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Insights

The SPACs boom

Europe picks up the pace

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Introduction

A boom in special purpose acquisition companies (SPACs) in the US in recent years is beginning to cross the Atlantic. Europe might not match the scale of the US boom, but there is a growing expectation that the number of SPAC listings will increase.

A boom with US origins

THERE HAS BEEN a boom in special purpose acquisition companies (SPACs) in US markets in recent years, with issuance of more than $80 billion in 2020. Europe is well behind, but showing signs of following the US path. SPACs are growing in popularity because they represent a faster route for companies to go public and have greater certainty on pricing than traditional initial public offerings (IPOs), though SPACs do have complications of their own. Issuance in Europe is relatively low but growing, as we examine here, and we expect SPACs to become more important in European markets.

SPACs, sponsors and de-SPACs – how it all works

SPACs are blank-check companies whose only objective is to raise capital in an IPO to acquire one or more operating companies through what is termed a **business combination** – when a privately owned company merges with a SPAC.

Usually a highly qualified group of individuals, with vast experience in the target industry – or in private equity, hedge funds or as entrepreneurs – forms the SPAC. These groups of individuals are called **sponsors**.

Typically, sponsors provide the initial SPAC capital in exchange for founder shares, which usually represent 20 per cent of the SPAC's shares post-IPO.

After going public, SPAC IPO proceeds are placed in a trust account until the business combination is completed, which should happen within 24 months of the IPO. If not, the SPAC dissolves and the money raised must be returned to shareholders.

Depending on the jurisdiction, the fair market value of the initial business combination may need to be at least 80 per cent of the assets held in the trust account. Typically, however, the value of the target company is around two to five times the gross proceeds of the SPAC IPO. In which case, SPACs raise the additional capital needed via a private investment in public equity (PIPE). The offering is typically aimed towards qualified investors and is subject to consummation of the business combination.

Following the SPAC IPO, the sponsors start to identify potential private companies within the target industry or sector disclosed during the IPO process. But in most cases, SPACs maintain a certain degree of flexibility, giving them freedom to identify opportunities in other sectors. Once the target has been identified, the business combination approved and the merger closed, the **de-SPAC process** takes place, where the target company becomes a public listed entity. For the future success of the new listed entity, it is crucial that the target company is made ready to act as a public company prior to the de-SPAC.

Target companies may want to go through what is commonly known as **IPO readiness** – a rigorous assessment process covering all areas of the organisation to identify potential gaps of being a public listed entity and to ensure they are ready to comply with all listing requirements post de-SPAC process.

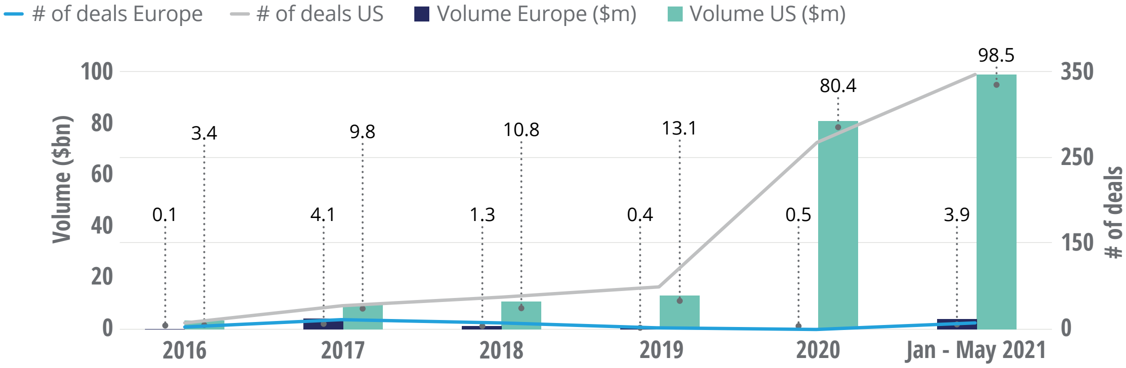
The US trajectory and Europe's beginnings

European exchanges are not completely new to SPACs. However, the number of SPAC IPOs and amounts raised in Europe are at present dwarfed by the same metrics in the US.

