Lowenstein Sandler's Insurance Recovery Podcast: Don't Take No For An Answer

Episode 37 -
Has the SPAC Bubble Burst? Lessons Learned From the early days of SPAC Mania

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Lynda Bennett: Welcome to "Don't Take No For An Answer". I'm your host, Lynda Bennett, Chair of the Insurance Recovery practice here at Lowenstein Sandler, and today I'm very pleased to welcome two guests to the show, Yelena Dunaevsky a Vice President of Transactional Insurance at Woodruff Sawyer, and Jared Kelly, who is a Partner in our Capital Markets and Securities group. So Yelena and Jared, welcome to the show.

Yelena Dunaevsky: Thanks very much, Lynda. Great to be here.

Jared Kelly: Yeah. Thank you. Thank you for having me.

Lynda Bennett: Of course. Happy to have you. So really pleased to have you both here today to talk about SPAC-mania, which took hold of public markets back in 2020 and into the first half of 2021. As we all know the SPACs raised a staggering 80 plus billion dollars in IPOs in 2020. And if that wasn't incredible enough, another 160 billion in IPOs in the first half of 2021 came along. We also started to see in 2021 more than 250 dSPAC transactions, but things seem to have slowed down. So I'm fortunate to have two experts who are knee deep in these types of cases. So Jared, let me start out by asking you what's behind the cooling off that's associated with SPACs and dSPACs right now?

Jared Kelly: Just oversupply, I think. That's all it has to do with it. A lot of sponsors came out during that 2021 period and were able to raise money very quickly and all the investors in the back half of 2021 started putting their money in other places. And I think real quickly, the second part is yields are going to go up. So people are placing their money in different, different investments.

Lynda Bennett: That's great. Have there been particular industry sectors that have been hit hard?

Jared Kelly: I would say not more, none more than any others, but for a while it was FinTech and healthcare tech or biotech that were, they were 75% of the SPAC market. And now that the SPAC market's cooled so much, there's just less M and A activity and sponsors coming out, looking for those targets. So if anyone was hit hard, it was the industry that benefited from it the most anyway.

Lynda Bennett: Yelena, what are you seeing in your neck of the woods? Are there particular industries that are hotter or colder right now?

Yelena Dunaevsky: Yeah, I would say that electric vehicles came out pretty hot at the beginning and everyone was piling into those. But then we started seeing a lot of litigation around that area and some projections that perhaps were a little bit more optimistic than they should have been. And so when you approach an insurer and tell them that there's an electric vehicle target that's on the table, they usually back away slowly.

Lynda Bennett: All right. Well, as we know, a dSPAC transaction has to be completed within a designated timeframe, usually 18 to 24 months from the IPO. What's going to become of all of this capital that's been raised that seems to becoming stale and for which the right M and A targets seem to be elusive? Jared why don't you give us your insights on that?

Jared Kelly: Well, there's a big maturity wall coming at the end of this year because of, like you mentioned, all those IPOs that went public in 2021. Most SPACs got a two year window. Now it's much less, now it's one year to 18 months, but most of them out there are dealing with a two year window. And, and then the ones that came out in the market this year had a one year window. So they're all sort of maturing at the same time. They all will not find targets. And so some percentage of that money right now, some bankers are telling me maybe a third of it is going to be just redeemed back to the public shareholders and sponsors are going to be out a lot of money from, for their at risk capital.

Lynda Bennett: Is there going to be a liquidation path for any of these backs to follow if they don't make it in time?

Jared Kelly: There's a mechanism. Yeah, sure. There's a mechanism that if you don't do a deal by X date, you just, the money goes back to the public shareholders plus interest. The interest is usually just treasury yields. And so it's a sort of easy liquidation. The other liquidation question that's probably going to be interesting is what happens to all the companies that went public through a dSPAC and are not meeting their target projections as Yelena mentioned, and what happens to them if they are liquidated in the future, when, if they've taken on too much debt or, or just lose public interest.

Lynda Bennett: Yelena, are you seeing barriers on new SPAC transactions? Are you seeing insurers taking a different approach? Are there some lessons learned that have developed over the last two years when the mania first started to this cooling off period, how are insurers approaching these risks differently, if at all?

Jared Kelly: Yeah, that's a great question. So I think all of us have been learning sort of as we go, including the insurers on how to approach and figure out what kind of risks they're getting themselves into and having seen the activity over the last few months, and also seeing the redemptions that are in the market. They're still think holding maybe 90%, which is unfortunate. They are more hesitant to write those policies. Definitely more hesitant to write policies for new IPO, new SPACs coming to the market, seeking to IPO, but also hesitant writing policies for those go-forward, post-merger companies, they're asking a lot more questions than they used to around conflict of interest around disclosure, around compensation making sure that the parties that are involved, their affiliate transactions or anything related to that. So they're definitely digging deeper and being a lot more picky on the companies that they choose to underwrite.

