance. Post-completion SPACs were seen to have negative raw returns of -20.6% annually. Data compiled by Jenkinson and Sousa (as well as every other paper on the topic) supports the conclusion that SPACs do not trade post closing as they should. Post completion, the stock price begins to reflect events that may not have been foreseen during the SPAC transaction period, so it may become a less relevant measure of the value of a deal. Even in the shortest of time horizons, when most future events can be seen, SPACs do not conform to Lewellen's third hypothesis. Jenkinson and Sousa compute negative cumulative abnormal returns in the very short window of four months after the transaction. Assuming there can be little material differences in the company over such a short period, the stock should trade close to or above its transaction price, especially with the vote of confidence received at transaction approval.

### *Risk*

With any financial instrument, especially relatively new ones, it is very important to understand the risks involved. Stowell identifies four main risks that SPACs face: 1) SEC regulation, 2) arbitrage opportunities, 3) liquidation risk, and 4) behavioral analysis of risk management by the SPAC management team (Stowell, 2009). Because SPACs represent an alternative to IPOs, they can be used to access the public markets without the usual SEC inspection process. As SPACs grow in popularity, it can be assumed that the SEC will move to close this loophole and increase regulation and listing requirements.

Stowell discusses liquidation as a risk. Because a proposed transaction must not be rejected by more than 20% of the shareholder base, investors can easily vote to liquidate the trust rather than risk an acquisition. This is especially likely if valuations in the market have fallen since the SPAC IPO, or if investors' interest in speculative



investments falls. Because of the short 18-month time horizon, SPAC managers have to find a suitable acquisition, any economic event that dissuades investor appetites for acquisitions may be more likely to lead to a liquidation. SPACs do not have the ability to “wait out the storm,” if investing conditions during their short investment window are not ideal.

SPAC founders are compensated for their efforts with a standard “management allocation” of approximately 20% of the post-IPO shares in the SPAC. These shares are typically bought as warrants for a very nominal price, and are subject to different restrictions than typical IPO shares. For one, they are often subject to a two-to-three-year lockup, eliminating the liquidity seen by IPO investors during the merger process. This invested capital is also at risk, in the sense that founders do not receive a pro-rata share of the trust at liquidation; this also keeps the value in the trust at the level of IPO funds plus income from government securities. These securities also lack voting power when approving transactions. All of these restrictions essentially mean that the only way for SPAC founders to profit from this opportunity is to close a deal and then gain the liquidity from their shares.

Stowell was not the only researcher to notice this risk stemming from differing founder incentives. Jenkinson and Sousa noticed that many SPAC transactions were “value destroying,” deals in which the stock falls post transaction. They find that SPACs have an average cumulative return of -24% over six months and -55% over one year. They attribute this consistent failure of SPAC acquisitions to perform in the market to the conflicting incentives facing the SPAC founders. Just as Stowell noted, SPAC founders only benefit from the SPAC if a transaction is completed. Jenkinson and Sousa propose that SPAC founders complete value-destroying deals because their profit method is capital-based rather than profit-based. Investors profit when the value of their shares appreciates in the market. SPAC managers obviously want to see their shares appreciate as well, but are still able to profit as long as the SPAC is not liquidated.

Jenkinson and Sousa were able to expand on this observation and hypothesize that SPAC managers routinely do benefit from value-destroying deals. They created a decision rule with the assumption that the stock price of the SPAC should be in excess of the trust value if the market is behind the transaction, and otherwise the SPAC should be liquidated; the market is signaling that it believes the deal will not create value. The SPACs that didn’t follow this rule performed statistically worse than those that did.

For Jenkinson and Sousa, the explanation for why SPAC investors routinely approve deals, despite obvious indications from the market of their impending failure, lies again in the differing incentives for SPAC founders. Because SPAC founders are free to buy the securities in the open market, it benefits them to purchase voting shares if they are nervous about the approval from investors. In the days leading up to the vote, investors who disagree with the proposed deal will be the ones selling and trying to get out of the investment, so by buying shares in the market, founders are increasing their voting share while decreasing the number of potential “no” votes. SPAC managers will likely take the loss in the form of transaction costs and potential capital depreciation because it will soon become negated when the founder shares become active after the transaction.

Though much of the literature seems to be very antagonistic to SPAC investors, Anh Tran (2009) shows that SPACs make better acquisitions, thus providing a distinct advantage of the SPAC structure. By using Officer’s (2007) “comparable industry transaction” technique, it is shown that SPACs pay 7.6% less for other bidders in the same industry. Tran also cites Officer’s findings that private company buyers generally pay a smaller premium than public company buyers. He hypothesizes that SPACs benefit from their ability to make more focused investments. He also attributes some of the marginal gains to the expertise and knowledge of SPAC managers over their peers in private equity. This piece of literature seems to dispute many worries about SPAC founders’ conflicts of interest. Investors worry about the moral hazard facing SPAC managers, that they may overpay, just to consummate a transaction within the allotted 24-month period and receive the payout in their warrants. This study refutes that assertion, instead showing how the expertise of SPAC managers and their focus on private companies yields profits for investors in terms of lower purchase prices.