The US has seen a spurt of SPACs in recent years and especially in 2020, driven by the high liquidity in the market. Issuance volumes multiplied nearly six times, from $13.1 billion in 2019 to $80.4 billion in 2020. And as of 31 May 2021, the US had already exceeded last year's impressive numbers by around a fifth ($98.5 billion).[1] This unparalleled streak for US SPACs has been slowing, however, since April. Europe's case is quite different. Looking back, Europe has seen a few SPACs in previous years, although, taking out some exceptions, most of them were relatively small and went to the alternative markets in some cases. This time around what we are seeing are seasoned sponsors pouring more money into SPACs and listing them in key European regulated markets, for example, Frankfurt and Amsterdam. The SPAC trend is similar to the recent wave of SPACs in the US, and in Europe it is just beginning, although at much lower levels, with $3.9 billion in SPAC issuance so far in 2021.

FIGURE 1

SPAC issuance in the US vs. Europe since 2016



Source: Refinitiv Eikon, May 2021.

What we have seen so far in Europe

Europe has lagged behind the US with just 12 SPAC IPOs worth $3.9 billion from January to May 2021 (vs. 331 SPAC IPOs worth $98.5 billion for the same period in the US). Nonetheless, Europe's numbers show impressive growth, comparing 2021 to 2020. The number of deals has tripled, while the volume raised by these transactions has multiplied almost eight times (from $496 million across 4 SPACs in 2020 to $3.9 billion across 12 SPACs in 2021).[2]

IN RECENT YEARS, the European SPAC IPO deal size has evolved and grown larger. In 2019, the average size of these transactions was around $75 million. In 2020, it increased to approximately $124 million, and so far in 2021, the average size has escalated to around $320 million.[3] This remarkable increase is partially due to the investor appetite for SPACs and the enhanced quality of sponsors of the newly formed SPACs.

Larger SPACs, especially in Amsterdam

In 2021, there have been very sizeable SPAC IPOs in Europe. The largest to date has been the Tikehau Capital-backed Pegasus Europe SPAC, which raised $606 million in April in a Euronext Amsterdam IPO. This transaction was followed by Hedosophia European Growth, which raised $483 million with its SPAC, also listed in the Netherlands.[4]

It is this venue, Amsterdam, that has been the most active in SPAC issuance, followed by Frankfurt – and several more Amsterdam SPACs are expected to come to market soon. Dutch regulations and the international orientation of the Euronext market may be the leading reasons for this surge in SPACs in the Netherlands. One-third of European SPACs have been incorporated in the Netherlands, while another third have chosen Luxembourg as their nationality of incorporation. SPACs have refrained from listing in London as its system is more restrictive and does not allow investors to sell their participation in a SPAC if they do not like the proposed deal. A revision of rules is planned by the UK government as well as by other countries, including Spain, which are making efforts to adapt their regulations to ensure their participation in what may be an increasing trend in the European equity capital market space.

Differences between US and European SPAC markets

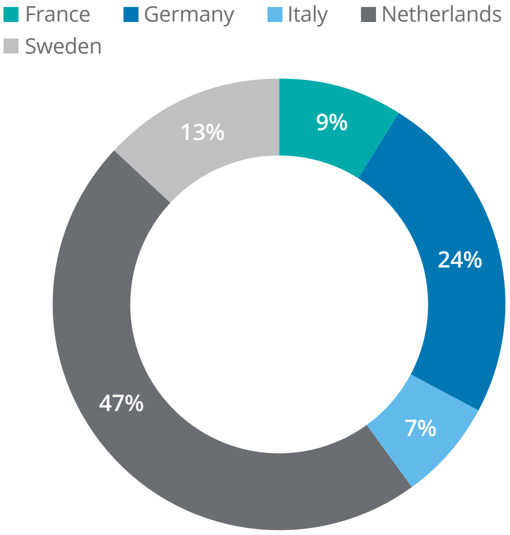
As the numbers indicate, the arrival of SPACs in Europe has been gradual rather than sudden and concentrated in continental Europe (figure 2).

The much lower level of Europe's SPAC issuance can be partially explained by different factors. Traditionally, the US has much **deeper capital markets**. SPACs have been part of the US capital market for decades. Proof of the more dynamic startup ecosystem in the US is that even European sponsors have traditionally been more inclined to list their SPACs in the US stock market than domestically.

