PitchBook

Uncertainty Clouds Future for SPACs

SPAC market update Q3 2021

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Published on September 28, 2021

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Key takeaways

- **New special purpose acquisition company (SPAC) IPOs fall QoQ but remain far above the long-term average.** Q2 recorded 106 SPAC IPOs that raised $20.9 billion, representing a 66.5% decline on count and 81.3% decline in capital raised relative to the record-shattering Q1. We believe the cost of the traditional IPO process is a strong enough push to sustain the need for SPACs in the current ecosystem, albeit at a level closer to what we recorded in Q2.

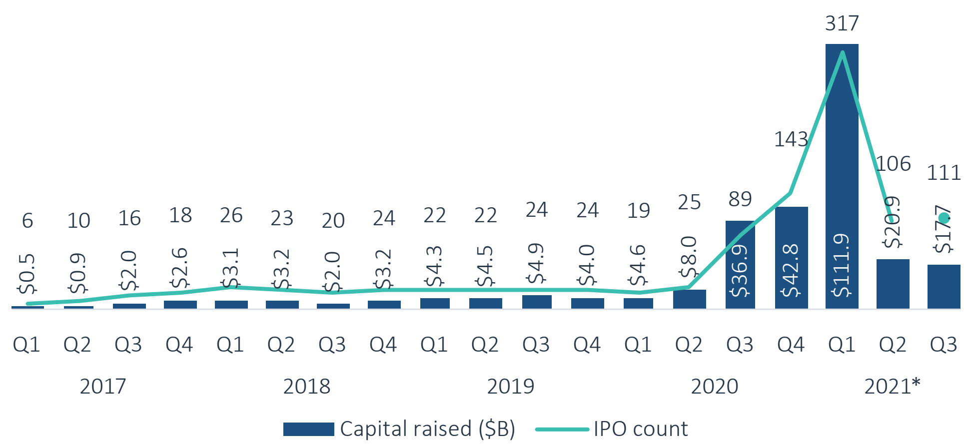
- **SPAC business combinations start to ramp up.** We tracked 48 closed acquisitions through Q2 and 69 added so far in Q3, putting this quarter on pace to set a new record for SPAC acquisition deal count. Billion-dollar SPAC acquisitions have driven the majority of this acquisition value each quarter, accounting for 90.1% and 96.8%, respectively, of Q2's and Q3's total acquisition values.

- **The future success of SPACs faces uncertainty.** The recent lackluster aftermarket performance for SPACs, both pre- and post-acquisition, could intensify the downward pressure on new SPAC IPO issuance and general enthusiasm for the product. We expect a related decline of investor sentiment around SPACs, if returning capital due to failure to find a target becomes a regular occurrence. Regulation and litigation risks are also looming, which may discourage new SPAC activity.

SPAC formation

The SPAC market has been facing a moment of reckoning over the last few months, with minimal SPAC IPO activity closing in stark contrast to Q1's explosion. Q2 recorded 106 SPAC IPOs that raised $20.9 billion, representing a 66.5% decline on count and 81.3% decline in capital raised relative to Q1. It is important to note that these QoQ comparisons are being matched up against the outlier quarter of Q1 2021, which saw more than double the IPO count than the next most active quarter. The 106 completed IPOs in Q2 represent the third-highest count seen in a quarter. Even as sentiment around the structure has become more questionable, 111 closed deals in the third quarter through September 20, 2021, are setting up another historically high quarter for deal flow. After the explosion in Q1, it was nearly inevitable that we would see some reversion given the 317 new blank-check vehicles piling on an already crowded SPAC market. The spike in Q1 2021 has continued to ratchet the competition for both investors and target companies to dizzying new heights. We envision the downtrend toward 100 SPAC IPOs per quarter as a bit of rationality returning to the space and expect the true steady state to be somewhere under 100 per quarter. The end of 2020 and start of 2021 was marked by some overexuberance in the SPAC market from institutional and retail investors alike, which amounted to an unsustainable level of demand.

