

Vinson & Elkins

Introducing the Up-SPAC Structure

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Up-SPAC Structure

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Introducing the Up-SPAC Structure

As the pace of SPAC IPOs continues to set records, evolution of the economic terms has accelerated. We have seen changes to the warrant and promote structure (including “tontine” warrants), call rights motivating cashless exercise of warrants, and warrants in lieu of promote shares. But the SPAC structure itself is also an area ripe for evolution. **One possible adaptation is the “Up-SPAC”, which capitalizes on the SPAC trend by combining, at the launch of the IPO, a traditional SPAC IPO structure with the added value, flexibility and tax benefits of a traditional Up-C structure.**

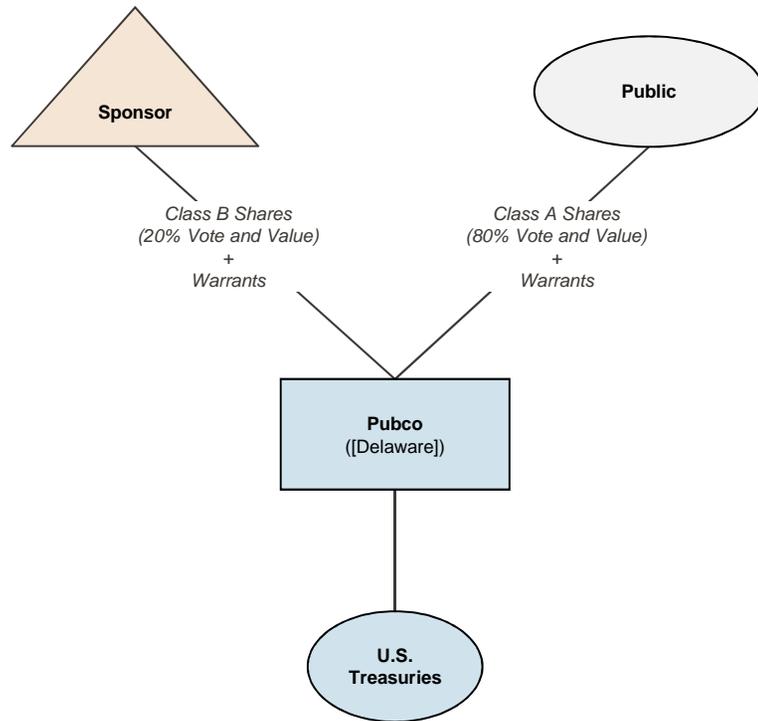
With the rise in popularity of de-SPACs as a way to access capital markets, the landscape is becoming increasingly competitive. **Sponsors and SPACs are looking for ways to distinguish themselves and add value** for both SPAC and target company shareholders. Some shareholders may be more receptive to structures that result in **less dilution from founder shares**. In addition, some sponsors may prefer **“profits interest” tax treatment** for their founder shares.

One **proven solution** that could **create shareholder value and tax advantages** if applied to SPAC IPOs **is the Up-C structure** (which is particularly advantageous for corporate issuers who expect to have material tax burdens in the future or who may be valued based on multiples of distributable cash). The **“Up-SPAC” structure combines two well-known IPO structures, the SPAC and the Up-C**, which allows founders to provide additional value through their founder shares. This value is created through the generation of **tax basis step-up to the SPAC upon future conversion of founder shares** into SPAC Class A shares. The added value to the SPAC is directly proportional to the value of the founder shares, offsetting some of their perceived dilution. The Up-SPAC structure also potentially allows the **founder shares to be issued pursuant to profits interest rules**, which sponsors often prefer.

An Up-SPAC is essentially a SPAC structured as two entities at IPO: (1) a SPAC “Pubco”, which would be the issuer of Class A shares to the public (and would be treated as a corporation for tax purposes), and (2) an LLC “Opco”, which would be partially owned by the SPAC Pubco (and treated as a partnership for tax purposes). **Founder shares could be issued as units in the LLC Opco (as profits interests)** with corresponding non-economic, voting Class B shares of the SPAC Pubco. Founder warrants might also be exercisable at the LLC Opco level. **After de-SPAC, the founder shares/units of LLC Opco would be exchangeable for Class A shares of SPAC Pubco** as and when the founders are ready to sell shares. The SPAC Pubco would receive a tax basis step-up in any appreciated assets upon the exchange, as in a traditional Up-C, creating value for shareholders. The structure **could be implemented with or without a tax receivable agreement** (a “TRA”), depending upon the desire of investors and sponsors.

