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ARTICLE

Interest in SPACs as an Exit Strategy Grows in the UK

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SPACs became a major force in the U.S. during 2020, but there have been relatively few in the U.K.—or indeed across Europe—in recent years.

Given the relatively straightforward route to the public equity markets that a SPAC offers and the sheer volume of capital raised by U.S. SPACs, interest is growing rapidly both in the U.K. and Europe.

In the U.S., there were 242 SPAC initial public offerings raising in excess of $83 billion in 2020. And the first two months of 2021 have shown no signs of investor appetite ending, with record amounts of capital being raised in the U.S. through SPACs.

This volume of capital is spurring investor appetite in the U.K. In addition, interest in the U.K. has also heightened following the recently published review of the U.K. Listing Regime by Lord Hill which, amongst other things, recommended a change to the U.K.'s reverse takeover rules as they relate to SPACs—a move that would ease a major regulatory hurdle. So far this year we have seen Amsterdam emerge as the listing venue for SPACs but in light of such proposed regulatory reform, we anticipate that London will start to show its SPAC credentials.

Increasingly, SPACs—whether listed in the U.S., the U.K. or elsewhere in Europe—are becoming an enticing exit route for private equity sponsors seeking a sale of portfolio assets.

For those new to SPACs, short for special purpose acquisition companies, the term refers to shell companies formed by a management team with a track record that use the proceeds from going public to buy another company. The resulting merger with a target company offers a faster and lower-cost way to market than a traditional IPO.

Why combine with a SPAC as an exit strategy?

A prime reason for combining with a SPAC relates to speed and pricing certainty. A typical IPO takes months to complete and is subject to the fluctuations of the capital markets. As a SPAC has already listed, merging a portfolio company with a SPAC enables a private equity firm to avoid the uncertainty caused by market changes that might take place during an IPO process, with the possible negative impact on value. There is therefore greater certainty of the selling company's valuation than in an IPO process and less dependence on timing the market.

Another key factor is that a business combination with a SPAC will typically be structured such that a private equity seller will not be able to cash out its shareholding in full and will instead have a portion of its holding locked up post-closing. By retaining an equity interest, even on a mandatory basis, the private equity firm stands to benefit from future growth of the combined entity. Related to this, it is also worth bearing in mind that the founder SPAC sponsors will likely bring knowledge and experience to the portfolio company, as well as public company experience, which can help stimulate further growth.

In addition, as going public through a SPAC is in effect an M&A transaction, there is flexibility to build in to the acquisition structure performance-based earn outs that are designed to bridge differences between the seller and the buyer as to valuation.

Finally, as SPACs are required to consummate a business combination within a stated period (usually 18-24 months), private equity firms may have helpful pricing leverage in negotiating a deal with a SPAC that is nearing the end of its lifecycle.

Important things to consider

In thinking about whether a combination with a SPAC is potentially the optimal exit route, a private equity seller should prepare for the longer term, as it will likely have to retain an interest in the combined vehicle.

It also should ready the portfolio company for life as part of a listed company. Its financial, governance and administrative systems, in particular, will need to be reviewed and adapted in advance of sale.

It will also need to consider the disclosure requirements for its financial statements, whether the audit is up-to-date and to what reporting standard they have been prepared.

In addition, it should review the terms of its existing investment and finance documents, in conjunction with its legal counsel, to determine the extent to which an acquisition by a SPAC is covered by existing exit provisions.

And finally, it should continue to consider other exit options, (by running an auction process, for example), as a sale to a SPAC will generally take longer to complete. Also, a SPAC is unable to deploy the capital raised in its trust account until a deal is closed, so a SPAC is likely to be unable to pay a meaningful break fee.

SPACS in the U.K.'s future

As the SPAC model continues to grow and the U.K. regulatory treatment evolves, inevitably optimal terms and structures will evolve and private equity firms should continue to monitor the market. Combinations with SPACs may well become a genuine exit alternative to a traditional IPO exit or out-and-out sale for private equity sponsors.

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