DECEMBER 2020
www.bdo.com/lifesciences

INSIGHTS FROM THE BDO LIFE SCIENCES PRACTICE

LIFE SCIENCES COMPANIES AND THE SPAC ADVANTAGE

BDO

Special purpose acquisition companies (SPACs) nearly went the way of the dinosaur after the 2007–2008 financial crisis. However, COVID-19 has seemingly brought them back to life as pandemic-driven market volatility continues to disrupt and complicate the traditional path to an IPO.

For investors, SPACs are lower risk, and the potential returns are higher than ever given SPACs' unique access to capital, low interest rates and their ability to move quickly to close an acquisition. For target life sciences companies, SPAC IPOs provide the potential to access additional capital and grow exponentially despite the coronavirus recession. As a result, companies and investors alike are re-assessing the traditional IPO process and considering the benefits of leveraging SPACs as an **express track** to the public markets.

The rising popularity of SPACs is increasingly evident in the life sciences industry. In fact, in 2020, several large biotech investors—like Cormorant and RA Capital—**announced the formation of new SPACs**. But why are we seeing such an interest in SPACs in the life sciences space? And what should life sciences organizations consider before pursuing a SPAC?

SPAC ADVANTAGES FOR LIFE SCIENCES COMPANIES

SPACs are attractive to life sciences companies seeking to benefit from a less burdensome, more stable and expedited route to the public markets—with management's attention and resources remaining more focused on the business during the execution of the privately negotiated transaction compared to the extensive regulatory process associated with the traditional IPO. Life sciences companies are also attracted to the potential for higher valuation and price certainty, since with SPACs the negotiation of terms takes place privately with one entity, the SPAC sponsor, without the uncertainty and last-minute timing often associated with traditional IPOs. For example, during a traditional IPO the size and share price is set following an underwriter book-building process with attendant day-of pricing, risk of volatile markets, investor interest, mispricing and the potential for leaving money on the table.

For cash-intensive life sciences businesses, SPACs also have the potential to be a larger financing opportunity, which is particularly attractive when commercialization may be years away. SPACs are often led, now increasingly so, by well-known investors with operational expertise and institutional investor access. An attractive feature of SPAC transactions is a concurrent private investment in public equity (PIPE) transaction. This is a way for companies to bring new investors who traditionally invest primarily in public companies, signaling to public investors that the company is potentially a good investment. The SPAC structure also enables the life sciences companies the ability to structure the transaction in a manner not available in a traditional IPO or exit, including cash-out to existing owners and earn-outs.

SPAC Tax Considerations

As with a traditional IPO, a change in ownership can trigger an annual usage limitation on tax attributes, beginning from the date of change (i.e., net operating loss and research credit carryforwards). Any losses or credits generated after that date would not be subject to the limitation unless another ownership change event occurs.

SPACS IN THE BIOTECH SECTOR AND BEYOND

There are many different types of SPACs, some with a focus on life sciences companies broadly and others interested in specific sectors such as biotechnology, biopharma, medical technology, therapeutics, diagnostics and digital health. Currently, some SPAC sponsors are seeking larger, mature companies—for example, in sectors such as med tech—and have raised large amounts to enable such deals.

The biotech sector tends to be a good fit for a SPAC. Traditionally, biotech companies often go public earlier than other businesses due to the lack of cash flow early on and the need for access to broader capital sources to support development of their product pipelines. In lieu of the traditional IPO path, a SPAC can achieve the same goal for a company that has an emerging product pipeline with near-term expectation of clinical news and a strong management team. Additionally, any entity—such as a biotech company—that needs **regulatory approval for their products** can benefit from the immediate capital raised by a SPAC, especially if they have no other avenues through which to pursue funding.

RISKS AND CHALLENGES ASSOCIATED WITH SPACS

When reading about the advantages of SPACs, the question arises: why does **anyone** pursue a traditional IPO instead of a SPAC?

The answer lies in the strict regulatory and compliance requirements that SPACs must fulfill. Both the SPAC sponsor and target company must fulfill a complex set of requirements with little-to-no flexibility—failure to do so can lead to serious consequences that can damage all parties involved financially and reputationally.

For **sponsors**, compliance with regulatory requirements can determine the success or failure of a SPAC. SPACs must comply with recurring SEC filing requirements, despite having little-to-no operations—failure to file on time can affect the historical filing requirements of the future target financials.

Once a De-SPAC (the stage after the execution of a definitive agreement and prior to the actual combination of the SPAC with the target operating company) transaction has closed, the SPAC must announce the merger via Form 8-K within just four days. SPACs also typically have a finite life span of two years, with the potential to extend in order to finalize an identified acquisition. If a SPAC fails to consummate a merger within the specified term, the trust is liquidated and returned to the stockholders, while warrants expire worthless. Target companies may have an advantage here—they may be in a position to negotiate favorable SPAC acquisition terms as the end of the SPAC's life approaches. However, the expedited timeline can also cause the SPAC to acquire a sub-par company, reducing the ROI for investors.

The list of requirements for **target companies** is no less daunting. In order to complete the De-SPAC transaction, the target company must supply all necessary information for the SPAC's SEC filing. Any prior audits performed under AICPA standards must be re-audited under PCAOB standards and must be completed by an independent accounting firm under the SEC independence rules, which may require a change in the firm's auditors. Implementing required internal controls can also be extremely time-intensive and may require a robust risk assessment, additional hiring and training of personnel and new processes or systems to support financial reporting and operational management. The company must also review its entity structure and organizational management, financial reporting close process, IT systems, investor relations, treasury functions and internal or external SEC legal functions.

While SPACs can offer both sponsors and target companies many benefits, pursuing a SPAC unprepared can open all parties to significant risk. Fortunately, with the right tools and expertise, this risk can be mitigated.

Thinking about pursuing a SPAC but not sure where to start?
Check out our 7-part series on SPACs and reach out to us for more information.

People who know Life Sciences, know BDO.

www.bdo.com/**lifesciences**

CONTACT

TODD BERRY, CPA
Assurance Partner, Life Sciences National Co-Leader
617-239-4125 / tberry@bdo.com

MICHAEL STEVENSON, CPA
Partner, Accounting & Reporting Advisory Services National Practice Leader
214-665-0707 / mstevenson@bdo.com

LANCE MINOR
Principal, Life Sciences National Co-Leader
301-354-0711 / lminor@bdo.com

ELENI LAGOS, CPA
Tax Partner, Life Sciences National Tax Leader
212-817-1739 / elagos@bdo.com

ROB TRINCHETTO
Partner, Accounting & Reporting Advisory Services Northeast Region Practice Leader
631-927-1171 / rtrinchetto@bdo.com

ABOUT BDO LIFE SCIENCES

BDO's Life Sciences Practice provides the guidance that pharmaceutical, biotech, and medical device manufacturers need, when they need it. From understanding the complexities of research and development tax credits and FDA regulations, to licensing agreements and due diligence, we help our clients grow.

ABOUT BDO

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, and advisory services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of skilled and committed professionals. The firm serves clients through more than 65 offices and over 740 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multi-national clients through a global network of more than 91,000 people working out of over 1,600 offices across 167 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information please visit: www.bdo.com.