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SPECIAL PURPOSE ACQUISITION COMPANIES

An Alternative Route of Listing in Capital Markets

An overview of Special Purpose Acquisition Companies (SPACs)
and a discussion of their suitability for the Saudi market

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Executive Summary

Special Purpose Acquisition Companies (SPACs) have spread widely in the USA, then in Europe, and have recently gained the attention of Asian markets. SPACs provide an alternative way of listing on capital markets, instead of the typical Initial Public Offerings (IPO). Because of their unique features, SPACs are attractive to a category of companies that may not find the IPO path suitable. For investors, SPACs provide a new investment product that allows them to diversify their portfolios.

In short, SPACs are established by a group of founders with one goal only: to acquire a private company during a specified period of time. The SPAC's units are listed on the capital market through an IPO. At the same time, the founders start searching for a promising company to acquire. If a company is selected and the shareholders of both the SPAC and the target company come to an agreement, the SPAC funds will be transferred to the target company and the units of the SPAC will be replaced by shares in the target company. With that, the target company is listed on the capital market without the need to go through an IPO.

SPACs are shrouded in a lot of uncertainty when they are established, as nobody knows for certain whether the company will succeed in acquiring a successful company. That's why investors pay great attention to the experience of the founders and structure the deal with the founders in a way that motivates them to produce the best outcome. Furthermore, many capital market authorities enforce several regulations to align the founders' interest with current and potential investors and to ensure that the founders are qualified to carry out the SPAC's objectives.

SPACs have several advantages compared to IPOs. For investors, SPACs enable them to invest in promising private companies before they are listed in the market. They also allow investors to invest more money in the company compared to typical IPOs. Moreover, SPACs benefit the experience of the founders and their ability to select one of the best companies available for acquisition.

For target companies, listing through a SPAC is attractive because of its fewer requirements, lower costs, and shorter duration. In addition, negotiations are limited to a small group of specialists and withdrawal is easy in case the proposed deal was not satisfactory. For regulators, SPACs enable a new path to listing, which helps in increasing listings in the market, attracting new types of companies to the market, and diversifying investment products available for investors.

On the other hand, SPACs come with some disadvantages, as the founders may fail to complete a successful acquisition deal. The less stringent due diligence can increase the margin of error in assessing the value of the target company. In addition, investor's ownership in SPACs is significantly diluted due to the sizable share allocation that founders receive as a succuss fee.

From the viewpoint of target companies, SPACs lack the publicity and marketing that usually comes with typical IPOs. Also, there are no underwriter guaranteeing the completion of the transaction. For regulators, are the lesser due diligence and filling requirements may lead to listing poor companies that might cast a shadow on the capital market.

We, at Tharaa Financial Center, believe that SPACs enjoy a set of advantages that align with the objectives of the Financial Sector Development Program, especially its seventh game changer which aims to motivate the private sector to be listed on the Saudi stock market. SPACs will open a globally proven path that would be more suitable for certain companies, which will help in increasing listings and raising the market value of the Saudi stock market.

To ensure a successful application of SPACs, we stress the importance of limiting this path initially to qualified investors and limiting licensing to large capital firms that have extensive experience in listings and dealing with private equity. As the local market gains more experience, these restrictions can be relaxed.

Introduction

Special Purpose Acquisition Companies (SPACs) first emerged in the USA as an alternative way of listing in capital markets, instead of Initial Public Offerings (IPO). SPACs have unique characteristics which make them attractive for small and medium sized companies as well as investors.

In short, the idea is that a group of founders create a SPAC with only one goal, acquiring a private company during a specified period of time. The SPAC's units are listed on the capital market through an IPO, where they are traded in the market. At the same time, the founders start searching for a promising company to acquire. Then, if a company is selected and the shareholders in both the SPAC and the target company come to an agreement, the SPAC funds will be transferred to the target company and the units of the SPAC will be replaced by shares in the target company. Thus, the acquired company becomes publicly traded without the need to go through an IPO.

The widespread popularity of SPACs and their increased value and number over traditional IPOs in the United States have made this alternative method the center of attention for other global markets, as SPACs have started to gain significant traction in both European and Asian markets. This prompts us, at Tharaa Financial Center, to study SPACs and their mechanisms, identify their most notable advantages and disadvantages, evaluate their performance in different countries compared to traditional IPOs, and then discuss their suitability for the Saudi market.

What are SPACs?

SPACs are publicly traded companies established for one purpose only: finding a suitable target private company within a specified period (typically 18-24 months). Usually, the SPAC's target sector and geographic location are specified at the time of launching the SPAC. SPACs are put up for an initial public offering by the founders to raise funds from shareholders, who are attracted to the offering by the founders' expertise, the target sector, and their desire to invest in high-growth private equity, which is not easily available to small investors.

After listing the SPAC in the capital market, the subscribers' funds are placed in highly liquid, low risk money market funds until the target company is selected. When a company is selected, the SPAC and the target company negotiate the target company's value and terms of acquisition. If an agreement is reached, the issue is presented to the SPAC's shareholders for voting. A deal typically gives shareholders of SAPCs an opportunity to agree and exchange units of SPACs with stocks in the target company or disagree and redeem their SPAC's units to get back their original investment, plus the profit earned while that money was invested in money market funds.

If the majority of shareholders vote for the acquisition, the minority shareholders who have voted against the acquisition receive their funds back, while the remaining shareholders' funds are transferred to the acquired company in exchange for shares in it. If the funds are insufficient for the acquisition, additional funds are collected in a special round called "Private Investment in Public Equity" (PIPE). Table No. 1 shows the path of a successful SPAC with the approximate duration of each stage.