### **III. Cases**

This research will primarily investigate a few cases of SPAC acquisitions to see the specific environment and scenarios that lead to a SPAC acquisition. Jamba Juice has been held up as a prime example of a successful SPAC. This research also aims to investigate international SPACs, as found in both Star Maritime Acquisition Company’s acquisition of Star Bulk and China Opportunity Acquisition

Corporation's merger with Golden Green Enterprises. These two transactions also showcase some alternative ways founders have used the SPAC structure. In one case, they essentially started an operating company; in the other, they used the SPAC as a minority recapitalization vehicle.

### **Case No. 1: Services Acquisition Corp. International's Acquisition of Jamba Juice**

Services Acquisition Corp. International (SVI) was a SPAC founded by Steven Berrard and a team made up of Thomas Aucamp, Thomas Byrne, Steven Edelson, and Nathaniel Kramer. The SPAC's founders, all directors, obtained their collective 3,750,000 shares pre IPO for \$25,000. This group represented 20% of the post-IPO shares,<sup>1</sup> with Berrard owning 6% while each other founder would own 3.5%.

On July 6, 2005, \$127 million was raised in SVI's IPO, selling 17.25 million units to pursue a service business with recurring revenue and stable cash flow.<sup>2 3</sup>

On March 10, 2006, SVI announced that it had executed a merger agreement between the newly formed and wholly owned JJC Acquisition Company and Jamba Juice Company, "the category-defining leader in healthy blended beverages, juices and good-for-you snacks."<sup>4</sup> To help provide the additional capital needed to effect the transaction, SVI also entered Securities Purchase and Registration Rights Agreements for a private placement.

The transaction was completed, and the stock of the newly merged company began trading on November 29, 2006. The private placement was completed on the same day, raising \$224.85 million from 48 investors.<sup>5</sup> The transaction was an all-cash buyout of the current shareholders in Jamba Juice for a total value of \$265 million. Paul Clayton, CEO of Jamba Juice, stayed on as CEO after the merger. In addition, the only two remaining members of the SVI board were Thomas Byrne and Steven Berrard, who continued as non-executive chairman. The board of directors of the newly merged company was composed of six former Jamba Juice directors and two SVI directors. In addition, following the acquisition, the company changed its name to Jamba Juice (JMBA).

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1 Services Acquisition Co. IPO prospectus (S-1, February 14, 2005)

2 Services Acquisition Co. 8-K, July 6, 2005

3 Services Acquisition Co. IPO prospectus (S-1A, June 27, 2005)

4 Services Acquisition Co. 8-K, March 13, 2006

5 Services Acquisition Co. DEFM14A, November 8, 2006

### *Interesting Features of the Transaction*

#### *Private placement*

In order to complete a deal valued at \$265 million, the SPAC founders would have to raise significantly more than the \$127 million netted in the IPO. The simultaneous execution of the two deals meant that those investing in the private placement would forego the voting rights of IPO investors. But because both deals needed to be approved together, the investors, like the SPAC founders, would get nothing but wasted effort if a deal were not completed. According to the deal prospectus dated November 8, 2006, the private placement shares were issued at \$7.50. On that day, shares were trading at \$10.57, and the value of the funds held in the trust was approximately \$7.80 per share. Those participating in the private placement received a large value premium for their investment. This may reflect the desperation on the part of SPAC founders and IPO investors. With the stock trading at more than \$10 since October 13, both founders and investors would lose a sizable profit if the deal were not completed. SVI would have been forced to liquidate if it did not enter another merger agreement before January 7, 2007. In the prospectus, these fears are confirmed: “Management of SACI believes that it is unlikely that SACI will have the time, resources, or capital available to find a suitable business combination partner before (i) the proceeds in the trust account are liquidated to holders of shares purchased in SACI’s initial public offering and (ii) SACI is dissolved pursuant to the trust agreement and in accordance with SACI’s certificate of incorporation.”<sup>6</sup> Desperation seems to have forced the pricing for the private placement.

