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Europe: The next destination for SPACs?

SPACs **(special purpose acquisition companies)** have been making a splash in US markets. Over the pond, 244 US-listed SPACs raised almost $80 billion last year[i]. The first quarter of 2021 is not even through and that sum has already been eclipsed as demand continues to accelerate amongst retail and institutional investors alike.

Also known as **blank cheque companies,** SPACs are essentially shell companies with no commercial operations. They are set up with the sole purpose of raising capital through initial public offerings (IPOs). The money raised is then used to acquire or merge with an existing company.

These vehicles themselves are not new, but their popularity is; they've come out of the fringes of US capital markets into the limelight, as an increasingly popular avenue for firms wishing to list their shares.

SPACs raise money from investors who, when parting with their cash, usually do not know which

companies will be targeted in the subsequent acquisition. Therefore, they place a lot of trust in those running the SPAC to identify lucrative prospects. Intuitively, you would therefore assume that SPAC founders are Wall Street veterans and market mavens, but indeed not. Rap stars, tennis champions and athletes are now counted amongst SPAC founders, prompting concerns that a bubble is forming.

At the time of the IPO, SPACs are typically priced at a nominal $10 per unit (which is not based on a valuation of an existing business). These units usually comprise a share of common stock in the to-be-acquired-firm and a warrant to purchase more stock at a later date. The money raised in the SPAC IPO is held in an interest-bearing trust account (similar to an escrow arrangement when buying a house) until a deal is identified, and investors can ask for their investment back at any time. So, in a nutshell, they get potential upside exposure after the deal is done, with reduced capital risk. Typically, if the SPAC fails to conduct a deal within two years, the funds must be returned to investors.

If a deal is struck, the stocks in the acquired firm begin trading publicly. As with all listed shares, their market prices may fluctuate. Lately, professional investors have been showing a tendency to sell their stake after the deal is announced and those who stay invested may be exposed to additional risks such as potentially bad deal terms and dilution from the free warrants.

The rise in SPAC activity in the US means that there is intense competitive to find promising private firms to take public – the SEC (the US regulator) has already warned that attractive opportunities for SPACs could become scarcer. SPACs could begin trading at a discount to the $10 listing price, if the vehicle is approaching the end of its 2-year hunting period without scoring a deal or if the market starts to look saturated with new launches, all scouring for businesses to take public. Already, this month, listed SPAC prices started to falter amid heightened issuance and rising bond yields.

With the US market starting to look crowded, Europe could well be the next frontier for SPAC vehicles. It recently emerged that LVMH founder Bernard Arnault and former UniCredit chief Jean Pierre Mustier are creating a SPAC called Pegasus, to invest in European financial companies, citing a landscape ripe for consolidation. Pegasus will list in Amsterdam (currently London is off the cards for SPACs due to prohibitive regulation).

While SPACs could bring some dynamism to European markets, there is a danger that the party is starting a little bit late as interest rates begin to gradually rise, which could eventually tarnish the relative attractiveness of such vehicles. Investors considering SPACs should devote more time to reading all the small print in the prospectus, than to reading compelling marketing documents (SPACs give their founders much more “storytelling freedom” as they are not governed by the same “safe harbour” rules which prevent companies from issuing forward-looking corporate statements in a traditional IPO). Further, given that SPACs don’t have an operating history to evaluate, investors would do well to let the business background of the

vehicle's founders and sponsors tell its own story. In the US, the SEC has already published an alert noting "*It is never a good idea to invest in a SPAC just because someone famous sponsors or invests in it or says it is a good investment.*"

[i] According to Refinitiv data

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