BRIEFING NOTE

September 2021

Offshore SPACs in Asia – the next chapter

2020 saw an explosion of special purpose acquisition companies ("**SPACs**") in the United States that was largely driven by favorable economic returns to SPAC IPO sponsors, liquidity and pricing certainty offered by SPACs to target companies and investors. The extended low-interest rate environment and the speed to market that SPACs offer compared to traditional IPOs has also played a significant role. Although an initial drop of SPAC activity characterized the second quarter of 2021 - due to the US Securities and Exchange Commission's concerns regarding forward looking statements and the accounting treatment of warrants - 2021 looks set to be another record-breaking year for SPACs with around US$110 billion raised in capital as at 15 April 2021[1].

Most SPAC IPOs have so far been arranged by US managers and take place on NASDAQ or the New York Stock Exchange. However, the tides are turning as Asian players are looking to enter this space and we have seen an increase in enquiries from Asia-based sponsors and investors with respect to SPAC IPOs and de-SPACs alike. The Singapore Exchange announced new rules on 2 September 2021 to enable SPACs to list on the Main Board of the Singapore Exchange which, coupled with the influx of seasoned managers with proven track records and the increasing volume of high-profile SPAC transactions, has arguably lent sufficient credibility to the structure as a reputable investment vehicle to trigger widespread interest in Asia.

In this article, we provide an overview of SPACs and their advantages, consider the future of SPAC IPOs in Asia and the role that the British Virgin Islands ("**BVI**") and the Cayman Islands play in facilitating them.

1. What is a SPAC?

A SPAC is a shell company which is specifically incorporated by its initial sponsors for the purpose of raising capital through an IPO for use in the acquisition of a target company. The SPAC does not have any operating assets or operations and is commonly a BVI or a Cayman Islands company.

2. What is a de-SPAC?

The acquisition by a SPAC of a target company is usually referred to as a de-SPAC. Most SPACs typically have between 18 and 24 months in which to identify a target company and complete an acquisition. If an acquisition is not completed within that

[1] Pitchbook: SPAC Market Update: Q2 2021.

timeframe, the proceeds of the IPO need to be returned to the investors. Investors can also redeem their shares prior to the de-SPAC if they do not want to participate in the acquisition.

3. Why are SPACs generally attractive to sponsors?

The SPAC sponsor typically receives shares for nominal consideration at the time the SPAC is incorporated. These shares normally represent around 20% of the SPAC equity following the SPAC IPO, which predominantly serves as a "finder's fee" for identifying a target company, conducting due diligence and closing the de-SPAC transaction. Coupled with the current extended low-interest rate environment, these highly favorable economic returns have continued to attract sponsors to invest in SPACs.

4. What are some of the key features of SPACs?

SPACs have various distinctive features as follows:

i. SPAC trust account: The proceeds of a SPAC IPO cannot be used for any purpose other than to fund the relevant de-SPAC transaction or to redeem the shares sold to the investors in the IPO. The funds that are raised from the IPO are held in an interest-bearing trust account.

ii. IPO units and classes of shares: Each unit that is sold to a public investor in a SPAC IPO typically comprises a class A share and a fraction of a warrant to purchase a class A share in the future. The units typically become separable 52 days after the IPO, at which point the component securities can trade separately. In contrast, class B shares are purchased by the sponsor at the formation of the SPAC which typically convert into class A shares at the time of the de-SPAC transaction on a 1:1 basis. Unlike the class A shares, the class B shares are usually subject to transfer restrictions and are not subject to redemption. The class B shareholders also typically have the right to appoint and remove directors prior to the closing of the de-SPAC transaction.

iii. No acquisition target at the time of the IPO. A SPAC may (and commonly does) identify certain geographic areas and/or specific industries in which it will pursue a target company in order to de-SPAC in its IPO prospectus. That being said, a SPAC cannot identify its acquisition target prior to the closing of the IPO and there are typically disclosures regarding this in the relevant prospectus.

iv. Structuring of a de-SPAC: A typical de-SPAC is usually structured as a merger transaction, but the specific method that is used to acquire a target company will depend on where it is incorporated, tax considerations, whether the target company is also a listed entity and the methods of merger that are available in the applicable jurisdictions to complete the de-SPAC transaction. Typically, the target company will merge with a wholly-owned subsidiary of the SPAC and the shareholders of the target company will receive new shares in the SPAC in consideration for their shares in the target company. Both the BVI and the Cayman Islands have

straightforward and well-tested statutory merger regimes which are conductive to de-SPAC transactions and familiar to corporate lawyers.

5. What are some of the key advantages of SPACs compared to more traditional structures used by private equity and venture capital firms for investment?