#### *Valid Founder/Management Experience*

One of the main marketing points for SPACs is the benefit of having experienced, educated executives help run the acquired companies. The idea is that seasoned, MBA-clad SPAC founders can bring value to companies that are being run by founders with no prior professional management experience. In most cases, however, SPAC managers are seasoned finance professionals (often from the banking, private equity, or venture capital fields) who acquire a working business outside their realm of direct expertise—they are accustomed to working with acquisitions and deals, but not necessarily with actual management. In this case, the management of SVI has direct experience in the service sector. Steven Berrard was co-CEO of AutoNation, as well as CEO of

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6 Services Acquisition Co. DEFM14A, November 8, 2006

Blockbuster Entertainment. Other founders were also executives at Blockbuster, and they have experience in finance as founders of New River Capital. Berrard's direct experience in leading service companies represents an unusual synergy in this transaction, and it certainly was a selling point for Jamba Juice at the time of the merger. CEO Paul Clayton commented, "The unique circumstances of this merger have produced a very powerful partnership. Teaming with SVI offers both short- and long-term benefits for Jamba Juice and its current shareholders, including an attractive capital structure that provides a cost-effective method of giving liquidity to our shareholders. At the same time, it provides Jamba Juice with the capital to reach its full potential while maintaining its unique culture. In addition, we look forward to leveraging SVI management's experience growing premier consumer brands and its relationships with an outstanding investor group."<sup>7</sup>

### *Returns*

At deal closing, Jamba Juice shareholders received liquidity, at a valuation of more than 30 times their earnings, and perceived intangible benefits from an experienced team of advisors. At the same time, they were able to raise growth capital through the additional paid-in capital from the private placement.

The SPAC founders held securities worth more than \$44 million, on a token investment of under \$30,000.

At the time the transaction closed, investors had securities worth \$17.54.<sup>8</sup> This netted IPO investors a return of 119% on their initial \$8 investment, with no investors voting to redeem their shares. Despite this seemingly perfect transaction for all involved, this has been a failed venture for long-term investors. As of February 27, 2012, those who purchased units in the IPO for \$8 held securities worth \$2.14.<sup>9</sup> This may demonstrate how the perceived benefits from the SPAC capital infusion and professional, experienced management may not deliver after the deal is completed, or it may demonstrate how the incentive to complete the deal by both SPAC founders and IPO investors led to overpricing.

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7 Jamba Juice Co. press release dated March 13, 2006 <http://ir.jambajuice.com/phoenix.zhtml?c=192409&p=irol-newsArticle&ID=1189237&highlight=>

8 Prices Yahoo Finance as of February 27, 2012 (if warrant was immediately exercised)

9 Calculated as current share price plus weighted return on portion of warrants exercised

### **Case No. 2: Star Maritime's Acquisition of Star Bulk**

Star Maritime Acquisition Co. was founded by Akis Tsirigakis and a team of directors. These directors acquired an aggregate 9,026,924 shares pre IPO for \$25,000. The SPAC management team also purchased another 1,132,500 units for the price of \$10 per share in a private placement before the IPO. Together this meant the SPAC management team would control 35% of the post-IPO shares.<sup>10</sup>

On December 21, 2005, Star Maritime completed its initial public offering, selling 18,867,500 units for \$10 each. After the underwriter's discount and proceeds from the private placement were factored in, \$188,675,000 was placed in the trust account to fund investment ventures. As with many SPACs, a portion of the payment to the underwriters (\$3,773,500) was deferred until a merger could be consummated. This aligns the interests of the investment bank and the founders, as the investment bank is essentially in the same boat as the founders; it doesn't get paid unless a deal is made.

On November 30, 2007, Star Maritime Acquisition and Star Bulk Carriers completed their merger. Star Bulk Carriers was a subsidiary of Star Maritime chartered in the Marshall Islands; since Star Bulk was the surviving entity, the acquirer (Star Maritime) was redomiciled as a Marshall Islands corporation.<sup>11</sup> By acquiring their own subsidiary, the SPAC was able to purchase assets, in this case eight drybulk carriers from a subsidiary of TMT Bulk Co. The purchase price for the eight ships was \$345,237,520. This consisted of \$224,500,000 in cash and 12,537,645 shares of common stock of Star Bulk. In order to finance the cash portion of the deal, Star Bulk received a \$120 million credit line secured by the ships being purchased, which was added to the cash already on hand post IPO.<sup>12</sup>

Because this SPAC essentially purchased assets rather than an existing company, it did not have to deal with a target management team; the SPAC founders continued in their roles on the board, and Akis Tsirigakis and Syllantavos continued to act as CEO and CFO, respectively, of the newly formed company.<sup>13</sup> The board also added one member from TMT Bulk Co. (who sold the shipping vessels) and another from Advance Capital Japan, changing the makeup of the board to five SPAC directors and two outside directors. The company maintained the name and trading symbol of the acquired company (Star Bulk).