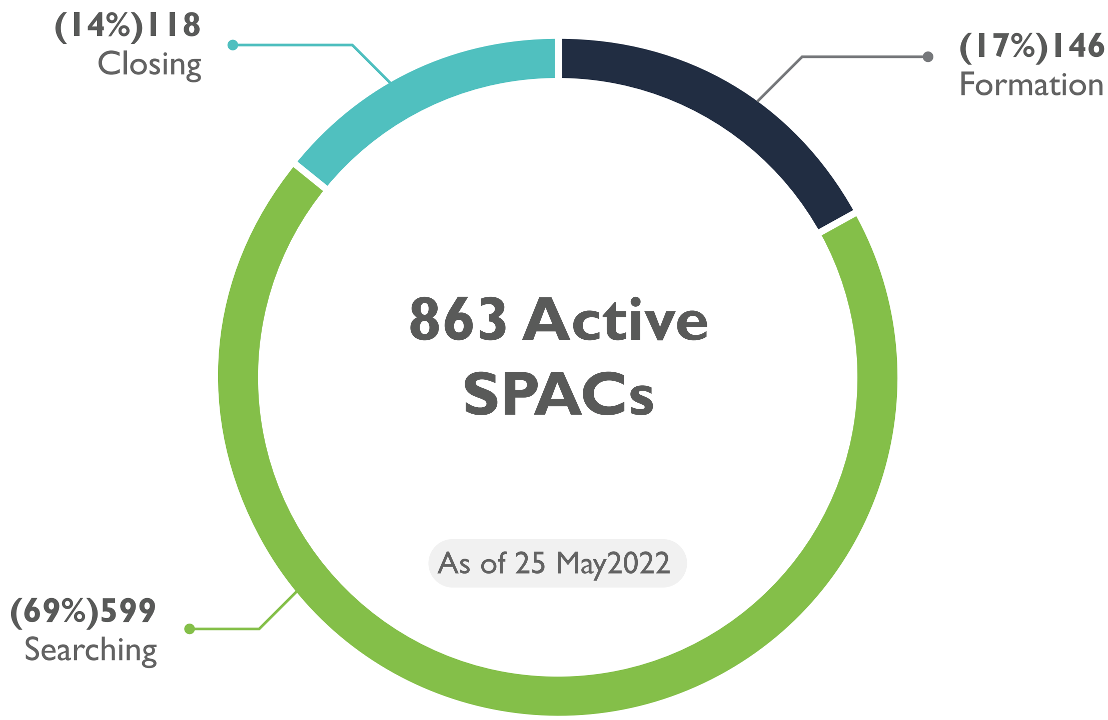
Table 1: Major Milestones for SPACs

Stage	Steps	Approximate Time Frame
Formation	Founding the Special Purpose Acquisition Company	6weeks
	IPO and listing in the capital market	
Searching	Searching for a promising company to acquire	19 months
	Negotiating with the target company	
	Shareholders voting on the acquisition deal	
Closing	Collecting more funds through PIPE if necessary	5 months
	Finalizing the deal and exchanging shareholders' units in the SPAC with stocks in the target company	

Source: Tharaa Financial Center

These steps show that a SPAC is simply a temporary entity that does not carry out any commercial transactions other than searching for a promising company to acquire. Hence, some call them "Blank Check Companies." These steps also show that target companies become available for trading in the market without the need to go through a traditional IPO. Figure 1 illustrates the number of SPACs in the USA in each stage as of 25 May 2022.

