Not Even a Raging Bull Market Can Rescue SPACs

Last month we spoke of the impressive Everything Rally in financial markets in 1H24 despite the absence of Fed rate cuts that were widely expected coming into the year — a rally that has extended to other major asset classes, including leveraged credit, commodities and cryptocurrencies. But we overlooked one corner of public equity investing that hasn't seen any benefit at all during this fierce rally: special-purpose acquisition companies, better known as SPACs (also referred to as "blank check companies"), which have continued to unravel practically en masse while carving out their place in the lore of investing manias.

The recent Chapter 11 filing of Fisker, Inc., an EV automaker taken public in late 2020 via a reverse merger with a SPAC[1] that sported a market value exceeding $6 billion within several months of the deal closing, was another reminder of how woefully many of these post-reverse merger SPACs have continued to perform. For the restructuring profession, this boom-to-bust reversal of fortunes for SPACs was arguably foreseeable and is still in the early innings.

Much has been written on the meteoric rise and fall of SPACs since 2020, when renowned investors, and often, famous celebrities[2] were rushing to cash in on the SPAC craze, thereby providing potential investment targets with an end-run to a fast-tracked IPO and a public listing. A *New York Times* article from December 2020 noted that 25% of global IPO proceeds in 2020 were raised by SPACs, easily an all-time high, with nearly 250 newly formed SPACs going public that year.[3] It got even better in 2021. Overall, some $210 billion of equity capital was raised by nearly 750 large U.S. SPAC IPOs from 2019-2022, with the majority of capital ($126 billion) raised in 2021.[4]

Despite the huge hype around SPACs through 2021, there is nothing magical about the SPAC structure per se, with the success of any SPAC dependent on its sponsor's ability to source an attractive investment opportunity, make a deal promptly[5] and convince limited investors to commit to the deal. Most sponsors do not have a lot of capital at risk in their SPACs. Instead, they typically receive a 20% promoted interest in a consummated reverse merger with a target, which represents a potentially lucrative payoff for sponsors if the deal performs well but not much to lose out-of-pocket if a merger transaction either isn't consummated or fails to live up to projections. In other words, sponsors do not have a lot of skin in the game and are strongly incentivized to get a deal done. This risk/reward asymmetry for sponsors *(Heads I win big, tails I don't lose so much)* created perverse incentives for sponsors to find deals in a very crowded market, with many hundreds of them competing to find targets in an investment market overwhelmed by SPAC IPO money and a shortage of suitable targets. Despite these imbalances, many SPACs forged ahead and a few hundred reverse-merger deals got done despite the shortage of attractive targets. Consequently, many SPAC acquisition targets were not established and profitable "IPO ready" companies but were more akin to late-stage startups that had yet to achieve profitability. Investors are living with the fallout of many of those ill-advised deals today.

