Fuelling the boom: Are SPACs in the energy sector here to stay?

SPACs | As special purpose acquisition companies, or SPACs, prove a popular route to public markets for private energy businesses in the US, Fieldfisher's Jack Mason-Jebb and Brad Isaac consider whether the trend has enough momentum to take it across the Atlantic.

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The US markets have seen the majority of SPAC listings, but could they spread across the Atlantic?

The surge in popularity for using special purpose acquisition companies (SPACs) to launch privately-held companies into publicly-listed entities was a trend that defined US capital market activity in 2020 – and one that accelerated further in the first four months of this year.

While they have been most prevalent in the US tech sector, SPACs have also been enthusiastically embraced by the energy industry, specifically for renewable power, clean tech, hydrogen, energy storage, electric vehicle charging and battery technologies.

Although there is nothing in particular about SPACs that lend them to energy company floats, a cluster of clean energy companies that went public via SPAC acquisitions in the US in 2019 saw dramatic increases in their valuations over their first 18 months of trading.

This has tempted more capital to the sector over the past year, with investors hoping to identify the next runaway success story at a time when politicians and investors are motivated to tackle climate change through "energy transition" solutions.

Conventional energy companies in the oil and gas sector have also seen an uplift from the SPAC boom, but to a much lesser extent than their clean energy counterparts.

What are SPACs?

SPACs, in their current form, have been around since at least the early 1990s. Often referred to as "blank-cheque" companies, they are empty cash shells with no business operation, created with the sole purpose of holding investors' cash and listing on a stock exchange, with the objective of acquiring a company or asset.

SPACs are formed by a sponsor, or group of sponsors, consisting of a management team who will seek a private business to purchase using their pool of invested cash. Private companies that are acquired by/merged with SPACs become publicly-listed and the SPAC relinquishes its acquisition vehicle status (known as "de-SPACing").

If the acquired company trades well and its share price increases, investors receive a return on their investment.

Although SPACs do not usually have a specific target in mind at the time of listing, the sponsors typically have industry-specific knowledge and will target businesses in these industries. As part of the acquisition, the SPAC's sponsors will often join the acquired business' management, and may serve on the board of the public company. Investors in SPACs do not know what company the SPAC will ultimately acquire, but trust their capital to sponsors to select a target.

Once listed, SPACs typically have two years in which to acquire a private business, or they must return the money to their investors.

To date, the vast majority of SPACs have been born from the US' burgeoning tech sector and the inclination of seasoned Silicon Valley executives, inspired by examples of entrepreneurial success in taking companies public, to use their experience to pursue new ventures.

Some of this experience and appetite has spilled over into renewable energy and related technologies, seeking to ride the wave of interest in low/zero-carbon power and circular economy solutions.

Why have SPACs become so popular?

The attractiveness of SPACs in the US has been boosted by a combination of factors.

Near record-low interest rates have prompted investors to look to equities for returns and made it cheaper to raise debt for new M&A deals. Meanwhile, fiscal stimulus measures from central banks have flooded markets with cash. Such circumstances often prompt private companies to make a dash for public markets to take advantage of the available capital.

SPACs can offer a quicker and cheaper route to the public markets than a traditional initial public offering (IPO) and consequently appeal to early-stage businesses with growth potential in need of fresh liquidity. The start-up culture that emerged from the 2008/9 financial crisis has created a huge choice of potential targets for acquirers, and these are beginning to be snapped up rapidly. In the US, data from various SPAC trackers suggests that the amount of time between SPAC IPOs and closing acquisitions has shortened in tandem with rocketing valuations.

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What are the main benefits of SPACs?

One of the principal 'benefits' of SPACs from the perspective of gaining access to public markets is that they do not have to comply with the tougher listing rules that apply to traditional floats. Floating a company on a major stock exchange is typically a lengthy process that requires a business, with the help of financial and legal advisers, to draw up a detailed prospectus or admission document designed to give potential investors as much information as possible about its operations.

For energy companies, especially those with novel technologies and/or complicated business models, this can be a particularly long and complicated part of the listing procedure.

While this rigorous practice is designed to prevent companies from providing insufficient or misleading information that could harm the interests of investors, company management teams may regard IPO requirements as overly onerous and expensive when weighed against the benefits of a listing.

Another draw of SPACs versus IPOs is that company founders get to keep or redeploy a greater share of the IPO rewards, rather than paying significant shares of the listing proceeds to banks. Investment banks working in parallel with companies undertaking an IPO can expect to receive between 5% and 10% of the proceeds through underwriting fees alone, and legal and accounting costs incurred through due diligence further eat into companies' finances. By opting for a less expensive route to market via a SPAC, companies can choose to channel the money they save into, for example, marketing or research and development for future growth.

For smaller companies seeking to access the public equity markets, where underwriting the fundraising is much less common, listing via a SPAC de-risks the potential for the fundraising to fail. The company and the SPAC can also agree a valuation for the business upfront, rather than have it determined (or "priced") through the IPO marketing process.

A SPAC listing, particularly merging with an entity with the proceeds of a previous funding round, is therefore an attractive prospect to early stage pre-revenue companies. Reversing into a cash shell or investing company has for instance been a popular way for exploration and appraisal companies in the natural resources sector to come to market.

A less significant but nevertheless noteworthy feature of SPACs is that, for now at least, their acquisitions tend to attract less media attention than IPOs. IPOs often receive close media scrutiny, from the publication of the intention to float right through to first day of dealings, which can be desirable and useful but can also be negative and/or unhelpful, particularly if the business looking to float is a complicated energy business whose proposition or target market is difficult to sell to the press. By contrast, SPACs can make acquisitions and bring companies to market relatively quickly and quietly.

What are the chief concerns about SPACs?