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<sup>10</sup> Star Maritime Form 10-K filed March 31, 2006

<sup>11</sup> Star Bulk 6-K filed December 4, 2007

<sup>12</sup> Star Maritime Preliminary Proxy Statement filed March 14, 2007

<sup>13</sup> Star Bulk 20-F filed June 30, 2008

### *Interesting Features of the Transaction*

#### *Trust Returns*

As with all SPACs, the proceeds from the IPO were held in a trust until needed for a transaction or liquidation. In the event of a liquidation, investors usually receive slightly less than their initial investment due to the underwriter's discount, as well as administrative costs in searching for a target. In this case, the SPAC managers eliminated that risk by participating in a private placement equal to these costs and waiving the rights to liquidation distributions on the shares of the units—essentially pegging the pro-rata share of the trust at the IPO price of \$10. Because shareholders can redeem their shares for a pro-rata share of the trust by voting against a business combination, the founders' private placement essentially eliminates downside risk for the period until the deal is consummated.<sup>14</sup>

#### *Asset Purchase*

Unlike a typical SPAC, which looks to acquire an existing private company, Star Maritime used the SPAC structure to create a completely new company. Due to the high entry barriers in the shipping industry (carriers cost tens of millions of dollars), it is very difficult to start a shipping company. Rather than attempting to finance their company with hundreds of millions of dollars in debt that would be both difficult to acquire and very costly, Akis Tsirigakis and his team were able to issue equity as a way to help pay for the venture. Issuing of equity is normally only a capital-raising tool in the arsenal of established companies, but in this case the SPAC's structure allowed the management team to start the company without typically burdensome debt. Debt investors would have had difficulty financing a company with little collateral and no history of stable cash flows. On the other hand, equity investors are typically more risk-prone, and therefore a better fit for this type of venture. In under two years, Tsirigakis was able to have a publicly traded company with a market cap over \$400 million, a feat that is not often replicated with traditional startups. The SPAC structure allowed for a lower-cost and leverage solution to the challenge of forming a company in a sector with high startup costs.

#### *Returns*

At deal closing, the SPAC founders held securities worth \$160 million. This represented a significant return, despite the founders'

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<sup>14</sup> Star Maritime 8-K filed December 28, 2005

sizable investment to ensure the trust value stayed at par. Net, the founders made \$148 million at the time of the transaction.

The SPAC founders assumed the management duties of the new company formed to execute this transaction. This means the “returns” or incentives for the target are not particularly relevant, and they align with the interests of the SPAC founders.

IPO investors also received significant benefits. At closing, they held securities worth \$22, representing a 120% return on their initial investment of \$10. This led to no redemption rights being exercised by holders of the IPO shares—an indication of a favorable transaction.<sup>15</sup>

This deal was financially beneficial to all parties at the time of the transaction. Star Bulk, however, suffered a long-term fate similar to that of Jamba Juice; it has a current share price (as of April 12, 2012) of just 90 cents.<sup>16</sup>

### **Case No. 3: China Opportunity Acquisition Corp.’s Merger with Golden Green Enterprises**

China Opportunity Acquisition Corp. (COAC) is a SPAC founded by a team led by Harry Edelson to acquire a company with primary operations in the Peoples Republic of China.<sup>17</sup> As with many other SPACs, the founders received their shares pre IPO—in this case a collective 1.5 million shares for a nominal \$25,000.<sup>18</sup>

On March 26, 2007, China Opportunity completed its IPO, raising \$41,400,000 on 6.9 million units. The units comprised of one share of stock and two warrants to buy the stock for \$5. At the same time, the company sold 2,266,667 warrants to the same group that received pre-IPO shares for \$1,360,000 (\$.60 per warrant). These warrants are the same as the warrants found in the IPO units, with the limits that they cannot be sold or transferred until after the completion of a business combination; until that time, they are not redeemable. The company also granted the underwriters an option to buy 600,000 units at a price of \$6.60.<sup>19</sup>

On November 12, 2008, COAC entered into an Agreement and Plan of Merger with Golden Green Enterprises, a “private manufacturer of high precision cold-rolled specialty steel products in China.”<sup>20</sup>

On March 17, 2009, COAC successfully merged with Golden Green,

15 Star Bulk 20-F, June 30, 2008

16 China Opportunity Acquisition Co S-1 Prospectus, September 29, 2006

17 China Opportunity Acquisition Co S-1 Prospectus, September 29, 2006

18 China Opportunity Acquisition Co 8-K, March 28, 2007

19 China Opportunity Acquisition Co 8-K, March 28, 2007

20 China Opportunity Acquisition Co 8-K, November 12, 2008



with Golden Green as the surviving entity. This transaction can be seen as a minority equity recapitalization for Golden Green, as the shareholders of COAC received 2,245,723 shares of Golden Green, as well as similar replacements for warrants at par.<sup>21</sup> The board of directors was then made up of two directors from COAC and five from Golden Green, and Golden Green's management continued in their pre-merger roles. Shares would trade on the OTC bulletin board. Following the merger, COAC received two of the 11 board seats of Golden Green.

### *Interesting Features of the Transaction* *Share Repurchase*

This transaction represented an interesting facet of the SPAC structure, the SPAC's ability to purchase its own shares. One of the protections typically afforded to SPAC investors is the ability to vote against a proposed deal and liquidate their shares. In this case, that privilege was used in excess. Knowing the deal was going to fail based on initial proxies, the SPAC purchased 4,732,407 shares of its own stock (split from the warrants), from investors who would otherwise have voted against the transaction, for slightly more than the original purchase price of the units.<sup>22 23</sup> Despite this massive purchase, 1,421,870 shares were still voted against the transaction. In the end, only 2,245,723 COAC shares were converted to Golden Green shares. By doing this, COAC was able to complete the transaction, albeit on a much smaller scale.