Up-SPAC Structure

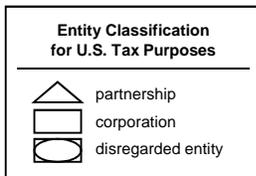
Traditional SPAC Structure Post-IPO (Simplified)



Structure Notes

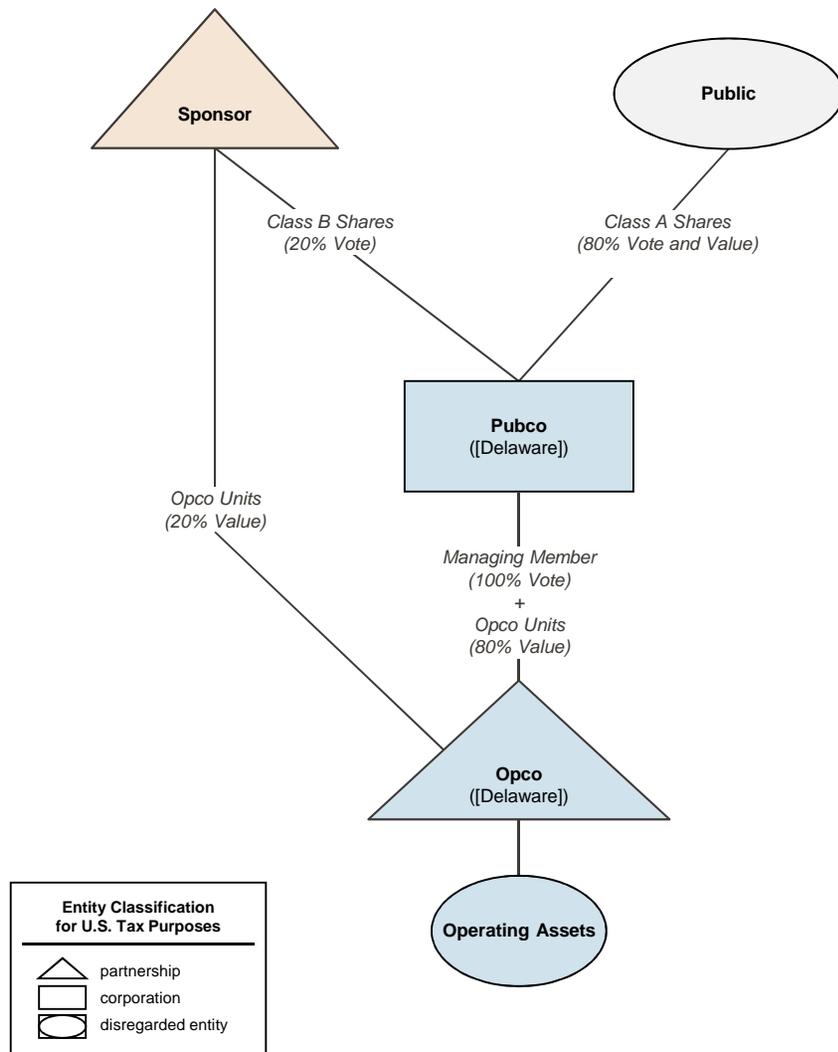
- In a traditional SPAC, the public owns Class A Shares and Warrants in the public company (“Pubco”), and the Sponsor owns Class B Shares (sometimes referred to as “founder shares”) and Warrants in Pubco.

 - The Pubco Class A Shares and Warrants are initially issued and trade together as “units” (e.g., one Pubco Class A Share and a fraction of a Warrant).
 - The Pubco Class A Shares vote as a class with the Pubco Class B Shares, but, prior to initial business combination, only certain Class B shareholders have the right to vote.
 - Each whole Warrant is exercisable for one Pubco Class A Share.
 - The Pubco Class A Shares have certain redemption rights in connection with a de-SPAC or upon a failure to de-SPAC.
 - The Pubco Class B Shares are exchangeable for Pubco Class A Shares upon de-SPAC and are structured so that they represent 20% of the total common stock of the Pubco. In addition, the Pubco Class B Shares are initially subordinated in liquidation (e.g., in a failure to de-SPAC) and do not have the redemption rights that the Pubco Class A Shares have.
- Pubco may be organized as a U.S. entity or a non-U.S. entity, depending upon the expected target profile.