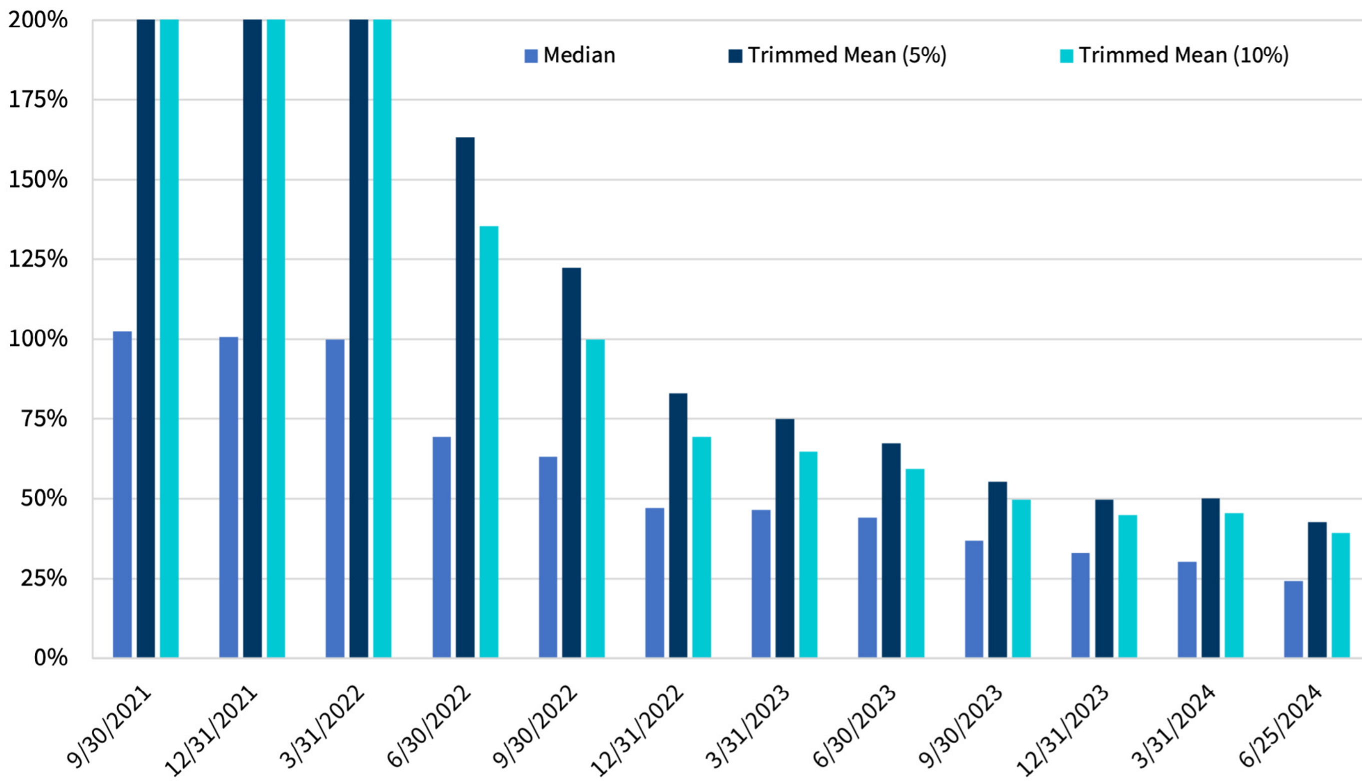
The end of SPAC mania began in mid-2022 and coincided with the beginning of Fed tightening and rising interest rates, a sell-off in equity markets generally, and disappointing operating results for many SPAC targets that underperformed expectations, often by a wide margin. My colleagues documented the poor market performance of SPACs thereafter, which steadily deteriorated through 2023 and represented huge losses of market value for most SPAC investors.[6]

Today some prominent cheerleaders of the SPAC craze in 2019-2021 are left to live with their own cringeworthy comments that have aged poorly within a few short years, with one banker involved in SPAC fundraising saying in late 2020, "I think the SPAC business has become a large and sustained ecosystem."[7] Of course, there were also warnings about excessive speculation in SPACs, but those voices often were drowned out by the shouts of biased advocates and the allure of celebrity endorsements.

The SPAC sell-off has continued through 1H24. In a year when even meme stocks and meme cryptocurrencies have rallied, SPACs haven't caught a break. Currently, 85% of some 300 SPACs that completed reverse mergers though 2022 are trading below their IPO price compared to 80% a year ago and 64% in June 2022. Worse yet, the average SPAC is valued currently at just 43% of its IPO price compared to 50% at the end of 2023 and 67% a year ago **(Figure 1)**. This compares very unfavorably to a 15% return for the S&P 500 in 1H24 and a 23% return since June 2023. Finally, 85 SPACs (29% of our SPAC set) currently trade at equity market prices below $1 per share compared to 60 SPACs (21%) at the end of 2023 and 38 (12%) one year ago **(Figure 2)**.