This transaction also showed another facet of the SPAC: its possible use in a minority recapitalization. The SPAC would end up with only approximately 22% of the outstanding shares.<sup>24</sup> After all of the buybacks, the SPAC ended up owning only approximately 7% of the surviving company. The fact that this deal was merely a recapitalization, rather than an acquisition, meant that the smaller size of the trust was less of an issue. The variable nature of the trust would create huge issues in a merger, as the purchase price and post-transaction valuation would change significantly. The at-par stock swap also made the change in trust size easier than if the deal was a cash purchase.

The original three shareholders in Golden Green also received a 1 million-shares-per-year incentive program for hitting certain profit marks for the three years following the transaction. After the

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21 Golden Green 20-F, July 15, 2009

22 China Opportunity Acquisition Co 8-K, March 12, 2009

23 Golden Green 20-F, March 23, 2009

24 China Opportunity Acquisition Co. Prospectus filed February 17, 2009

transaction, due to the lower cash position of COAC, those growth goals looked improbable, and the shareholders were allocated a one-time distribution of 2,850,000 shares. Two of the three investors were subject to six-month lockup agreements on their shares, while the third investor was subject to a one-year lockup.

What were the benefits and motivations of all parties involved in these investment and merger opportunities? Looking at the financial returns is typically an easy way to understand the parties' motivations. In this case, however, there are multiple factors to consider. For IPO investors, this deal was unfavorable, as seen by the massive number of shares that had to be purchased before the deal was approved. Even with the purchase, many shareholders still voted against the deal, showing how unfavorable it was. Even Golden Green doesn't have an entirely positive opinion of the deal saying, "At the time of our merger with COAC, we received less cash than was originally expected, which caused us to temporarily delay some of our anticipated capital expansion and improvement projects. Consequently, it was expected that we would grow at a slower rate than anticipated at the time of the merger"<sup>25</sup> Golden Green ended up paying more for this transaction than they bargained on spending; the SPAC founders' shares, which usually represent a minority of the transaction and have no linked trust-account cash, ended up being most of the shares exchanged. This meant that Golden Green turned over a lot of shares for very little growth capital. Golden Green did benefit from going public in a slightly cheaper way, but that was more than offset by the lack of growth capital. This variable feature wherein the amount in the trust is determined by the redemptions and buybacks is a major drawback for target companies. This SPAC transaction can be seen as a success only in that the transaction was actually completed.

### *Returns*

At deal closing, the SPAC founders had securities worth approximately \$8.1 million. After having invested only \$1.3 million, this represented a sizable return, especially on a transaction that received very little shareholder support and disappointed the target company.

IPO investors received differing returns. Those who held onto their securities held \$5.30 worth of investments at the time of transaction—a 12% decline in their initial investment of \$6. Those who redeemed for their portion of the trust received approximately

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25 Golden Green 20-F, May 4, 2010

\$5.91 and had warrants redeemable for \$0.20 (two warrants at \$0.10 each). Shareholders who entered into repurchase agreements received approximately \$6 for their shares, and they held warrants worth \$0.20.

The target company was able to go public and receive a small amount of growth financing, but at a much more expensive relative rate than originally expected, with much less growth capital as well. From its point of view, the variability of the SPAC structure that allowed the deal to get done resulted in a much less favorable transaction. Just as Jamba Juice is usually held up as a well-handled “vanilla” SPAC, this SPAC demonstrates how solutions can be implemented to complete a deal, even under unfavorable circumstances.

## IV. Methodology

### A. Data

Data for this research is primarily qualitative, but uses some quantitative measure in terms of return and valuation. For this portion of the research, the dataset will be the 186 SPAC offerings that have been completed as of March 1, 2012. For comparisons of long-term returns, the dataset will have to be limited to the 98 successful acquisitions. For our analysis of the decision-making process, however, it will be useful to examine the 65 offerings that failed to find an acquisition, as a way of determining what led to these failures (for a total of 163 SPAC offerings). The 23 SPACs that have issued shares but have yet to find an acquisition do not offer us enough information to be included in our sample.

This performance data for alternative datasets will be secondary in nature—obtained from financial reporting websites such as Google Finance or Yahoo Finance. Performance data for SPACs as they trade in the market on a day-to-day basis will be obtained in a similar way from similar sources.

The selection of the three case studies presented here was based on an assessment of the 98 SPACs that had found an acquisition. Deals that were not consummated would be less interesting and relevant to those who want to see how this investment vehicle can work. There is also generally less information about deals that were not completed. An effort was made to find deals from different years (late 2006, 2007, and 2009) to show deals being done in different economic climates. More recent deals were not considered due to the lack of information about specific deal attributes that may not have been reported immediately. Also,

the number of deals that occurred in 2008 and 2009 very much limited the variety of transactions that could be examined. Another important feature in the selection of the individual cases was the interesting use of the SPAC structure, or unique circumstances and problems—such as those presented by international deals or economic misfortune.