Up-SPAC Structure

Traditional Up-C Structure Post-IPO (Simplified)

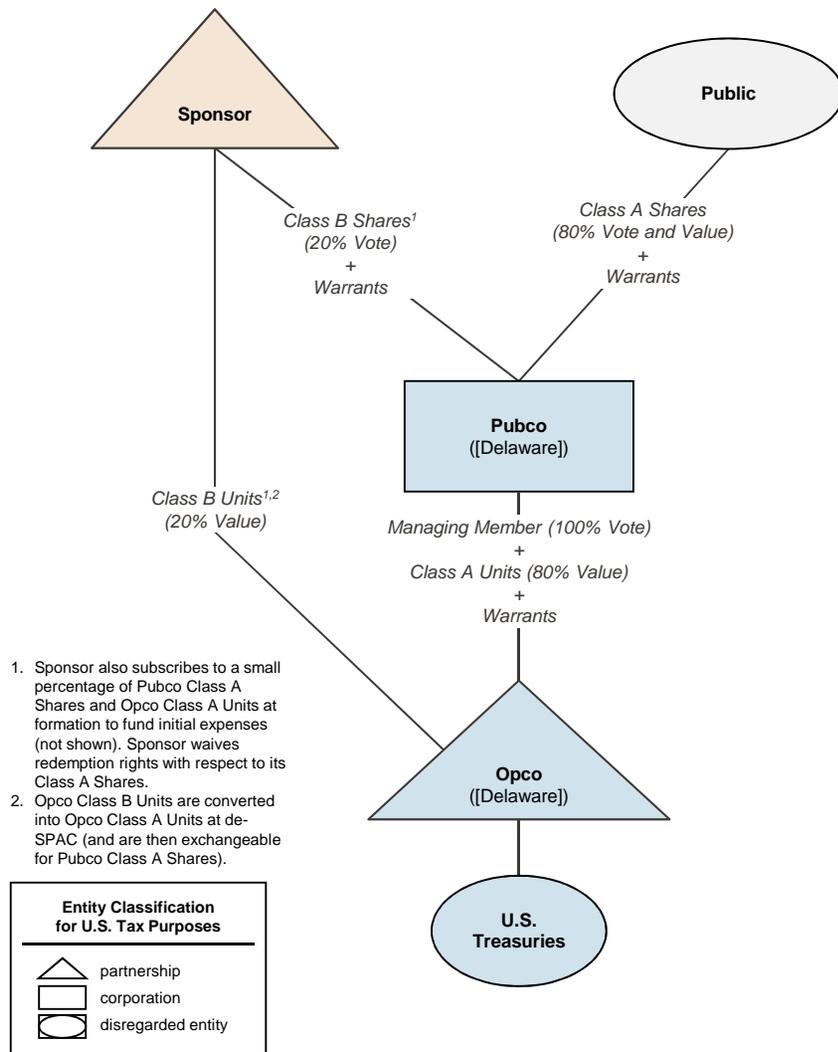


Structure Notes

1. In a traditional Up-C structure, the public company (“Pubco”) typically owns a substantial equity interest in a subsidiary holding company (“Opco”), which owns the operating assets. The equity interests in Opco not held by Pubco are held by some or all of the Sponsors.
 - Pubco issues Class A Shares to the public, which have economic and voting rights and trade on an exchange.
 - The Sponsor holds Opco Units and a corresponding number of Pubco Class B Shares. Each Opco Unit (together with a corresponding Pubco Class B Share) may be exchanged for a Pubco Class A Share. The Opco Units have economic rights but do not have voting rights. The Pubco Class B Shares have no economic rights but generally vote together with the Pubco Class A Shares as a single class.
2. Generally, Pubco uses proceeds from the IPO to make a capital contribution to Opco in exchange for a number of Opco Units equal to the number of Pubco Class A Shares sold in the IPO and is designated as the managing member of Opco.
3. Pubco (and in turn Opco) is managed by the board of directors of Pubco, which is elected by Pubco’s stockholders.
4. Exchanges by the Sponsor of Opco Units for Pubco Class A Shares generally deliver tax step-up benefits to Pubco. If desired and acceptable to bankers, a tax receivable agreement (“TRA”) could be included, but this is not necessary.

