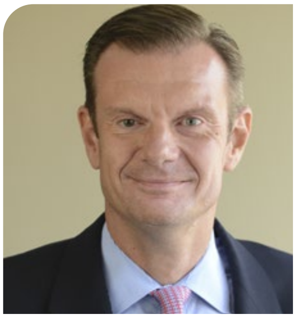

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Spacs may dilute equity, but they offer lifelines to businesses that are struggling

Since the beginning of 2020, more than $191 billion has been raised in spac (special purpose acquisition company) IPOs. This money has such a short fuse — get a deal done in 24 months or management loses the IPO costs it covered — and there has been so much of it, that it has had an impact on the markets.

Even since the SEC began scrutinising spacs' accounting for warrants, over $8.5 billion of new spacs have gone public. Today, there's over $126.9 billion of dry powder in spacs — all keen to find a deal within the next two years.

Indeed, it is rare that a day goes by where the financial and mainstream media don't have articles talking about spacs. In our view, most are filled with undue hype or drama. Either way, there's no shortage of attention.

Strategic and financial buyers… now spacs

A question we are increasingly getting from investors is how the surge in spacs will impact the CLO market. To answer, let's take a look at where spacs stand in the hierarchy of business buyers.

First off, if you are selling a business, more likely than not you've owned it for a while and realised your thesis. Few sell businesses they think have room for significant profit growth. There may be some exceptions, particularly where businesses need capital to achieve that future growth, but it's important to remember that's the exception.

If you do want to sell a business, you want the best price and terms. In many cases, the best buyer is a strategic buyer — large, public and capable of paying cash. You might have to accept a small earn out, but you're leaving the closing table with most of your cash.

A second alternative is a financial buyer such as a private equity firm. They'll pay cash, but they're often thinking about who they'll sell the business to in a few years, and often pay less than a strategic buyer.

Your third choice is probably going public. It's a great experience to ring the bell at the exchange, but you're leaving with a lot of stock in the company you were trying to sell. You'll likely be subject to a six month lock-up and own so much stock you couldn't sell it all at once, even if you wanted to. So really you haven't 'sold', you've just lightened your exposure — and brought in public scrutiny.

If none of those options are available, you might have a business that's not hitting on all cylinders. Perhaps you're selling before a downturn? What better buyer than someone with a short fuse — someone who needs to get their capital to work and is facing a deadline.

When is a sale not a sale?

When you sell to a spac, you're likely going to have to take a lot of stock. That usually comes with a longer lock-up than a typical IPO. A bigger drawback of selling to a spac, which doesn't get enough attention, is that you're selling to an entity where management and shareholders have a significant amount of warrants in the post-merger company, potentially diluting your upside. So you've 'sold' your company — but have you really?

Businesses that are not hitting on all cylinders are often considered a credit risk in CLO parlance. But as a creditor, seeing a struggling business merge into an entity flush with cash is nearly always a good thing. While equity holders might face dilution and lock-up, senior secured lenders just see a struggling company getting new cash.

To be clear, some companies that merge with spacs will be winners. And with many spacs trading at discounts to trust value, there are other great ways to make money investing in them. But overall, for creditors, it's hard to see how buyers with short fuses are anything other than a positive development that will help minimise credit risk.

> Spacs… what better buyer than someone with a short fuse who needs to get their capital working

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