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SPACtacular surge

by Chris Butcher

During a period of extreme volatility and a global pandemic, the initial public offering (IPO) market had a spectacular year in 2020 in terms of the number of new listings and proceeds raised, along with the rise in popularity for Special Purpose Acquisition Companies (SPACs) which have become one of the hottest investment trends on Wall Street.

Pandemic aside, 2020 has been referred to as the 'Year of the SPAC' in the US as the number that floated on the stock market reached an all-time high, with over $80bn raised across more than 240 SPAC listings. This accounted for nearly half of all listings on the US market, a significant increase compared to 2019. The momentum has certainly carried over into the start of 2021. Supportive monetary and fiscal stimulus, ultra-low interest rates and global markets at record levels have helped the US IPO market produce its busiest quarter in over two decades as issuers rush to sell while investor demand is hot and valuations high. The SPAC trend also continued, with 296 SPACs going public in the first three months of the year, already raising more capital than in the full year of 2020.

But what are SPACs and why have they become so popular in recent years? SPACs are not like regular companies as they have no commercial operations when they IPO. They are commonly referred to as "blank-check companies" as they raise a sum of money with the purpose of buying a yet-to-be determined private company within a specified period of time, usually 24 months. If they do not make an acquisition and are unable to get shareholders to grant an extension, they are wound up and cash is returned to shareholders.

The SPAC surge has been fuelled by a wider realisation of the benefits for various stakeholders. SPAC investors get the opportunity to be part of the process, and the financial upside, of taking a company public, with some downside protection as a result of their option to redeem their capital prior to any acquisition. For private companies, the key incentives include the ability to become a publicly traded company a lot faster compared to the traditional IPO process, with more certainty as to pricing and control over deal terms.

However, investors should also be aware of the risks involved when investing in SPACs. Shareholder advocates are sounding alarms about misaligned interests, sponsor compensation, celebrity sponsorship and the potential for retail participation drawn in by the hype of a few successful, high-visibility SPACs such as Virgin Galactic in 2019.

The SPAC trend has predominantly been a US phenomenon, but is now catching on in Europe and Asia with increased interest from sponsors, investors and potential target companies. Regulators, including the Financial Conduct Authority (FCA) in the UK, are looking to reform rules on SPACs to attract new, fast-growing companies. Cazoo, the online used car seller, is an example of a UK tech business that has opted to sidestep the lengthy IPO process and list in the US through a SPAC in recent weeks.

As the reflation trade has taken hold this year, technology stocks have lagged the broader market and this has weighed on the performance of some companies that have recently listed, both via the traditional IPO process and SPACs. An index that tracks SPAC listings has dropped 22% from its February high, with worries mounting about valuations and a bubble in that corner of the market. The unprecedented surge in the SPAC market has coincided with, and has no doubt been supported by, huge liquidity injections from the Federal Reserve and other central banks around the world; as such an even higher level of scrutiny and due diligence is warranted before participating.

At Momentum, we look beyond the current "hot topic" when selecting our investments. We access private companies before the IPO stage through carefully selecting publicly listed investment trusts, which enables us to invest in exciting high growth companies earlier on in their development without creating a liquidity mismatch in our portfolios. Furthermore, we do so in a diversified way, and we conduct thorough due diligence to ensure that our managers have aligned interests with us and our clients. The SPAC trend is certainly an interesting market development, but one where we generally see greater risks than opportunities for investors at present.

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