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ODLUM BROWN
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SPACtacular Valuations

For the better part of a year, there has consistently been news about companies going public via a SPAC (special purpose acquisition company) and the sky-high valuations that come along with the transaction. This trend, which began to gain some traction in 2019, has since exploded into a full-blown blitz of activity, with transaction values increasing to record levels. In 2020 alone, according to SPACInsider, the total SPAC transaction value was US$83 billion. So far in 2021, that amount is already US$98 billion! This is compared to the US$331.3 billion raised in 2020 via the conventional IPO route, according to PwC Global (up from US$199 billion in 2019). As this continues to gain steam, it's worthwhile taking a little time to understand what exactly a SPAC is, their attributes and their risks.

What is a SPAC? How does it work?

A SPAC is, like the name implies, a company whose sole purpose is to acquire businesses. Also known as a "blank cheque fund," SPACs are financed by a group of investors, are publicly traded (more on this later) and have the ability to raise a *lot* of money for the purpose of making a purchase within two years.

What makes these entities so unique is how easily they can access the public market. Typically, if you're a company that is looking to IPO, there is a very involved due diligence process that looks at your historical financials, business viability, legal standing, etc. In the case of a SPAC, however, this process is significantly less intensive since the SPAC is, essentially, just a pot of cash waiting to be spent. Because of this, the common IPO process that could take the better part of a year is significantly reduced *and* costs a lot less to do.

Here's where it gets very interesting (and dubious). When a SPAC goes and acquires a private company, that private company is essentially made public as part of the amalgamation with the SPAC. However, unlike other private companies that go public, there is no IPO process. There is not the same level of required due diligence or regulatory scrutiny applied to the acquired business. In essence, they get to skip many (mostly necessary) hurdles that other businesses must face in order to be allowed access to public markets. A lot of these provisions, designed to inform and protect public market shareholders, receive less daylight.

One gap in oversight, which is currently receiving increased scrutiny, is the difference in what type of information investors get regarding the company. In a typical IPO, due diligence on the company focuses a lot on historical financials in order to give an accurate assessment of how the business has done. The law prohibits companies from disclosing forward-looking details that might favourably colour investors' perception of the business, as those forecasts could very well not play out. However, with a SPAC, forward-looking projections are fair game. This feature by itself presents a significant risk for investors, but combined with the speed with which this type of transaction has grown and the brand name association for some (from venture capitalist Chamath Palihapitiya to former NFL quarterback Colin Kaepernick), there is reason to be wary.

Putting it All Together

There are many legitimate reasons for a SPAC, and many legitimate practitioners of the corporate structure making reasonable investment decisions. The reality of the situation at this point is that there are still significant regulatory gaps

designed to protect everyday investors. I imagine that, as the dollar values continue to climb, SPACs will come under increased scrutiny and (hopefully) more adequate safeguards will be put in place.

As always, I'm happy to chat anytime and can be reached by phone or email if you have any questions or concerns regarding the markets or your investments.

Sincerely,

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