Externalisation Of Holding Structure

A Trend in Vogue for Startups



SPACs in news

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one of the mechanisms to externalise the holding structure

Part Three: Everything about SPACs as

The funds raised in SPAC¹ deals have been raising eyebrows, of late. But this is not something new².

news

SPACs in

In the Indian context, way back in 2016, the Indian company Yatra Online listed on NASDAQ through a merger with Terrapin 3 Acquisition Corp, a Special Purpose Acquisition Company (SPAC).

Azure Power too listed on NASDAQ through a SPAC in the same year. The most recent SPAC listing (August 2021) is the one in the renewable energy sector where ReNew Power completed its merger with a SPAC (RMG Acquisition Corporation II). Apart from the United States, other destinations like Europe and Singapore are popular for SPAC listing. These countries have an established and a dedicated framework which recognizes SPACs

¹ Special Purpose Acquisition Companies ² Mr David Nussbaum, the CEO of GKN Securities, was perhaps the first person to successfully exploit the SPAC structure in 1993. Since then, many have followed his steps - https://indiacorplaw.in/2021/03/the-spac-tacular-rise-of-blank-check-companies-in-india.html

While SPACs involve listing on overseas exchanges, listing on the Indian bourses is not far behind. Many companies have chosen the reverse merger route for listing on the Indian stock exchange. A reverse merger involves the merger of a profitable company

Companies and for the investors. This attracts more and more

participants in exploring SPACs as an investment class. It also

attracts Target Companies desirous of seeking a profitable exit

A well-managed SPAC creates wealth – for the Target

or listing on overseas bourses.

into a loss-making company or a holding company into a subsidiary company. Notable deals in pipeline include the reverse merger of IDFC First Bank and IDFC Ltd.; DHFL and Piramal Capital and Housing and so on.

and enables their smooth functioning.

The world is a global village and SPACs are mode of wealth creation in this global village.

What are SPACs?

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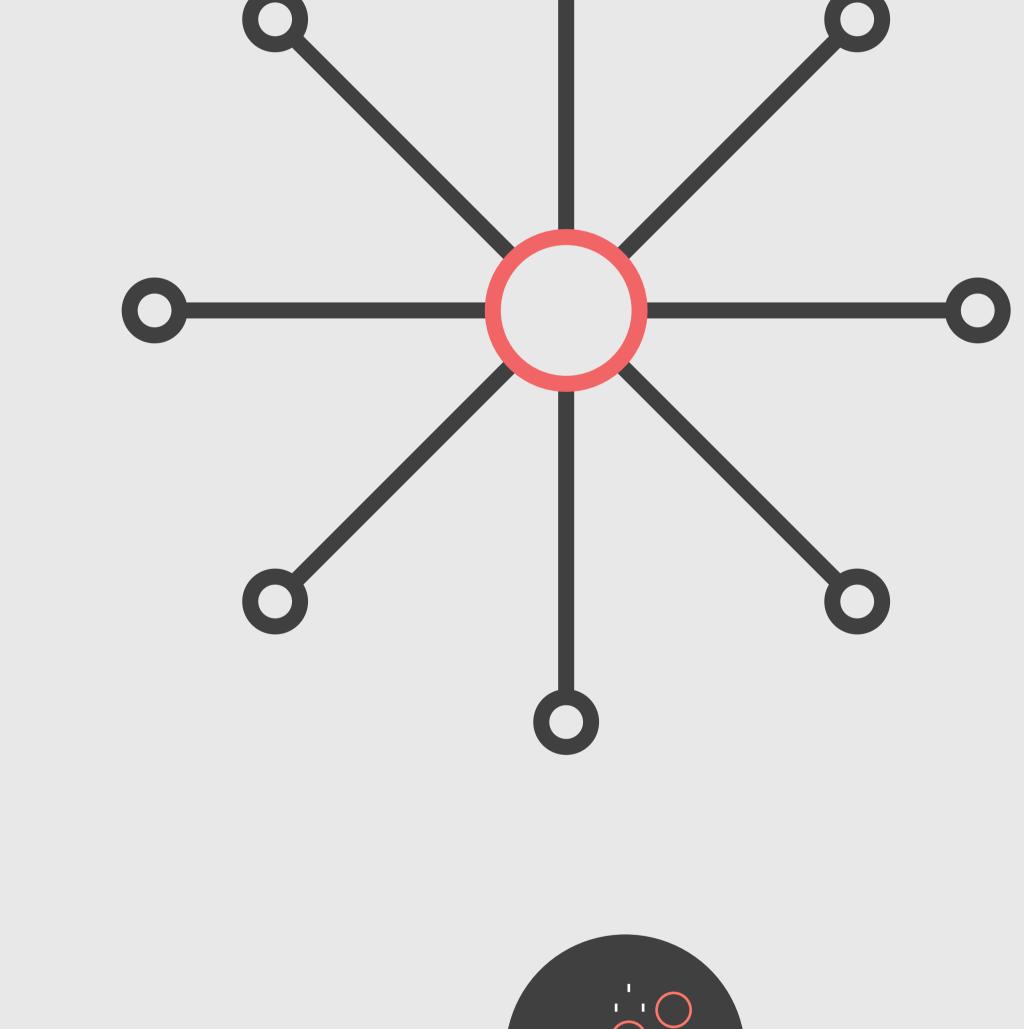
operations or financial history. It is endorsed by a sponsor who is also a key investor in the SPAC. The SPAC raises the balance funds from investors by

