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What to think about when SPACs go shopping

James Ellis-Rees, associate at Faegre Drinker Biddle & Reath LLP, comments on investment into special-purpose acquisition companies (SPACs) in a post-pandemic world.

SPAC (special purpose acquisition company) activity has been a significant feature of the bounce-back in US stock markets from the subterranean depths of the pandemic, while here in the UK the picture has been very different. In 2020 there were only four SPAC listings in the UK compared with 248 in the US in the same period and in the first half of 2021 UK listings were still in single figures while there were 377 SPAC IPOs in the US and 16 elsewhere in Europe.

The UK has been left behind largely due to regulatory features that make SPACs less attractive than elsewhere. Under the Listing Rules SPACs suffered from a presumption that trading in their shares would be suspended once an acquisition was announced as such acquisitions are considered reverse takeovers. Investors therefore did not have the option of redeeming their shares at the time of the deal which is typically one of the features of the SPAC package.

In response, the FCA amended the Listing Rules with effect from August 2021 with the aim of providing "*a more flexible regime for larger SPACs… potentially resulting in a wider range of SPACs listed in the UK, increased choice for investors and an alternative route to public markets for private companies.*" The rule changes allow larger SPACs (those that raise at least £100 million from public investors) to avoid suspension provided they comply with various investor protections and additional disclosure requirements.

This new flexibility and the associated safeguards will make the larger SPACs a more compelling investment proposition, so what should investors be considering in relation to the acquisition stage of the SPAC lifecycle?

Speed and price certainty – The basic attraction of SPACs is that, as listed shell companies with capital ready for investment, an acquisition by them is a swifter route for a business to become a public company and offers greater price certainty than going through an IPO. The relative certainty on price is due to it being determined by the largely bilateral acquisition negotiations rather than the protracted investor interactions and bookbuilding of an IPO where the outcome is only known at the last minute and can also suffer from added uncertainty when markets are volatile.

Limited timescale – Under the new rules there is a two-year limit on the period in which SPACs can look for acquisitions, although with a one-year extension if shareholders approve and a further six months to complete a transaction that is underway. This limits the period of uncertainty before an acquisition is made but it could also be viewed as potentially encouraging a less than ideal transaction if time starts running out due to the founders' incentivisation to get a deal done.

Acquisition targets – The SPAC will usually identify its target sector for acquisitions in its IPO prospectus. There will be caveats around this and the investor should factor in the potential for a different outcome, including no acquisition being made in the required timescale.

Disclosure obligations – The SPAC must provide investors with sufficient disclosure of key terms and risks during its search for acquisitions and specific disclosures relating to an acquisition once it is announced. SPACs cannot have a premium listing on the London Stock Exchange as they do not have the necessary trading history so investors will need to assess whether they can tolerate the less comprehensive the disclosure requirements of a standard or AIM listing. Following an acquisition they may be able to step up to a premium or standard listing but this should not be assumed.

Dilution – The founder team generally holds a "promote equity" stake that typically converts on completion of an acquisition into a 20% holding in the SPAC. This has a significantly dilutive effect on the remaining investors' equity.

Shareholder approval – The new rules require an initial acquisition to be approved by the shareholders, excluding the founders and directors.

Redemption option – Investors will have the option to redeem their shares at a predetermined price prior to completion of an initial acquisition. The price will either be a fixed amount or a fixed share of the funds for acquisitions raised at IPO. This is a key protection for investors even though they will only invoke it if they are unhappy with the acquisition.

While these changes give a measure of protection for investors contemplating SPACs, most that were part of the recent surge are still in their two-year acquisition periods so their post-acquisition lives are uncharted territory – investors should probably exercise caution.