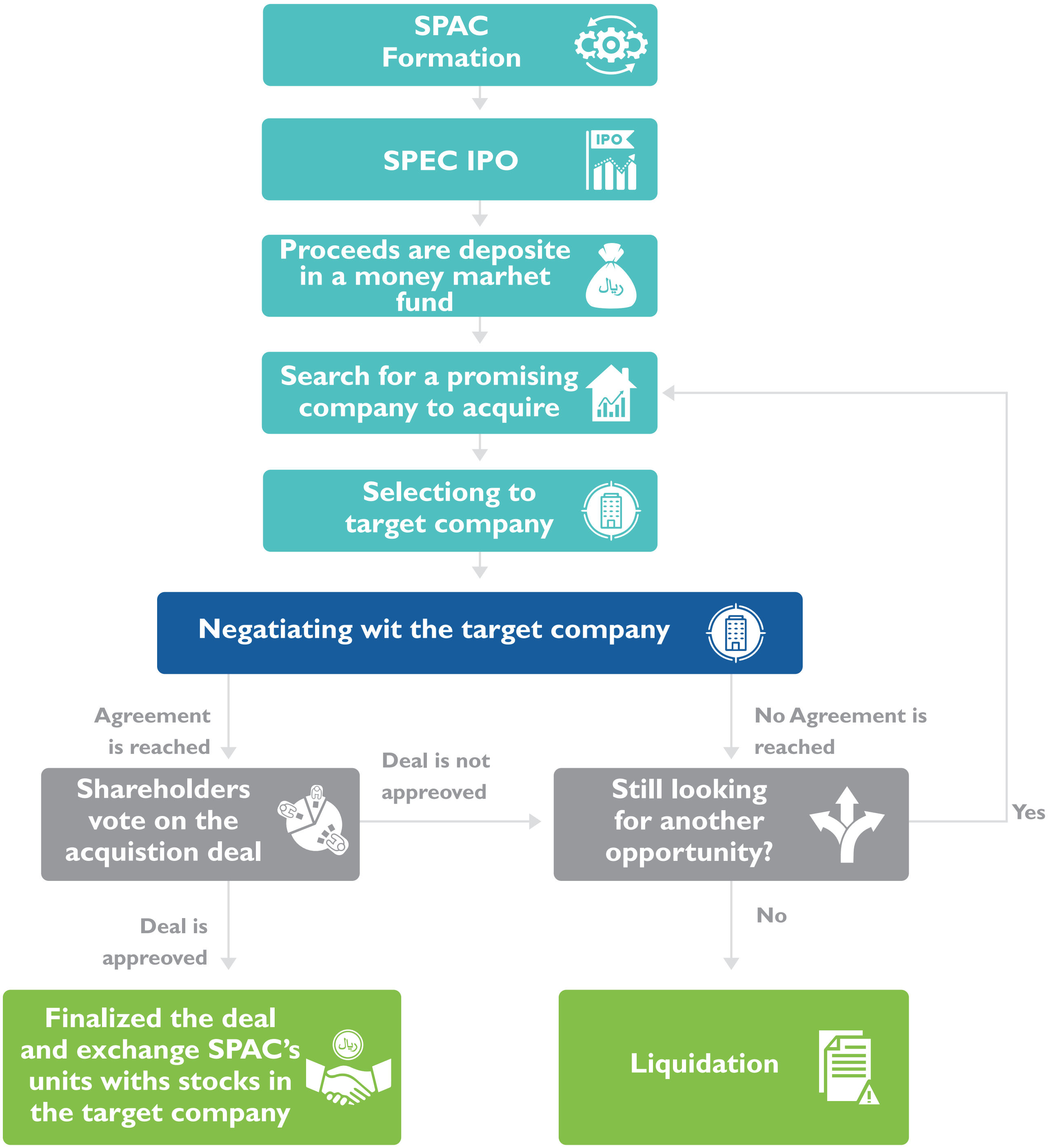
Figure 1: Active SPACs in USA by Stage



Source: SPAC Research

The preceding steps summarize the successful path of a SPAC. However, some of these steps may not necessarily take place as planned, as the founders may fail to reach an agreement with the target company or the shareholders may not vote in favor of the proposed transaction, in which case the founders can go back and search again or re-negotiate with the target company. In case the specified period for SPACs ends without an agreement, the money is returned to the shareholders along with any profit gained from investing in money market funds. Figure 2 illustrates the full journey of a SPAC.

Figure 2:The Life Cycle of a SPAC



Source: [Tharaa Financial Center]

Table 2: Examples of SPACs with Successful Completion

SPAC Name	Target Company	Stock Exchange	SPAC IPO Date	IPO Size (Million USD)	Completion Date	PIPE Size (Million USD)	Acquisition Size (Million USD)	1-Day Return	Annualized Return	Business Description
Foley Trasimene Acquisition Corp	Alight Inc	NYSE	27-May-2020	1,035	2-Jul-2021	2,015	3,050	-10%	-9%	Cloud-based provider of integrated digital human capital and business solutions
Churchill Capital Corp IV	Lucid Group	Nasdaq	30-Jul-2020	2,070	23-Jul-2021	2,330	4,400	11%	71%	Manufactures luxury EV cars
Altimeter Growth Corporation	Grab Holdings Ltd	Nasdaq	30-Sep-2020	500	1-Dec-2021	4,000	4,500	-21%	-48%	Mobile app for food delivery and digital payments services
Soaring Eagle Acquisition Corp	Ginkgo Bioworks	NYSE	23-Feb-2021	1,725	16-Sep-2021	775	2,500	13%	-68%	Biotech specializing in genetic engineering to produce bacteria with industrial applications
Reinvent Technology Partners Y	Aurora	Nasdaq	15-Mar-2021	977	3-Nov-2021	10,023	11,000	13%	-41%	Self-driving technology

Source: SPAC Track, Tharaa Financial Center

The Founding Team

Much ambiguity surrounds SPACs when they are founded, as no one knows for certain whether the acquisition company will succeed in choosing a distinguished company and reaching a profitable agreement for the investors. Thus, investors pay a lot of attention to the expertise of the founding team and their past performance in selecting companies, managing negotiations and completing the acquisition.

Given the importance of the role assigned to the SPAC's founding entity, which is usually one or more financial institutions, the contract between the investors and the founding entity is considered one of the key elements for the success of the SPAC. On one hand, investors are keen to provide an adequate incentive to push the founders to achieve the best results, while at the same time they do not want that incentive to be excessive. Therefore, it is a common practice for the financial compensation to be tied to successfully achieving the required goal, and it is usually as follows:

A percentage of ownership in the acquiring company of up to 20% due upon deal completion.

A percentage of ownership in the acquiring company of up to an additional 10% on achieving certain performance goals through warrants.

In order to provide guidance on corporate governance before and after acquisition of target, regulatory bodies in capital markets impose a set of regulations to ensure the founders' benefits are aligned with those of the current and future investors. Some of the general regulations are as follow:

1. Imposing a lock-up period where sale is prohibited for the founders for up to 12 months after the completion of the acquisition, to align the founders' interest with the interest of the present and future investors and to ensure the founders do not focus on short term performance only.

2. Banning stock trading for founders and their relatives before the announcement of the acquisition to prevent insider trading.

3. At least one of the founders must contribute 10% of the founders' shares, to ensure that there is at least one founder who contributes a significant amount that makes them pay sufficient attention to this investment.

4. Banning the founders from participating in the acquisition vote in case they have a personal benefit to gain from the deal to prevent conflict of interest.

Some regulatory bodies also place a number of conditions to ensure the founding team brings to the table adequate management and legal experience to deliver on the expectations for both the SPAC's and target company's shareholders. Such conditions may include the following:

1. At least one founder must be licensed by the Capital Market Regulatory Authority in the field of asset management or corporate finance consultation.

2. The majority of the board members must be from the top management of the founding entity, such as the CEO of the corporation and his deputies.

3. The members of the founding team must meet the standards of the regulator in terms of relevant experience and qualifications.

And to increase their credibility and quality of performance, regulators in some capital markets obligate SPACs to:

- Have an independent entity participate in the evaluation process, whether through private investments (PIPE), or through an independent external evaluator.

- Include independent, non-executive members in the board of directors of the SPAC.

It is worth noting that these regulations vary from one capital market to another, however, many regulatory bodies have paid special attention to rules related to the founding team due to its significant importance for both SPAC's and target company's shareholders.

Advantages of SPACs

Undoubtedly, the US has emerged as the most popular market for SPACs followed by European and Asian markets. Enabling regulatory environment and economic conditions along with innovation in listing products have emerged as major drivers of SPACs' popularity. The latest innovation in finance brings multiple advantages for both SPAC's and target company's shareholder.

