COLLAS CRILL

Special Purpose Acquisition Companies ("SPACs"): SPAC to the future

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Special purpose acquisition companies ("**SPACs**") or "cash shells" are back in fashion. We are seeing greater interest than ever before in the use of these vehicles.

SPACs have had a mixed reputation for a while, through no fault of their own.

Many readers will be familiar with the saga surrounding Nat Rothschild's £700m LSE listed cash shell, Vallar (which later morphed into Asia Resource Minerals). Vallar was incorporated in 2010 in Jersey for the purpose of acquiring a major business or operational asset in the global metals, mining and resources sector. Which it duly did, in the form of its investment into Bumi Resources and Berau Coal Energy, well- known names in the Indonesian mining and resources sector. This was followed by several high-profile spats involving the company, its board and some of its more vocal shareholders, culminating in Nat's decision to sell his stake (announced in early June), thus putting an end to his turbulent and expensive five-year foray into Indonesia's coal sector.

Not all SPACs have to end in tears. And of course they don't just gravitate towards the main market of the London Stock Exchange. There is a healthy flow of SPACs to the Alternative Investment Market ("**AIM**").

Collas Crill recently advised Challenger Acquisitions, a Guernsey company on its IPO on LSE's main market by way of a Standard Listing. Challenger was formed to invest in the leisure and entertainment sectors.

We are currently seeing other SPAC related activity with clients across a number of sectors. This article looks at the flexibility that SPAC structures give investors, particularly where Jersey, Guernsey and Cayman Islands companies are used.

Attractive to investors

SPACs are used to raise capital for a very specific investment objective, for example to acquire assets or businesses in a defined sector(s). They are well suited to industries where there is an unknown element of risk associated with the target assets. Speculative investments are typically dependant on a number of factors for success. These may not be evident at the time when capital needs to be raised to secure the rights to further investigate and develop the project.

A SPAC allows capital to be raised within a structure where investors and owners of the assets can receive shares in a transparent, listed vehicle. Investors inject cash which (in the case of an AIM listed SPAC, must be deployed within a time limit of 18 months). The cash is held in trust for that period to protect investors.

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Investors may also have the right to approve any proposed investment or to be able to redeem their shares if they do not approve. If investments do not proceed, there is a clear mechanism to return the majority of the capital raised.

While a SPAC will generally invest in private companies with illiquid securities, investors in the SPAC may freely dispose of their shares (subject to liquidity of course). This can also be of benefit when making acquisitions, as potential sellers may be offered shares in the SPAC which would give them an interest in all investments made by a SPAC.

A listed SPAC can be used to access a greater range of investors than are typically possible in private equity fund structures which are sometimes restricted to professional and institutional investors by law or regulation.

Is a SPAC a fund?

SPACs sometimes resemble investment funds in that they invest in a similar way, with investors allowing discretion to the management team to make investments on their behalf, and in similar types of assets as a private equity fund.

However, the costs associated with establishing a SPAC and its supporting structure are generally lower than those applicable to a fund. A SPAC does not require a fund management company to be established. This saves time and cost of set-up and compliance with regulations applicable to funds and managers.

It should also be noted that SPACs' investment policies and objectives are not intended to achieve a spread of risk for investors. This is another key distinguishing feature of SPACs from investment funds.

Incentive for management teams

Due to the relatively open-ended nature of investments that may be made by a SPAC, investors are placing faith in the management team's track record with the proposed investment strategy. The team will usually sit on the board of directors of the listed SPAC.

The incentive structure for the management team usually involves granting around 20% of the shares in the listed entity. Warrants (which are long term call options to be issued shares at a pre-set price) may also be issued to investors and management to allow them to enhance investment returns.

Operating a SPAC

Its role in most cases is to be an active investor and acquire a majority stake in assets, but minority investments are also permitted.

If capital is raised upon IPO, there is usually a time limit by which the SPAC must have made its initial investment (18 to 24 months is fairly standard). If capital is raised after listing, new shares will be issued to

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investors.

Standard listing or AIM?

A SPAC is not eligible for a Premium Listing on LSE, one of the reasons being its lack of trading history.

Hence the choice will come down to a Standard Listing or AIM. Both benefit from lighter touch regulation when compared to a Premium Listing on the LSE.

It's worth noting that a SPAC with a Standard Listing:

- does not need to appoint a financial adviser, sponsor or a Nomad (an AIM listed SPAC must have a Nomad)
- is not subject to any corporate governance codes
- does not need to provide shareholders with pre-emption rights
- does not need shareholder approval for reverse takeovers
- is not subject to any time limit to make its initial investments
- generally has greater flexibility around share dealings and related party transactions.

In practice a SPAC with a Standard Listing is likely to adhere voluntarily to certain codes of practice which are generally accepted in industry.

A Standard Listing provides a convenient and cost-effective stepping stone to a Premium Listing once the company reaches certain milestones, usually upon a reverse takeover.

On the other hand, an AIM listed SPAC which is subject to more regulation than a Standard Listing from the outset, does not normally look to transition from AIM to the main market of LSE, following an acquisition.

Jersey, Guernsey and Cayman Islands structures

Using an offshore company as the SPAC entity provides a number of advantages. The company laws of Jersey, Guernsey and the Cayman Islands are flexible and adaptable to the rules of most relevant stock exchanges. They have been recognised as providing a good balance between appropriate investor protection and operational flexibility. For example:

- dividends and other distributions may be paid out of company assets provided the company remains solvent (as determined by the directors)
- financial assistance given by the company in relation to the issue of shares can be dealt with flexibly a Jersey, Guernsey or Cayman Islands SPAC is tax efficient as no local taxes are levied on the SPAC entity in its jurisdiction of incorporation.

SPACs, especially on AIM, will continue to attract interest, particularly amongst entrepreneurs. It has proven to be a popular route for Asian companies listing in London, thanks to the familiarity of advisers with the AIM

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regime and a healthy appetite for offshore companies.

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