US regulation is also more favourable to SPACs. Listing requirements for companies planning to launch a traditional IPO are stricter in the US, encouraging them to find an easier, faster way to IPO via SPACs. In Europe, however, the differences between a de-SPAC merger and an IPO from a regulatory standpoint may not be overwhelmingly different.

FIGURE 2

Split of European SPAC IPO volume by country (January - May 2021)



Source: Refinitiv Eikon, 31 May 2021.

Current regulation in many European countries does not easily allow SPAC investors to leave the SPAC and get their funds back if they do not approve of the target identified for the new business combination. Therefore, companies may still opt for the traditional way of listing – the IPO.

In addition, the low amount of SPAC issuance in Europe means investors have not enough evidence that a de-SPAC, especially from the new wave of more sizeable European SPACs, can be executed successfully. Once the already listed SPACs (which are currently looking actively for targets to purchase) complete their business combinations and demonstrate successful aftermarket performance, European SPAC issuance may increase.

SPACs focus on innovative companies

In terms of sectors, SPACs and their sponsors are looking to invest primarily in innovative tech or fintech companies, as well as environmental businesses. In general terms, SPACs typically have up to 24 months to create a new business combination. In all recent cases, they have specified a target sector but give themselves some room for manoeuvre and leave it up to the management to decide the choice of sector.

More and more professionalised sponsor teams are leading this kind of vehicle – sponsors with years of experience in the sector or sponsor teams backed by investment firms, as in the cases of Pegasus Acquisition Co Europe BV (backed by Tikehau Capital), Obotech Acquisition SE (backed by Obotritia Capital) and ACQ Bure (backed by Swedish investment firm Bure).[5]

We see several factors driving the popularity of SPACs in Europe, including the abundance of capital in a low interest rate environment, with investors chasing higher returns, and the rapid growth of Europe's technology sector.

This popularity and growing expectations that SPACs will become a more common type of issuance is reflected in the number of new SPAC teams in European investment banks, such as JPMorgan,[6] Goldman Sachs[7] and Deutsche Bank,[8] among many others. SPACs are a lucrative business for banks as they participate in the IPO issuance of the SPAC and afterwards in the M&A process of the de-SPAC.

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Advantages and disadvantages of SPACs

SPACs may bring numerous benefits to all parties involved and especially to companies accessing liquidity via the public market and looking to fast-track the IPO process. SPACs offer an alternative path for companies to go public. Among the benefits of going public via a SPAC is the speed of the process. A company may be listed in around four months via a SPAC, while in a traditional IPO the process takes at least six to eight months to complete.

ADDITIONALLY, THIS WAY of going public can be cheaper for the target company compared to a traditional IPO. In some cases, the sponsor may act as a strategic partner after the de-SPAC process, meaning it may provide the target company with an experienced leadership team to guide it after going public. But the biggest advantage for target companies may be valuation certainty. In contrast to a traditional IPO – where the valuation is set by investors, market conditions have a large impact and issuers are not permitted to provide future projections – in a SPAC the valuation is negotiated between the sponsor and the target company, as in an M&A process, and, importantly, the target company may provide future projections to the sponsors in order to set a value for the business.

Advantages for investors and banks

SPACs also have numerous advantages for **investors**. As a time limit is set to carry out the SPAC acquisition, the proceeds are placed into an escrow account, and investors may redeem their shares for a return of their funds if they do not approve of the final business combination, thereby significantly reducing their downside risk. SPACs also bring investors further opportunity to profit as they can invest in the initial SPAC and purchase additional shares after the acquisition through warrants. For the sponsors, the easy access SPACs offer to capital because of fewer regulatory hurdles than for traditional IPOs is appealing, as is the significant profit upside the SPAC offers. As previously mentioned, sponsors typically receive 20 per cent of SPAC shares after the IPO, which can lead to millions of dollars in gains – without a doubt, one controversial aspect of the SPACs boom as sponsors can make outsize gains compared to those obtained by ordinary investors in the SPAC.

A less obvious but clear beneficiary of the SPACs boom are **investment banks**. Typically, there is a size threshold for companies looking to IPO, with smaller companies unable to launch them. However, such companies may be attractive to SPAC sponsors, and therefore SPACs can multiply the deal flow for banks. Additionally, the fee pot tends to be greater, as the banks are usually involved with sponsors in both transactions, the SPAC IPO and the de-SPAC process, or advising target companies in negotiations for the reverse merger with the SPAC.

