ALGER

PODCAST TRANSCRIPT

How Special Are SPACS?

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"As the frenzy in the SPAC market continues, impacting hundreds of companies, we believe investors should make sure they understand the ramifications." Weatherbie Chief Investment Officer George Dai explains the positive and negative implications of the current onslaught of special purpose acquisition companies.

ALEX BERNSTEIN: Hello, I'm Alex Bernstein and you're listening to **The Alger Podcast: Investing in Growth and Change**. As the economy reopens, investors have seen a flurry of headlines regarding SPACs – or special purpose acquisition companies. These are exchange- listed companies with the sole purpose of acquiring a private company to bring it public without going through the more traditional IPO process. But for investors, understanding the positives and negatives of SPACs can be daunting. Here to shed a little light on the subject is Weatherbie Chief Investment Officer and Senior Portfolio Manager George Dai. George, thanks so much for talking with me this afternoon.

GEORGE DA: Thanks, Alex.

ALEX: George, just to start off, what exactly is a SPAC?

GEORGE: So, it stands for special purpose acquisition company, which is a publicly traded company that holds nothing but cash, and in history they're also called blank check companies. So, after they go public, they look for private companies to merge with and bring the private companies to the public market, bypassing the traditional IPO process.

ALEX: And besides being in the news, SPACs have had quite a high volume of activity this year. Is that correct?

GEORGE: So traditionally, SPACs have been a very minor avenue for companies to come public and to raise capital, which otherwise wouldn't survive the scrutiny of the normal IPO process. However, in 2020 because of the tremendous amount of liquidity injected into the market all over the globe, SPACs actually took the place of the IPO madness of the 2000s.
And, as a result, SPACs actually raised $83 billion in 2020. Now in the first half of 2021, the pace even accelerated. SPACs raised over $100 billion. So, in six months the SPACs have already exceeded the whole year's capital raise in 2020. Currently there are more than 430 SPACs – empty shell companies with nothing but cash – that are looking for private companies to merge with. We are still kind of in a frenzied state of the SPACs. It is such a force that you cannot ignore. We believe we'd better learn something about it and make sure we understand it.

ALEX: George, can you tell me, are SPACs regulated the same way IPOs are?

GEORGE: I would just say that the whole process is shortened, and the corners are cut, and there is less regulatory scrutiny on the SPACs than on the traditional IPO process. We believe it's kind of in a gray area which has been explored by some very savvy financial sponsors, including some of the not-so-ready private companies to take advantage of the hot market to come public and to raise capital at very high valuations and without subjecting them to the normal scrutiny of the normal IPO process.

ALEX: What prompts a company interested in going public to take the SPAC route, versus the traditional IPO?

GEORGE: Generally speaking, the management claims that the SPAC routes offer some advantages. For example, they claim that the SPAC saves time, because you only negotiate with the sponsors and perhaps his advisors.

GEORGE (continued): It takes a few months, vis-à-vis the traditional IPO, which takes about six to twelve months to complete. That's reason number one. And reason number two is because it is a merger and it is not in the traditional sense of an IPO. These companies under the current rule can project well into the future of their financial performance. So, they can basically project whatever they want. Number three reason is, we believe, they probably are not going to tell you that they can get a much fancier valuation.

ALEX: Can you tell me more about the shortened timeframe? How does that work?

GEORGE: So, instead of six to twelve months for a traditional IPO, they say it only takes a few months and, therefore, I can spend the time on my business. So, it sounds reasonable, but really? Isn't it? In a traditional IPO the investment banks that underwrite the deals do sufficient amount of due diligence before presenting the company to the public world, and they are doing it not only for the investing public but also for their own reputation and ongoing business consideration, and they do not want to see a company that they just bring public has some unveiled scandals.
But in the SPAC world, oftentimes, two people are enough to bring a company public, and we believe the economics are such that these people make enough money after just one SPAC so that they do not have to worry about the reputation risk let alone worrying about the future business. So that's on the underwriting side. We think, because of the lack of due diligence, a lot of the risk that should have been mentioned or brought to the attention of the investors oftentimes has been omitted. For example, there is a durable medical equipment company that went the SPAC route. It just turns out that the CEO was charged with tax fraud in 2014 to 2015 in Denmark. But it was not disclosed when the company came public.

ALEX: And, from your research, you believe that some SPACs may exaggerate their numbers? You have an example of one company?

GEORGE: An electric vehicle company that actually had an exaggerated preorder number that they cannot substantiate. So, we believe that, oftentimes, companies just project extremely rosy pictures, but it turned out they cannot really substantiate that claim. This led to a subpoena from the SEC, and on the production side, the plant costs soared while full-scale production was delayed. As a result, the CEO and the CFO both resigned.

We think because of the lack of adequate disclosure or transparency, these companies didn't really go through the exercise of strengthening their internal control, their internal compliance, the disclosure requirement for public companies. And we believe these are the necessary exercises you have to go through in order for the company to become a responsible publicly traded company.

ALEX: Did this kind of activity draw more scrutiny for SPACs from the SEC?

GEORGE: The SEC started to question the optimistic revenue projections used by startups and in addition the SEC also looks into certain accounting issues such as how to account for warrants. So, these regulatory actions are having a cooling effect on the SPAC segment, and I think that the SEC is going to do more in this regard to protect the investors' best interest.

ALEX: George, I know that there have been cases at Alger, where we've found some very good companies through SPACs. In your opinion, what other advantages do you see in SPACs?

GEORGE: So, one cannot say that there is nothing positive about SPAC but, relative to the companies going through the normal IPO process, we believe it is much less desirable. As a result, actually, we think that the SPAC world is a fertile ground looking for short ideas. We have an organized effort within Weatherbie Capital of mining this field, looking for companies that are overly futuristic, have no product, oftentimes no revenue and are not really making money. So, we don't have to have all these ingredients in place for the short ideas to work, but if you have a good combination of these criteria, we believe that actually leads to a pretty good potential hit ratio on the short side.

ALEX: George, final question. Do you think SPACs are here to stay?

GEORGE: Yes, in different shapes and forms, and I hope that the SEC is going to further study this field and put more rules and regulations and to make sure that there are adequate disclosures, adequate transparency that at least it should be at par with the normal IPO process.
As I said in the beginning, the frenzy in the SPAC market makes it such a powerful force that we have to reckon with. I mean are we going to join the wave or we are going to resist the wave?

GEORGE (continued): Or the third way would be we really understand what the wave is made of and what are the advantages that we can explore to benefit our clients, and what are the pitfalls we can explore to actually generate profits for our shareholder on the short side?

ALEX: George, thanks so much for joining me this afternoon.

GEORGE: Thank you very much, Alex, for bringing me to your podcast platform, and thanks for the opportunity.

ALEX: And thank you for listening. For more of our latest insights, please visit www.alger.com.

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