Up-SPAC Structure

Combined Up-SPAC Structure Post-IPO (Simplified)



Structure Notes

- In an Up-SPAC structure, the public company (“Pubco”) is generally structured in the same manner as a traditional SPAC, except that the founder shares are issued as interests in an LLC subsidiary (“Opco”) of Pubco, similar to a traditional Up-C structure:
 - The public owns Pubco Class A Shares and Pubco Warrants with generally the same rights as in a traditional SPAC. As in a traditional SPAC, the Pubco Class A Shares and the Pubco Warrants are initially issued and trade together as “units” (e.g., one Pubco Class A Share and a fraction of a Pubco Warrant).
 - Like a traditional Up-C structure, Pubco is the managing member of Opco and has Opco Class A Units and Opco Warrants that correspond to the outstanding Pubco Class A Shares and Pubco Warrants.
 - The Sponsor owns Opco Class B Units, which generally have rights equivalent to those of Pubco Class B Shares in a traditional SPAC, including conversion into Opco Class A Units upon de-SPAC, which Opco Class A Units are then exchangeable for Pubco Class A Shares. The Opco Class B Units are identical to the Opco Class A Units held by Pubco except that they are initially subordinated in liquidation (e.g., in a failure to de-SPAC), as in a traditional SPAC.
 - In addition, the Sponsor owns Pubco Class B Shares that have no economic rights but generally vote together with the Pubco Class A Shares as a single class (as in a traditional Up-C). Each Opco Class A Unit (together with a corresponding Pubco Class B Share) may be exchanged for a Pubco Class A Share.
 - The Sponsor’s warrants are exercisable for either Opco Class A Units or Pubco Class A Shares.
- Exchanges by the Sponsor of Opco Class A Units for Pubco Class A Shares generally deliver tax step-up benefits to Pubco. If desired and acceptable to bankers, a TRA could be included, but this is not necessary.
- Pubco and Opco may be organized as U.S. entities or as non-U.S. entities, depending upon the expected target profile.

Up-SPAC Structure

Up-SPAC vs. Traditional SPAC

Up-SPAC Structure

- Based on tested structures that are familiar to the market
- Sponsors remain in pass-through structure, unless they want to unwind at de-SPAC
- Future sell downs by Sponsors generate tax basis step-up for Pubco
- More complex structure (financial reporting, cash management, tax reporting and fund structuring)
- Cash flow less susceptible to changes in tax rates
- Offers greater flexibility in structuring acquisitions
- Tax basis step-up upon exchange of Opco Class A Units for Pubco Class A Shares
- If no TRA included, all tax benefits accrue to shareholders; if TRA included, potential for additional sponsor value
- Founder shares are “profits interests”

Traditional SPAC Structure

- Tested structure that is familiar to the market
- Less impediments/costs to change of control transaction
- No tax basis step-up related to founder shares, so no benefit to shareholders and no potential for TRA
- Less complexity
- Cash flow more susceptible to changes in tax rates
- IPO process potentially a bit faster
- Founder shares are not “profits interests”

Up-SPAC Structure

Illustration of Basis Step-Up from Founder Shares

<u>Illustrative Share Price @ Time of Exchange</u>	<u>\$10.00</u>	<u>\$30.00</u>
Class A Shares @ \$400 MM IPO	40 MM	40 MM
Founder Shares @ \$400 MM IPO	10 MM	10 MM
Founder Shares Basis Step-up	\$100 MM	\$300 MM
Corporate Tax Rate (when Pubco has taxable income)	25%	25%
Cumulative Cash Tax Benefit (all shareholders)	\$25 MM	\$75 MM
<u>If Used in a "YieldCo"</u>		
Assumed DD&A Life	7 yr SL	7 yr SL
Annual Distributable Cash Flow Benefit (all shareholders)	\$3.6 MM	\$10.7 MM
Annual Distributable Cash Flow Benefit (per share)	\$0.07	\$0.21
Additional Annual Yield	0.7%	0.7%
Additional Market Cap at 15x Distributable Cash	\$54 MM	\$161 MM