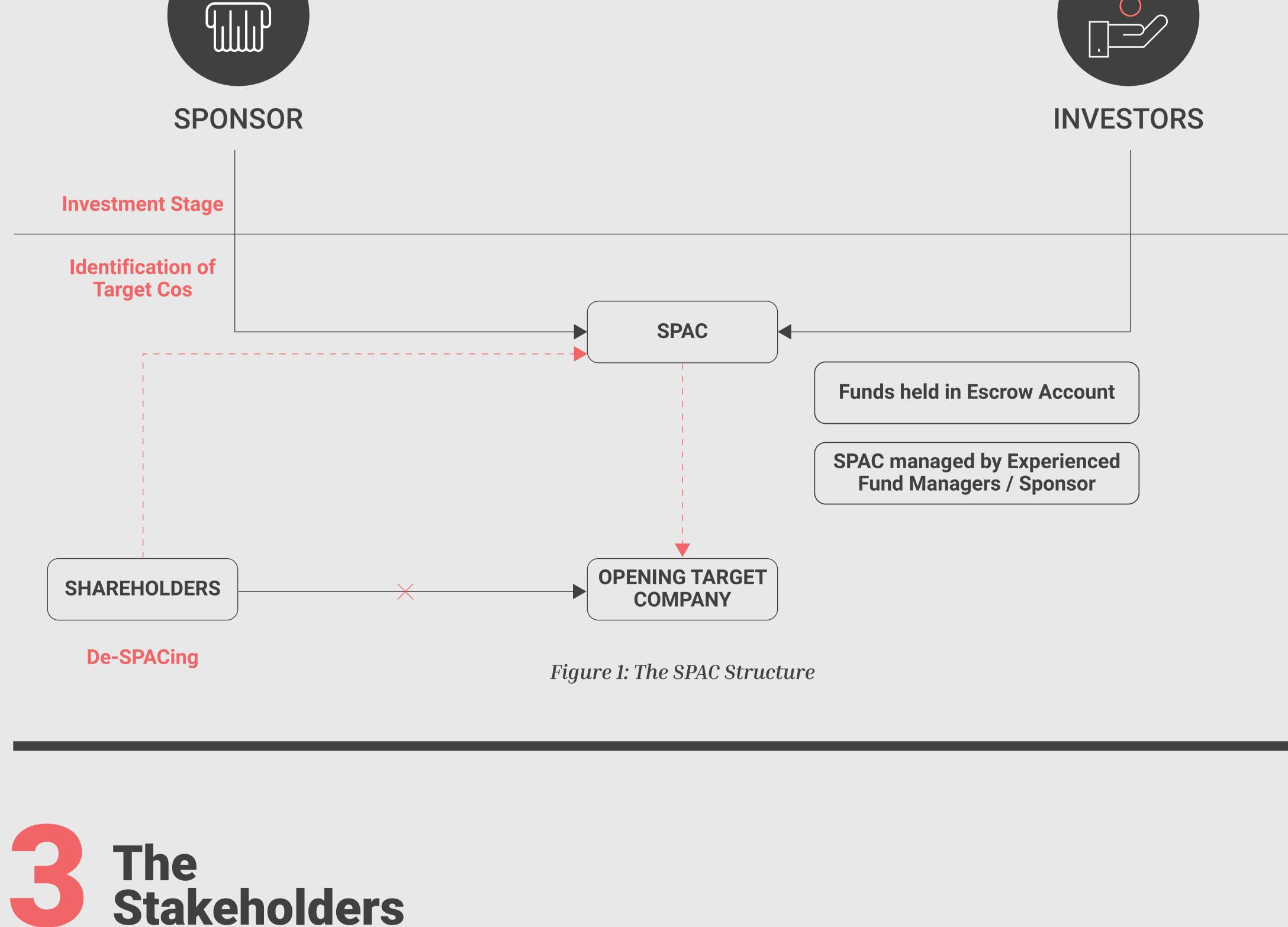
A SPAC is a new age investment structure; a kind of Externalisation.

