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Hong Kong SPAC Listing Framework to Launch in 2022

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The Hong Kong Stock Exchange ("HKEx") has published the consultation conclusions on its proposals to create a listing framework for SPACs in Hong Kong. Taking into account market feedback, amendments to the original proposals have been made and the new Hong Kong SPAC rules will take effect on 1 January 2022. In this article, we cover key points to note for those considering launching a SPAC in Hong Kong or pursuing a Hong Kong listing via a De-SPAC.

Background

SPACs have gone global, with a wave of US SPAC listings coming to market in 2020/21 and the past half-year seeing major listing markets around the world introduce changes aimed at welcoming SPAC listings — the UK modernised its SPAC listing rules in August 2021 and Singapore introduced a SPAC listing regime in September 2021. While keeping in mind the need for a competitive listing framework, Hong Kong regulators have prioritized its commitment to investor protection when formulating Hong Kong's new SPAC rules.

A special purpose acquisition company ("SPAC") is a shell company formed by a promoter to raise capital in an IPO for the purposes of consummating a business combination ("De-SPAC") with an operating company. In practice, there is typically an 18-month to two-year timeline following IPO

for completion of the business combination with the De-SPAC target.

The SPAC listing

1. Who may invest in the SPAC IPO?
Hong Kong SPAC IPOs will be open only to professional investors and, before completion of a De-SPAC transaction, only professional investors may trade the SPAC's securities. This is a significant restriction as compared to other jurisdictions such as the US and Singapore where all investors (including retail investors) can participate in SPAC IPOs and trade SPAC securities.

2. The SPAC promoter
The SPAC promoters will need to meet eligibility requirements — significantly, at least one SPAC promoter must hold at least 10% of SPAC promoter shares and be a firm licensed by the SFC for asset management (Type 9) or corporate finance advisory (Type 6) activities. Waivers may be granted on a case-by-case basis.

When assessing the suitability of promoters, the HKEx will consider their track record (including investment management and SPAC promoter experience), character and integrity. The HKEx will view favourably SPAC promoters with experience managing assets with an average collective value of at least HK$8 billion over a continuous period of at least three financial years, or holding a senior executive position (e.g., CEO/COO) at a Hong Kong-listed company that is or has been a constituent of the Hang Seng Index or an equivalent flagship index.

In terms of sponsor economics, the HKEx has adopted a less restrictive approach than originally proposed. For example, the proposed warrant to share ratio cap and separate cap on dilution from SPAC promoter warrants will not be adopted. Subject to certain conditions, SPACs are also permitted to issue earn-out rights to SPAC promoters that are convertible into ordinary shares of the successor company upon the successor company meeting pre-defined performance targets.

Nevertheless, the HKEx will still limit the number of promoter shares to no more than 20% of the total number of shares the SPAC has in issue as at the date of its listing, and will require the terms of warrants issued to the SPAC promoters to be no more favourable than that of warrants held by general SPAC investors. A dilution cap of 50% will also apply to all warrants and the minimum exercise price of all warrants must be at a price that represents at least a 15% premium to the issue price of the SPAC shares. New investors in the successor company must be fully informed of this dilution prior to their investment. Promoter warrants cannot be issued at less than 10% of the issue price of SPAC shares per warrant.

3. SPAC directors

Instead of requiring the majority of the SPAC board to be composed of representatives of the SPAC promoters who nominate them, the HKEx will require the board to include at least two Type 6 or Type 9 SFC-licensed individuals (including one director representing the licensed SPAC promoter).

4. Shareholder distribution and minimum fundraising size

The Hong Kong SPAC must have a minimum of 75 professional investors, of which at least 20 (down from the original proposal of 30) must be institutional professional investors. In addition, the SPAC must distribute at least 75% of SPAC shares and warrants to institutional professional investors.

The minimum IPO fund raising size is HK$1 billion.

The De-SPAC transaction

1. Timing

The SPAC must announce a proposed De-SPAC transaction within 24 months of listing and complete the De-SPAC transaction within 36 months of listing. An extension is possible subject to shareholder and HKEx approval.

2. The De-SPAC target

De-SPAC targets must have a fair market value of at least 80% of funds raised by the SPAC from its initial offering (prior to any redemptions). Given that the minimum fundraising size is HK$1 billion, this means that the De-SPAC route to listing will only be available to businesses with a valuation of upwards of HK$800 million.