Key advantages from the viewpoint of investors:

1. SPACs allow small investors to access promising private companies before they are listed on the market. These companies usually enjoy high growth rates in their performance and market value at the pre-listing stage. As for IPOs, small investors cannot participate in investment until after the company is listed, so they miss out on the high returns of the pre-listing stage.
2. The low cost of listing the SPAC in the capital market and the ease of its requirements due to the absence of any commercial operations.
3. Shareholders can invest larger amounts in SPACs, unlike IPO's, many of which end with allocating small shares to investors.
4. The experience of the SPAC's founders is an added benefit as investors can rely on the founders' ability to select one of the best companies available for acquisition.

Key advantages from the viewpoint of target companies:

1. Fewer requirements, less disclosure, lower costs, and a shorter listing period compared to IPOs.
2. Negotiating with a small number of investors, as most of the negotiations are with the SPAC's founders, which facilitates the process of reaching a satisfactory agreement for both sides.
3. Ease of withdrawal if the proposed agreement is not satisfactory for the company, as opposed to IPOs where the price is determined based on the book building process, in which a large number of institutional investors participate. So, it's harder for the company to withdraw because of the negative impact it would have on its reputation in addition to the effort and money required to reach this stage.

Key advantages from the viewpoint of regulators:

1. The availability of a new globally tested path for listing will help increase and accelerate the number of listings in the market.
2. Attracting a new category of companies for listing, for which a SPAC is more suitable than an IPO, which leads to a greater diversity of companies listed in the market.
3. Diversification of investment products available for investors.

Disadvantages of SPACs

On the other hand, SPACs still faces some issues, the most important of which can be summarized by the following:

Key advantages from the viewpoint of investors:

1. Diluted investor's ownership due to the sizable share allocation for the founders, as it is customary for the founders to receive 20% of the value of the target company, in addition to a performance fee when a certain goal is achieved within a specified time frame.
2. Upon subscribing, investors do not know which company will be acquired, so some investors compare SPACs to signing a blank check.
3. The SPAC may not succeed in completing a deal within the time limit, thus liquidating, and returning the money to the subscribers with the small returns of from investing in money market funds, missing out on better returns in alternative opportunities.
4. Due diligence is carried out on a narrower scale and in less detail, which increases the possibility of error in the evaluation of the target company.
5. The lack of sufficient funding if a large number of subscribers elect to reclaim their money..

Key disadvantages from the viewpoint of target companies:

1. Giving up on a large portion of profits early on.
2. A shorter time frame for listing requires the company to fulfill the requirements in less time compared to an IPO.
3. The absence of the publicity generated for the company through the process of price exploration and book building.
4. The lack of the safety provided by an underwriter who commits to completing the requirements and raising sufficient funds to complete the listing.

Key disadvantages from the viewpoint of regulators:

1. Fewer requirements and a shorter listing time come at the expense of more detailed disclosure and due diligence.
2. The failure of the acquisitions, if it occurs, can cast a negative shadow on the market.
3. The possibility of low turnout from founders, investors or target companies.

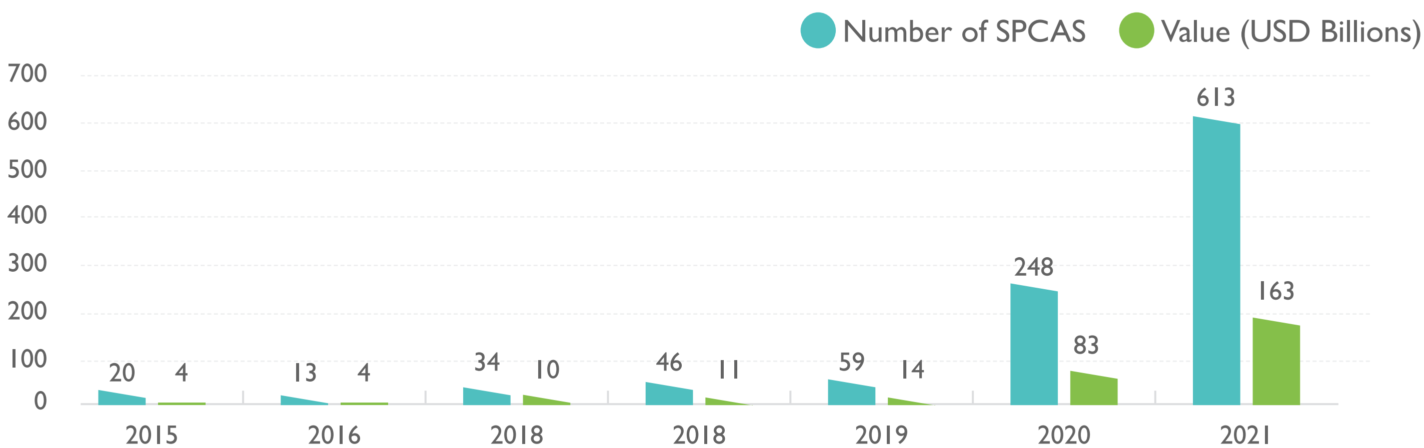
The Global Scene of SPACs

This section reviews the general trends of SPACs around the world, starting with the United Sates, the country of origin for traded SPACs, passing through the European markets where these companies have seen increasing popularity in recent years, and ending with the Asian markets which have started to catch up on this major trend in capital markets.

First: The Scale of the Spread of SPACs

Although SPACs were launched for the first time in 1990 in the USA, they only experienced a surge in popularity in the past few years. Figure No. 3 shows that the number of SPACs increased from 20 companies worth $4 billion in 2015 to 613 companies worth $163 billion in 2021, with a compound annual growth rate of 77% in the number of companies and 86% in their value.