1. Step-up per share assumes a \$400 million IPO and 20% founder promote (10 million shares valued at \$10.00 / share at announcement)
2. Founder shares tax basis step-up equal to the full fair market value of the founder shares
3. Assumes a federal tax rate of 21.0% plus a state tax rate (net of federal benefit) of 4.0%; future increases in corporate tax rates should increase the tax benefit of this structure.
4. Does not account for potential additional step-up from private placement warrants (if exercised at Opco level)

Up-SPAC Structure

Comparison of SPAC Structure Options – U.S. Tax Aspects

	<i>Traditional SPAC Structures</i>		<i>Up-SPAC Structure</i>
	U.S. Corporation (+ Conversion to Foreign Corporation if Needed)	Foreign Corporation (+ Conversion to U.S. Corporation if Needed)	U.S. Corporation* with Up-C for Founder Shares (+ Conversion if Needed)
Potential PFIC Issues	Generally none	Pubco potentially a PFIC	Generally none
Inversion Risk on de-SPAC Restructuring with Foreign Target	Material risk if target is foreign	Generally none	Material risk if target is foreign
SPAC Shareholder / Warrant Holder Gain on de-SPAC Restructuring	Potential gain depending on circumstances	Potential gain depending on circumstances (particularly if U.S. target)	Potential gain depending on circumstances
Target Rollover Gain on de-SPAC Restructuring	Potential issues with target rollover depending on circumstances	Potential issues with target rollover depending on circumstances	Target rollover may be more easily accomplished into existing Up-C structure
Founder Shares Treated as Profits Interests	No	No	Yes
Tax Benefit on Exchange of Founder Shares	Generally none	Generally none	Exchange of founder shares/private placement warrants may result in tax step-up benefits to Pubco

*May also be organized as a foreign corporation, but this requires additional analysis and is not reflected in the table below.

Up-SPAC Structure

Comparison to Traditional IPO Structures – Commercial Terms

	<u>Traditional SPAC Structure</u>	<u>Up-SPAC Structure</u>	<u>Traditional Up-C Structure</u>
Public Securities	Pubco Class A Shares and fractions of Warrants to purchase Class A Shares, which initially trade together as units	Same as traditional SPAC structure	Pubco Class A Shares
Warrants	Warrants become exercisable at the later of (i) 30 days after a de-SPAC and (ii) 1 year after closing	Same as traditional SPAC structure	N/A
Sponsor's Interests	Sponsor acquires <u>Pubco</u> Class B Shares equal to 20% of the Pubco Class A Shares offered to the public, which will convert into Class A Shares upon an initial business combination	Combination of both structures: Sponsor acquires (i) <u>Opco</u> Class B Units (together with a corresponding number of non-economic, voting Pubco Class B Shares) that equal 20% of the Pubco Class A Shares being offered to the public and that are convertible into Opco Class A Units in connection with an initial business combination, (ii) a small percentage of Opco Class A Units, and (iii) a small percentage of Pubco Class A Shares. Opco Class A Units are exchangeable for Pubco Class A Shares after an initial business combination.	Sponsor acquires <u>Opco</u> Units (together with a corresponding number of non-economic, voting Pubco Class B Shares), which are exchangeable for Pubco Class A Shares
Private Placement Warrants	<u>Opco does not exist</u> , so each private placement warrant is exercisable to purchase one Pubco Class A Share <u>only</u>	Similar to traditional SPAC structure except each private placement warrant is exercisable to purchase one Pubco Class A Share <u>or</u> one Opco Class A Unit	N/A
Voting Rights	Pubco Class A Shares and Pubco Class B Shares are entitled to vote together as a single class, but, prior to initial business combination, only certain holders of Pubco Class B Shares have the right to vote	Same as traditional SPAC structure	Similar to traditional SPAC structure except that pre-initial business combination limitations are N/A
Investment of Net Proceeds Before De-SPAC	<u>Pubco directly deposits</u> net proceeds from the offering in a trust account	Similar to traditional SPAC structure except net proceeds from the IPO are used to purchase Opco Class A Units and Opco Warrants, and <u>Opco deposits</u> the net proceeds in a trust account	N/A