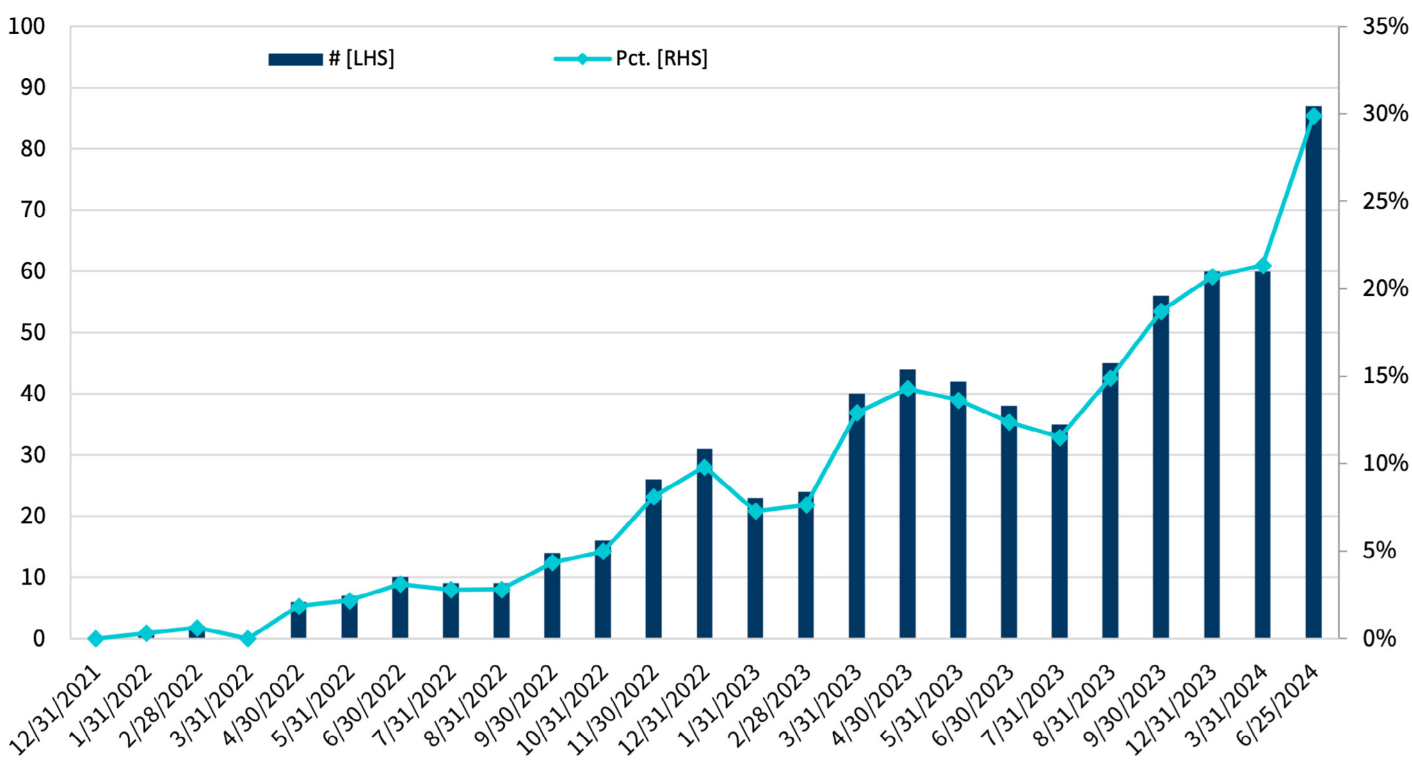
The rising tide of a raging bull market since mid-2023 hasn't lifted the SPAC boats. Such neglect is not without reason; 79% of our SPAC set was operationally unprofitable in 2023 compared to 83% in 2022, just a slight improvement. Of particular interest for the restructuring profession, only 8% of our SPAC set (about 25 companies) has filed for bankruptcy, gone out of business or been acquired despite this massive underperformance. Given the abundance of sub-$1 share prices, many more SPAC busts are likely coming. SPACs are overwhelmingly middle-market companies, and their ongoing struggles won't be headline-grabbers other than select high-profile names such as Fisker, nor will most be able to formally reorganize given their elusive profitability and relatively moderate levels of leverage employed. However, they still will be fertile ground for restructuring services in the year ahead, if not longer.

Figure 1: SPAC Prices Post-Reverse Merger Transaction As a % of IPO Price



Source: S&P Capital IQ and FTI Consulting analysis.

Figure 2: SPAC Prices Below $1 per Share



Source: S&P Capital IQ and FTI Consulting analysis.

Endnotes

[1] Danielle Kaye, "Fisker Files for Bankruptcy as EV Start-Up's Cash Runs Short," The New York Times (June 18, 2024).

[2] Matt Egan, "SPAC mania has entered the celebrity phase with A-Rod and Ciara," CNN Business (February 23, 2021).

[3] Michael J. de la Merced, "The Year in Deals Can Be Summed Up in Four Letters," The New York Times DealBook (December 19, 2020).

[4] Stuart Gleichenhaus and John Yozzo, "SPACS Flame Out in SPACtacular Fashion. Was It Inevitable?" The ABI Journal (December 2023).

[5] Most SPAC sponsors have a two-year time horizon from the completion of an IPO to consummate a reverse-merger transaction, or risk returning capital to investors, liquidating the SPAC and losing the carrying costs of SPAC operating expenses from inception.

[6] Stuart Gleichenhaus and John Yozzo, "SPACS Flame Out in SPACtacular Fashion. Was It Inevitable?" The ABI Journal (December 2023).

[7] Michael J. de la Merced, "The Year in Deals Can Be Summed Up in Four Letters," The New York Times Dealbook (December 19, 2020).

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