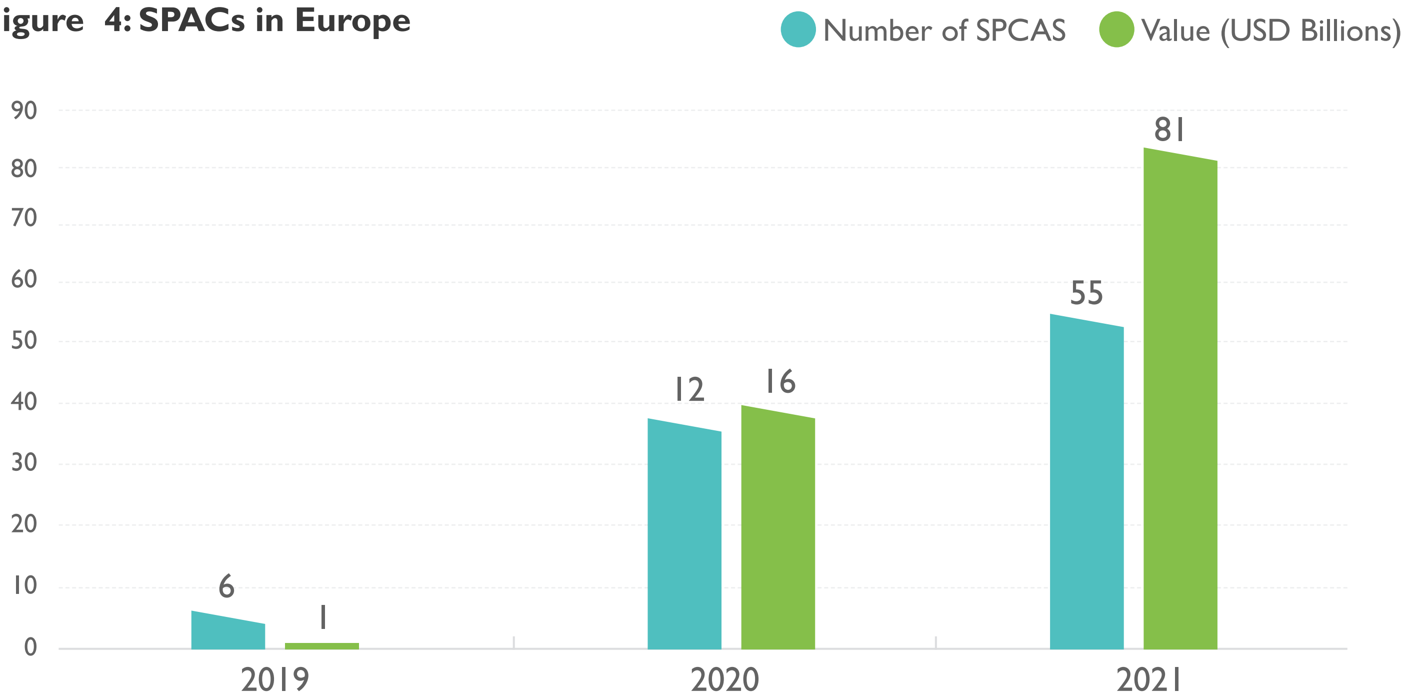
Figure 3: SPACs in the USA



Source: SPAC Research

European markets have caught up to US markets, as they started with 6 companies worth approximately one billion USD in 2019 and have grown to 55 companies worth 81 billion USD in 2021, with a compound annual growth rate of 203% for the number of companies and 800% for their values (see Figure 4). Like the U.S. market, the growth in SPACs in Europe shows a similar pattern of exponential jump in the last two years.

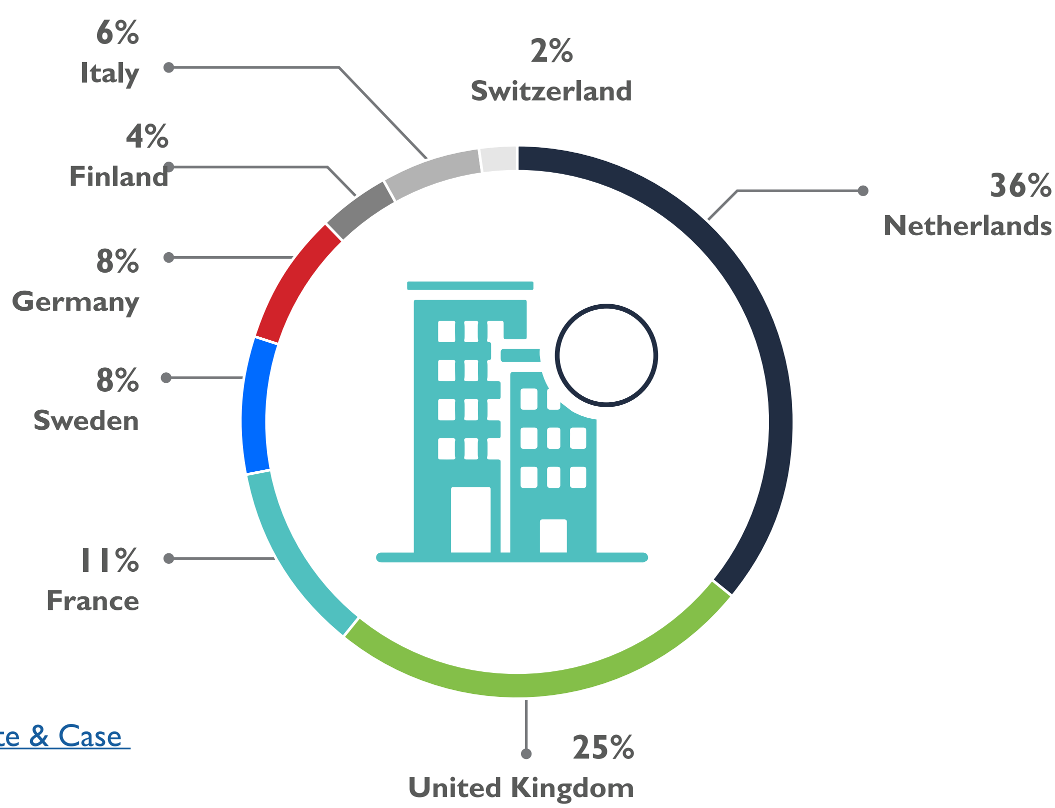
Figure 4: SPACs in Europe



Source: White & Case

Figure 5 shows that the lion's share of SPAC listings from 2019 to 2021 was for the Netherlands with a share of 36%, followed by the UK with a share of 25% and France with a share of 11%.

