SPAC Impact on Leveraged Finance Markets

Robert Cohen | April 2021

The rise of special purpose acquisition companies (SPACs) over the last year has been a significant news story in capital markets. For years, SPACs have had a tarnished reputation for having conflicts of interest and lackluster returns. On the surface, investing in SPACs, or "blank check companies" as they are also known, seems dubious given the absence of an actual operating business at IPO. Notwithstanding these legitimate concerns, the proliferation of SPACs has been a clear positive for investors in leveraged capital markets, in particular, bank loans and high yield (HY) bonds. Highly leveraged companies are attractive targets for SPACs, which bring to the targets a source of capital that was largely unavailable as recently as 2019. As a result, investors in the debt issues of leveraged companies have event-catalyst upside when target companies are ultimately merged into SPACs. Debt prices of target companies have experienced price appreciation of up to 4% after a SPAC has announced a target company. In addition to price increases, credit investors benefit from significant deleveraging (i.e., strengthened solvency) and a fresh cash injection into the target company (i.e., improved liquidity). Credit investors should be on the lookout for bonds trading below their change-of-control put price or loans trading below par that can benefit from a SPAC transaction.

Equity Investor Risks, Leveraged Company Advantages, Credit Investor Opportunities

SPACs have been around for decades. In general, a SPAC is a publicly listed entity created with the purpose of raising capital through an initial public offering (IPO) to acquire an undisclosed operating company. SPACs have recently become more popular among underwriters and investors while persistently maintaining a spot at the top of the current news cycle. Calendar year 2020 saw a boom in SPAC creation with $77 billion raised compared to $13 billion in 2019. Historical SPAC issuance has traditionally been less than $10 billion per year.

SPACs have distinctive positive factors for companies seeking financing. First, they can take private companies to market faster compared to a traditional IPO. Next, the issuer of a SPAC benefits from reduced disclosure requirements. For example, the announcement of a SPAC transaction will include guidance and projections or announce the target company's turnaround story. Such forward-looking projections are precluded in an IPO. Lastly, the fees associated with going public via a SPAC merger are typically lower compared to an IPO.

The aforementioned advantages notwithstanding, several risks are associated with SPACs. The agency issue presents a potential conflict of interest with the SPAC sponsor's promote. The sponsor is the management team that forms the SPAC. The promote is a fee paid to the SPAC sponsor in the form of shares equal to 20% of the total SPAC equity shares plus the sponsor's investment in warrants, which could create an incentive to find any deal, whatever its merits and risks to SPAC investors. Meanwhile, the increased media attention surrounding SPACs has caught the eye of retail investors, who are potentially investing in SPACs without sufficient due diligence on the underlying business. Lastly, some investors wonder if SPACs are part of a greater financial market bubble stemming from the Federal Reserve's near-zero interest rate policies.

While significant risks confront SPAC investors, there remain opportunities for leveraged credit investors. In the leveraged finance market, SPACs have acted as a source of capital for overlevered borrowers seeking an exit event. In the weeks following the announcement of a merger with a SPAC, the price of a leveraged borrower's debt has generally appreciated with the news of the infusion of capital to the target company, funding that is generally used to deleverage by paying down existing debt.

As illustrated in the graph below from Bloomberg and Barclays Research, HY and loan borrowers often see substantial increases in trading prices after the announcement of a SPAC transaction. *(Figure 1)*

High Yield and Loan Performance around SPAC Announcement

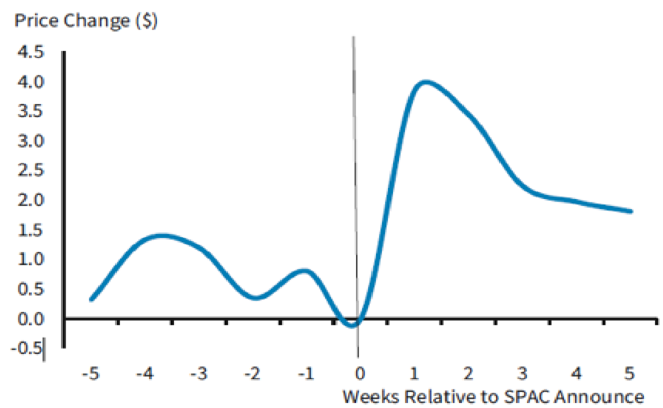

Figure 1
Source: Bloomberg, Barclays Research. Note: Limited examples available.

