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Appetite for SPACs

Demand for shares of SPACs continues to be strong

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IF there is a particular group of stocks that fuel stock market appetite, drive volumes and raise big money, the trophy would go to special purpose acquisition companies (SPACs).

The SPACs that were listed in 2013 were Sona Petroleum Bhd and Cliq Energy Bhd, which respectively raised RM550mil and RM300mil during their initial public offering.

Their performance on the local stock exchange was just as impressive. Sona and Cliq's shares and warrants are still actively traded and are presently up 40% and 37% respectively since their listing.

So far, no qualifying acquisition (QA) has been made.

A SPAC is a firm that is listed with no core operations but is formed specifically for the purpose of making acquisitions from the cash raised via the initial public offering.

SPACs have a 36-month deadline to make the qualified acquisition (QA) happen.

But the SPAC universe took a hit recently, when the first one to list, Hibiscus Petroleum Bhd, failed to strike oil in its first well in the Oman 50 block. The stock was sold down fiercely from its recent highs, and this sentiment could spill over to the other SPACs.

Even so, since its listing in July 2011, Hibiscus shares (including warrants) are still enjoying a 303% return on investment to its IPO investors, based on its last traded price of RM1.77 and warrants of RM1.25.

Following the "success" of Hibiscus, many others were interested in floating SPACs.

After all, the management team of Hibiscus got their IPO shares at a cost of one sen. So not surprisingly, there were many working on SPACs applications in 2013.

The SPACs story hasn't been all smooth sailing though.

There were those that failed. Most notably, the rejected ones were mining SPACs Australaysia Resources Bhd and TerraGali Resources Bhd.

On this note, the Securities Commission has recently introduced new guidelines as it felt that the keen interest in SPAC listings has caused applicants and their advisers to not fully observe the listing principles of SPACs.

One of the key changes though that could discourage some from venturing into SPACs is the requirement that promoters must own at least 10% of the paid-up capital of the SPAC, and that the promoters can only enjoy a maximum of 90% from the initial public offering price.

So, for example, if a SPAC has a paid-up capital of RM100mil and is raising RM1bil from the IPO, then management must raise RM10mil of its own. (RM10mil is 10% of the paid-up capital of RM100mil).

The discount on the IPO price is a maximum of 90%, thus if the IPO price is 75 sen, management must cough up 7.5 sen.

Previously, SPACs like Hibiscus and Cliq only needed to pay one sen for their IPO price or almost a 100% discount.

Another significant change is that the proceeds from the IPO should not be used for the remuneration of the management team or their related parties.

SPAC rules dictate that 90% of proceeds raised be placed in a trust. The balance 10%, which previously could be used to pay salaries, can now only be used for expenses incurred in looking for the qualifying asset.

The basis of this rule is to protect investors from the situation of where promoters raise a lot of money, only to enjoy hefty salaries even before they find an asset that starts generating returns for the SPAC.

The appetite for SPACs, particularly in the oil and gas sector, continues to sizzle.

However, one entrepreneur felt that this rule was going to make it difficult for companies to operate and get by on a daily basis.

"Who's going to join you if you can't pay them a salary?" he lamented.

"I feel that this rule is a little too strict," he added.

Another entrepreneur in the oil and gas industry said that under these new rules, it would discourage SPACs who were looking to buy assets in the exploration stage.

(This is in reference to the new rules on the issue of the moratorium placed on promoters, which state that if the SPAC involves resource-based exploration assets, then the moratorium on promoters' shares extends until the said asset commences commercial production and one full year of audited operating revenue.)

"It is very likely that they will only go for assets in the producing stage. This is because if it were in the exploration stage, how are they going to last? They can only sell their shares once the assets have generated one full financial year of audited operating profits and positive cash flow from operating activities. That could take five years!" said the oil and gas observer.

"For a resource base SPAC, a huge amount of capital is required. If the SPAC were to raise RM500mil, management would have to cough up RM5mil of their own. How many people have that kind of money?" said an oil and gas analyst.

However, it should be noted that the rule changes also came about after industry feed back.

There must have been groups who wanted stronger investor protection. In the case of salaries, this school of thought argues that the intitial investor should be bearing the bulk of this cost, considering that they are enjoying a huge discount to their shares.

And on the issue of enhancing the moratorium, this puts SPACs in a similar structure as the private equity professionals, who can only see a share of profits once the asset they acquire shows enhanced value.

Observers says that most of the SPACs in the pipeline will have to restructure and tweak their business case to comply with the new rules.

"For many of the SPACs who had to hold back their submissions because of the new guidelines, the 90% discount along with the fact that they cannot draw salary will have significant consequences for them.

However, the SC wants to take all measures to ensure that it has done its utmost best to protect shareholders," remarked an observer.

Thus moving into 2014, SPAC appetite might be more tempered.

Hibiscus shares hit a peak of RM2.68 on Dec 13, and has been free falling since Dec 18.

The counter was suspended on Dec 23, and the official announcement on the discovery of 'non-commerciable hydrocarbons ' were made on Dec 24.

Upon the resumption of trading on Dec 26, the shares were heavily sold down, shedding 17% of its value. The stock is now back to mid 2013 levels at the RM1.77 level.

Hibiscus is giving it one more shot. It will be drilling Well 2, also in the Oman Block 50 area, two weeks from now.

This will be a keenly tracked event, and will decide the future and strategy of Hibiscus over the mid term.

Meanwhile, the SPACS that are looking to list (before the new guidelines were announced), include food and beverage SPAC Red Sena Bhd which will be led by former Fraser & Neave Holdings Bhd chief executive officer Datuk Tan Ang Meng.

Market watchers are looking forward to Red Sena, as its key management are the same people who were instrumental for F&N's growth in Malaysia.

Other SPAC hopefuls include a first of its kind, a medical healthcare SPAC.

The appetite for SPACs, particularly in the oil and gas (O&G) space, continues to sizzle.

The most imminent of the lot would be Reach Energy Bhd, the upcoming O&G exploration and production shell, which has Daya Materials Bhd as its initial investor.

Daya will be paying RM8mil for a stake in Reach Energy, headed by its director Shahul Hamid Mohd Ismail.

In July, Daya told Bursa that it will subscribe to 533,334 redeemable convertible preference shares in Reach Energy at RM4.50 each and acquire 12.44 million shares in the shell company at 45 sen each.

On the other new stricter guidelines for SPACs, it includes extending the moratorium on promoters and initial investors as well as capping the discounts these investors enjoy in their SPAC shares.

The new rules also stipulate that the initial investors of a SPAC can only enjoy a 40% discount on their shares.