H.Y. Leung & Co. LLP

April 2021 Newsletter

14 April, 2021

Special Purpose Acquisition Company - a new trend in Hong Kong going forward?

Special Purpose Acquisition Companies, SPACs are effectively shell companies with no business operations that raise money from investors through IPOs. A SPAC after listing would identify and acquire a private company (business of which is unknown to the public investors at the time of listing), allowing the acquisition target to have publicly listed stock.

Notwithstanding that a particular company is not identified at the time of listing, SPAC management teams typically target an industry or sector before IPO. Once a SPAC becomes listed, it has a designated timeline— usually 18 to 24 months — to use its funds to acquire a target, otherwise the funds raised have to be returned to the investors.

The listing of SPAC has gained traction recently in the US with their IPO fundraising hitting a record of $13.6 billion in 2019—more than fourfold the $3.2 billion they raised in 2016. According to SPAC Insider, in 2020, 248 newly formed SPACs raised $83 billion in capital through IPOs[1]. In 2019 and 2020, more SPACs were created in those two years than in the prior 18 years combined. At the time when this newsletter was published, there are already 307 newly formed SPACs, raising $97 billion in capital through IPOs.

Advantages of SPAC

1. The price of selling the private company to a SPAC is usually higher than that selling to a private equity fund.

2. Private companies are willing to be acquired by SPACs than going through IPOs as such acquisition is more flexible and can avoid the tedious procedures required for listing.

3. The lock-up periods for the private company founders to sell their newly listed shares as in IPOs can be circumvented.

Mechanism of SPAC

Under the New York Stock Exchange Listed Company Manual of the US, a minimum of 90% of the SPAC IPO proceeds must be held in an escrow account. More often than not, more than this percentage is held in escrow for potential acquisitions.

After the IPO, the SPACs' management teams will search for a potential acquisition target. The SPAC's business acquisition has to be approved by a majority of the votes by public shareholders or they are given the right to redeem a pro-rata share of their contribution in the trust account. In the US, The target business must have operating businesses or fair market value equivalent to 80% of the net assets in the escrow account. The management teams have three years to search

[1] https://spacinsider.com/stats/

for a target company under the SEC. Should the teams fail to identify such a company, the SPAC has to be dissolved and the money held in the escrow account has to be returned to the investors.

After the acquisition of a target company, the combined business will be required to meet the continued listing requirements applicable to listed companies.

Adoption of SPACs in Hong Kong

Hong Kong has been the world's top IPO destination in seven of the last 12 years. Hong Kong regulators have imposed more stringent rules to prevent back-door listings and the use of shell companies as listing vehicles. These rules are essential to ward off underachieving and sub-par assets for potential investors. The Securities and Futures Commission (SFC) and Hong Kong Exchanges and Clearing (HKEX) are now studying proposals allowing SPACs to raise capital on the Hong Kong stock exchange. It had been opined by the senior government official that there has to be proper investor-protection guidelines in place before approving the listing of SPACs in Hong Kong. It remains to be seen whether Hong Kong will approve the listings of SPACs and we will stay tuned to any upcoming new polices.

by **H.Y. Leung & Co. LLP**

梁浩然律師事務所
有限法律責任合夥
H.Y. LEUNG & Co. LLP
SOLICITORS