The tide is turning in SPAC land; what comes next?

I went into last weekend all prepped to write two articles this week.

1. The first was going to be a "quickie" idea on Enlab getting a bump; I was super excited about that one because it had the same activist (Alta Fox) from another quickie idea, CLCT, and I had a lot of familiarity with Stockholm's laws for taking out minority shareholders from a prior investment (Radisson).
2. The second was a post on Berkshire's annual letter.

But then life got in the way of my posting schedule. Entain bumped their offer for Enlab earlier than expected (and I may never forgive Alta for that), and Berkshire's letter was basically a reheat of past letters. Given his past letters are fantastic, that's completely ok, but it didn't really set my writing muse on fire.

So my plans for writing this week were shot.... but that's turned out to be ok, because something even more interesting has been going on: the SPAC world has been completely upended.

Regular readers know I've been obsessed with SPACs recently. Half of my predictions for 2021 involved SPACs, they featured prominently in my 2021 state of the markets, and last summer I called them the most ludicrous bubble we'll ever see. If you're looking for background on the SPAC markets and my thoughts on them, I'll refer you to those posts.

So why do I think the SPAC world has been upended? Well, consider four things (and note that I wrote the majority of this this morning before the market opened; if I updated this to "real time" prices as I get ready to post this around 10:45 AM, the marks would be a lot worse as SPACs are getting slaughtered today! For example, QELL's stock touched $10.10/share for a brief time versus the ~$10.75 they closed at last night).

1. For the first time in months, we've seen SPAC IPOs start to trade below trust. This is a huge divergence from the rest of this year, where basically every SPAC IPO was so in demand that it would open up 5%+ above trust. An example might show this best; consider ABG Acquisition Corp I (ABGI), which IPO'd in the middle of February right when the SPAC market was hottest. Its first trade was ~$10.35, so buyers enjoyed a 3.5% pop right on the first trade. Compare that to African Gold (AGAC), which IPO'd last Friday. It's currently trading for $10/share (so at trust), but hundreds of thousands of shares have traded hands just below $10/share over the past few days.
2. Buzzy pre-deal SPACs have seen their premiums come in enormously. Almost every pre-deal SPAC was trading for a ~15% premium to trust 10 days ago, and the buzziest SPACs would often trade for 25% premiums. Those premiums have vanished over the past few days. For example, consider "the King of SPACs" two current pre-deal SPACs: IPOD and IPOF. Both of these are pre-deal SPACs, but in mid-February investors were so excited about the potential of these that they were willing to pay enormous premiums to get involved (both traded >50% above trust, with IPOF trading over $15/share and IPOD trading over $17.50/share). Those premium have come in enormously, as I write this, IPOD is set to open below $12.50 and IPOF is set to open below $12. On the non-

buzzy SPAC side, consider something like CCAC; a few weeks ago, that pre-deal SPAC saw its shares approach $12/share as investors were excited about the prospect of any deal announcement. Today, shares are trading for ~$10.20/share, only a slight premium to the ~$10.05/share the company currently has in trust.

3. SPACs that announce deals have stopped moonshotting; in fact, many are trading down or even to trust value on deal announcement. For example, consider VMAC. Yesterday, they announced a deal to merge with Anghami. They had closed the previous day at $10.15; on that announcement, they closed at ~$9.99/share. So, not only did shares drop, they dropped below VMAC's trust value of $10/share. SPACs have even stopped moonshotting on buzzy rumored deals. Bloomberg broke the news yesterday that QELL was in talks to merge with a German Flying-Taxi start up. It doesn't get much buzzier than that; a month ago, QELL was a buzzy pre-deal EV SPAC trading at $14/share, and they just had a rumor to merge with a buzzy start up. If this rumor had broke last month, I would guess QELL would be trading in the high teens or even low $20s; however, in the current market, QELL's shares barely budged on the news; they actually traded down on the day and are currently trading for <$11/share, a small premium to trust.
4. We're seeing signs that some SPACs with announced deals are going to have trouble getting the votes to close their deal. A bunch of SPACs that have announced deals are trading at or below trust value, generally a sign that the SPAC might fail. Consider, for example, GIX (look at prediction #2 here for more background). That SPAC has an announced deal; however, they're also coming up on the end of the SPACs life and need shareholders to vote to extend the SPACs life in order to get time to complete that deal. GIX shares are currently trading for ~$10.03/share versus $10.10/share in trust. They also just had to postpone the meeting to extend their SPAC.

> Everything about that situation (trading under trust; company postponing the meeting) screams that the company is having trouble getting shareholders excited about their deal. There's a real chance that GIX can't get approval to extend or enough shareholders vote to redeem that the SPAC liquidates / the deal fails. I can't remember the last SPAC deal failure; market prices are suggesting we could have a wave of them in the near future.

My bottom line here: most of the froth in the SPAC market seems to have been pulled out, and it's come out very, very quickly. What pulled all of the froth out?

The obvious culprit is the "disappointment" of the Lucid / CCIV deal. I've mentioned it twice (in my monthly links and in my PSTH write up), so I won't recap it too much here, but the basics are that CCIV traded up to $60/share (which was absolutely crazy) as the frenzy of them announcing a Lucid deal hit a peak, and then they dropped 50% when the deal was actually announced. It's funny that deal has been framed as such a disappointment; if you just looked at CCIV from a 30k view, it would be impossible to call it anything other than a screaming success: the SPAC has $10/share in trust value, they struck a deal so good a bunch of investors were willing to put in $15/share in a PIPE to get access (50% premium to trust), and as I write this shares are trading for ~$25/share. So I think the deal was a screaming success, but there's been a pretty obvious correlation between CCIV falling and almost every other "buzzy" pre-deal SPAC seeing their premium bleed out.