SPAC disadvantages

Although SPACs may bring many advantages, the path of listing and raising capital they offer will not suit everyone, as there may be challenges compared to traditional IPOs. A traditional IPO allows issuers to enjoy increased **analyst coverage** because there is typically more than just one underwriting bank. Furthermore, investors in SPACs are usually less specialised in the target sector.

A traditional IPO also allows the company's management to have direct interaction with their future shareholders and ensures **management continuity** post-IPO, as this usually is one of the key selling points at the IPO stage. In a de-SPAC transaction, the terms are negotiated between sponsors and the target company and, in some cases, may result in changes to the management team of the target company. In case the SPAC takes a controlling stake and requests a replacement of certain executives in the target company, the latter should be aware of any potential golden parachute payments (amount agreed between company and employee in case the employee is terminated) it is bound to fulfil. Furthermore, a SPAC brings challenges for target companies, as after the de-SPAC process, the sponsors will be new shareholders, with decision-making power, and therefore historical shareholders will lose some control.

Finally, though the clear advantage of a SPAC for companies is to be able to access public markets without the difficulties of a traditional IPO, they must nonetheless be compliant with all the regulations European companies must meet following their IPO – or, in their case, following the de-SPAC process. And although with a SPAC merger there is a degree of flexibility negotiating certain terms with the SPAC sponsors, including the **valuation**, it should not be far from the level public markets are willing to pay for the stock. If valuations are perceived as too high once shares are traded publicly, chances are that the stock will underperform – as many de-SPAC companies have in the past. According to a Bloomberg Law article back in February, 14 out of 24 of the companies that went public as a result of a merger with a SPAC from 1 January 2019 until 10 February 2021, "reported a depreciation in value as of one month following the completion of the merger". The article highlights that some companies showed "some improvement, with one-third reporting a year-to-date depreciation in value".[9] Therefore, a poor aftermarket performance is a clear disadvantage and is raising concerns among investors about SPACs. "The concern is also being reflected in a rising number of securities lawsuits filed by SPAC stockholders post-merger".[10]

What SPACs mean for European companies

It is unlikely that the European SPAC market will replicate the boom seen in the US. European capital markets are shallower and the regulatory constraints tighter in many European countries. But we expect the thinking of many companies on how they might go public and the timing of that move within the company growth cycle will shift as the number of European SPAC IPOs increases.

Traditionally, SPACs have been best suited to small and mid-sized companies that otherwise lacked access to public markets. In the recent US SPAC boom and the few SPACs recently listed in Europe, these new vehicles are led by top-quality sponsors, allowing SPACs to raise more money and therefore acquire larger, more mature companies. This presents a new way to go public, although it is vital for companies to assess the pros and cons of the SPAC process and see which way of accessing public markets is best suited to them.

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SPACs may seem attractive to many startups as they provide new money and an open door for future financing rounds. But startups need to assess what going public at an earlier stage may mean for their business culture, which in many cases is one of the key drivers of success. Being listed means having structured governance and precise processes that need to be followed to meet regulatory requirements. This could hamper the creative process for some.

Therefore, careful consideration should be given to whether a SPAC is the best option and to the timing of the IPO/de-SPAC process.

Furthermore, European companies may be targeted by the numerous US SPACs that have been listed recently. It is important that the management of potential targets understand the implications of listing in the US and the stricter requirements (such as compliance with Sarbanes-Oxley) they would face. It is also possible that companies are targeted for part of their business.

Finally, some sectors, such as tech and biotech, among other growth sectors, may be strongly attracted to the SPAC option, as it allows the company to share its forecasts with investors – a practice prohibited in traditional IPOs. Sharing projections may allow companies to obtain higher valuations from the market.

Endnotes

1. Refinitiv Eikon, 31 May 2021.
2. Ibid.
3. Ibid.
4. Ibid.
5. Ibid.
6. www.fnlondon.com, 16 Feb 2021.
7. www.fnlondon.com, 2 Mar 2021.
8. www.fnlondon.com, 2 Mar 2021.
9. Grace Maral Burnett, “Analysis: Post-Merger SPAC Performance Is Mixed,” Bloomberg Law, 12 February 2021.
10. Ibid.

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