A SPAC involves the formation of 'blank check companies' having no

through an initial public offering (IPO) are used to acquire target companies over a period of 2-3 years. If the SPAC fails to acquire the Target Companies, the funds lying with the SPAC are distributed amongst the investors.

listing on a recognised stock exchange outside India. The funds so raised





THE SPAC SPONSOR

Fund the SPAC IPO roadshow; Provide the working capital necessary to identify target companies for a business combination; or Pay the ongoing compliance, professional and other fees with respect to the business combination;

The capital provided by the Sponsor generally represents 5% to 7% of the anticipated

The public investors buy units in the SPAC through the IPO. The

The management of the SPAC is reponsible for the execution of the

identification of target companies, negotiations, De-SPACing and the

entire process right from SPAC formation, procuring investments,

balance stake of nearly 80% is held by the public shareholders

Sponsors may be granted an early exit before the expiry of 2-3 years.

documentation and regulatory filings at every stage.

The SPAC sponsor may be an individual or a group of individuals

person or entity of repute having a respectable social image which

Retain the lead underwriter, auditors, counsel and other advisors as capital markets

coming together or any other entity. The Sponsor is generally a

The Sponsor contributes to the initital capital of the SPACs for around 20% stake.

can garner the interest of other investors in the SPAC.

The initial investment by the Sponsor is utilized to:

advisor;

SPAC IPO gross proceeds.

through these units in a SPAC. Each such unit comprises of share or warrants of a common stock.

the shareholder of a SPAC

PUBLIC INVESTORS

MANAGEMENT

THE TARGET

COMPANIES

The Sponsors may or may not be part of management team of the SPACs. The Target Companies are companies which merge into the listed SPAC. The shareholders of the Target Companies become shareholders / unitholders of the SPAC. Depending on the terms of

to manage the business of the Target Company post merger or

the merger, the shareholders of the Target Companies may continue

restrict their involvement in SPAC only to the extent of the rights of

This is the first stage in the lifecycle of the SPAC. In this stage, the

management of the SPAC arranges for procuring funds from the

Sponsor and other investors through the IPO. It involves detailed

documentation and making regulatory filings with the securities

The IPO proceeds so collected are placed in an escrow account and held in trust until the SPAC

is ready to acquire the Target Companies. The funds lying in the escrow account are released

upon a successful business combination, to fund shareholder redemptions, or in the event of

exchange. It also involves managing the process of the IPO

market advisors and legal counsels.

SPAC and the Target Companies etc.

