Star Wars – The Evolving SPACs Galaxy

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The first Special Purpose Acquisition Companies (SPACs) emerged in the US some time ago (1990s). Since then, there have been several waves of SPACs, and their rippling effects have certainly reached Europe in the meantime. One example of a SPAC is Richard Branson's Virgin Galactic. In the last few years, SPACs have gone mainstream, especially in the US where Wall Street is obsessed with them, and they can now be tracked through an exchange-traded fund (ETF). But there are also signs of their existence in Europe, more so in the UK where the London Stock Exchange is reportedly exploring how to attract SPACs following their impressive uptick in the US. And, as usual in the corporate world, US and UK trends tend to reach continental Europe, including Belgium, of course. Belgian biotech companies are already having access to the US public market and could indeed be well-positioned to consider this type of vehicle.

The SPACs Galaxy

A SPAC is also known as a "blank check company". It is a newly incorporated company with no existing operations or underlying business. It is founded for the sole purpose of acquiring an existing company (read: opportunity), which is not always identified at the time of the SPAC's incorporation. The SPAC's funds are raised through an IPO of its shares (called units), and the SPAC will use those funds for one or more acquisitions.

The founders or sponsors of the SPAC usually hold 10 to 20% in it. At the time of the IPO, investors receive shares and warrants, and the cash raised from those investors are often held in an interest-bearing trust account and may not be released until the envisaged acquisition is completed. These acquisitions take place through reverse mergers, hence taking the target public.

In the US, investors can vote on the acquisition, and dissenters are free to redeem their money if the proposed deal does not appeal to them. Proposed acquisitions can also be blocked by a 20% vote. This obviously creates some uncertainty for the deal. In Europe, there is no such redemption rule, and sponsors can execute deals more quickly after an IPO. But investors here have tighter restrictions in the interim period between a deal's announcement and the approval of the prospectus. Another difference with SPACs in the US is the 80% spending rule, following which the acquisition typically has a fair market value of 80% or more of the SPAC's net assets. Many EU stock exchanges do not have this spending rule, so these SPACs can acquire multiple smaller targets.

If the SPAC does not acquire a target within the specified timeframe, usually 18-24 months, funds are returned to the investors and the SPAC is wound up.

The Force and The Dark Side

A SPAC comes with a unique set of benefits and challenges for the parties involved.

***Investors* –** Access to otherwise unreachable PE investments, easy exit (in the US), and the availability of knowledgeable management and sponsors connections are key characteristics of SPACs that attract investors. A risk for investors would be when other investors take advantage of the redemption option (in the US). When they do, a SPAC can seek new funding from other sponsors or investors, which could potentially dilute existing shareholders. Another risk for investors would be the lower scrutiny level compared to a traditional IPO. This would push investors to take decisions on a less informed basis.

***Sponsors* –** Founders or sponsors will often have a 10-20% equity holding. They generally sit on the boards of the listed companies and perform management services to the SPAC to identify targets and opportunities. If the SPAC is wound up because no acquisition is timely made, sponsors mainly bear the cost of the expenses incurred from incorporation through the winding-up. We see PE firms increasingly acting as sponsors, as they see this as an alternative route to raising capital beyond the limited partnership structures. This also allows them to convert their investment by selling their shares on the stock exchange and thus working around the IPO lock-up periods.

***Targets* –** Going public through a SPAC has been an attractive option for companies that wish to retain control of their business operations. In addition, SPACs can be completed in a few months compared to a traditional IPO, if no shareholder approval is required. So, it can be a faster alternative, saving time and energy. However, SPACs are not yet cheaper than IPOs.

The Rise of SPACs

For private companies interested in going public, being acquired by a SPAC is an alternative to the traditional IPO route. This is certainly worth considering.