Our Views

Special Purpose Acquisition Company (SPAC) – A new method of doing IPO

Capital Markets globally are embracing several new initiatives. So is the case in India. The recent announcements in the Union budget regarding One Securities Markets Code, trading in Gold and Corporate Bond markets are very progressive, creative, and promising. In the same spirit, India could consider embracing an alternative methodology for Initial Public Offering (IPOs) called Special Purpose Acquisition Company (SPAC).

IPOs are an age old and well-established methodology for companies getting first time listed on the capital markets. The practice is well evolved both globally and in India. Our IPO market and processes are very well structured and established. In the last few years, some of the global markets have introduced SPAC as an alternative method of IPO. Over the last 10 years SPAC has been gradually gaining traction in the US markets. It has indeed scored preference in the last 3 years – in 2020, SPAC was used as a listing methodology for every alternative transaction ie. 50% of the transactions were done through SPAC. As much as USD 83bn was raised through SPAC. Given the success of SPAC in the US, our regulators should examine whether there are merits for this approach to be introduced in India as well.

SPAC is formed as a blank cheque company by a group of experienced management team or a sponsor with nominal invested capital, resulting into ~20% interest in SPAC. Remaining ~80% interest is held by public shareholders through units offered in an IPO of SPAC's shares. Each unit consist of a share of the common stock and a fraction of a warrant for future fund raise. SPAC's IPO is based on an investment thesis focused either on a sector or a geography which is executed from the IPO proceeds. A group of people or a management team come up with the idea in a particular sector and put together a busines plan. Sometimes they are backed by a group of investors. The team goes out with the idea to raise resources by way of public offering. IPO money is kept in escrow with a trustee to be used later once the target is identified.

Once the target is identified, the SPAC merges the target with itself and the money kept in the escrow is released. Depending on the target sometime more money is also raised. In this way the private/ unlisted target gets automatically listed. Of course, at that time disclosure of the target as per the public disclosure requirement is made.

The management of the SPAC usually gets 24 months to identify and complete a merger with a target as per the plans set out by SPAC. If the SPAC is not able to find a target and complete the merger within that timeframe it initiates the process of liquidation and money kept with the trust escrow along with any interest on that minus some expenses like taxes etc is immediately refunded to the investors.

A major benefit of this product is a reduced timeframe for IPOs and that it makes fund raising more certain for the issuer. The involvement of professionals in identifying the target also makes the investment a well thought-through and a well-governed process. Though this is a new product, it has picked up notable momentum with ~248 SPAC companies listed on the US exchanges just in 2020 with an average fund raise of USD 335 million. In 2009, there was only one SPAC with a fund raise of USD 36 million. Interestingly, the average initial money raised by a SPAC has also increased from USD 200 million in earlier years to USD335 million. So far, in the current year, ~100 SPACs have been set up with an average fund raise of 291mm. While earlier almost 20% of SPACs had to be liquidated, now the success ratio to find a target and merge for SPAC is almost 90%. Another factor at play is that the SPAC has started attracting several senior professionals and managerial talent.

In conclusion, SPAC is gaining significant popularity as an alternative to IPOs in the US markets. Given India's large and mature IPO market, I think our regulators should consider allowing SPAC listing in India – of course, with all required checks and balances. It is understandable that there may be some skepticism around the risks associated with a new product. However, even if we make a beginning in a restricted way, over a period the framework would evolve. In my view, in the recent past, our markets and regulators have exhibited the openness towards new ideas and products, and SPAC could well be the next new kid on the block.

https://economictimes.indiatimes.com/markets/stocks/news/should-india-embrace-spac-the-new-alternative-to-ipo-around-the-world/articleshow/80745313.cms

Sunil Sanghai
Founder & CEO
NovaDhruva Capital Pvt. Ltd