Figure 5: SPACs in European Capital Markets from 2019 to 2021

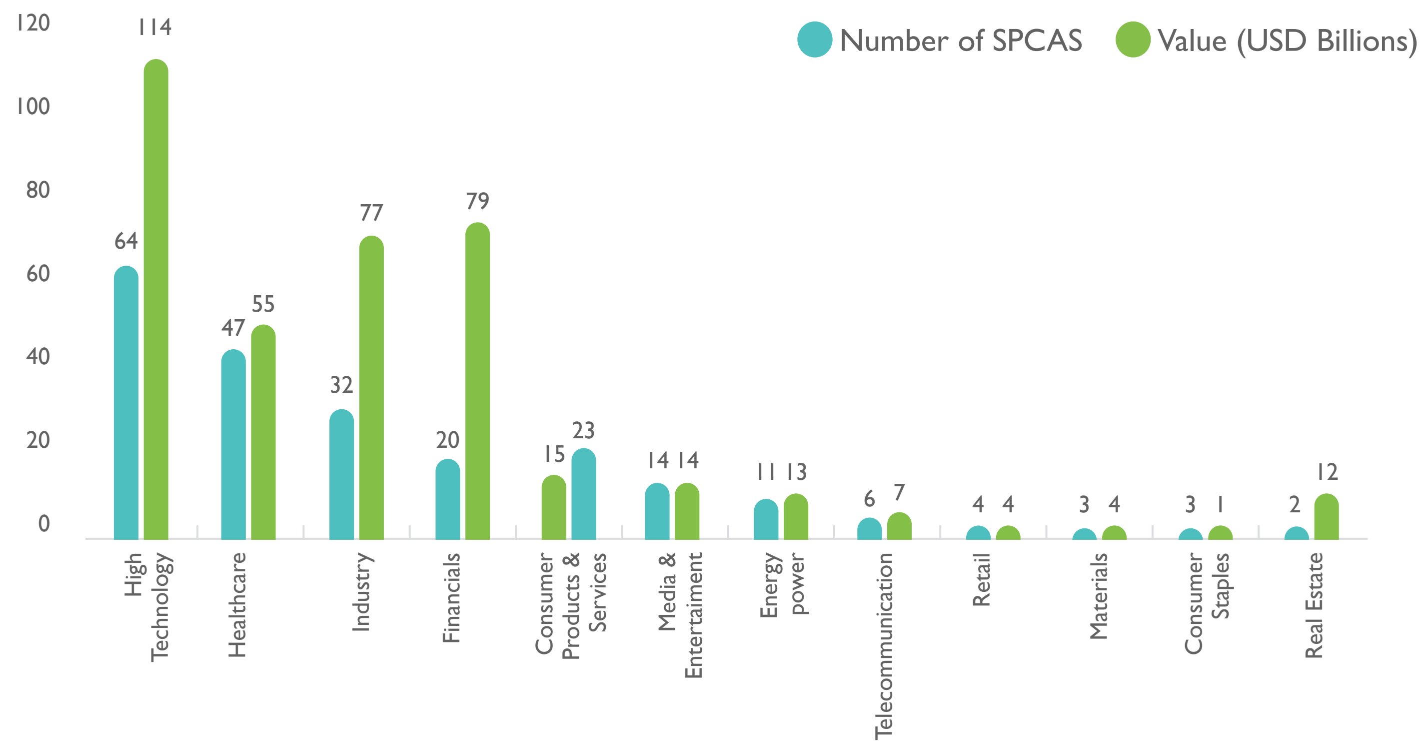


Source: White & Case

Second: Special Purpose Acquisition Company Sectors

SPAC target industries have varied in the USA, but the focus has been on tech companies, followed by healthcare, Industrial, and financial companies according to White & Case's data for 2021.