The successor company must also meet all new listing requirements (including minimum market capitalization requirements and financial eligibility tests). In this respect, the HKEx's approach does not differ significantly from other jurisdictions, as the Singapore and US exchanges still apply equivalent or stringent eligibility requirements.

3. Process

The HKEx will treat any De-SPAC transaction as a new listing application — a listing document will be required for the De-SPAC, and any forward-looking statements included in the listing document must be verified to the same standard as that required for a new listing. Faster execution (vs. a traditional IPO) is therefore unlikely, as the procedure and steps required for a target company to list via a De-SPAC transaction will be comparable. Nevertheless, those considering a potential listing may still prefer taking the De-SPAC route due to certain procedural advantages such as the ability for pricing certainty through an upfront determination of equity value.

4. PIPE transactions

Hong Kong SPACs are required to conduct a PIPE share placing to professional investors simultaneously with the De-SPAC transaction. The requirements ultimately adopted are stricter but more nuanced than originally proposed — the required size of independent PIPE investment varies depending on the negotiated value of the De-SPAC target. This ranges from 25% where the negotiated value is less than HK$2 billion, down to 7.5% if the negotiated value is equal to or more than HK$7 billion. If the negotiated value is more than HK$10 billion, a waiver may be considered by the HKEx on a case-by-case basis. In addition, 50% or more of the independent PIPE investment must come from at least three sophisticated investors, each with assets under management or a fund size of at least HK$8 billion. These requirements impose additional hurdles to deal certainty in relation to the De-SPAC transaction. There is no equivalent requirement in the US, though the inclusion of PIPE deals is considered standard.

5. Redemption of shares

The Hong Kong rules on redemption of shares by SPAC shareholders were originally proposed to be much more restrictive than in the US and other jurisdictions. Under the consultation proposals, the HKEx's view was that a SPAC shareholder should only be able to redeem their SPAC shares if they vote against (a) a material change in the SPAC promoter managing a SPAC or the eligibility and/or suitability of a SPAC promoter; (b) a De-SPAC transaction; or (c) a proposal to extend the De-SPAC announcement or transaction deadline.

The above proposal has now been scrapped, in response to concerns that this may incentivise shareholders to vote against the De-SPAC transaction for the sole reason that it provides them with the option to redeem.

SPAC shareholders who elect to redeem will receive a pro rata amount of 100% of the funds raised by the SPAC at its IPO, at the price at which such shares were issued.

SPAC shareholders will be entitled to keep their SPAC warrants even if they elect to redeem shares — this allows shareholders to be compensated for the lack of return on their investment held in trust before completion of a De-SPAC transaction.

6. Shareholder vote on De-SPAC transaction
A De-SPAC transaction must be made conditional on approval by the SPAC's shareholders at a general meeting. Under the Hong Kong listing rules, a shareholder and its close associates with a material interest in the transaction must abstain from voting, and if the De-SPAC transaction results in a change of control, any outgoing controlling shareholders of the SPAC and their close associates would only be permitted to vote in favour of the De-SPAC transaction in certain circumstances. This effectively means that the SPAC promoters and their close associates must abstain from voting.

This may make it more challenging to achieve the requisite level of shareholder approval for the De-SPAC transaction.

7. The Takeovers Code
The Takeovers Code will continue to apply in general to a SPAC — a waiver will need to be applied for in relation to the De-SPAC transaction, though it is expected that this will normally be granted subject to certain conditions.

Overall

Admittedly, the rules in Hong Kong are more stringent than those in other jurisdictions, but the HKEx's priority clearly lies in ensuring quality listings rather than in attracting a high volume of SPAC IPOs. The launch of the Hong Kong SPAC listing framework is a welcome change offering more options to investors and those considering a listing on the HKEx. Particularly in respect of portfolio companies with a geographic anchor in Asia, a Hong Kong De-SPAC offers a viable alternative to traditional exit options with the potential for triple-track exit strategies (i.e., M&A, IPO, De-SPAC) in today's markets.

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Suggested Reading

- 16 February 2022 - 18 February 2022 Sponsored Event Global Fund Finance Symposium
- 17 December 2021 Press Release Kirkland Advises Engineered Controls on $631 Million Acquisition by Dover
- 17 December 2021 Press Release Kirkland Advises Gorelick Brothers Capital in Sale of Majority Stake to Bridge Investment Group and Recapitalization of $660 Million Portfolio