According to a March 2, 2021, report by Goldman Sachs Research, of the $130 billion of SPAC capital raised over the past year, targets for capital deployment have been announced for only $27 billon (about 20%). The amount of uncommitted capital in the SPAC market provides optionality for lenders to generate meaningful returns when credits trading below their call price get acquired by a SPAC.

Target Company Balance Sheets: Before and After SPAC Transactions

The DoubleLine Global Developed Credit team surveyed 15 recent SPAC acquisitions to gauge the amount of deleveraging that occurred after the announcement of each transaction. On average, the target companies reduced their ratios of debt outstanding to earnings before interest, taxes, depreciation and amortization (EBITDA) from 5.4x to 3.8x, a meaningful reduction of 1.6x. Only two of the target companies emerged from the transaction with no change in leverage. (Figure 2)

These examples illustrate how cash proceeds from a SPAC merger are frequently used to improve credit quality by paying down debt. Such debt reductions often allow companies more time to execute business plans, creating the potential for stronger performance.

Lead Sponsor	Close Date	Ticker	Company	Leverage	PF Leverage	De-leveraging	Debt Paydown ($bn)	EV ($bn)	EV/ EBITDA	PF LTV	LTM	NTM / Forward
Carlyle	12/20/2019	KLDI	KLDiscovery	4.8x	3.0x	1.8x	$0.1	$0.8	10.7x	27.8%		
H&F	10/8/2020	MPLN	MultiPlan	6.8x	5.8x	1.0x	$0.7	$11.1	12.9x	45.0%		
Platinum	2/10/2020	VRT	Vertiv	6.3x	3.6x	2.7x	$1.5	$5.3	9.8x	36.7%		
Blackstone	1/17/2020	VVNT	Vivint	5.5x	4.3x	1.2x	$0.7	$5.6	10.5x	41.0%		
Insight	2/5/2021	ETWO	E2Open	7.7x	4.1x	3.6x	$0.4	$2.6	21.3x	19.2%		
CVC/LG	10/28/2020	ADV	Advantage Sales and Marketing	5.7x	3.7x	2.0x	$1.0	$5.2	10.1x	36.6%		
Family Controlled	8/28/2020	UTZ	UTZ Quality Foods	7.2x	3.8x	3.4x	$0.4	$1.6	14.3x	26.2%	109	
Apollo	11/4/2016	TWNK	Hostess Brands	5.6x	4.8x	0.8x	$0.2	$2.3	11.1x	43.3%	207.4	
Clearlake	2/23/2018	CVON	ConvergeOne	3.5x	3.5x	-- x	$ --	$1.2	8.4x	41.7%	127	144
Platinum	2/10/2020	PAE	PAE	4.5x	3.5x	1.0x	$0.2	$1.6	8.9x	39.9%	161.2	174
Platinum	10/17/2018	VRRM	Verra Mobility	4.5x	3.9x	0.6x	$0.1	$2.4	11.0x	35.5%		218.5
GTCR	6/29/2017	CISN	Cision	6.5x	5.2x	1.3x	$0.3	$2.4	10.5x	49.5%	207	227
Silver Lake	8/28/2020	GB	Global Blue	3.3x	3.3x	-- x	$ --	$2.3	12.1x	27.3%	182	190
H&F	11/17/2020	GCMG	GCM Grosvenor	3.5x	0.4x	3.1x	$0.3	$2.2	13.9x	3.1%	100.4	139.5
Landry	12/29/2020	GNOG	Golden Nugget Online Gaming				$0.2	$0.7			20.2	
			Average	**5.4x**	**3.8x**	**1.6x**		**$3.2**	**11.8x**	**33.8%**		
			Total				**$6.1**					

Figure 2
Source: DoubleLine, Public Filings

Case Study: MultiPlan

One example of a credit benefiting from a SPAC transaction is MultiPlan (MPLN), which merged via SPAC with Churchill Capital Corp. MPLN provides healthcare software analytics and has 1 million providers on its network of preferred provider organizations to help large healthcare plans manage out-of-network costs. Over the prior two decades, MPLN had been bought and sold by a number of private equity (PE) firms, undergoing five PE-to-PE leveraged buyouts, the last in 2016 with Hellman & Friedman taking ownership. Not atypical of other SPAC target acquisitions, MPLN was a highly leveraged company facing refinancing uncertainties.

At the time of the SPAC transaction announcement, MPLN's total leverage was 7.3x through its most structurally subordinated debt. MPLN's outlook was muddied by the COVID-19 pandemic, substantial near-term maturities and legislative uncertainty. These factors caused the company's bonds to trade at a sizable discount despite generally solid credit fundamentals.