Lynda Bennett: Has the capacity issue been dealt with? You know, just about a year ago in April 2021, one of the hardest things was finding a carrier who could do the deal, right? Have we seen a change in market conditions there where there's more capacity available if you are able to faithfully and fully answer those questions you just mentioned?

Yelena Dunaevsky: So I think it changed in the sense that I wouldn't say there's more capacity available, but there's more capacity available for certain kinds of teams and certain kinds of deals. So the teams that have done multiple deals in the past and have shown sort of their track record and have proven themselves in a way, the underwriters are more willing to write those policies and to speak to those teams. Newer teams get backlogged, but at the same time, I'm not seeing an increase in capacity that's available. And I think the reason for that right now is that it's the same group of underwriters that are underwriting these back IPOs and the go forward policies.

We've seen a huge decrease in the number of SPAC IPOs that are coming into the market. We're seeing maybe one or two or three a week right now versus tens or dozens a week this time last year. But on the flip side, we're seeing a lot more deals happening, dSPACs happening. On the dSPAC side, the policy that's written is much larger tower of a policy. So 20, 30, 40 million versus on the IPO side, which is maybe 5 million. So the underwriters are kind of trying to allocate that capacity, but they're not willing to put in too much of a capacity on any one deal. So we're still in a situation where fewer deals are happening, but the capacity hasn't improved and it's still a difficult time in the market.

Lynda Bennett: Got it. So, Jared, how are pipe investors impacting the dSPAC market that Yelena was just talking about and target prices in particular?

Jared Kelly: Yeah. So pipe investors come into basically act as a backstop to redemptions on the SPAC trust account. That's, well, that's been their historical role. There was a period of nine months or so late 2020, early 2021, where 90% of the SPAC trust account investors were staying in the deals, approving them and keeping their funds and instead of redeeming. But now that's trickled back off to historical levels where two thirds to 75% of the SPAC trust account redeems, it's their funds, and so the SPAC trust account's left with very little. And so now the pipe investors have, they can throw their weight around a bit more because their money's more important, but they're playing a huge role right now because a lot of them are backing out.

Jared Kelly: There were huge pipes done in connection with very large deals. These back deals in late 2020, early 2020, well, actually all of 2020 and be first half of 2021 where institutional pipe investors put up large sums of money. And one thing they're finding out is they, they didn't get as liquid, as security as they thought they were getting. And so they're pulling back and that means less, less financing for, for dSPAC transactions. And which really pushes the SPAC vehicle into sort of just a reverse merger shell vehicle where there's not that much cash for businesses on a go forward basis.

Lynda Bennett: So other than the pipe investors, are there any other factors driving the competitive market conditions that we're seeing right now in terms of finding an acquisition target?

Jared Kelly: Yeah, I think, there's like too, too much supply, right? There's hundreds of these vehicles out there looking for targets. There's not enough target companies that are public company ready. A lot of times you're trying to fit a square peg and round hole with these companies, the targets that are, some of them don't have CFOs. Some of them don't have the accounting staff, some of them don't have legal, et cetera, and becoming a public company is a giant exercise. It costs a lot of money to remain a public company. So that's, it's just a supply and demand issue. As simple as that, there's too many SPACs out there looking and not an enough public company target ready companies. [crosstalk 00:11:00]

Yelena Dunaevsky: Yeah. I'll jump in there quickly. What I'm seeing is that true public company readiness is one of the bigger issues in the market right now. The SPAC teams that we're working with, they're looking everywhere. They're not limited to the US at this point. Many are looking elsewhere for companies that haven't been tapped yet, perhaps in Europe or other regions. That becomes problematic if you go to regions that are not sort of in the safe zone for the insurers. So while that's a possibility and it's a different market and a new deal, capacity, if you will, that is something that I would caution SPAC teams to think carefully about because they might run into problems getting coverage.

Lynda Bennett: So, that's a great point and I'm going to save for next time because Yelena and Jared have been kind enough to come on back for another episode. As if these market conditions weren't challenging enough, when we pick up next time, we're going to talk about the game changer of the SEC rearing its ugly head into this very volatile market. So thank you Yelena and Jared very much for joining us today, and so pleased to have you come on back next time.

Jared Kelly: Absolutely.

Yelena Dunaevsky: Thank you, Lynda.

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