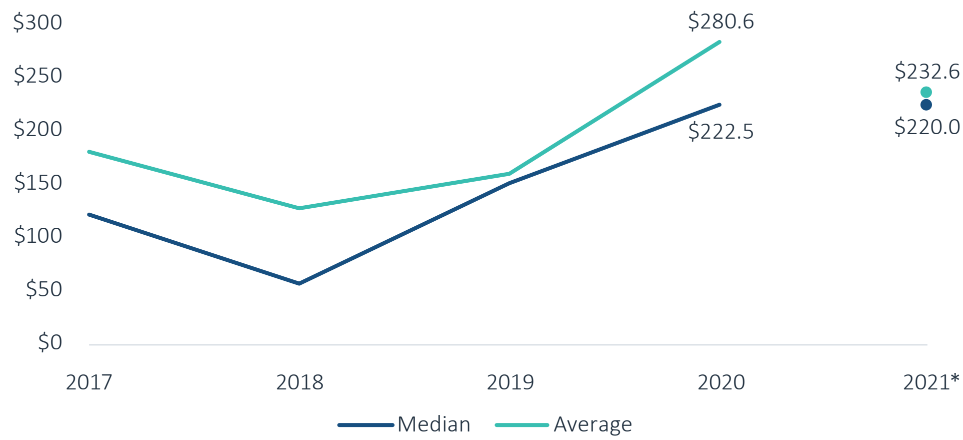
SPAC IPO activity



Source: PitchBook | **Geography:** US
*As of September 20, 2021

While the onset of the pandemic in the US may have been one catalyst for the growth in SPAC IPOs during 2020, another underlying factor was the inefficiency of the pricing mechanism of the traditional IPO market that had disillusioned many CEOs from making the step to public markets. We believe the cost of the traditional IPO process is a strong enough push to sustain the need for SPACs in the current ecosystem, albeit at a level closer to what we recorded in Q2. This pathway to the public markets will not be suitable for most private companies looking to make the jump to the public side. However, given the flexibility of the SPAC structure, SPACs can carve out specific niches such as capital-intensive businesses—companies in need of a growth catalyst to find success.

Median and average SPAC IPO size ($M)



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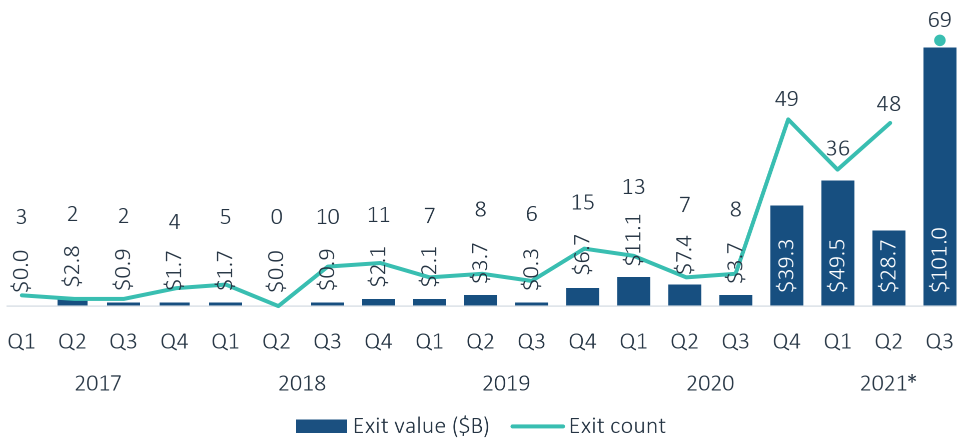
Additionally, over the last few months, potential litigation issues for some SPACs have emerged that could have knock-on effects on the entire space. The group of lawyers filing these lawsuits claim that the SPACs in question should have registered as investment companies under the Investment Company Act of 1940 because they exhibit behaviors other than merging with an operating company. Swift and fervent counterarguments have been presented in response to these lawsuits, with a separate group of lawyers standing against the initial claims questioning the legal basis around forcing SPACs into the '40 Act. While we cannot confirm which side will win out or whether the Securities and Exchange Commission (SEC) will further regulate the structure, it is clear that this may be an existential threat to the longevity of the SPAC market. A significant portion of this legal scrutiny has been directed toward Pershing Square Tontine Holdings (NYSE: PSTH), the largest SPAC ever, raised at $4.0 billion. This capital may be returned to shareholders after the proposed deal between the SPAC and Universal Music Group (AMS: UMG) was scrapped, resulting in the former facing pressure from pending lawsuits. Regardless of the outcome, uncertainty is often the enemy in the financial markets, and it could deter some new SPAC formations or new allocations from institutional investors until more clarity on regulation and litigation is available.

DeSPAC activity

SPAC business combinations have come alive during Q2 and Q3 as the flood of SPACs from late 2020 and early 2021 finally started executing on deals. We tracked 48 closed acquisitions through Q2 and 69 added so far in Q3, setting a new quarterly record for SPAC acquisition deal count. The value of these companies also had a strong showing, with Q2 recording $28.7 billion—but Q3 has been the real standout, accounting for $101.0 billion of aggregate company value transitioning to the public market.