On July 12, 2020, MPLN announced it would be acquired by the Churchill Capital Corp. III SPAC. At the time of the announcement, MPLN was valued at $11 billion, or approximately 15.0x last-12-months EBITDA. The transaction included an infusion of up to $3.7 billion of capital in the form of equity and convertible debt. At the consummation of the merger, $1.2 billion was used for debt repayment, $1 billion went to balance-sheet cash, and the balance was used to buy MPLN equity. With this capital infusion, pro forma (PF) leverage declined by approximately 1.5x to 5.8x. The SPAC merger transformed MPLN's capital structure from that of a highly leveraged, stagnant company to that of an appropriately capitalized company, poised to pursue growth.

For MPLN bondholders, the recapitalization marked a significant win. The company's junior bonds due in 2022 traded up approximately 13 points to a $102 call price due to the redemption. The 2024 senior bonds traded up roughly 8 points to a $103.5 call price on expectations of a refinancing. *(Figure 3)*

MultiPlan Bondholders Benefit From SPAC Transaction

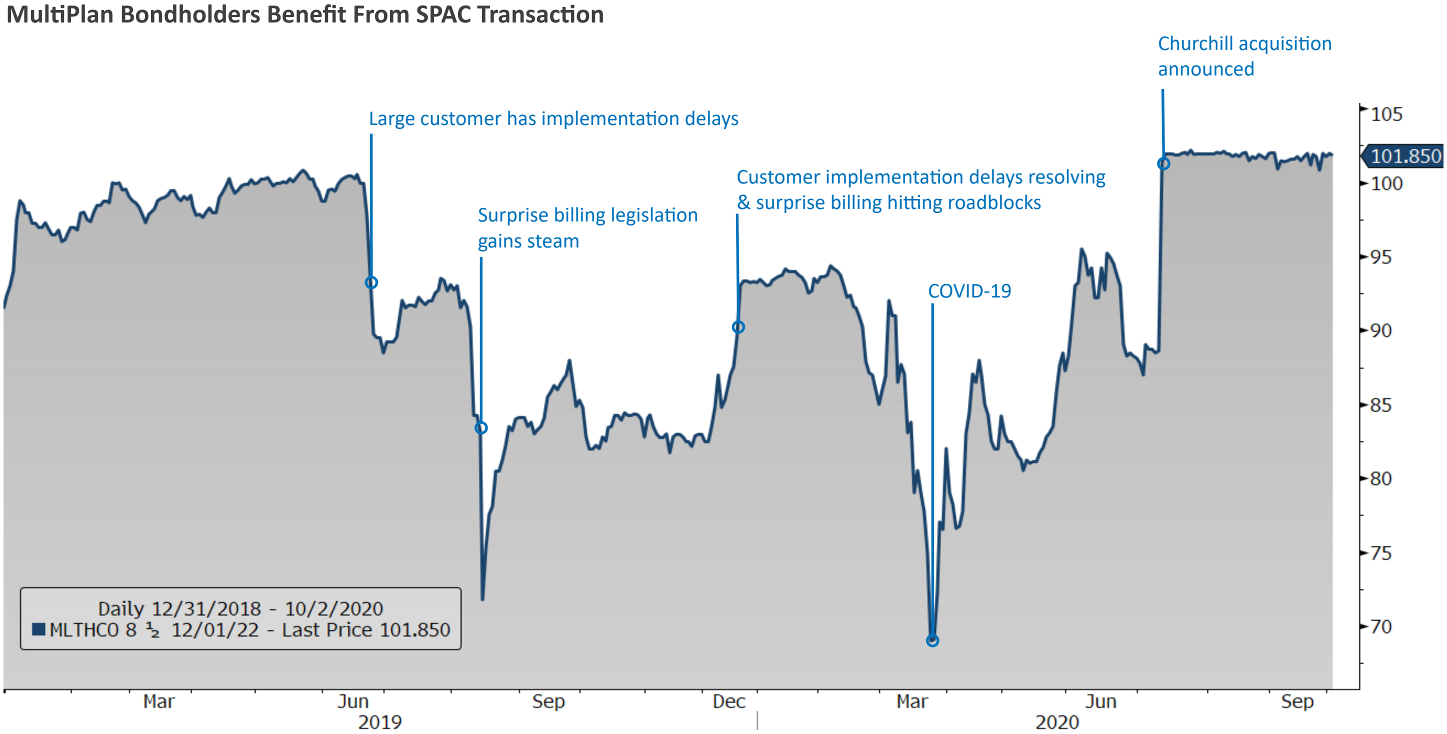

Figure 3

Source: DoubleLine, Bloomberg. This bond was redeemed in October 2020.