For an investment of USD 10, each investor is allotted 1 share valued at USD 10 and a warrant representing a fraction of the value

liquidation of the SPAC.

colletively with other agencies like the lead managers, capital

Stages involved in SPACs

INVESTMENT STAGE

Subsequent to the Investment Stage, the Management of the SPAC **IDENTIFICATION OF** identifies and shortlists the potential Target Companies. The TARGET COMPANIES Management may undertake preliminary negotiations with the

definitive agreements with them. Generally, the SPAC is given a time of 2 - 3 years from its inception to identify Target Companies and utilize the proceeds in the escrow account. If the SPAC fails to identify the Target Companies, the funds lying in the escrow account are distributed to the unit holders / shareholders in the SPAC after providing for expenses incurred by the SPAC. The DeSPACing stage commences once the definitive agreements are executed. This is the most action-packed stage which involves seeking approval of the shareholders of the SPAC, regulatory filings

with the stock exchange, financial reporting in the jurisdiction of the

Since SPAC is a listed public entity, shareholders' approval is mandatory. In case where the any

option by redemption of their shares or warrants. At this stage, the SPAC is normally ready with

of the shareholders dissent to the acquisition of a Target Company, they are allowed an exit

Apart from merger of the Target Companies and the SPAC, the entities may combine under

other forms of arrangement like a reverse merger, share swap, slump sale demerger of an

undertaking of the Target Company into the SPAC. Whatever may be the arrangement, the

Target Company merges into the SPAC and becomes a company listed on foreign bourses.

Target Companies and close the transaction by executing the

The Sponsor invests in the SPAC. The Sponsor may hold special voting rights.

additional funding from PIPE Investors (Private Equity in Public Entity).

The SPAC arranges for redemption by procuring investment from PIPE investors. If the SPAC does not find a target company, the investors are repaid the value of their investments in SPAC.

of the share.

Like any other investment vehicle, SPAC too has

Two Sides of the SPAC Coin

certain advantages and disadvantages.

Investor invests in SPAC at IPO at say USD 10 per unit.

The proceeds of the IPO are held in an escrow account.

Once the SPAC goes public, it tries to find a target company to acquire.

If the SPAC finds a target company, each investor can opt for redemption of their units in the SPAC.

INVESTORS SPONSORS Most importantly, SPACs provide an For the investors, SPAC is a new investment

and return on investment.

shares and warrants of the SPACs.

Listing on an overseas exchange allows the investors an exposure to the upsides of the overseas markets. Companies can go public without complexities of the market such as multiple investor negotiations, underwriter negotiations, valuation uncertainty, etc. Further, public listing provides full reporting and transparency. Liquidity is not a concern as the investors can trade and monetize

The redemption feature in-built in the SPAC structure provides

downside protection on investment. Stockholder can decide

opportunity. Experienced management teams

identification of promising Target Companies,

could spawn higher standards for fund raising

looking into the management of funds and

Companies. They are provided a smooth exit if they opt for redemption of their shares / warrants in the SPAC.

whether or not to participate in business combination of the Target

lead to generation of millions of dollars, regardless of how well the Target Company performs after the merger. Besides, having procured the funds prior to identification of the Target Companies places the SPAC in a favourable position on the negotiation table. It also ensures faster culmination of the De-SPAC process and authenticates the efforts of the Sponsor.

opportunity to quickly achieve unparalleled

value escalation by raising capital overseas.

Sponsors typically receive 20% of the SPAC shares post-IPO,

along with an exit option after a certain period of time, which can

Public listing provides an arbitrage

opportunity to institutional investors.

CHALLENGES

Some of the challenges which emerge in a SPAC structure are that the targets are not identified in advance and the outer time limit of 2 - 3 years to identify the target may prove insufficient.

Besides, a cross-border acquisition of the Target Companies may entail planning, compliance with multiple regulations in both the jurisdictions and detailed reporting. The costs of being a public company are also high (SEC reporting, investor relations, audits etc.).

Being a listed entity, the SPAC has greater compliance responsibilities as compared to its unlisted peers.

De-SPACing

Steps for investing in SPAC

b.



In addition to the regulatory implications discussed in Article 1 of this Series, here we discuss the recently enacted regulations in the SPAC space.

LISTING OF SPACS IN THE GIFT CITY

The International Financial Services Centres Authority (IFSCA) was established under the International Financial Services Centres Authority Act, 2019 to regulate and develop financial activities in International Financial Service Centres (IFSCs) in the country; the first centre being set up in Gandhinagar, Gujarat. While the IFSC is located within India, it is considered as an offshore jurisdiction for all purposes including foreign exchange regulations, taxation purposes, etc.

Gujarat International Finance Tec-City (GIFT City) has introduced a framework allowing the listing of SPACs in the GIFT City under the International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021 (GIFT City Regulations) published in the Official Gazette on 16th July 2021³.