The meteoric rise of SPACs in the US over the past year has refocused attention on their role in the market and generated some debate about whether the SPAC operating model requires reform. Unlike IPOs, where a company's business proposition and valuation is scrutinised through investor presentations and verification of the admission document by legal and financial advisers (and the press) before it floats, such detailed examination is largely absent in SPAC mergers.

This lack of regulatory scrutiny and thorough due diligence is one of the principal concerns about the potential hazardousness of SPACs as investment vehicles. Protection of retail investors is a key concern for institutional investors and financial market regulators, and SPACs are considered particularly risky because investors usually decide to invest in the SPAC based on little more than the sponsors' reputation and a hope that they will choose a successful target.

In the UK, when a SPAC buys a company, the transaction is classed as a reverse takeover and the SPAC's shares are suspended and trading cannot resume until a deal prospectus is published, for which there is no deadline, meaning investors' money can be locked up for years.

The lack of transparency around sponsor compensation and incentives for insiders has also generated concern, as has the sustainability of valuations being given to pre-revenue companies by the acquisition frenzy. The popularity of SPACs with largely unsophisticated retail investors (in some cases thanks to celebrity promotion of certain SPACs) has prompted unease among regulators about consumer protection. In September 2020, the US Securities and Exchange Commission (SEC) indicated that it plans to enhance disclosure and transparency requirements for SPACs, following regulatory concerns over recent fundraisings.

So far this year, the SEC has issued various further statements covering a range of SPAC-related issues, including commentary on celebrity endorsements, what it considers to be misunderstandings about liability risks involved in de-SPAC transactions and possible accounting and financial reporting changes for SPACs.

Are we likely to see more SPACs in the UK?

While UK capital markets activity and IPOs have been buoyant since the middle of last year, SPAC mania has so far not infiltrated the London markets. The main reason for this is the UK listing

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regime is not designed to cater for SPACs. The "reverse takeover" classification of SPAC acquisitions and corresponding suspension of shares has resulted in the paralysis of a number of UK SPACs, and effectively halted any momentum behind this trend.

Another deterrent for listing SPACs in London is that, to join the Primary Segment of the London Stock Exchange (which is a requirement for companies to be included in the FTSE indices, and therefore eligible to be purchased by index tracker funds), companies must fulfil various criteria. This includes a financial trading history, which, given they are cash shells, renders SPACs ineligible.

A Treasury-backed review published in March 2021 recommended, among other modifications, that the UK listing regime be amended to make the London markets more attractive for SPACs by removing the suspension of their shares after an acquisition of a target company. The report highlighted fears that London's burdensome IPO requirements are harming the competitiveness of its capital markets in the face of competition from other exchanges – which in the case of SPACs includes New York and, more recently, Amsterdam.

The report's findings are merely recommendations and will require further regulatory consultation, as well as primary legislative changes to become law. Nevertheless, the UK's Financial Conduct Authority welcomed the report's proposals and has indicated that some changes could be made before the end of 2021.

For energy companies thinking about a SPAC listing in London, it remains to be seen whether these structures will find favour with oil and gas and related conventional energy businesses that have historically dominated the energy segments of the London markets, or whether new doors will open for renewable energy companies that have so far made relatively little impact on UK exchanges.

What is the European perspective on SPACs?

London is not alone in its cautious approach to SPACs. Europe's conservative capital markets have also been largely sceptical of these vehicles and to date European regulators have resisted emulating the US' enthusiasm for SPACs – although there are signs that this is beginning to change.

As of April 2021, France's Euronext Exchange had only seen two SPAC listings. However, the Autorité des marchés financiers (AMF), the French financial markets authority, issued a statement in April clarifying that the professional segment of Paris' regulated market "is a suitable listing place for SPACs, which, in their initial phase, mainly target such qualified investors".

AMF also noted that it had "observed a significant increase in the number of SPACs preparing their listings on the Paris stock exchange since the beginning of 2021" and stressed that the French legal framework and regulatory requirements are equipped to "welcome" SPAC listing in Paris, while providing appropriate investor protection.

Italian regulators have also indicated their interest in seeing more domestic SPAC listings, although the effectiveness of such financial vehicles is undermined by the difficulties in finding appropriate targets and Italy's complicated process for approving business combinations.

In Germany, the Frankfurt Stock Exchange has seen a modest number of SPAC listings over the past decade and is now facing calls to encourage more to join its markets, encouraged by comparisons between the Frankfurt Exchange's SPAC structure and the structure used for such companies on the New York Stock Exchange.

The Netherlands is most hotly tipped to emerge as the European capital for the SPAC craze. Like Frankfurt, Amsterdam's stock market (the Euronext Amsterdam) bears comparison with the NYSE in its treatment of SPACs. Unlike most other European jurisdictions, Dutch law does not have rules that apply only to SPACs, and allows further flexibility to entities formed as a BV (a private limited company). Investors in Amsterdam-listed SPACs can exercise redemption rights at ease, and also remove their money in the SPAC if they do not like the proposed target chosen for the merger.

Euronext Amsterdam also has earned a reputation as a European home for many international and technology-focused companies and may be a more natural venue than London for renewable energy and clean-tech related growth companies.

Are SPACs in the energy sector here to stay?

The future of the SPAC boom depends to a large extent on how the trend develops in the US. If the US' SPAC bull market, which is already starting to appear saturated, turns bearish, it seems unlikely that, even with potential capital markets reforms in London and across Europe, a rush of SPAC reverse takeovers will flood Europe's stock markets.

If SPACs are destined to remain a modest feature of European capital markets, such structures can still offer a useful way for small and growing energy companies to achieve a public listing as an alternative to an IPO.

In the current climate, energy companies with a technology aspect to their business or a focus on renewable energy may be best placed to take advantage on the SPAC boom.

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