

SPACs – An Indian Perspective



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SPACs or Special Purpose Acquisition Companies are in the international financial news almost every day in the last couple of years. This is one of the latest innovations in the capital markets in the USA and will eventually reach Indian shores in some form. A total of 248 SPACs raised US\$ 83 billion in 2020. In the first quarter of 2021, US\$ 73 billion has been

raised by 228 SPACs, signaling the growing popularity of this approach in the USA.

A SPAC is a blank check or a shell company which is formed with the specific object of acquiring a target company within a definite time frame. The sector, industry or the nature of the target company is also usually defined when the SPAC is formed. The SPAC raises funds through an IPO, with such funds to be eventually used for the acquisition of the target company. In the US markets, SPACs raise funds from the whole gamut of institutional investors. At the time of raising funds through an IPO and listing on the stock markets, the SPAC is a shell company with no underlying business or assets. Hence the ability of the SPAC to raise funds successfully essentially depends on the people behind it viz. the sponsors or the managers. The sponsors are therefore individuals or firms with an established track record and reputation, particularly with reference to the kind of target proposed to be acquired. The sponsors typically have a 20% interest in the SPAC pre-IPO and the terms of the SPAC include preferential arrangements on shareholding and profit sharing for the sponsors. The funds raised by a SPAC are held in escrow or trust until a suitable target is acquired, usually within a time frame of 12-24 months. If the SPAC does not conclude a merger or acquisition within the stipulated time period, it will be liquidated and the funds will be returned to the shareholders who subscribed to the IPO. Once a target is identified, the SPAC acquires the target through a merger, consolidation or other forms of business combination. This transaction is referred to as the “de-SPAC” transaction. On conclusion of the de-SPAC transaction, the target becomes a part of the SPAC and thereby gets listed.

There are benefits to each of the parties involved in a SPAC transaction. The sponsors get equity in the SPAC at more favorable terms than investors in the IPO. Post the de-SPAC transaction, the sponsors typically hold

around 20% stake which would have been obtained at a relatively nominal cost. This will be converted into a stake in the target on conclusion of the de-SPAC transaction. This is the primary motivation for the sponsor to set up a SPAC, raise funds, identify and acquire the target and eventually enable monetizing the target through the listing. For the target company, the benefit in the SPAC is a saving in time, cost and effort to go public. The costs associated with the de-SPAC transaction are lower than that of traditional IPOs; further the time frame to get listed is considerably shorter through this mechanism. Further the target can become a listed company without going through the complexities of IPO regulatory approvals, investor and underwriter negotiations, and valuation discovery. The shareholders in the SPAC benefit from getting access to the target’s shares through the SPAC and the resultant unlocking of value.

Currently there is no regulatory mechanism for SPACs in India. While a shell company can possibly be incorporated in India, it is not possible under the extant SEBI and Companies Act regulations for such a company to either raise funds from the public through an IPO or get listed on the stock exchanges. It has however been reported that SEBI is working on a framework for SPACs. The Companies Act, 2013 was amended in 2020 to permit direct listing of Indian companies on foreign stock exchanges. Taking advantage of this route, one of India’s largest renewable energy companies, ReNew Power recently announced an agreement to merge with an US SPAC named RMG Acquisition Corp II. Through this US\$ 8 billion transaction, ReNew Power plans to get listed on the NASDAQ in the second quarter of 2021.

There are several regulatory challenges for an Indian company to participate in a de-SPAC transaction such as the one mentioned above. An Indian target company seeking to merge with a foreign SPAC requires to comply with the Foreign Exchange Management (Cross Border Merger) Regulations, 2018. The shareholders of the Indian entity will receive shares of the combined entity as a share swap or as consideration for the merger. This transaction is subject to various provisions of the Foreign Exchange Management Act, including the annual limits for individual investments in foreign entities (currently US\$ 250,000). A more vexing issue is that the de-SPAC arrangement will create a taxable event for Indian shareholders on issue of the shares, even though the shareholders have not monetized their investments. Hence it may be concluded that several multi-disciplinary issues need to be addressed for Indian companies to be able to participate seamlessly in SPACs.

The International Financial Services Centers Authority (IFSCA) has recently come out with a consultation paper to facilitate listing of SPACs in the Gujarat

International Finance Tec-City (GIFT City). The consultation paper contains detailed guidelines for SPACs including stipulations on offer size, minimum application, minimum subscription, compulsory sponsor holding, acquisition timelines, and sponsor rights and obligations. This is the first step in the creation of a regulatory framework for SPACs in India. It is expected that SEBI will, in the near future, address the matter of SPACs and Indian domestic companies through another consultation paper.

Finally the question to consider is the advantages for an Indian company to consider going public through the SPAC route and the kind of companies which are more likely to benefit by this approach. As compared to a traditional listing process, the SPAC route may offer the benefits of speed, certainty and a faster timeline to go public. The SPAC combination transaction is done at a negotiated price while in the traditional IPO process there is the uncertainty attached to the market based price discovery approach. The SPAC approach is currently more suitable for new and non-traditional businesses such as e-commerce, internet and technology

businesses where conventional valuation methodologies may not fully reflect their potential value. Many such companies in India already have overseas holding companies in jurisdictions like Singapore which may make it easier for them to merge with a SPAC in another foreign jurisdiction. On the other hand, for companies in more traditional businesses with a track record of growth and profitability, the traditional IPO route may yet be the better option. Institutional and retail investors are able to assess the valuation of such companies in a stable capital markets environment. A SPAC structure results in substantial dilution in favor of the sponsors which may be an avoidable cost for such companies which can opt for a traditional IPO. For retail investors, as compared to SPACs, traditional IPOs have the advantages of an established regulatory framework, familiar valuation methodologies and copious information flow.

In conclusion, it is early days for SPACs in India. However, it is a financial mechanism which is probably here to stay and may eventually influence and transform the capital markets in some ways.
