BGM UPDATE - MARCH 2021

Special Purpose Acquisition Companies (SPACS) and Cash Shells

Since the beginning of the Coronavirus pandemic, there has been a great deal of publicity around high profile SPACS that have listed on NYSE / NASDAQ and Amsterdam, many with cash war chests running into hundreds of millions of Dollars.

The UK has lagged behind in the SPAC activity due to its more conservative regulatory framework. However, Xavier Rolet, the former CEO of the London Stock Exchange, recently quoted that the UK's current review of its regulations presents a "golden opportunity" to draw companies to London's stock exchanges over New York or Amsterdam.

SPACS and Cash Shells (a term more commonly used in the UK) are simply entities which have no assets apart from cash and are listed on a stock exchange. These entities can provide an attractive option to private enterprises with ambitious growth plans looking for funding and a stock market listing, without having to undergo a full IPO process.

Through this guide, we endeavour to provide an introduction to cash shell transactions and the key issues that privately-owned businesses may wish to consider when weighing up cash shells as a potential route to a stock market listing.

Key Features of Cash Shells

Cash shells are companies with a stock market listing that have an established board of directors, an amount of cash in the bank but no operating business. There are two types of cash shells, namely:

- **Clean Shells** – These are newly incorporated companies that are listed on a stock market with cash ready to invest in a suitable private business. Other than cash, these shells have no assets but they benefit from a board of directors which may have particular business sector knowledge, expertise and connections relevant to a target investing policy.

- **Dirty (Legacy) Shells** - These are listed entities that have disposed of or wound up their trading business and are left with some residual cash in the bank and a 'caretaker' board of directors. These cash shell companies are also likely to have an existing shareholder base that has been built over a number of years. In many cases, these shells undertake a fundraise prior to undertaking any investing activity in order to have sufficient funds in the treasury to cover the professional fees which can amount to several hundred thousand Pounds.

Investment approach of cash shells

There are basically 2 investment methodologies followed by cash shells:

- Cash shells that are specifically established as 'investing companies' with a set investing policy. They are likely to have a material amount of cash available to participate in share placings within the guidelines of the investing policy. Investing companies would generally be looking to make investments in a number of targeted businesses over time.

- Other cash shells including 'dirty (legacy)' shells are likely to have a modest amount of cash available and would typically seek a single enterprising investment opportunity, resulting in a 'reverse takeover' transaction contemporaneous with a share placing to raise enough money to satisfy the working capital requirements of the new business. In a reverse takeover, the quoted cash shell acquires through an issue of new shares, an enterprise that is more valuable than itself; thereby the majority of the shares and control of the business passes to the shareholders of the private enterprise upon completion of the merger.

Benefits of a Reverse Takeover and Listing

There are several benefits afforded by cash shells both for its own shareholders and the owners and management of enterprises in a reverse takeover (RTO) transaction.

For the shareholders of the shell, the main benefit is that the RTO would enable them to retain a minority stake in a newly transformed entity which hopefully will then grow in success and, over time, enhance shareholder value.

For owners and management of the enterprise moving in, there are several benefits with the main ones set out below:

- Enhancing the profile of the business
- Access to capital markets and institutional investors for further capital
- Liquidity in company shares
- The ability to use their shares as currency for new business acquisitions
- Potential exit strategy for existing shareholders

Drawbacks of a Reverse Takeover and Listing

There is limited downside for existing shareholders of a cash shell in an RTO transaction provided that it is (a) successful and (b) the company acquired in the process has the potential to grow and enhance shareholder value.

For the owners and management of the enterprise which is being reversed into the cash shell, there are a few potential drawbacks which should be borne in mind, namely:

- Costs associated with the RTO process are not insignificant and need to be weighed up against the medium and long term benefits.
- Call on management time through additional investor relations and regulatory responsibilities.
- Managing shareholder and investor expectations.
- Difficulty in raising future funds through a lack of business performance or a downturn in market sentiment.

