

SPACS AND DE-SPACING - WHAT AUSTRALIAN COMPANIES NEED TO KNOW

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Legal Briefings - By **Tom O'Neill, Tony Damian, Nicole Pedler and Henry Simpson**

In 2020, SPACs overtook traditional IPOs in the US by number and each of them will need to find acquisition targets or be liquidated within a set time frame. Increasingly, Australian companies are on the radar as acquisition targets for SPACs. In this article we examine what they are, why Australian SPACs are less likely to emerge and the key considerations for Australian businesses being acquired by a SPAC as an alternative to a private sale or going public through an IPO.

IN BRIEF

- A special purpose acquisition company (**SPAC**) is a newly formed company with no assets or operations that raises initial capital in an IPO (most commonly in a US public offering) with the purpose of finding an operating company to buy with the proceeds of the raise and any subsequent raise at the time of the acquisition (a process known as 'de-SPACing').
- SPACs are not currently able to list on the ASX due to its rules against cash-box companies and it would take a sizeable policy shift for this situation to change.
- Acquisition by a SPAC is in substance a back-door listing for the acquisition target, which means targets of SPACs need to be in effect IPO and listing ready and prepared to meet foreign (usually US) governance and regulatory requirements.

WHAT ARE SPACS?

A special purpose acquisition company (SPAC) is an entity, sometimes referred to as a 'shell company', with no business of its own which raises initial capital and becomes publicly listed with the purpose of finding an operating company to buy within a set time frame - usually 24 months with the possibility of an extension - using the proceeds of the capital raising. The process of the listed SPAC acquiring its target company is known as 'de-SPACing'. SPACs in the United States will usually raise additional capital at the time of the de-SPAC in an equity offering commonly called a 'PIPE' transaction to finance both the cost of the acquisition beyond the initial raise as well as the redemptions in cash available at the time of the de-SPAC to shareholders of their initial investments in the IPO.

There are few parameters on a SPAC in that it may or may not specify in its prospectus a particular type of industry or geographic focus for its acquisitions. The investment thesis and attractiveness of the SPAC to investors in the IPO is a function both of the target industry and geographic focus as well as the strength and track record of the sponsor/management team. However, it must identify its target to acquire within a specified time frame, which is typically around 24 months and subject to extension. If SPACs do not complete their acquisition before their specified deadline, or in the case of a US regulated SPAC within three years of completing its IPO, they must liquidate and return the capital raised on listing plus interest. To compensate for the illiquidity and lack of returns prior to the acquisition completing, SPACs will commonly employ mechanisms such as the issue of units of common stock and warrants with differential pricing which trade separately. The sponsor of the SPAC will typically receive around 20% of the SPAC's common stock as well as management fees following the de-SPACing.

SPACs have surged in popularity in the US\$83 billion of capital was raised by US listed SPACs in 2020 (a 513% increase from 2019),¹ and the capital raised by US SPAC listings so far in 2021 has already exceeded that amount.² US listed SPAC IPOs accounted for more than half of the overall US listed IPOs in 2020. In terms of the increase, whilst there were 59 SPAC offerings in the US in 2019, in 2020 there were 248, representing a 320% increase.³

Whilst traditionally a US structure, in Europe SPACs are rising in popularity. For example, in 2020 Herbert Smith Freehills advised Morgan Stanley and UBS as joint global co-ordinators and joint bookrunners on the English/US aspects of the US\$340 million IPO of EverArc Holdings Limited, a British Virgin Islands-organised SPAC and its standard listing on the London Stock Exchange. Although only 4 SPACs were listed in the UK in 2020,⁴ the UK Listing Review (a review commissioned by the Chancellor of the Exchequer to review the UK listing process) recommended in March 2021 that existing listing rules should be relaxed to encourage an increase in UK listed SPACs. In the meantime, there has been a very substantial surge in European SPACs listed on Euronext Amsterdam, which has succeeded in capturing much of the European demand in view of its flexible regulatory structure and ability to assimilate into deal structures many of the US SPAC features that have not historically been part of UK SPAC practice. Herbert Smith Freehills is currently working on several ongoing SPAC listings in Amsterdam.

CONSIDERATIONS FOR AUSTRALIAN TARGETS

It would require a sizable policy shift on behalf of ASIC and ASX to allow for the IPO of a SPAC in Australia due to existing restrictions under the ASX Listing Rules on 'cash box' entities, back door listings and the ASX's view on the appropriate structure and operations of a listed entity.

