Special purpose acquisition companies

**Borrowed money funded share purchases by ‘Spac king’**

**Palihapitiya**

Blank-cheque company promoter was lent $200mn for marquee deals while touting ‘skin in the game’

Miles Kruppa in San Francisco and Antoine Gara in New York 6 HOURS AGO

Chamath Palihapitiya, the most vocal promoter of a new wave of blank-cheque companies, financed two signature deals with borrowed money while emphasising the importance of sponsors having their own capital at risk.

The investor is known as the ‘Spac king’ for his series of special purpose acquisition companies, which raise capital by listing on the stock market and then seek a merger with a target company. His deal to take the space tourism company Virgin Galactic public in 2019 sparked renewed interest in Spacs, bankers said.

Palihapitiya has also touted large personal investments he has made in his own Spac deals and proposed that regulators force other promoters to put more of their “skin in the game”.

Yet Palihapitiya borrowed from the bank Credit Suisse to finance $200mn of his initial share purchases in Virgin Galactic in 2019 and insurer Clover Health in 2020, according to regulatory filings reviewed by the Financial Times. He secured the financings by pledging his stock in the companies to the lender.

The borrowing arrangements indicate that Palihapitiya put less personal cash into his deals than was previously obvious as he built an empire in Spacs.

Both Virgin Galactic and Clover’s share prices have plunged over the past year because of worse-than-estimated earnings and steep losses. Many corporate governance experts dislike insiders pledging shares as collateral because it can add to volatility in a company’s stock and misalign incentives between insiders and ordinary stockholders.
Palihapitiya stepped down as chair of Virgin Galactic’s board last month after selling his personal stake in the company. When the FT asked in 2020 whether he had taken out a loan to finance his $100mn investment in Virgin Galactic, Palihapitiya denied it was the case, writing: “That is NOT correct”.

A spokesperson for Palihapitiya’s investment firm, Social Capital, said last week that it would be “both disingenuous and naive” to position his borrowing as “new, novel or unusual”.

“A basic mechanism of the financial markets is buying and selling on margin using a standing revolving facility,” the spokesperson said. “Banks, hedge funds and large family offices all use them — it’s tax advantageous and reduces the need to sell positions with embedded gains.”

Most large US companies forbid executives and investors from share pledging, and the proxy adviser Institutional Shareholder Services in 2013 said it was “not a responsible use of equity”.

“It levers up his holdings — it makes it riskier,” said Jason Zein, a professor of finance at UNSW Business School who has studied share pledging.

Stefano Bonini, an associate professor of finance at Stevens Institute of Technology, said he would “very much disagree” that Palihapitiya’s borrowings represented skin in the game.

Spacs usually reward their creators with thousands of shares purchased for nominal sums, which can result in lucrative payouts if they successfully find a deal. In the case of Virgin Galactic and Clover, Palihapitiya also purchased $100mn of shares in each company at $10 apiece through private investments.

Those deals, known as “Pipes”, help raise extra funding and provide a stamp of approval for
companies in Spac mergers.

While Palihapitiya profitably exited his wager on Virgin Galactic, he has taken a hit on Clover, whose shares have fallen by more than 90 per cent from their peak.

Clover jumped to more than $28 a share in June last year after striking a deal with Palihapitiya’s Spac. Since then the stock has nosedived, dropping to as low as $2 as it faces questions about the sustainability of the company’s business model and relationships with medical care providers.

One month before Clover went public, Palihapitiya entered a loan agreement with Credit Suisse to fund his Pipe investment, according to regulatory filings, which said he had pledged all 10mn shares from the Pipe to secure the deal.

Palihapitiya previously used a similar loan agreement to purchase the same quantity of shares in Virgin Galactic as the company went public, according to filings. The filings did not disclose the terms of the arrangements.

Credit Suisse declined to comment on its lending to Palihapitiya. The bank also advised his Spacs on the deals they struck with Clover and Virgin Galactic.

Share pledging can be risky during stock market declines, forcing lenders to request more collateral from shareholders who might offload their holdings to meet the new requirements.

All told, Palihapitiya has doubled the roughly $500mn he invested in his own Spac transactions and broken even on $200mn of investments he made in other people’s Spac deals, according to an analysis by New York university law professor Michael Ohlrogge, who has studied promoter compensation.

Ohlrogge’s analysis was based on public filings, which might not capture all of Palihapitiya’s buying and selling activities. In November, Palihapitiya said he had sold 15 per cent of his stake in the fintech company SoFi Technologies to make investments in a battery maker and two cryptocurrency companies, citing confusion about the macroeconomic environment.

Palihapitiya also sold his entire Pipe investment in Virgin Galactic for more than $300mn beginning in late 2020. The company’s stock has since dropped by about three-quarters to $8.25 a share.

Ordinary investors who purchased shares following the Spac deals have probably performed worse than Palihapitiya. Spac transactions rarely benefit new shareholders unless promoters “can touch a company and make it instantly far more valuable than it was”, Ohlrogge said.

*Additional reporting by Nikou Asgari and Nicholas Megaw*