Undertaking a Reverse Takeover Transaction

Although more straightforward than a straight IPO, undertaking an RTO transaction is usually a complex process involving a number of stages in common with any company going through an IPO. These are summarised as follows:

- Preparation – development, articulation and scripting of the business development strategy that also demonstrates the benefit of this approach to market.
- Confirmation of Value – obtaining an independent valuation of the business from a competent party.
- Appointment of Advisers – careful selection of advisers, agreeing their mandates and negotiating fees.
- Researching and Targeting – working with the advisers to identify the right cash shell.
- Negotiations – carrying out negotiations with the board and advisers of the cash shell in order agree terms of the transaction.
- Due diligence and Legal & Regulatory Formalities carrying out the necessary legal, financial and regulatory due diligence on the cash shell and preparing the necessary documentation to complete the transaction and listing.

If any additional funding is sought in conjunction with the RTO, the process would also involve an investor roadshow which is usually managed by the appointed brokers.

Choice of the Market

There are usually a number of cash shells available on the various UK stock markets at any given time. Each market has its own profile, characteristics and regulatory framework. In considering the merits of a cash shell, it is also important to consider the merits of the market on which it is listed.

London Stock Exchange Main Market

There are two segments within this Market - the Standard Listing Segment and the Premium Listing Segment.

The Standard Listing Segment offers more relaxed rules and therefore an increasing number of cash shells have chosen this route. Some companies opt for a Standard Listing as a stepping stone to an eventual Premium Listing with its heightened entry requirements..

The main benefits of a Standard Listed cash shell are:

- No requirement to retain a sponsor following the listing and flexibility over share dealings by the company and management or related party transactions
- No requirement for shareholder approval for an RTO transaction
- No requirement to comply with the codes on corporate governance
- No requirement to offer new shares for cash on a pre-emptive basis to shareholders, subject to statutory requirements
- Reduced listing costs and ongoing expenses
- Much cheaper to join than AIM

The Premium Listing Segment imposes the highest standards of regulation and corporate governance. For these reasons, cash shells are unable to obtain a Premium Listing on the London Stock Exchange.

Alternative Investment Market (AIM)

AIM is regarded as the world's most successful growth market with over 800 companies currently listed. The regulatory framework of the market is designed to be suitable to the needs of smaller growing companies requiring several fundraisings along their business development journeys.

It also has significant tax advantages for investment into qualifying companies and this attracts money from specialist funds and UK investors.

Since 2016, AIM has introduced more stringent rules both for new investing company cash shells and existing companies turning themselves into cash shells. These have reduced the overall availability of cash shells on this market but there are still a few available at any given time.

The main benefits of an AIM cash shell are:

- Part of the London Stock Exchange
- Access to a significant pool of investment capital for further fundraisings

- Liquidity in the market
- Regulatory regime designed specifically for growth businesses
- Well regarded internationally with many non-UK businesses listed on it.
- Certain tax benefits available for AIM investors

Aquis Exchange (AQSE)

This was known as NEX Exchange prior to 15 April 2020. AQSE is divided between Main Market and Growth Market. The Main Market is designed for larger established companies whereas the Growth Market is designed for early stage entrepreneurial companies.

Like AIM, it has significant tax advantages for investment into qualifying companies making it attractive to UK tax payers. Unfortunately at present, there is little investment interest being shown by institutional investors.

The process of listing on AQSE is straight forward, less costly than AIM or Standard Listing and quick. These features provide an alternative to companies wishing to list without going through an RTO process. The main disadvantages of listing on AQSE are the junior status of the market and low liquidity.

We at BGM Corporate Finance LLP hope that the above provides an informative insight to the UK Stock Markets and world of cash shells. For further guidance and to discuss your business growth strategy or listing, please feel free to contact Hemant Thanawala at hemantthanawala@bgmcf.co.uk