Norwich

Media Release

Hong Kong SPAC 2.0

Asia's SPAC Pioneer Proposes Reforms to Boost Hong Kong's SPAC Appeal

April 19, 2023 – Hong Kong SAR – Mr. Jason Wong, Chairman of Norwich Capital Limited, known as "Asia's SPAC Godfather", pointed out that Hong Kong's Special Purpose Acquisition Company ("SPAC") listing rules ("Rule 18B") and related implementation practices have disrupted the inherent balance of SPACs and slowed the development of SPAC listings in Hong Kong. In light of this, Mr. Wong made several recommendations, including allowing the participation of retail investors in SPAC subscriptions and transactions, cancelling promoter earn-out rights, encouraging cash basis warrant exercise, and recommending that SPAC mergers and Private Investment in Public Equity ("PIPE") investments be promoted synchronously to attract more high-quality merger targets.

Mr. Wong attributes the slow development of Hong Kong SPACs to the current SPAC listing rules and related practices that have disrupted the inherent balance of SPACs. In contrast, SPACs in the U.S. have flourished due to their ability to balance the interests of all parties involved.

Professional Investor Restriction and a Lack of Liquidity

From an investor's perspective, prior to the completion of the business combination, participation in Hong Kong SPACs is solely restricted to professional investors, with requirements for quantity, structure, and trading units. Dilution for warrants in Hong Kong SPACs is also capped at 50%, which is significantly less attractive than for U.S. SPACs. As a result, overall fundraising has been low (mostly due to the requirement of meeting the minimum HK$1 billion fundraising amount under Rule 18B) with a lack of liquidity owing to limited international investor participation, which has meant there have been periods with low to zero transaction volume.

From a promoter's perspective, Rule 18B provides significant benefits such as earn-out rights, which entitles them to receive a maximum of 30% of the total number of shares issued by the SPAC on the day of listing, including both shares of the successor company issued upon conversion of the promoter's shares as well as earn-out shares. Additionally, SPACs in Hong Kong use promoter warrants as a mechanism to pay for expenses, with the number of promoter warrants generally exceeding the number of promoter shares for this purpose. On paper, these measures should attract more promoters; however, the high eligibility requirements – which have not been very clear in practice – coupled with a relatively less predictable and efficient listing approval process have hindered promoter participation. There are currently 9 high-quality SPACs that have yet to be listed, with influential professional institutions such as BOCHK Asset Management involved among them. Initial submission dates for these SPACs were over a year ago.

Promoter-Heavy Benefits and Over-Dilution of Share Capital

From the target company's perspective, the SPAC's emphasis on the interests of its promoters, combined with the use of cashless basis warrant exercise, results in significant hidden costs. For example, if a SPAC issues 35 million promoter warrants and agrees to a valuation of HK$4 billion for the target company with a PIPE investment of 15% of the agreed valuation and a redemption rate of 50% at the time of the merger, the simple dilution of shares due to promoter share conversions, earn-out share grants, and all warrants being exercised on a cashless basis to the target company could reach up to 11.8%. In addition, Rule 18B requires that SPACs secure PIPE investments before announcing a merger, which poses a challenge as PIPE investors usually require time for due diligence and investment decision-making, which ultimately adds to the burden of a timely merger transaction. Hong Kong SPACs have yet to announce a merger to date.

Targeted Proposals to Enhance the Attractiveness of Hong Kong SPACs

In summary, the current dilemma faced by Hong Kong SPACs is that investors are either highly restricted or not given enough incentive to participate, promoters have significant interests but face high barriers to entry, and target companies have high implicit costs and uncertainty over the listing process. Mr. Wong believes that the pain points of all parties involved must be addressed in a targeted manner to improve the structural balance of SPACs. To this end, he proposed "Hong Kong SPAC Version 2.0" with the following recommendations:

1) Hong Kong SPACs should include retail investor participation in subscription and trading to increase liquidity. In February this year, the Hong Kong Securities and Futures Commission consulted with market participants on whether licensed virtual asset platform operators should be allowed to provide services to retail investors. Compared with riskier virtual assets, Hong Kong SPACs provide investors with redemption protection, valuation endorsement through a mandatory PIPE investment, compliance with strict listing regulations for successor companies, and investor protection through the need to appoint sponsors for successor companies.

2) Appropriately increase the dilution cap of warrants (such as issuing one warrant per SPAC share) and adopt more attractive terms conducive to market efficiency in order to attract international investors.

3) Clarify the eligibility requirements of SPAC promoters under Rule 18B and in practice to improve the predictability and timeliness of the SPAC listing approval process.

4) Cancel the promoter's earn-out rights and allow promoters to directly participate in the subscription of SPAC shares issued when the SPAC is listed (equivalent to the investment units sold through private placement in U.S. SPACs). This will reduce the potential

dilution impact of promoter warrant exercise, as Mr. Wong believes that 20% of the promoter's shares are already a sufficient commercial incentive.

5) Adopt a cash basis warrant exercise. Under this model, newly issued shares from warrant exercise are obtained via cash subscription at a warrant exercise price that is 15% higher than the initial sale price of the SPAC. For the successor company, this will bring additional financing and increase its net asset value per share (NAV).

6) Allow the merger transaction and PIPE investment to proceed simultaneously, balancing valuation endorsement and merger transaction efficiency. The SPAC listing model should have overall advantages in convenience, thereby attracting more high-quality targets.

Mr. Wong stated that his proposal for the Hong Kong SPAC Version 2.0 does not conflict with the current positioning of the Hong Kong Exchanges and Clearing Limited ("HKEX") towards Hong Kong SPACs. The HKEX aims to bring in high-quality promoters, increase constraints on the valuation of SPAC merger targets, and regulate M&A transactions; practices that were viewed to be lacking or insufficient in past U.S. SPACs. What needs to be reviewed is the balance of interests and demands of investors, promoters, and target companies. Ultimately, the goal is to attract participation and enable high-quality target companies to quickly go public and raise funds without compromising the overall quality of market participants, reflecting the unique advantages of SPACs. Following this session, Mr. Wong and his team will continue to consult with professional market participants and submit a collective recommendation report to the HKEX.

Hong Kong's SPAC market has had a slow start for over a year since its launch, with only 5 out of 14 applications approved for listing, coupled with low trading volumes for the listed SPACs. The 5 listed Hong Kong SPACs have yet to announce any merger deals and only 1 new SPAC has been launched since Q2 2022.

Mr. Jason Wong, Chairman of Norwich Capital Limited

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