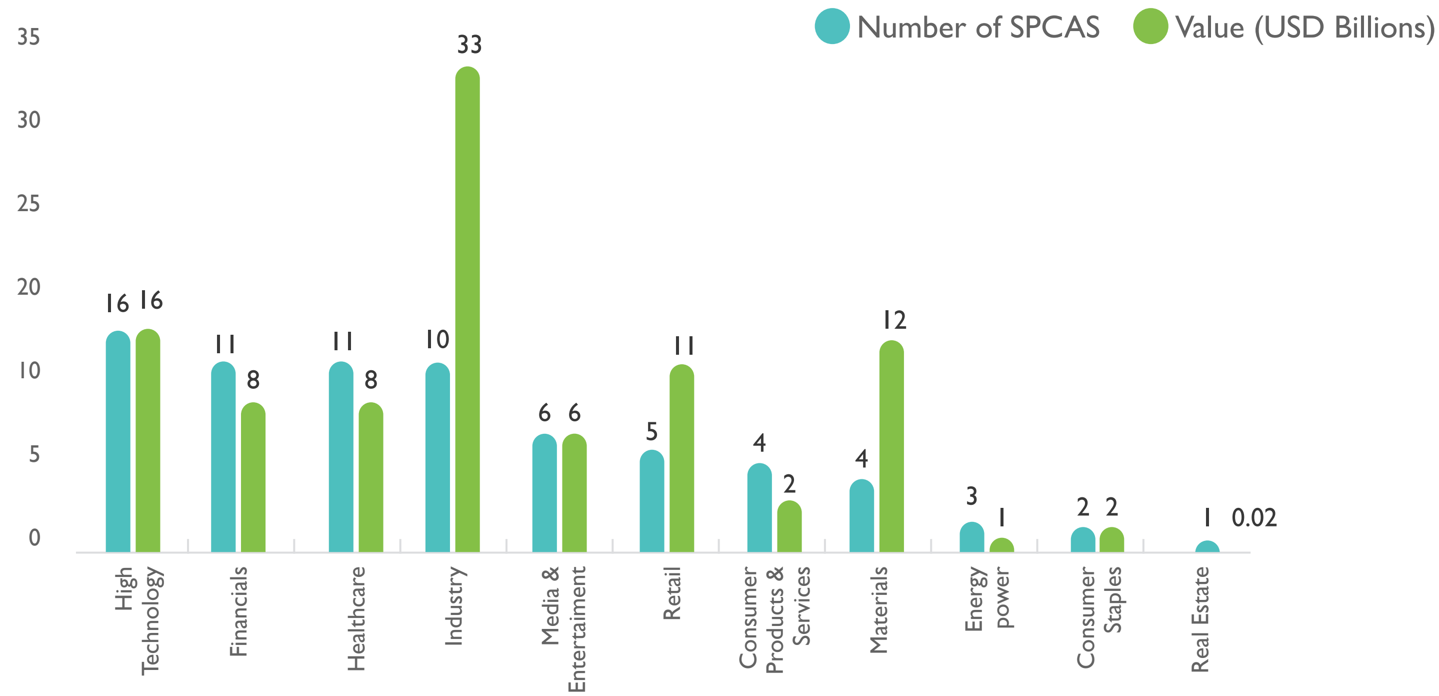
Figure 6: US SPACs by Industry in 2021



Source: White & Case

Likewise, SPACs' industries have varied in the European continent, and the focus was also on tech companies, followed by financials, healthcare, and industrial companies, based on the data provided by White & Case from 2019 to 2021.

Figure 7: European SPACs by Industry from 2019 to 2021



Source: White & Case

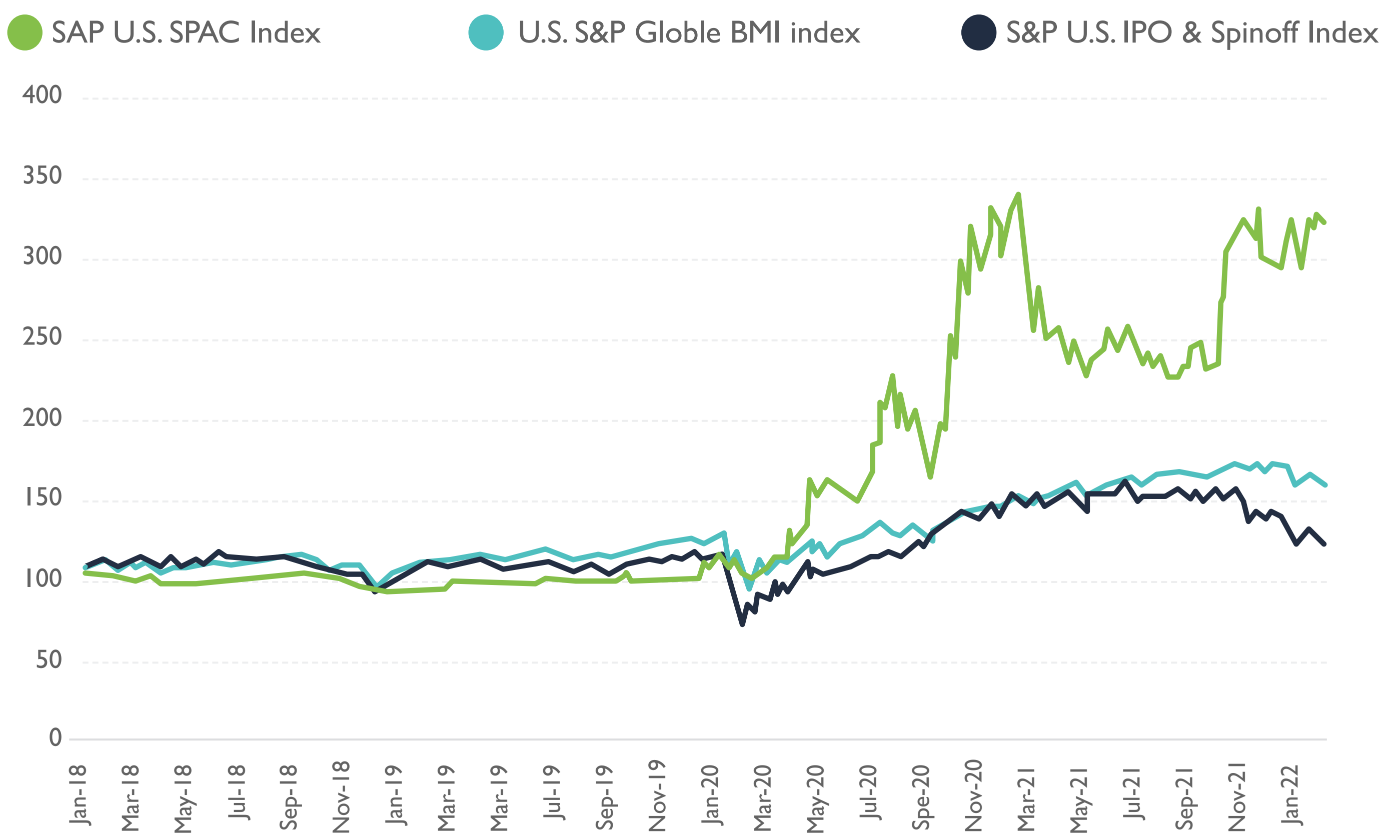
Third: Performance of SPACs

Given the relative modernity of SPACs, most of their indices only date to a few years back. For example, the S&P SPAC Index was launched in August 2021, with its data starting from November 2017 and including every traded SPAC in main US markets.

To assess the performance of SPACs, we will compare performance of the S&P SPAC index since its launch with the performance of the S&P U.S. IPO & Spinoff Index (IPO Index), and the performance of the U.S. S&P Global BMI index (All-Market Index), which includes all companies traded in the U.S. markets.

Figure 8 and Table 3 reveal that the high demand for SPACs in the US was accompanied by exceptional performance in 2020 specifically, where the SPAC Index achieved a total return of 250%, compared to a 28% total return for the IPO Index and a 19% total return for the All-Market Index during the same time frame. However, the performance of the SPAC Index was the lowest compared to the other two in 2018, 2019 and 2021.