Case Study: Golden Nugget

In 2017, through a transaction that facilitated his purchase of the Houston Rockets, Tillman Fertita, CEO and owner of both the Landry's Inc. and Golden Nugget companies, merged the two and borrowed proceeds against those assets to finance the $1.6 billion equity distribution necessary to acquire the team. The transaction combined Landry's, one of the largest restaurant companies in the U.S., with Golden Nugget, a large regional gaming company (five casinos), to become a premier leisure and entertainment company, owning brands such as Mastro's Restaurants, Morton's Steakhouse and the Golden Nugget casino in Las Vegas. Pro forma for the transaction showed the company's balance sheet was levered nearly 7.0x, with debt remaining elevated despite very steady operating performance. In 2020, the pandemic struck, impacting every aspect of Fertita's conglomerate as restaurants and casinos initially closed entirely and subsequently operated at extremely reduced capacity. In the second quarter of 2020, revenues fell nearly 70% versus the second quarter of 2019, and the company generated negative EBITDA while burning cash every month throughout the quarter.

While the company conducted various transactions to improve liquidity during the pandemic (including a spinout of the online gaming company and IPO via a SPAC), the balance sheet remained overlevered, and liquidity was deteriorating. This was despite improving trends and green shoots to economic recovery in the leisure space toward the end of the year. In February, the company announced that it was merging with Fast Acquisition Corp., a public SPAC, to become a publicly listed company and raise proceeds to bolster liquidity, reduce debt and provide dry powder for future business strategies. Through the SPAC merger, the company expects to repay $1.2 billion of Golden Nugget corporate debt, taking leverage (based on fiscal year 2019 EBITDA) from 7.5x to 5.5x. This transaction should put the company on a more sustainable footing for the long term.

Conclusion

As SPAC transactions continue to make headlines, levered credit investors should take note. The multiplying number of SPACs should present opportunities for highly levered corporate borrowers and their debt investors. Notwithstanding legitimate concerns facing equity investors in SPACs, DoubleLine's research shows that these transactions have enabled leveraged companies to raise cash and reduce debt, resulting in healthier credits post-merger. Thus, it behooves savvy investors to be on the lookout for potential SPAC acquisition targets trading below their put price. ■

Author Biography

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Mr. Cohen joined DoubleLine's Global Developed Credit team in 2012. He is a Portfolio Manager and the Director of the group. He is also a permanent member of the Fixed Income Asset Allocation Committee. Prior to DoubleLine, Mr. Cohen was a Senior Credit Analyst at West Gate Horizons Advisors (and its predecessor ING Capital Advisors), where he worked as an Analyst covering bank loans and high yield bonds. Prior to ING, he was an Assistant Vice President in the Asset Management Group of Union Bank, where he managed a diversified portfolio of leveraged loans as well as a portfolio of collateralized debt obligation securities. Prior to Union Bank, he was an Associate Director of Corporate and Investment Banking at the Bank of Montreal in its Natural Resources Group. Mr. Cohen holds a B.A. in Economics from the University of Arizona and an MBA from the University of Southern California. He is a CFA® charterholder.

Definitions

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) – Measure of a company's overall financial performance that is used as an alternative to net income in some circumstances.

Enterprise Value (EV) – Measure of a company's total value, often used as a more-comprehensive alternative to equity market capitalization. EV includes in its calculation the market capitalization of a company but also short- and long-term debt as well as any cash on the company's balance sheet. EV is a popular metric used to value a company for a potential takeover.

EV/EBITDA Ratio – Popular valuation multiple used in the finance industry to measure the value of a company. It is the most widely used valuation multiple based on enterprise value and is often used in conjunction with, or as an alternative to, the price-to-earnings (P/E) ratio to determine the fair market value of a company.

LTM – Last twelve months.

NTM – Next twelve months.

Private Investment in Public Equity (PIPE) – Selling shares of a public company in a private arrangement with a select investor or group of investors. A special purpose acquisition company (SPAC) can seek a PIPE deal if it needs to raise additional capital to close a merger transaction with a target company. A PIPE deal might become necessary when the cost of acquiring a target company exceeds the funds that a SPAC has in its trust account.

Pro Forma (PF) Leverage Ratio – The ratio of total indebtedness at a particular