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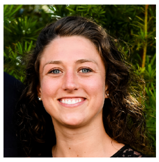
Timing Considerations for SPAC Equity Grants



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The page-turner that was 2020 wouldn't be complete without a post-mortem of some of the biggest and most influential public equity trends likely to shape markets for the next decade. Unofficially dubbed, "the year of the SPAC (Special Purpose Acquisition Company)," surging issuance and nearly $80 billion of capital raised for this previously seldom-used structure has afforded companies an alternative to the traditional IPO process. Efficiencies of the SPAC approach and incentives for SPAC sponsors make this process of going public more viable. The SPAC momentum has continued into 2021 and currently shows no sign of slowing down.

One oft-overlooked nuance of these transactions is what happens around transaction equity awards (let's call them "de-SPACing awards"). Simply stated, de-SPACing is the process by which the target company is acquired or merged with the SPAC and effectively takes over the public company status of the SPAC. To align the interests of the boards, management teams, and rank-and-file employees with those of all other stakeholders, how, or more importantly when, equity is granted remains a crucial aspect of long-term incentive planning. The target company may grant awards as a private entity prior to the transaction and/or as a newly public company post de-SPACing. The timing of such awards is important because it can have significant implications on the grant date fair value of the equity award, and/or the exercise price of a stock option award.

Before the de-SPACing process is complete, the target company will still have usage of its private company equity plan to cover any awards granted prior to the transaction; however, awards will be constrained by the number of shares currently available and timing of grants given "cheap stock" concerns. Any shares under the current equity plan are often retired, commensurate with the de-SPACing, leaving the target company in a "use it or lose it" state.

To avoid "losing" these shares, private companies often grant awards to executives to "top off" ownership levels. When situations arise, awards extend throughout the company, often targeting high-performing, key employees who are critical to the success of the company post-transaction as well as individuals that have very little "retention runway" (i.e., a small portion of unvested equity).

These grants should follow the private company's historical practices—usually stock options that vest over a period of three to five years. Full-value awards may be used as long as the equity plan allows. In either case, and this is the important part, the grant or strike price is set by the target company, which essentially locks in a pre-merger price prior to the transaction. If structured correctly, award recipients are likely to enjoy the anticipated stock price *"pop"* on the day of de-SPACing. Interested companies should consult trusted legal and tax counsel to evaluate their individual circumstances.

In addition to any awards granted prior to the de-SPACing, the company may wish to make equity awards to employees concurrent with or shortly after the closing. This decision should not be made in a vacuum, but instead consider any pre-merger grants, the company's compensation philosophy, and desired equity overhang levels. It's also important to note that the fair value of any stock or options granted after de-SPACing will be set at whatever the prevailing market share price is—often much higher than the $10/share starting price for many SPAC transactions.

When deciding whether to grant awards before and/or after de-SPACing, companies should consider their unique situation to determine the best path forward. The goal should be to best align the interests of all stakeholders, reward top performers for their long-term contributions to the business, and engage employees to deliver future value.

About the Author

Kimberly is a principal at Pearl Meyer providing analytical and project management support for client endeavors across the country. She is committed to providing clients with efficient and effective analytical support and solutions to achieve desired objectives and help enhance performance. She is experienced in executive, board, and broad-based employee compensation assessments and strategies.

About Pearl Meyer

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