The GIFT City Regulations provide for a regulatory framework for listing of specified securities in the GIFT City. These include:

- an initial public offer of specified securities by an unlisted issuer;
- listing of specified securities by a start-up company or an SME company;
- an initial public offer of specified securities by a Special Purpose Acquisition Company;
- listing of depository receipts;
- listing of debt securities;
- listing of debt securities focusing on Environment, Social and Governance (ESG).

The GIFT City Regulations further provide for the following:

Recognition of SPACs - The regulations recognise the concept and the business model of SPACs by specifically defining SPACs as "a company which does not have any operating business and has been formed with the primary objective to affect a business combination." The term business combination "means a merger or amalgamation or acquisition of shares or assets of one or more companies having business operations."

Eligible entities - Companies incorporated in an IFSC, company incorporated in India or companies incorporated in a foreign jurisdiction are eligible for listing securities in the GIFT City. The regulations further provide that any trust established under any Central or State Act is also an eligible entity. Thus, in addition to companies, trusts may also be eligible for listing their securities in the GIFT City.

Eligibility - An eligible entity or an eligible SPAC can list securities in the GIFT City if:

- The primary objective of the issuer is to effect merger / amalgamation / acquisition of shares / assets of a company having operating business;
- The issuer does not have any operating business;
- The target business combination has not been identified prior to the IPO; and
- The SPAC has the provisions for redemption and liquidation in line with these Regulations.

Needless to say, the SPAC, its sponsor and the key personnel should have a clean track record and should not be considered as defaulters under any law.

Monetary thresholds - Listing in the GIFT City requires a certain minimum issue size, i.e., USD 50 million / any other amount as specified by the authority. The pricing, arrived by the lead managers, should be at least USD 5 per share. Further, sponsor should hold the post issue paid up capital of the SPAC in the range of 15%-20%. Here, it would be pertinent to note, that the monetary thresholds are not linked to the past performance or tangible assets of the SPACs; rather they are linked to the issue size and sponsor's holding.

The securities proposed to be listed on the GIFT City should be freely transferable and held in dematerialised form.

There are certain SPAC specific obligations in connection with listing, viz.,

- At least 90% of the proceeds from the IPO to be kept in an escrow account;
- The proposed business acquisition to be approved by majority of the votes cast by shareholders (other than sponsors).
- Business acquisition to be completed within 36 months of the date of listing on the GIFT City. The time period may be extended by 12 months, subject to approval by 75% or more of the total shareholders.
- SPAC issuer shall have a liquidation distribution provision. In case of liquidation and delisting, the sponsors shall not participate in the liquidation distribution.

³ https://egazette.nic.in/WriteReadData/2021/228383.pdf

Generally, startups which grow to the size of listing, have foreign investors. Listing – whether on Indian or on overseas bourses – is seen as a preferable exit route for investors.

SPACs are being considered as an alternative platform to the traditional IPO. They provide quick listing or quick exit to the Target Companies and an opportunity of wealth creation to investors in addition to the benefits of an overseas listing.

Along with SPACs, the new entities (Zomato, Nykaa, etc.) being listed on the Indian bourses are also making news on account of their sheer size, value of bids received far exceeding the issue size, etc. Indian stock markets, unlike earlier, now have the requisite depth and an appetite for new-age businesses. While considering the SPAC route, it may be also worthwhile to consider the possibility and benefits of listing on Indian bourses.

Broadly, executing the SPAC route may be justifiable where the startup intends to tap overseas public investors, or when the Indian tax and regulatory uncertainties under the SPAC route do not augur well with the founders / investors. SPAC may also be a preferred route where the externalisation has already taken place and it may not be feasible for the overseas holding company to list in India due to regulatory hurdles.

Needless to say, the decision of listing, whether in India or overseas, must be driven by commercial expediency and the long-term goals of the founders / investors rather than the regulatory hurdles involved.

More in this series

In this piece of knowledge, we observe that externalization can be achieved in different ways. It is always advisable to be guided by experts in the field who can help you navigate through the maze of externalisation process.

Part Four enlists some regulatory changes in the pipeline which are sure to see the light of the day in the near future.