The primary data for this research is very qualitative. Data on deal structures, post-deal corporate management structures, and potential problem-solving was gathered in order to discuss the interesting features that arose in these transactions. This data was obtained through the SEC's EDGAR financial reporting database, company press releases, and independent consumer news outlets. SEC filings included merger agreements, proxy statements, 8-K's, 10-K's, 10-Q's, 13D's, registration statements, statements of changes in beneficial ownership, as well as forms 6-K and 20-F for the SPACs dealing with international deals. These sources assisted in isolating the individual motivations and incentives that are seen by all parties in the transaction, particularly by providing details that performance statistics cannot illuminate. The unique nature of each transaction can be seen through the changes in company and deal structure, as filed during the period leading up to and immediately following a successful transaction.

### B. Data Analysis

The share price data will be analyzed using long-term return statistics, in order to determine returns to IPO investors, SPAC founders, and, potentially, the target company. As other studies have demonstrated, this data may need to be sliced into distinct groups and have returns calculated from IPO to announcement, closing, present, or end of the SPAC founders' lockup period. This will be accomplished by looking at the actual total returns to investors, including the value of stock appreciation and any warrants that are still outstanding. The formula to calculate average annual returns, as per the SEC (SEC Final Rule: Registration Form Used by Open-End Management Investment Companies: Sample Form and Instructions Item 21b-1), is:

$$T = (ERV/P)^{1/n} - 1$$

Where:

P = a hypothetical initial payment

T = average annual total return

n = number of years

ERV = ending redeemable value

Warrants will be valued as the intrinsic value on the day the deal was completed. Because this research focuses on SPACs as a transaction, all return statistics have been measured to the actual day of the deal. This may represent an opportunity for future research to delve into the warrant pricing of SPACs after deal completion.

Seeing returns to investors and founders at different points in the transaction shows the incentives for these parties. In particular, these returns will show important aspects of the decision-making process as different investors buy, hold, and sell the SPAC.

To help frame the motivations and actions seen in the quantitative data, the qualitative data will be analyzed to create a picture of how and why a typical SPAC acts as it does. In addition to examining profit incentives, it will be interesting to look at the challenges and decisions made by investors in their voting behavior, founders in selecting a target, and companies in choosing this route to the capital markets. This analysis will be based on the rationales presented by management in a company's SEC filings and press releases. In addition to examining the stated solutions and rationales by reviewing a company's financial statements and filings, we might find implicit rationales, such as debt levels, lawsuits, or growth pipelines.

## **V. Potential Contributions**

This research should be particularly interesting to practitioners, as it will show the process of this complex investment vehicle. It demonstrates the opportunities presented by SPACs to investors, founders, and companies, and shows how certain problems have been resolved and addressed by SPACs. By examining these deals in detail, practitioners should be able to gain valuable information for future transactions.

This research just scratches the surface of the body of knowledge concerning SPACs, but it will serve to advance the current research and understanding in the field, building especially on the work of Berger. It may provide the basis for other studies regarding the process of founding and executing SPAC transactions. Research that may build on this might concern unsuccessful offerings, a facet not examined in this paper. More quantitative research concerning performance has