Figure 8: S&P SPAC Index, S&P U.S. IPO & Spinoff Index, and U.S. S&P Global BMI index



Source: Bloomberg, Tharaa Financial Center

Table 3: Annual Returns for S&P SPAC Index, S&P U.S. IPO & Spinoff Index, and U.S. S&P Global BMI index

Year	U.S. S&P Global BMI index (All-Market Index)	S&P U.S. IPO & Spinoff Index (IPO Index)	S&P SPAC Index
2018	-7%	-13%	-15%
2019	28%	26%	11%
2020	19%	28%	250%
2021	24%	2%	-2%

Source: Bloomberg, Tharaa Financial Center

With regard to volatility, the SPAC Index was calm in the first two years, recording in 2018 and 2019 an annual standard deviation less than what was recorded by the IPOs Index and the All-Market Index. However, the volatility of the SPAC Index increased significantly in 2020 and 2021. In 2021, the SPAC Index recorded a standard deviation of more than twice the standard deviation of the All-Market Index, and 66% more than the standard deviation of the IPO Index.

Table 4: Standard Deviation for S&P SPAC Index, S&P U.S. IPO & Spinoff Index, and U.S. S&P Global BMI index

Year	U.S. S&P Global BMI index (All-Market Index)	S&P U.S. IPO & Spinoff Index (IPO Index)	S&P SPAC Index
2018	17%	17%	10%
2019	13%	15%	6%
2020	35%	44%	43%
2021	14%	22%	37%

Source: Bloomberg, Tharaa Financial Center

The performance of the SPAC Index can be justified by two things: 1) The novelty of this type of investment. 2) The calmness that accompanies the company's performance before announcing the acquisition deal.

As most SPACs were in the searching stage in 2018 and 2019, the SPAC Index had a modest performance and low fluctuations. As many SPACs moved to the completion phase, the index witnessed a huge growth and exceptional results in 2020, which in turn led to an increased demand from investors, which in turn caused SPACs to exceed their fair values, leading to a corrective decline in 2021.

Regulatory rules for Listing SPACs

Several studies have compared SPAC regulations in multiple jurisdictions. For example, Clifford & Chance reviewed SPAC regulations in each of the U.S., Singapore, and Hong Kong. Similarly, Freshfields compared SPAC regulations in the US, the UK, the Netherlands, and Germany. These studies clearly point out wide disparity in the rules regulating the listing of SPACs, ranging from strict to lenient. It appears that the laws of the U.S. markets and the Netherlands are the most flexible compared to their counterparts, and this may be the reason for their prosperity in the number and size of listed SPACs in both countries.

One of the main advantages of SPACs is the relative ease of listing the target companies, as the acquisition requirements are considered lower and easier than the requirements for listing through an IPO. Thus, tightening the accompanying laws may take away the attraction and competitive advantage of this alternative.

On the other hand, excessive leniency in the acquisition and listing requirements could lead to the listing weak companies that are ill-suited for capital markets, particularly for retail investors. This would reflect negatively on investors and their views on the quality of the market and may lead them to leave for other markets or alternative investments. Herein lies the role of the regulators to strike a balance to maintain the competitive advantage of SPACs without violating the integrity of the capital market.

Suitability of SPACs for the Saudi Market

Saudi Arabia has given special attention to the financial sector and launched the Financial Sector Development Program, one of the main programs to achieve Vision 2030. The board of directors of the program is chaired by the Minister of Finance and include the Minister of Investment, the Governor of the Saudi Central Bank, the Chairman of the Capital Market Authority, the Governor of the General Authority for Small and Medium Enterprises, and the Head of Global Capital Finance at the Public Investment Fund.

The Financial Sector Development Program aims to achieve three strategic objectives: 1) enabling financial institutions to support private sector growth, 2) ensuring the formation of an advanced capital market, and 3) promoting and enabling financial planning. The program has launched multiple game changers to achieve these strategic goals, Including the seventh game changer which aims to motivate the private sector to be listed on the Saudi stock market, in order to achieve these two results by 2025:

1. Raise the market capitalization (equities) ratio to GDP (excluding Aramco) to 80.8%.

2. Increase the number of listings on the Saudi Stock market to 134.

The Financial Sector Development Program clarified in its program charter plan that it targets 16 listings in 2020, 20 listings in 2021, 24 listings in 2022, 2023 and 2024 each, and 26 listings in 2025.

We, at Tharaa Financial Center, believe that SPACs enjoy a set of advantages that align with the objectives of the Financial Sector Development Program, as enabling listing through SPACs will open a new globally tested path which may be more suitable for certain companies than IPOs.

From the target companies' viewpoint, we believe that the most attractive features of listing through a SPAC are the fewer requirements, the lower costs, and the shorter duration to get listed compared to a typical IPO. In addition, the value of the company is determined at an early stage in the process, the negotiations are carried out with a small group of specialists, and withdrawal is easy if the proposed acquisition is not satisfactory.

SPACs offer several benefits for investors as well, as they enable investors to access promising private companies before they are listed and allow investors to invest larger amounts, unlike IPOs, which often end with allocating small shares to subscribers. Moreover, SPACs are accompanied by active participation from the founders, who usually have good experience and ability in finding suitable target companies.

To ensure a successful implementation of this approach, we suggest that, at the beginning, investments in SPACs be restricted to qualified investors and licenses be limited to large capital firms that have extensive experience in listings and dealing with private equity. As the local market gains more experience, these restrictions can be relaxed.

Who are we?

Tharaa Financial Center is a research center affiliated with Prince Sultan University (PSU). Tharaa aims to contribute to the development of financial markets in KSA by promoting investor education, training of young finance professionals, and providing research and financial consultancy. In this regard, Tharaa focuses on two major fields: (A) Publishing value-added analytical research on Saudi capital markets and (B) Preparing objective reports on major issues related to policy makers, investors, and the public. Tharaa is staffed by well qualified market professionals with extensive experience in investment research, private equity, investment banking and asset management.

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