Nonetheless, with approximately US\$83 billion raised via US SPAC listings in 2020, and that figure having already been surpassed by 2021 US SPAC listings, the emergence of a more active market in Europe and the substantial interest of other global stock exchanges in the SPAC product, it seems only a matter of time before Australian companies are identified as the targets for a merger or acquisition by a SPAC. In the near term this is overwhelmingly likely to involve US SPACs contemplating backdoor listings of Australian targets on a US stock exchange, however bidders will increasingly be listed in other jurisdictions. We are already seeing entities in Australia considering whether they might be appropriate SPAC targets and what this means for them compared to an IPO or another form of sale.

Recently, the prospectus of Catcha Investment Corporation, a SPAC listed on the NYSE in February 2021 stated that it would focus its search for a target in the Australian and Southeast Asian technology sector.

As the de-SPAC process is a form of backdoor listing, Australian companies should be keenly aware about what an acquisition by a SPAC on a foreign exchange would mean for them.

Key considerations include:

- **Timing:** In the US, a de-SPAC takes on average around three to five months from announcement to completion (which is faster than a traditional US listing). Additionally, as the target of a SPAC, a company will not have the same time to internally consider their readiness for, and the implications of, listing they would otherwise have during a traditional IPO process even though the backdoor listing will necessitate many of the same disclosure and regulatory requirements of an IPO. The target will also not have the level of control over the process as it would in an ordinary IPO. None of this should carry negative implications – rather prospective SPAC targets should proactively assess and develop their IPO readiness ahead of an approach.
- **Pricing:** Importantly, SPAC targets may often achieve through negotiations akin to a traditional M&A process greater certainty on pricing than is the case with a traditional IPO, which sellers may consider a substantial benefit particularly in a volatile pricing environment.
- **Becoming a listed company:** A lot of work is involved in ensuring the target is ready for listing, including ensuring its Board composition, corporate governance, disclosure processes, and accounts will need to meet the necessary requirements initially and on an

ongoing basis. The short time for the execution of the de-SPACing transaction means that the target should already be, or will need to swiftly adopt, the governance, Board and disclosures of a listed entity. The SPAC target must also be ready to comply with the ongoing reporting and governance obligations of the jurisdiction of the listing, which to date has been overwhelmingly the United States but will increasingly include other jurisdictions.

- **Prospectus level disclosures:** The target company will be required by the regulatory body governing the foreign exchange or local securities laws to provide information similar to that required if they were listed via a normal IPO procedure. Some of the key disclosures are:

- the terms of the de-SPAC transaction;
- a description of the target and its management, directors and governance structure;
- a description of the target's business as well as valuation and projections;
- the audited financial statements of the SPAC and the target for the relevant track record period. All financial statements and information will need to be prepared under the required auditing standard;
- unaudited interim financial statements if required based on the date of the most recent financial statements;
- unaudited pro forma financial information reflecting the proposed acquisition;
- management's discussion and analysis for the SPAC and the target; and
- a description of the risk factors associated with the de-SPAC.

- **SPAC shareholder approval:** In the US (and in the Netherlands but not in the UK (yet)), there is typically a requirement that the public stockholders of a SPAC must approve by a majority of votes the de-SPACing transaction.

- **Redemption rights:** In the US (and in the Netherlands but not in the UK (yet)), public stockholders have the right to redeem their public shares for a pro rata proportion of the proceeds of the IPO. It is also common to see sponsors and their directors enter into a letter agreement pursuant to which they agree to waive their redemption rights. There is little recourse for the target of the de-SPACing transaction if the deal does not go through.

With their meteoric rise in the US and rapid acceptance in other jurisdictions, SPACs should be seen as an exciting new opportunity for Australian companies. Nonetheless, the prospect of listing on a foreign exchange will come with its own unique considerations, so Australian targets need to understand and be prepared for their involvement in a de-SPACing transaction.

ENDNOTES

1. Bain & Company, 'Global Private Equity Report 2021'.
2. Thomson Reuters; 'U.S. SPACs overtake 2020 haul in less than three months', 17 March 2021.
3. NASDAQ.com; 'A Record Pace for SPACs', 21 January 2021.
4. 'UK Listing Review', 3 March 2021.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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