Billion-dollar SPAC acquisitions have flourished in the current SPAC environment, which has driven most of each quarter's acquisition value. For example, that billion-dollar-plus valuation was achieved by 25 of the 28 acquisitions closed in Q2 and 43 of the 69 closed so far in Q3. These deals have been crucial to the market as they accounted for 90.1% and 96.8%, respectively, of Q2's and Q3's total acquisition values. Key deals contributing to the increase in total business combination value include Ginkgo Bioworks (NYSE: DNA), Lucid Motors (NASDAQ: LCID), SoFi (NASDAQ: SOFI), Alight Solutions (NYSE: ALIT), Blue Owl Capital (NYSE: OWL), and 23andMe (NASDAQ: ME). Looking at the entire market, we saw specific surges in acquisition activity within the financial services and healthcare space along with sustained dealmaking within the transportation and mobility industry.

SPAC acquisition activity



Source: PitchBook | **Geography:** US
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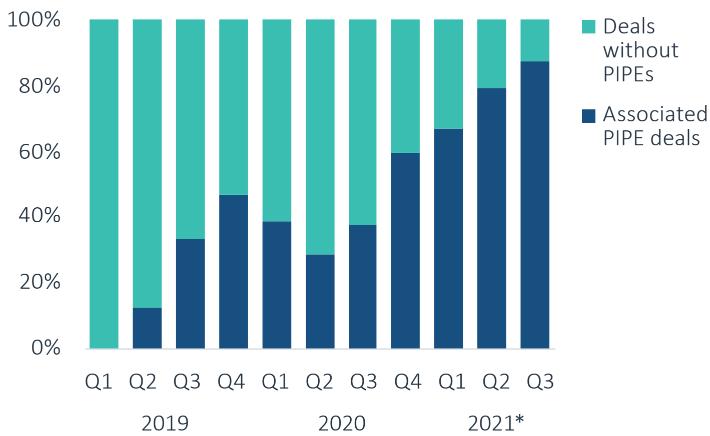
PIPEs have continued to cement their importance in providing capital for deal closing within the deSPAC ecosystem, with 79.2% and 87.0% of Q2 and Q3 deSPAC transactions including a concurrent PIPE investment. These third-party placements have also swelled in size during 2021, with a median PIPE coming in at $210.0 million. This is relative to 2020's median of $158.5 million, representing a 32.5% increase. Despite the increase in capital investment from both the SPACs themselves and the accompanying PIPEs, the median multiple of post-money valuation to capital raised has climbed to a new height of 4.4x, implying that the increases in SPAC and PIPE sizes are not the only drivers behind the larger business combinations.

Even at the faster pace of acquisitions closing, there is still a clear mismatch between SPAC IPO volume and volume of the resulting business combinations. Since Q3 of 2020, there have been 766 SPAC IPOs, while over that same time frame, only 210 deSPAC events have closed. Logically, a lag between the SPAC IPO and acquisition exists, but we still have not seen a single quarter with more than 100 closed business combinations, even though SPAC IPOs have hit that mark each of the last four quarters.

Share of SPAC acquisition count by deal type



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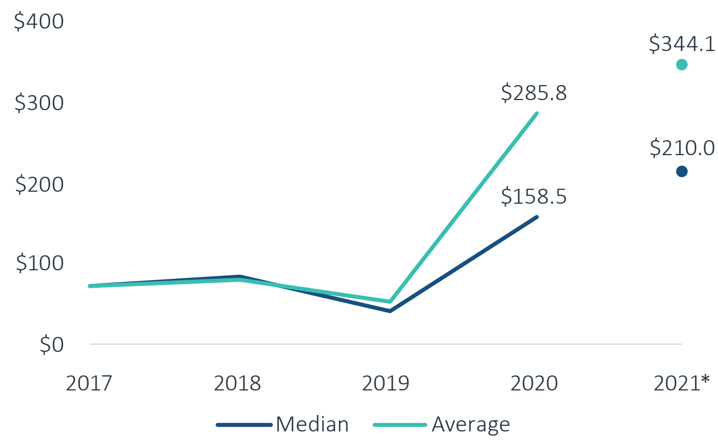
Median and average PIPE deal size ($M) accompanying SPAC deals