SPACs have arguably unlocked various advantages over more traditional structures used by private equity firms for investment. For example, SPAC investors benefit from the liquidity of publicly traded securities and have limited risk exposure as they are entitled to a return of their funds held in the trust account if the SPAC fails to complete an acquisition or the investor does not want to participate in one. In addition, there is typically no cash compensation paid to the management team of the SPAC pending completion of the de-SPAC transaction and their reward will depend on the success of the acquisition.

6. Are SPAC IPOs speedier to complete than traditional IPOs?

Yes, a SPAC IPO will be speedier to bring to market because it will not be necessary to complete due diligence on an existing operating company. As a direct consequence of this, some SPACs can complete an IPO within 8-12 weeks versus 12 months (or more) for a traditional IPO.

7. Are SPACs in Asia going to become popular?

Asia-based sponsors and investors have demonstrated a keen interest in SPAC IPOs on US stock exchanges, particularly in the technology sector. In response to this, the Singapore Exchange announced new rules on 2 September 2021 to enable SPACs to list on the Main Board of the Singapore Exchange. This is a welcome development that may also revive Singapore's lagging IPO market which saw only 3 IPOs in the first half of 2021[2]. Other stock exchanges in Asia, such as in Hong Kong, are also considering lifting their long-standing prohibitions on raising funds for unspecified purposes. Whilst Asia's more conservative approach to SPACs is unlikely to match the level of deal-flow or capital raising seen in the US in the short or medium term, Asia's financial markets are reliant on a steady-stream of IPOs to remain competitive so we foresee that key financial centers in Asia will develop a suitable regulatory framework for SPACs. It should also be noted that a number of SPACs are currently exploring de-SPAC opportunities in China and South Asia where an abundance of private equity backed companies with promising growth prospects are located.

8. Considering that SPAC fundraising in Asia may be more limited, what options are available to a SPAC to mitigate the liquidity risk associated with shareholder redemptions and to fund the post-closing operations of the combined entity?

Many SPACs issue new shares to institutional investors in a PIPE – which stands for private investment in public equity – that closes concurrently with the de-SPAC transaction in order to raise additional funding. These PIPEs are important in ensuring the completion of the de-SPAC transaction in the event there are significant redemptions and they also provide third-party validation of the terms and valuation of the acquisition.

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[2] EY Global IPO Trends reports Q2 2021.

The sponsor or institutional investors may also enter into forward purchase arrangements with the SPAC to commit to purchase new shares of the SPAC concurrently with closing of the de-SPAC transaction.

9. Why do Cayman Islands SPACs continue to be more popular than BVI SPACs?

Most SPACs pursuing US targets continue to be incorporated in Delaware, although the BVI and the Cayman Islands also remain popular. We expect the popularity of BVI and Cayman Islands incorporated SPACs to increase as SPAC activity picks up in Asia because BVI and Cayman Islands companies are widely used across the region and familiar to stock exchanges, regulators and other relevant market participants.

Cayman Islands SPACs are currently more popular than BVI SPACs, probably because the Cayman Islands continues to be the jurisdiction of choice for listed companies and private equity funds. That being said, BVI companies may confer certain advantages in the context of SPAC transactions. For example, the shareholder approval thresholds in a de-SPAC transaction for a statutory merger are typically lower in the BVI than the Cayman Islands.

10. What specific features of BVI and Cayman Islands law make these jurisdictions attractive for SPACs?

There are various features of BVI and Cayman Islands law which make these jurisdictions attractive for SPACs, including:

i. Unlimited objects. BVI and Cayman Islands companies may have unlimited objects and purposes which is important because SPACs will, in our experience, describe their target in terms that are as broad as possible in their IPO prospectus.

ii. Flexibility. There is significant flexibility in tailoring the articles of association of the relevant SPAC to accommodate the issuance of warrants and different classes of shares, as well as the incorporation of defensive takeover tactics.

iii. Capital maintenance. The rules on capital maintenance (where applicable) are flexible, permitting distributions and share redemptions from a wide range of sources subject only to the usual solvency tests.

iv. No takeover code. There is no takeover code or legislation that is specifically applicable to listed companies (with the exception of the Cayman Islands Code on Takeovers and Mergers that is only applicable to companies whose securities are listed on the Cayman Islands Stock Exchange).

v. Foreign private issuer. BVI and Cayman Islands companies that are listed on a US stock exchange may be able to qualify as a "foreign private issuer", thereby taking advantage of reduced disclosure and reporting requirements.

vi. Statutory merger regime. Both the BVI and the Cayman Islands have well-established and straightforward statutory merger regimes which are conductive to de-SPAC transactions.

vii. Secured creditor friendly. The BVI and the Cayman Islands are widely recognized as creditor friendly jurisdictions, which is helpful in the context of facilitating a financing that a SPAC may require to consummate a de-SPAC transaction. The BVI also has a straightforward system of registering security interests which is attractive to secured creditors.

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