So, yes, the CCIV "disappointment" is the obvious reason a lot of the froth has come out, but I do think there's another reason: supply has finally met demand. In the first two months of the year, there were 210 SPAC IPOs raising $66B. That's almost as much as the entirety of 2020, where we saw 248 SPACs raise ~$83B. Now, you might be thinking, "raising almost as much in 2 months as the SPAC market did in 2020 is aggressive but not insane," but consider the context. The SPAC market in 2020 was 8x larger than any previous year's SPACs proceeds; in fact, the 2020 SPAC IPO market was larger than the entire IPO market for any year since 2014 and it was larger than the combined amount of SPAC proceeds raised from 2012-2019. So it's not like we did almost an entire normal year in 2 months to start 2021; 2020 was orders of magnitude larger than anything the SPAC market had seen, and we basically repeated the whole thing in two months to start 2021!

So that's what I'm seeing in the SPAC market currently: the bubble has basically fully popped.

Here's the real question though: what comes next?

Well, you could make an argument that this is just a natural and healthy pause in the SPAC market, and that the market will reheat at some point. Maybe you believe it'll reheat to the insane levels of mid-Feb, or maybe you believe that it gets a little warmer but never returns to quite that level of frenzy. While I think the former (SPAC bubble going back to a huge frenzy) is incredibly unlikely, I know a lot of people who think the later (where the SPAC market gets reasonably hot but no where close to a bubble) is how this will play out. I think that vision would look something like this: new issue SPAC IPOs by non-buzzy sponsors trade up 1-2% on IPO, most SPAC announced deals are met with a yawn and trade to ~$10.50-$11/share, and reasonably buzzy deals with famous sponsors see their deals trade closer to $13-$15. Every now and then, a really attractive deal comes out and trades to >$20.

I think that "the SPAC market gets warm but not overheated" vision is a real possibility... but I can't shake the feeling that the froth coming out of the market is just going to slaughter the SPAC market and we're going to be in for a much leaner market going forward. What would that leaner market look like? Here's my quick takes, which I might build on further in a future post (note: not to toot my own horn, but a lot of the predictions I made in my 2021 SPAC predictions seem to be playing out / would be playing out in a more barren SPAC market, so please keep in mind that I may be writing from a position of slight mental bias).

1. We'll see waves of deal failures and SPAC liquidations. I've said several times that the supply of SPACs was way outpacing the supply of public ready companies. I think a bunch of companies that were not public company ready probably slipped through in the huge bullishness on SPACs over the past few months. No more. Shareholders will start voting down the sketchiest / least desirable SPAC deals, and they'll probably start turning a very skeptical eye towards deals more marginal deals as well.
2. A hidden little secret of the SPAC market was the PIPE (private investment in public equity) process. Basically any SPAC could be involved in any deal process, because there was a near unlimited demand to PIPE into the SPAC at deal terms. So, for example, consider CAP: they only had ~$300m in trust, but they could pursue a >$3B merger because they could get a PIPE to write a $300m check alongside them. With the SPAC market deflating, I think the PIPE market will cool as well; why would you commit to invest into a SPAC at trust value and have your shares locked up when you could just buy the shares below trust value on the open market and have instant

liquidity? As the PIPE market cools down, you'll see a negative feedback loop for smaller SPACs: their target pool is now smaller (they can only target companies they can reasonably take private with the cash in their trust), but the deals will be much more competitive (because most SPACs are in the $200-300m range, every SPAC will now be targeting the same companies). That competition will lead to higher prices.... which will lead to more deal failures!

3. One group of firms will benefit: top tier sponsors with large SPACs who can guarantee they get deals done. No company wants to go through the headache and distraction of a merger only to see their deal voted down, so companies are going to favor certainty of close over a fly by night SPAC that might have their deal voted down. An example might show this best: consider the CCIV / Lucid deal. That deal required ~$4.5B ($2B from CCIV's trust plus a $2.5B PIPE). Imagine a company similar to Lucid that wanted to come public through a SPAC tomorrow. How many SPACs in the world could write a multibillion dollar check and guarantee that the deal would close? There aren't many; only a handful of SPACs have even $1B in trust. In fact, there might be only one SPAC in the world that could write a multibillion equity check and guarantee closing: PSTH (which is of course one of my favorite ideas so I am, again, talking my own book). So the larger, more reputable SPACs will have a big advantage: companies will want to work with them because of certainty of close, and a lot of their competitors have vanished because the PIPE process will be dead. This is not to say that the large SPACs will face no competition; sellers will always have alternatives (remaining private and taking another VC round, selling to a growth private equity fund, or just doing an IPO), but they will face a lot less competition as other SPACs fall by the wayside.

Anyway, I continue to think the SPAC market is one of the most mispriced and presents lots of opportunities for alpha. A few weeks ago, the alpha was probably in buying companies who would benefit from the SPAC bubble in some way (and that opportunity still exists!). Today, the opportunity is probably in buying washed out SPACs trading below trust or top tier sponsors that will benefit from the drop in competition. Tomorrow, I would guess the opportunity is in buying deSPAC'd companies that have seen their share prices crash in a "baby thrown out with the bathwater" way or in finding / shorting companies that went public at the height of the SPAC boom that were no where close to public ready.