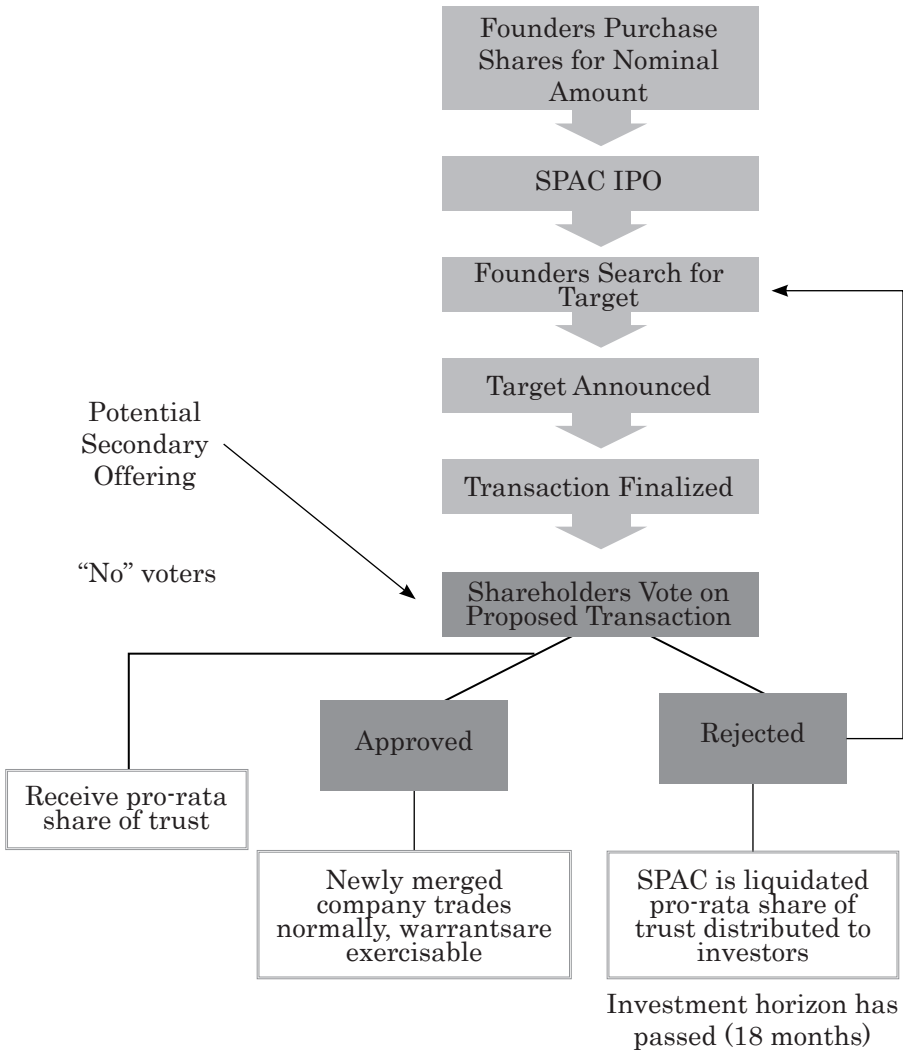
been conducted, but, due to the short time horizons in those works, more research may help build on the knowledge of SPACs. A deeper look into the trading of SPAC warrants may also be interesting, given the interesting ways they are used and traded from IPO to transaction. It may be interesting to see if they trade any differently post transaction than standard warrants, and whether the massive dilution that characterizes successful SPAC deals negatively impacts companies. Due to the relatively young nature of this transaction, there are many interesting ways to conduct additional research.

## VI. References

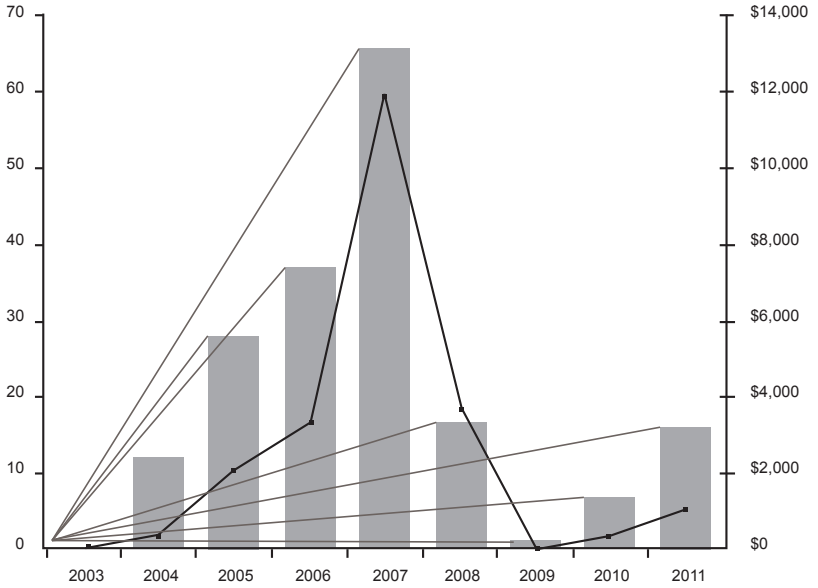
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## VII. Data and Figures

