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FUND FINANCE FRIDAY

WFF Global: What Is Going On In the SPAC Market?

April 23, 2021 | Issue No. 123

By Leah Edelboim
Special Counsel | Fund Finance

This week, Women in Fund Finance Global hosted a two-day virtual event covering all aspects of SPACs.

Day One covered “What Is Going On in the SPAC Market?” The panelists included Nichole Burnap, a portfolio manager in charge of the SPAC portfolio at Teachers Retirement System of Texas; Amit Chandra, a managing director and head of Natural Resources & Sustainable Impact Equity Capital Markets at Barclays; Carol Lowe, an independent director at TCW Special Purpose Acquisition Corp.; Brett Northart, a member of the management team at Kernel Group Holdings, Inc.; and Thomas Amburgey, a director at First Reserve and CFO of a recent SPAC. The panel was moderated by Marshall Shaffer, a partner at Kirkland & Ellis.

The panel began with a discussion of why SPACs are so very hot right now. Amit explained that the upside is incredible and, with a typical buy-in of $10 a share as your floor, there is a minimum yield of 2% and the upside is “limitless.” He called it a “best-in-class” investment in terms of risk-reward. And investors have lots to choose from, he noted, adding that there are 430 SPACs in the market right now looking for investment opportunities.

Nichole spoke from her perspective as an investor in the space. She explained how investors differentiate between investment opportunities given the volume in the market. She stressed the importance of a strong management team consisting of known operators with expertise in the relevant industry. She predicted a divergence in the market, which the panel echoed on Day Two, composed of “one-hit wonders” vs. those that have success and will be around for the long term.

Carol also emphasized the importance of quality and having a team that has the same values, the right network and the right plan to be successful. She said that while it is great that things can move so quickly with a SPAC IPO, the governance structure also needs to be right and the board needs to balance its obligations with the fast and furious pace of a SPAC IPO.

Day Two covered “The Nuts and Bolts of SPACs.” The panelists were Edward Best, a partner at Mayer Brown; Gus Garcia, the president and director of G | SPACs; Beth Michelson, who is on the management team at Cartesian Growth Corporation SPAC; Lauren Rosa Sangaline, tax managing director at KPMG; and Andrew Stull, a managing director in the Board Advisory Services and Opinion practice at Houlihan Lokey. This panel was moderated by Alex Lebenthal, senior advisor in the Financial Sponsors Group at Houlihan Lokey.

Alex opened the discussion by assuring audience members that if they feel like they waited too long to get up to speed on SPACs and that it’s too late, that is not the case. What followed was an incredibly comprehensive and educational discussion that touched on so many aspects of SPACs – from legal to management to accounting to banking, and the panelists even broke down the latest guidance from the SEC and its impact on the market.

First, the panelists discussed the current state of the market, which goes back about 15 years. Edward explained that SPAC IPOs started to take off in 2016 and 2017 before exploding with a record 247 SPAC IPOs in 2020. 2021 has remained hot with 298 IPOS in the first quarter, putting the pace at about 100 IPOs each month with $80 billion of value. To give a sense of the size of this market, there are presently over 400 SPACs holding approximately $140 billion in cash that are looking for targets. There are another 100 to 150 SPACs waiting to come out into the market. Given the quantity of SPACs and the two-year time horizon each one has to do a deal, Edward said this made for a “seller’s market” among attractive target companies.

While the market has been hot, the panelists did describe some shifts they are seeing. With the latest SEC guidance on how warrants should be treated, the IPO market has slowed a bit, with only 10 SPAC IPOs taking place in the month of April so far, which looks slow compared to the last few months. The panelists discussed that news, along with other shifts in the market and a return to certain fundamentals.

While the panelists unanimously agreed that deals will start coming out again, they also said that investors are getting more discerning. Gus noted the quantity of SPACs that have come to market and said it is a question of whether M&A activity will absorb them. He noted that sellers are more discerning, and some SPACs may not find the deal they are looking for. He also predicted that the buzzword will be “experience.” Simply put, management teams that can navigate both good times and bad will get capital allocated to them, and there will be a divergence in the market on that basis. Andrew also noted that he is seeing a shift in focus this quarter that differs from the fourth quarter of 2020 and the first quarter of this year: Now there is a shift towards companies that provide more stable growth and higher profitability. Beth also noted that sponsors are looking for clean, strong companies that are ready to go public, will make their numbers and are ready to report. There also needs to be the right match between the target and the investor for a successful partnership. Lauren also discussed seller readiness and the financial and tax preparation that is required when a target is going to go public and the steps it needs to take to perform as a public company on a go-forward basis.

Despite any shifts we may see, the market is predicted to stay hot, and one reason for it is that the economics are so compelling both for sponsors and for targets. Beth noted that a target gets more certainty of valuation, execution and liquidity. While the IPO process takes 1-2 years, a time during which the market can shift, a SPAC merger can be accomplished in as little as 3-

4 months. There are also benefits in the way that valuation is approached. Gus agreed that that speed means more certainty and that is possible in the SPAC process.

The conversation turned to the latest SEC guidance on treating warrants as a liability that is causing a pause in the market while SPACs determine what they need to do to properly address the guidance. Edward explained the situation from a legal perspective and how the shift from treatment as equity to a liability impacts financial statements and the associated risks. Lauren explained that all of the Big Four accounting firms are working with the SEC, having daily meetings to try to get the guidance right.

The panel ended with “rapid-fire” predictions for the next 18-24 months. The panelists predicted changes in reporting. They also predicted a continued shift in the type of target that is attractive to investors. Companies that have near-term and actual profitability will continue to get attention, showing that investors are putting more value on more stable and proven businesses. The days of “light diligence” are over. And, finally, given the quantity of SPACs in the market, it is predicted that more SPACs will not find a deSPACing partner and actually liquidate in the next year or two.