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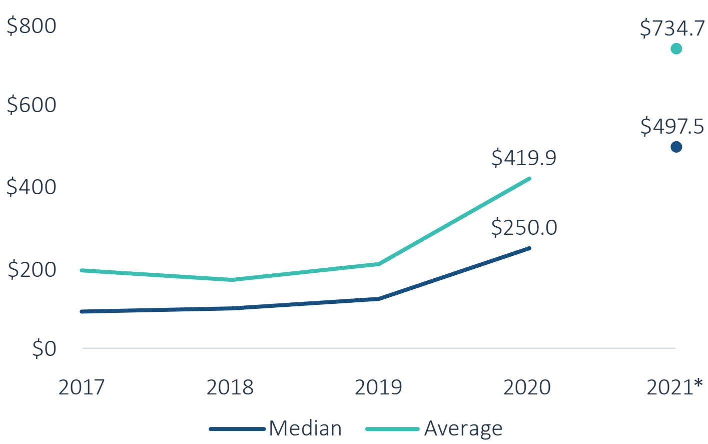
This pace brings up some concerns around a potentially large inventory of SPACs that could end up returning capital to shareholders. This would be a letdown for the SPAC structure and would imply that this pathway to the public markets garnered less enthusiasm than expected from the ecosystem of private companies. While the supply of private companies continues to swell, enough target companies may not fit the SPAC model, or we may see proof that most businesses would rather remain private than face the scrutiny of public investors.

Median and average SPAC acquisition total capital investment including PIPE ($M)



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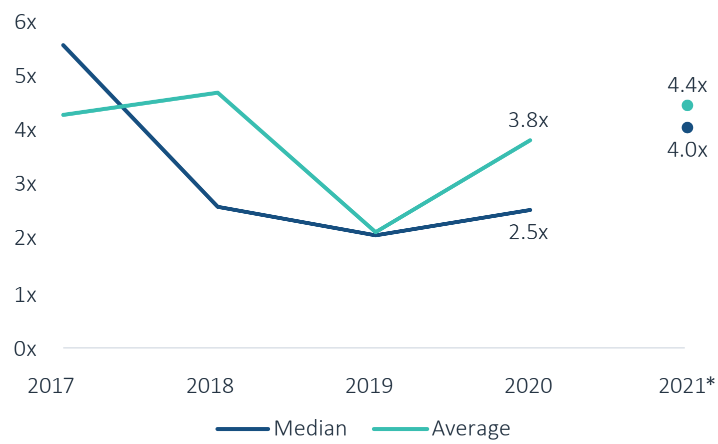
Median and average ratio of SPAC pre-money valuation to SPAC IPO size



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Outlook

2021 has been a roller coaster year for the SPAC market. The year started with extreme optimism as SPAC IPO activity reached dizzying heights. But nearly as quickly as it started, it fell precipitously at the beginning of Q2 and has continued at this slower pace through September. Still, even at the lower level of activity seen in Q2 and Q3, new SPAC issuance is drastically higher than the volume of activity we saw prior to March 2020, illustrating some rekindled interest in the product. In our view, the path for SPACs going forward is not extremely promising as far as any claims that it might usurp the traditional IPO process as the main route for private companies going public. The activity of traditional IPOs or direct listings has remained robust over the last four quarters, setting records in terms of both count and value.

The fluctuation in SPAC IPOs has been paired with a swell in SPAC acquisition activity over the last few quarters. Q3 is already posting a record amount of deal value and should soon reach a new record for closed acquisitions in a quarter.

While SPACs have found some success with businesses valued over $1 billion, a majority of the highest-valued private companies continue to choose other paths to public markets, which we expect to continue. We feel that companies the size of Coinbase (NASDAQ: COIN), Roblox (NYSE: RBLX), Stripe, or SpaceX have enough bargaining power and brand recognition that they will prefer more direct processes for breaching public markets.

The overexuberance of the market has started to wane, nearing what we believe could be a steady state for the SPAC market. A subset of businesses may continue to benefit from the SPAC process as a way to access capital. Furthermore, in the current public market environment, a class of investors may still be attracted to the exposure and could warrant incentive structures that SPACs provide.

Going forward, the lackluster aftermarket performance for SPACs, both pre- and post-acquisition, could intensify the downward pressure on new SPAC IPO issuance and general enthusiasm for the product. We expect a related decline of investor sentiment around SPACs, if returning capital due to failure to find a target becomes a regular occurrence. Regulation is another key risk for the SPAC market, and potential rule changes around safe harbor statements could make it more difficult to bring companies public via SPACs—if the company relies heavily on long-term projections. The outlook for the SPAC market contains a lot of uncertainty, but for now we are still seeing higher activity than we did pre-pandemic, especially on the deSPAC transaction side. We expect this will continue.