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Declining Popularity and Uncertain Outlook for SPACs

In 2020, special purpose acquisition companies (SPACs) began tremendous growth and looked to be a new mainstream avenue of investing. Two years later, the growth of SPACs across all industries, including healthcare, has plateaued and appears to be dropping in some industries. This Heath Capital Topics article will examine how SPACs grew to their 2021 height in popularity and their future in a post-COVID world.

SPACs are companies set up by investors that do not produce or sell their own products.[1] Instead, these companies, also termed "blank check companies," are set up solely to raise money through their initial public offering (IPO) and the future acquisition of other companies.[2] SPACs typically have a deadline of two years after the IPO to find an acquisition deal, and shareholders vote to approve these deals.[3] They differ from traditional *initial public offerings* (IPOs), which sell shares of stock to generate capital and transfer the ownership of that company to the stockholders, or public ownership. In other words, while transitional IPOs must make their pitch to a myriad of potential investors, SPAC-related transactions must only convince one company – the SPAC.

The number of SPACs has grown exponentially over the past decade, with the establishment of 35 times more SPACs in 2020 than in 2010.[4] The most recent surge in popularity can be seen by contrasting the number and value of deals between the end of 2020 and the beginning of 2021. In the third quarter of 2020, there were 119 SPAC-related deals, with a value of $40 billion;[5] in the first quarter of 2021, there were 437 deals involving SPACs, with an estimated value of $129.6 billion – a 244% increase in value.[6] The growth and strong performance of SPACs has been largely attributed to the market uncertainty resulting from the COVID-19 public health emergency (PHE), creating challenges for companies to raise capital the traditional way and consequently leading them to SPACs.[7] Given their strong performance and growth, the outlook for SPACs was high through the latter half of 2021 and into 2022. However, as of the first quarter of 2022, the popularity of SPACs has plateaued. Thus far, there have been just 25 SPAC-related deals, with an estimated value of only $4.1 billion – down from the 437 deals worth nearly $130 billion reported around this time in 2021.[8]

The rise in SPACs has been attributed to the sense of security they provide by having all the necessary capital raised beforehand, the high uptick in market valuations for companies who join a SPAC, and the increase in reputable names joining SPACs.[9] However, the subsequent decline in SPAC popularity over the last year has highlighted growing concerns regarding a lack of transparency and less rigorous vetting processes for companies involved.[10] SPACs are not required to divulge as much information about their investments as traditional IPOs.[11] This is evidenced by some SPACs rapidly dropping in value after going public. One such example is Cano Health, which was valued at $4.4 billion when it went public in 2021, but is now worth less than half that.[12] Another firm, SOC Telemed, has so severely underperformed that it recently announced it is reverting back to a private company.[13] In fact, roughly only half of all SPACs (across all industries) are value-creating, suggesting they are a risky investment.[14] Additionally, because of their reduced transparency and less rigorous vetting process, they struggle to curb fraud and other suspicious business activities.[15]

The stabilization of the financial markets post-COVID and the growing concerns mentioned above have limited the future prospects of SPACs. Since October 2021, only 20% of SPACs are trading at more than $10 a share, and over 80% of SPACs are trading at less than their expected value.[16] Further, research shows that SPACs are tightly bound to the technology industry, demonstrating an inability to conduct transactions with mature, non-technology businesses.[17] Another important factor in the decline of SPAC interest is the number of broken deals (i.e. agreed-upon deals that do not ultimately close), which has risen dramatically since the end of 2021 after remaining low in 2020.[18] Consequently, the number of SPAC deals, as well as the average value of these deals, is declining rapidly – in February 2022, the overwhelming majority of deals (9 of 10) were valued at less than $1 billion, a reversal from the last 24 months.[19]

Unlike some other industries, the rise of SPACs in recent years has significantly aided growth in the healthcare and biotechnology industries, allowing start-ups and emerging companies to go public quicker.[20] These industries have also been aided by the COVID-19 PHE and the shift to telehealth by demonstrating the need for new services and products.[21] Despite the growing concerns regarding SPACs and their popularity plateau in 2022, the healthcare industry seems to be defying the overall trends; as of March 2022, 52 SPACs are looking

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to make healthcare acquisitions contrasting all other sectors, which saw 20 cancelled deals in January alone.[22] While the overall number of healthcare SPAC deals may not reach 2021 numbers and value, it is expected that SPACs will likely continue playing a role in the industry, although the types of healthcare deals that are sponsored by SPACs may shrink.

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