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Headline: What does it really mean to De-Spac?

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We’ve read that Southeast Asia’s tech unicorn Grab has received Altimeter Growth Corp’s shareholders approval to proceed with a merger, and Grab is expected to begin trading on the Nasdaq from Dec 2.

Now that we’ve reached this milestone, what should SPAC investors be aware of during this stage of the SPAC life cycle? And what does it really mean to De-SPAC?

To recap, a Special Purpose Acquisition Company, or SPAC, is a shell company that raises funds from investors through an initial public offering (IPO) on a stock exchange, with the designated purpose of using the funds to acquire a target private company by a deadline in the future.

SPACs are often called a “blank cheque” company – Think of the scenario where investors presented a blank cheque to the SPAC sponsors without knowing upfront to whom the sponsors will subsequently issue the cheque to but relying on good faith in the sponsors to issue it to the best target company.

Typically, within a 24-month timeframe from the SPAC IPO, the sponsors must identify a suitable private company, ideally close to a pre-IPO stage in its product development or at least in the late stage and merge it into the SPAC to form a “business combination (BC)”.

Are SPAC shareholders left in the cold by sponsors on decisions regarding a business combination? The answer is thankfully “No”.

Upon majority approval by the board of the SPAC, the SPAC must present the target company for a shareholder vote. Once approval is obtained from a majority of shareholder votes, the SPAC sponsor can proceed to form the BC through a reverse merger.

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In a reverse merger, the existing owners of the acquired company usually becomes the majority owners of the merged entity – i.e the BC.

The ultimate outcome is that the private company will become public after the SPAC acquisition and their existing shareholders now hold majority ownership in a publicly listed BC and the BC takes on its operating business.

As for the SPAC investors, they can choose to become shareholders of the BC or if they choose not to, the SPAC will buy back their shares at the IPO price plus pro-rata share of accrued interests on the amount in the escrow account less pro rata share of any taxes paid. This is known as the redemption rights of the SPAC investors.

One key consideration for SPAC investors with regards to redemption rights, is that while costing nothing on paper, they have a “hidden” cost for investors. Imagine the opportunity cost of tying up your money for two to three years, only to exercise the redemption rights of recovering the initial principal and a little extra interest. It is as if one has deposited the principal in a time deposit account earning almost 0% interest.

Hence the best outcome is that the most suitable BC is proposed and investors get to enjoy the upside of their equity participation instead of redemption.

It is interesting that in the case of Altimeter Growth Corp’s proposed business combination with Grab, shareholder redemptions were merely at 0.02%.

However, we know the best outcome does not always happen. As reported in a Financial Times on Sept 27 2021 , the average redemption rate during the third quarter was 52.4% compared to 10% in the first quarter of the same year, according to Dealogic – a data provider that ran the numbers.

Now, what if the proposed target company was rejected by shareholders? As long as the deadline (including any extension) has not been exceeded, the SPAC sponsor can continue to search for another acquisition target.

In the event that the SPAC does not conduct a BC by the deadline, the SPAC must liquidate and return the IPO proceeds held in the escrow account to investors. Each investor can redeem his/her pro-rata share of the aggregate amount available in the escrow account at the time of liquidation.

The “De-SPAC” transaction is a critical step towards value creation/destruction for the SPAC investors. For instance, the BC could trade below IPO price if the SPAC overpaid for a hyped up target company which turned out far from ready for an IPO and which could even not have a ready prototype to roll out for mass production.

One could shrug it off by believing in the sponsors. Alas, as of 28 September 2021, 97% of more than 300 pre-merger SPACs in the United States are trading below their IPO offer price of US$10. As such, making an informed vote for or against the BC is therefore of paramount importance.

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Before investing in SPACs, investors must carefully consider all material information, check in on their own risk tolerances, investment needs, and trade off risk with returns in making an informed investment decision.

I strongly encourage prospective investors of SPACs to find out more. There are financial literacy webinars on SPAC available on a complimentary basis. Some of these could be less independent, being delivered by SPAC sponsors.

Choose an independent financial literacy source on SPACs. For example, I personally benefitted from the SPAC webinar by SIAS. In appreciation, I hope to contribute an independent piece on SPAC through this article.

Mandy Tham is an assistant professor of finance (education); academic director, Master of Science in Wealth Management; Sino Suisse Fellow, at the Lee Kong Chian School of Business, part of the Singapore Management University.