

## Activists Pounce on SPACs



By [Damien J. Park](#)

RealMoney Contributor

1/22/2009 11:29 AM EST

[Click here for more stories by Damien J. Park](#)

Last year was tough for special purpose acquisition companies (SPACs), and 2009 is shaping up to be even more difficult.

These relatively obscure investment vehicles are usually formed by a group of managers with operating or investment experience who raise capital through an initial public offering (IPO). After the offering, a majority of the proceeds are held in an interest-bearing trust account until the consummation of a business combination with an operating company.

If the scheme works as intended, SPACs can generate above-market returns for investors by expeditiously moving an undervalued private company onto a major stock exchange. Shareholders get to participate in a reverse-merger IPO with tremendous upside potential and management is rewarded with a substantial ownership stake in the new entity.

Alternatively, if management fails to identify an acceptable acquisition candidate, usually within 24 months of the IPO, the entity must be liquidated and all of the cash held in trust is distributed back to shareholders. Since insiders do not participate in the liquidation distribution, management receives nothing.

As private companies find it harder to access capital from frozen credit markets, tapping into the equity marketplace through this reverse IPO process can be very appealing. However, depressed stock market valuations have squashed many of the incentives for a private company to "go public" any time soon.

During 2008, 21 SPACs were forced to liquidate because they ran out of time to complete a transaction. For the SPACs that found deals, the market was unforgiving, punishing shareholders an average of 60% from their IPO debut.

All of this doom and gloom is creating a steep discount between the stock price and the cash value at 47 SPACs with a combined \$10.3 billion in acquisition capital. In 2009, 34 of these companies must find suitable acquisition candidates or face liquidation.

This has captured the attention of activist investors, who see an opportunity to generate high returns by forcing these companies to liquidate sooner rather than later.

One activist investor, Phillip Goldstein, who made his name busting open closed-end funds trading at a discount to their net asset value, raised a reported \$100 million for a SPAC-only activist fund. Other activists are following his lead.

Well-informed investors recognize that every SPAC is trading at a discount to its cash value and, if liquidated, will generate a return on investment proportional to the discount.

If management proposes a deal before the liquidation date, a shareholder has two excellent options. If the transaction is clearly remarkable, the investor can approve the transaction by voting in favor of it. If not, he or she can vote against the transaction and redeem ownership for a pro rata share of the trust account. Either way, there is a high probability the discount-to-trust will close.

However, if 20% to 40% of the shareholders vote against the transaction and request their money back (this threshold depends on the company's bylaws), the deal is scuttled and the SPAC will likely liquidate within a couple months.

Activist investors have identified this as a chance to boost returns. Better than anyone, they know how to turn a company's governance rules, like supermajority vote approval for transactions, to their advantage. By gaining control of enough shares to block any acquisition and demanding early termination, activists leave management with very few options or than liquidating.

In a recent example, Goldstein picked up an 18.5% stake in **TM Entertainment** ([TMI - commentary - Cramer's Take](#)) and demanded that it liquidate immediately. He needs support from just another 11.5% of shareholders to block a transaction, and he says there is virtually no chance that TMI can complete a business combination by Oct. 17, 2009, when a forced liquidation must occur. In an effort to hurry things along, Goldstein is trying to gain control of the board to prematurely liquidate the trust.

If liquidation takes place or a deal is successfully blocked by shareholders, TM's management must forfeit approximately \$2.5 million of their personally invested capital in the SPAC along with the 20% ownership stake that they would obtain in the post-acquisition company. As a result, management is pleading with shareholders to vote against Goldstein's takeover attempt.

The magnitude of the losses to management might predict a fierce and costly fight. However, unlike operating corporations, SPACs can't fight back using corporate money.

According to their bylaws, SPACs' funds are limited to working capital, taxes and moderate salaries. Legal and proxy battles, therefore, must be paid out of pocket by management, creating an equal playing field with someone like Goldstein who has long opposed the use of shareholder money to fight dissidents like him.

## Special Purpose Acquisition Companies (SPACs)

SPAC	Ticker	Liquidation Date	Discount to Trust	Activist(s) in Shareholder Base
Alternative Asset Mgt.	AMV	08/02/09	4.2%	Yes
Atlas	AXG	01/26/10	8.0%	Yes
BPW	BPW	02/28/10	8.5%	No
Global Brands	GQN	12/08/09	7.4%	Yes
Golden Pond Healthcare	GPH	11/08/09	7.1%	Yes
Highlands	HIA	10/04/09	6.2%	No
MBF Healthcare	MBH	04/23/09	2.5%	No
Media & Entertainment	TVH	03/13/09	2.0%	Yes
NRDC Acquisition	NAQ	10/19/09	6.5%	No
NTR	NTQ	02/01/09	0.9%	No
Prospect	PAX	11/16/09	6.9%	No
Santa Monica Media	MEJ	03/29/09	2.4%	No
Sapphire Industrials	FYR	01/19/10	7.5%	No
SP Acquisition	DSP	10/12/09	7.0%	Yes
TM Entertainment	TMI	10/19/09	5.9%	Yes
Trian Acquisition I	TUX	01/24/10	7.8%	Yes
Triplecrown	TCW	10/25/09	7.0%	Yes
United Refining Energy	URX	12/12/09	6.9%	No
Victory	VRY	04/26/09	3.1%	Yes

SOURCE: Morgan Joseph SPAC Market Update

It's hard to say which SPACs might be raided. All SPACs seeking acquisitions have significant exposure and limited firepower. For investors, even without an activist forcing liquidation, the value appreciation opportunity seems solid. But in 2009, we'll likely see many of these companies under considerable pressure to return their cash to investors sooner rather than later.

---

*Ian Manchel, analyst at Hedge Fund Solutions, contributed to this article.*

*Please note that due to factors including low market capitalization and/or insufficient public float, we consider Alternative Asset Management, Atlas, BPW, Global Brands, Media & Entertainment, Santa Monica Media, Sapphire Industrials Triple Crown to be small-cap stocks. You should be aware that such stocks are subject to more risk than stocks of larger companies, including greater volatility, lower liquidity and less publicly available information, and that postings such as this one can have an effect on their stock prices.*

*At the time of publication, neither Park nor Manchel had any positions in the stocks mentioned.*

*Damien J. Park is president and CEO of Hedge Fund Solutions, a Philadelphia-based firm focused on issues relating to shareholder activism. He founded the company in 2003 and has become the trusted adviser numerous investors and CEOs around the world.*

*Park is often quoted in leading business publications, including [The Wall Street Journal](#), [Business Week](#), [CFO Magazine](#), [The Deal](#), [CNN Money](#), [The New York Times](#), [The Nikkei](#) and [Newsweek Japan](#). He speaks at professional conferences and is the chairman of the [Hedge Fund Activism and Shareholder Value Summit](#), the largest annual gathering of activist hedge funds in the world.*

*Hedge Fund Solutions administers [The Official Activist Investing Blog](#) and also distributes a free in-depth weekly report analyzing recent activist investments.*