HARNEYS

SPACs – What family offices in Asia need to know

This article, originally published by Hubbis, offers a deconstruction of the increasingly pertinent phenomenon that is the SPAC structure. It breaks down what a SPAC is, before elaborating on the details of note surrounding SPACs, how they can be capitalised upon, and ultimately whether SPACs are here to stay, or are simply something of a flash in the pan.

What is a SPAC?

The acronym “SPAC” (which stands for special purpose acquisition company) is the buzziest phrase in equity finance, and will be at least vaguely familiar to most family offices with a passing acquaintance with the business pages.

Although the concept of a SPAC is not new, the recent momentum and exponential growth has been extraordinary. According to publicly available information, around US$80 billion was raised last year in the US. A similar amount has been raised in 2021 in the first quarter alone.

A SPAC is essentially an entity which is formed for the purpose of listing on a stock exchange to raise funds which will be used to make an acquisition. Because (until they find a target to acquire) they have no operating business, and no assets; they have also been described as a “blank check” company or “cash shell”. The investors in the SPAC are fundamentally putting trust in the sponsor team to find and acquire a privately held business, which would benefit from the sponsor’s expertise and the SPACs public listing status, to create a combined business which drives returns for shareholders in both entities. The SPAC will set out in its listing document the type of investment they are looking to make in terms of size and industry sector.

There are elements of the SPAC structure which are common to a traditional private equity model, and many PE sponsors have been behind recent listings. There are, however, very substantial differences. By definition, the SPAC is a public vehicle, not private. There is no diversification, the SPAC will almost always look to acquire a single vehicle. There is also a tighter investment window, most SPACs aim to make an acquisition within two to three years. Finally, rather than hold, grow and improve the portfolio company until exiting through a sale or IPO for a period of time, the target will be listed immediately on completion of the acquisition.

What have the British Virgin Islands and the Cayman Islands got to do with it?

Approximately a third of the SPACs launched in recent months in the US have been incorporated offshore, with Cayman dominating, but the BVI also popular.

Using an offshore company has all of the usual advantages that have made such entities popular with Asian family offices in a variety of contexts. They are tax neutral, flexible corporate jurisdictions with strong rule of law, and appeal ultimately to the Privy Council (which consists of the same judges who sit on the UK’s Supreme Court). Both jurisdictions have merger codes which resemble Delaware’s and hence are familiar to US lawyers. Service providers of all stripes in both jurisdictions are sophisticated and capable of handling complex, high value transactions such as listings and public company mergers.

Both BVI and Cayman vehicles also have strong track records as listed vehicles in the US and other major stock markets, as well as international reputations for being business friendly.

If properly structured, a BVI or Cayman vehicle may be a “foreign public issuer” under US exchange rules, which means that it is subject to a less onerous regulatory regime.

As we start to see more SPACs listed outside the US, and greater interest from sponsors outside the US (including across Asia) it is highly likely that the preponderance of offshore vehicles will increase.

SPACs go global?

While it may have begun as a US phenomenon, the extraordinary growth has caused interest around the world. We are seeing increasing interest from investors and sponsors across Asia in listings in the US using SPAC vehicles, or looking for a SPAC offering. At a time when many are cash strapped, the easy access to the capital markets is obviously appealing.

Stock exchanges outside the US are also paying attention. The total amount raised by SPACs in the US last year was more than the total proceeds raised by any type of listing on many of the world's exchanges. 2021 has already seen several vehicles listed in Amsterdam, while the UK has announced a consultation on changes to its listing rules hoping to lure more listings there. The Hong Kong Financial Secretary Paul Chan Mo-po announced in March that the Securities and Futures Commission and the Hong Kong Stock Exchange had been instructed to explore listing regimes that would attract SPACs. The Singapore Stock Exchange is moving ahead aggressively and published a consultation paper on 31 March 2021 about allowing SPACs to list with certain restrictions.

Where do family offices fit in?

There are essentially three separate ways in which a family office might become involved with a SPAC:

- It might invest, either in the open market or through a PIPE, in a SPAC
- It might look to sell a portfolio company to a SPAC
- It might try to launch or sponsor a SPAC.

Investing in a SPAC

The most likely of the three is perhaps the first. The glut of money which has flowed into SPACs over the last eighteen months or so has included considerable cash from many family offices and high net worth individuals.

Family offices may of course simply purchase shares in the SPAC in the IPO or on the secondary market once the SPAC is listed, as part of a portfolio of public equities.

Alternatively, many SPACs will have a PIPE (or private investment in public equity) element, whereby a select investor or group of investors can invest in the company "off market". PIPE deals may be more favourable to investors, and will often include warrants as well as shares (with or without preferred rights). A PIPE may be necessary for a SPAC to raise additional funds if they identify a target company and they do not have sufficient capital in their trust account to fund the acquisition costs. In this scenario, the PIPE investor will also have another advantage over the other investors in potentially having visibility over who the target will be.

Selling to a SPAC

Selling a portfolio company to a SPAC may be attractive to a family office for several reasons. First, as the consideration is likely to be wholly or partly in the form of shares in a publicly listed vehicle, the seller can retain some upside in the future performance of the business if they wish to do so, or indeed divest themselves over a period of time.

Second, as the SPAC has no other business, concerns over providing due diligence information to a competitor who might walk away with the know-how (which has always been something of a risk with an industry buyer) do not apply.

Finally, dealing with a SPAC carries a level of deal certainty. The availability of cash is a matter of public record. The SPAC is a motivated buyer who will likely have a limited range of targets within their investment strategy and, as noted above, a limited window to do a deal or give cash back to investors. Doing due diligence on a public company is fairly straightforward, and even more so on one which has no operations or assets of its own.

It is important, however, that family offices doing business with a SPAC seek appropriate legal advice. Where the SPAC is incorporated offshore, that will include BVI or Cayman advice (as appropriate). It is highly likely that the combination with the SPAC will contain some element of share consideration, so understanding the share structure of the SPAC and combined entity will be important. It is likely that the deal will be structured as a statutory merger, so the laws of the SPAC's jurisdiction of incorporation (and not just those of the target's) will drive deal mechanics and structure.

Launching a SPAC

For family offices with sufficient size and expertise, the idea of launching a SPAC may be attractive. It may allow them access to the capital markets at favourable rates and to raise cash or attract a target that would otherwise be out of reach. Successful SPACs can be very lucrative for sponsors who will receive their costs from the proceeds and receive a share of the equity which is disproportionate to the amount invested (often two or three times).

On the flip side, a SPAC is public by its nature and so may not be an ideal vehicle for those family offices which take confidentiality and privacy seriously.

SPAC for good?

There has been considerable speculation about whether the SPAC trend is a bubble or whether it reflects a longer term trend in capital markets.

There have been some noises from the SEC to suggest it may look at taking a tighter rein over SPACs (although regulation which increases investor confidence is not a bad thing). Debate rages over the returns on investment received by SPAC investors; there are studies which suggest a decent rate of return, but with a dip often occurring after the SPAC makes its acquisition (although one could make the argument that may reflect speculative investors stepping away, and more long-term investors, who are less worried about short term fluctuations, stepping in). It is worth noting that some sponsors are now on their second or third SPAC, so also have a track record that they can be judged on.

It is worth noting as well that while the current popularity may be unprecedented, blank check companies have been around since the 1980s, and have never truly been out of fashion (at least in the US), so there are clearly some fundamental appeals to the model.

It seems fair to say that the current level of growth cannot be sustained, although if other exchanges get in on the action and the SPAC phenomenon does go global, we may only be approaching the end of the beginning.

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