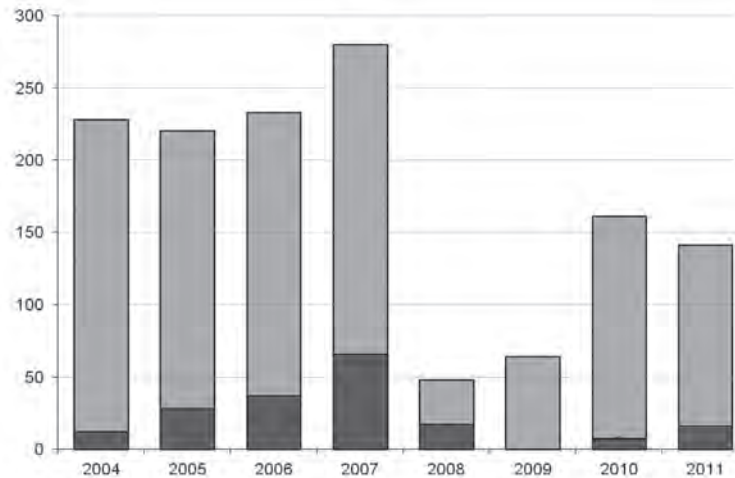
Figure 1: SPAC Transaction Timeline



**Figure 2: SPAC Market Trends**



**Figure 3: SPACs as a Portion of Total IPO Market**





**Figure 4: Sample Offering Structure (Star Maritime Acquisition Co.)**

| <b>Offering Structure</b>            |                      |                      |
|--------------------------------------|----------------------|----------------------|
| <b>Calculation of Trust Amount</b>   |                      |                      |
| Units Sold                           | 18,867,500           |                      |
| Price Per Unit                       | \$10.00              |                      |
| Total Proceeds                       | <u>\$188,675,000</u> |                      |
| Spread Paid at Closing               | 5%                   |                      |
| Spread Deferred                      | 2%                   |                      |
|                                      | <b>Per Share</b>     | <b>Total \$</b>      |
| Total Offering                       | \$10.00              | \$188,675,000        |
| Spread at Closing                    | 0.05                 | 10,093,636           |
| Net to Company                       | 9.95                 | 178,581,364          |
| Management Shares                    | 0.03                 | 25,000               |
| Management Buy-In                    | 0.06                 | 11,324,887           |
| Working Capital at Closing           | (0.00)               | (463,614)            |
| Closing Costs                        | (0.00)               | (792,637)            |
| \$ in Trust                          | <u>\$10.00</u>       | <u>\$188,675,000</u> |
| % in Trust                           | <i>100.00%</i>       | <i>100.00%</i>       |
| <b>Fully Diluted Ownership</b>       |                      |                      |
| <b>Public</b>                        |                      |                      |
| Shares                               | 18,867,500           |                      |
| Warrants                             | 18,867,500           |                      |
| Fully Diluted Ownership of Public    | <u>37,735,000</u>    |                      |
| % Fully Diluted Ownership of Public  | 77%                  |                      |
| <b>Sponsor</b>                       |                      |                      |
| Founders Shares                      | 9,026,924            |                      |
| Additional Shares                    | 1,132,500            |                      |
| Additional Warrants                  | 1,132,500            |                      |
| Fully Diluted Ownership of Sponsor   | <u>11,291,924</u>    |                      |
| % Fully Diluted Ownership of Sponsor | 23%                  |                      |

Figure 5: Summary Statistics

|                                     | <b>Services Acquisition Co</b><br>Jamba Juice | <b>Star Maritime Acquisition Co</b><br>Star Bulk<br>Asset Purchase - 8 ships | <b>China Opportunity Acquisition Co</b><br>Golden Green Enterprises<br>Minority Recapitalization |
|-------------------------------------|---|--|--|
| Founders Investment                 | \$29,179                                      | \$25,000   | \$25,000   |
| Founders Shares                     | 3,750,000                                     | 9,026,924  | 1,500,000  |
| Additional Buy-in                   |   | \$11,325,000   | \$1,360,000  |
| Additional Consideration            |   | 1,132,500 units  | 2,266,667 warrants   |
| PO: Units                           | 17,250,000                                    | 18,867,500   | 6,900,000  |
| Unit Price                          | \$8.00  | \$10.00  | \$6.00   |
| Unit Structure                      | 1 share & 1 warrant                           | 1 share & 1 warrant  | 1 share & 2 warrants   |
| Gross Proceeds                      | \$138,000,000.00                              | \$188,675,000.00   | \$41,400,000   |
| Underwriters fee paid               | -\$10,007,534                                 | -\$10,093,636  | -\$2,225,630   |
| Net Proceeds                        | \$127,992,466.00                              | \$178,581,364.00   | \$39,174,370.00  |
| Deferred Underwriting fees          | -   | \$4,000,000  | \$360,000  |
| Additional Underwriter Compensation | 750,000 warrants to buy a unit (\$10.00)      | -  | 600,000 warrants to buy a unit (\$6.60)  |
| Purchase Price                      | \$285,000,000                                 | \$345,237,520  | \$1,955,396  |
| Structure                           | Cash Buy-out                                  | \$224.5 cash & 12,537,645 shares   | 1:1 Stock swap (2,245,723)   |
| New Entity/ Name                    | Jamba Juice Co                                | Star Bulk Co.  | Golden Green Enterprises   |
| Management                          | Jamba Juice                                   | Star Maritime Founders   | Golden Green   |
| Board Structure                     | 6 Jamba, 2 SVI                                | 5 Star Maritime, 2 outside   | 5 Golden Green, 2 COAC   |
| Share Value @ Merger                | \$11.77                                       | \$15.00  | \$5.10   |
| Warrant Value @ Merger              | \$5.77  | \$7.00   | \$0.20   |
| Return to IPO Investors             | 119%  | 120%   | -12%   |
| Average Annual Return               | 75.20%  | 50.07%   | -6.08%   |
| Net to SPAC Founders                | \$41,108,321.00                               | \$148,968,860.00   | \$6,718,333.40   |

