The SPAC Craze Reaches China

'Special Purpose Acquisition Companies' offer Chinese companies what they want: a quick and easy way to get foreign capital and a foreign listing.

By Katrina Northrop — April 4, 2021

Blank check companies are flooding the boards, and now Chinese companies want in.

Credit: Christopher Berry, Creative Commons

Wall Street's latest craze for SPACs has reached a new frontier: China.

These so-called blank check companies — which raise money, go public and merge with a private company, typically within two years — have already raised $97 billion in 2021, according to SPACinsider, more than all of last year. And though the vast majority of that money has been raised by American sponsored SPACs, Chinese firms are starting to get in on the action.

SPACs, or "special purpose acquisition companies," are now a quick and easy way for Chinese companies to go public and access foreign capital, though some analysts worry that the already speculative structure is riskier in the China context.[1]

Over the past year, established Chinese firms like Primavera Capital Group,[2] Hony Capital, Greencity and CITIC Capital have listed SPACs on American stock exchanges. And a group of prominent businessmen, including Li Ka-shing, the Hong Kong property tycoon, Li Ning, the founder of the eponymous Chinese sports brand, and Kenneth Hitchner, the former president of Goldman Sachs in the Asia Pacific region, have announced that they are backing new SPACs. All of these vehicles are hoping to target acquisitions of companies with significant Chinese operations.

"We are already seeing more Chinese or Hong Kong owned blank-check companies getting listed in the U.S.," says

Tianlei Huang, a research analyst at the Peterson Institute for International Economics, the Washington think tank. "We will most likely see more Chinese-invested SPACs getting listed in the U.S. in 2021, since investors are interested in Chinese startups and Chinese-invested SPACs understand the Chinese market better."

Experts say that even non-Chinese invested SPACs are targeting Chinese companies for mergers. "Tech start-ups and high growth companies, particularly those that have attained 'unicorn' status, are very attractive targets for SPACs, and there are plenty of these in China," says Mark Uhrynuk, corporate and securities partner at the international law firm Mayer Brown.

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Going public with a SPAC is far quicker than a traditional IPO, or initial public offering. Instead of going through the extensive regulatory process of listing on an U.S. exchange, private companies essentially get a shortcut to going public. Every investor in a SPAC has a money back guarantee, either if the SPAC fails to find a suitable target or if the investor decides to redeem their shares. And the typical regulations surrounding pre-IPO projections do not apply to SPACs, allowing them to announce overly optimistic — and perhaps misleading — estimates without the fear of regulatory penalties or future litigation.

For Chinese companies in search of foreign capital and a foreign listing, SPACs are an attractive prospect. "Foreign listing is a certificate of quality," says Milos Vulanovic, a professor of finance at EDHEC Business School in France. "So if a Chinese company lists on the U.S. market, it shows that they are a good company."

But critics say that listing in the U.S. through this trendy shortcut may show something else entirely. SPACs have come under fire because they allow investors to put money into a company with no stated purpose until it finds a target and they facilitate public listings, without requiring private companies to file extensive paper work.

"Pre-merger, there are no disclosures," says Alex Korda, an analyst at New Jersey-based The Edge Consulting Group who has done research on the returns of SPACs over the past five years. "When they say blank check, it is a double entendre — there is no clarity on what type of company they are going to buy."

With the added China dimension, experts say it becomes even more risky. "The problem with SPACs is a lack of transparency, and these problems are multiplied in China," says Andrew Collier, managing director of Orient Capital Research and the author of *Shadow Banking and the Rise of Capitalism in China*. "People think that any way to raise capital from a hungry investor base without regulatory hurdles is a good idea. But whether this is a good idea in the long run is another question."

To some experts, SPACs are reminiscent of the late 2000s reverse merger boom, in which hundreds of Chinese companies went public by merging with small American public companies, also known as a back door listing. Some of these Chinese companies ended up being fraudulent, and the SEC cracked down with a wave of delistings.

"It is very similar to a reverse merger, which was very popular in China," says Drew Bernstein, the co-chairman of Marcum Bernstein & Pinchuk, a New York-based accounting firm. "They were guaranteed to go public at the end of the day, and it didn’t take a lot of time. A deal with a SPAC is kind of an enhanced reverse merger because you also know the price.”

Because of the inherent risks, successful SPACs are typically sponsored by established companies. “Within the SPAC space, it will be mostly reputable firms that are able to do this,” says Andrew Sinclair, an assistant professor of finance at the University of Hong Kong’s Business School. “They will have to be relying on the reputation of the founder.”

Chinese SPACs are still a nascent trend. “In the context of the number of SPACs searching for an acquisition target — around 430 and another 250 getting ready to IPO — the Chinese portion is still small,” says Kristi Marvin, the founder of SPACinsider. Part of this, experts say, is because of the fear that Chinese companies may be subject to delisting.

That problem could be solved if Asian exchanges start to allow SPACs. The Singapore and Hong Kong stock exchanges have said that they are considering allowing blank check companies as early as this year. Experts, though, say that it is unlikely that mainland Chinese stock exchanges in Shanghai or Shenzhen will allow SPACs anytime soon.

“I suspect that both Hong Kong and Singapore will allow SPAC listings,” says George Kaufman, the head of investment banking at Chardan, an investment bank which has formed multiple Asia-focused SPACs. “And if that happens, high profile Chinese SPACs may not list in the United States."

As popular as it is today, the frenzy could all come to an end if a Chinese SPAC deal blows up or if the returns of SPAC stocks continue to be mediocre. "For all the SPACs, average returns have been disappointing, including those which merged with Chinese companies," says Jay Ritter, a finance professor at the University of Florida, citing a recent paper he co-authored on the topic.

If that continues to be the case, investors could grow weary of giving SPACs carte blanche, even in the high-growth Chinese market.

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