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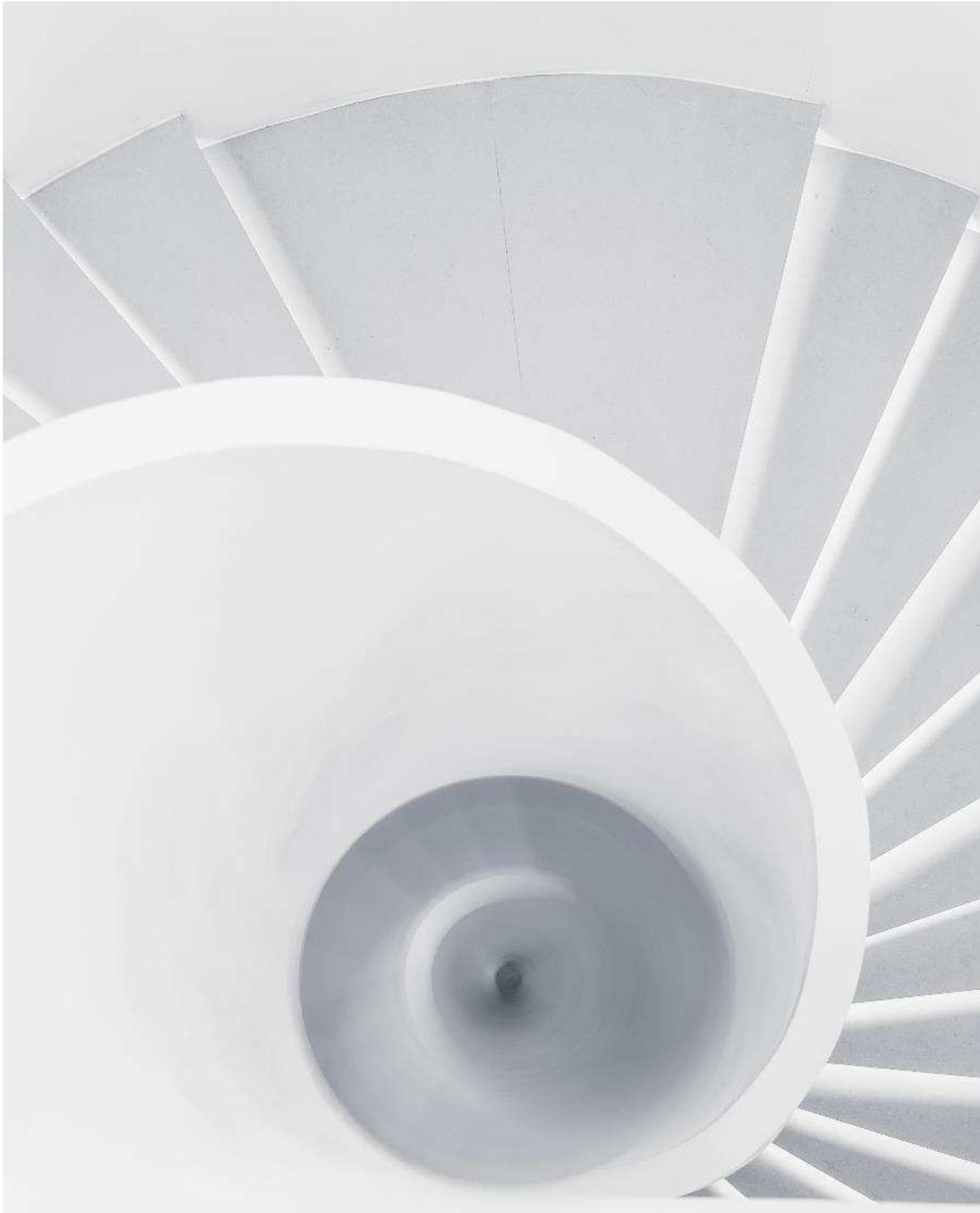
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