

# Are SPACs dying off? A few points to consider about the future of SPACs

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SPACs have had a fantastic run in the last year through the end of Q1 2021, rising from a total IPO count<sup>1</sup> of 59 in 2019 to 248 in 2020 and a whopping 311 in just the first quarter of 2021. Yes, the number of SPAC IPOs in the first quarter of this year exceeded the total of all of 2020. But the number of new IPOs dropped sharply in April.

SPACInsider lists 85 SPAC IPOs in January, 96 in February, 109 in March, but only 13 in April. While the SPAC market had been growing by 13% per month in the first quarter, April's total showed a drop of 88% compared to March's.

The drop in April was stark, but the real question is whether the drop portends a long-term pullback. We can't extrapolate a trend from a single data point, so any guess will simply remain that: a guess, at least until we have a few more months of data. Anticipating the trend will require first identifying some important market factors and regulatory hurdles.

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One important point is that a correction is a healthy move for the market. Double-digit growth month over month is almost certainly not sustainable long-term, so a pullback is not just expected but also indicative of a healthy market.

PitchBook recently released a new report<sup>2</sup> on the SPAC market and noted that current interest rates near historic lows have created an environment in which the opportunity cost of locking money in SPACs is very low, so investors are much more likely to risk their money in SPACs because the returns can be so much better than investments that rely on interest rates.

Certainly, other contributing factors also affect the market. For example, the flurry of activity in Q1 may be the last vestiges of the pent-up demand from last year. However, the possibility of a sharp increase in capital-gains taxes could be encouraging the sudden pullback.

Regulators have raised concerns about whether SPAC mergers — whereby a shell takes a target company public — bypass investor protections in traditional IPOs. Some market participants say legislative attention could prod regulators to move faster, regardless of whether bills get enacted.

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PitchBook also noted that the SEC is rumored to be considering a rule change regarding SPACs:

The main issue seems to be that the changes in the warrants' fair market value would now flow through as accounting earnings for the SPAC, complicating the once-simple SPAC financial statements. This adjustment may disincentivize the inclusion of warrants in new SPAC IPOs which, as noted earlier, are a critical benefit to the SPAC IPO investors.

The big difference between a SPAC IPO and a traditional IPO<sup>3</sup> is that a traditional IPO is selling based on three years of trailing revenues, whereas a SPAC is selling on three years of future revenue. The playing field is not level. Pending Congressional or SEC action could change that.

Some wonder whether a SPAC is a useful vehicle to advance technology innovation. SPACs offer simplicity and efficiency in an industry that simultaneously depends on both while also struggling with regulations at odds with them. But in a market that has seen such explosive growth, investors may choose to focus on their existing investments for now, rather than pursuing new ones.

Long-term, the market will find some sustainable level of SPAC IPO activity. Increasing by 13% per month only to drop by 88% the next month perhaps suggests that the market was not just oversaturated but that companies are still figuring out how best to use this investment vehicle that, while 30+ years old, has only recently gained widespread market acceptance. As long as SPACs

can provide some measure of simplicity to companies going public, they will likely remain popular.

Keep an eye out for any Congressional action, legislation or proposed rulemaking from the SEC, and see what effects any rise in interest rates or tax changes will have on SPACs, while also looking for any waning in investor SPAC fatigue.

#### Notes

<sup>1</sup> <https://bit.ly/2SSY817>

<sup>2</sup> <https://bit.ly/3fmtc12>

<sup>3</sup> <https://bit.ly/3fkKjjE>

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