BMO Middle Market M&A update

Continued momentum for SPACs

And the growing impact on the private equity landscape

A typical intent of a special purpose acquisition company (SPAC) is to acquire an operating private company, after which investors can co-invest "publicly" alongside a best-in-class private equity sponsor.

The structure of a SPAC (also known as blank check company) effectively enables a company to go public without the traditional initial public offering process.

As observed in 2020, SPAC participants continue to play an increasing role in the large cap deal space ($500M-$2B), as demonstrated by the 27 completed SPAC combinations in the first quarter of 2021, compared to 44 in all of 2020 and 17 in 2019. This compares to the overall volume of all M&A transactions in this size range, which has remained roughly flat, with 140 transactions in Q1 2021, compared to 306 in all of 2020 and 323 in 2019.

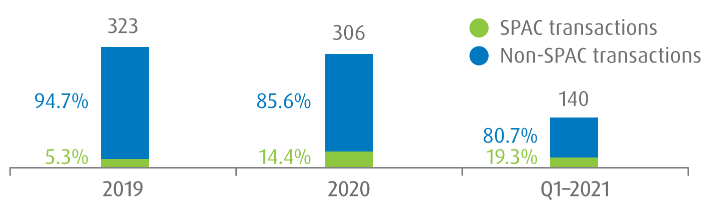
As a result, SPAC activity represented ~19% of transaction volume in Q1 2021, compared to ~5% in 2019—it appears indicative that the rise and acceptance of the SPAC product is displacing deals that would typically take place in the PE landscape.

As SPACs continue to have a strong presence in the larger cap deal space, there are several potential impacts:

- SPACs are prevailing in auction processes and consequently driving valuations higher.
- As SPAC activity continues, if traditional larger cap private equity and/or strategic buyers continue to be displaced, we believe they will continue to chase lower returns (i.e. pay higher valuations) by competing with SPACs or look to move down market into smaller sized platform investments in order to continue to deploy capital.

Entering Q1 2021, the number of SPACs targeting middle market deals (<$500mm TEV) has decreased, with the remaining middle market SPAC deal volume coming primarily in the healthcare sector. It is also worth noting that a subsector of these SPAC vehicles are being utilized by PE funds and management teams, without a resulting displacement of demand from larger cap PE funds.

Completed Deals by Type (2019 – Q1–2021)



Limited SPAC involvement in the middle market

Complexity and regulatory requirements often limit opportunities in smaller transactions

While SPAC activity is taking place in the upper middle market, it has been somewhat limited and focused on specific sectors. Regulatory requirements and complexity with executing the multiple transaction steps necessary for SPACs including the IPO, PIPE, and de-SPAC process limit involvement of many smaller funds because of the costs, resources required, and other complicating factors not typically suited for smaller teams. Similarly, middle market funds typically have fewer resources and are often not as well positioned to support the ongoing business management associated with a SPAC structure. It also appears unlikely that we will see middle market funds taking an increasing role in SPAC processes in the near term. In addition to the regulatory hurdles already in place, headwinds will increasingly come in the form of increased regulatory SEC supervision and possible changes to combat aggressive underwriting practices that have been used somewhat frequently by SPACs.

The SPAC activity present in the middle market has typically been in high growth sectors with strong public interest including ESG, tech-oriented consumer brands, pharmaceuticals, healthcare IT and cannabis.

Completed De-SPAC Transactions by Size Range

(2016 – Q1-2021)

2020	20	31.3%	44	68.7%
2018	10	76.9%	13	23.1%
2016	2	50.0%	2	50.0%

SPAC activity having likely impact on transaction valuations

Fierce competition driving up multiples across the U.S. M&A market

After a SPAC has been formed, the "de-SPAC" process involves the acquisition of a private company that combines with the entity that was previously listed publicly.

Following the trend seen in late 2020, the volume of de-SPAC transaction announcements continued its strong momentum in the first quarter of 2021, with nearly as many announced combinations in Q1–2021 as the entirety of 2020.

Over the past nine months, the average TEV/EBITDA multiples for all U.S. transactions have continued to trend upwards with rising SPAC transaction volume.

While other macroeconomic impacts are also in effect, it is worth noting the increased SPAC activity occurring, and the trend does coincide with the common characteristic of SPACs being valued off of projected future revenues rather than current EBITDA, as traditionally observed in most M&A transactions.

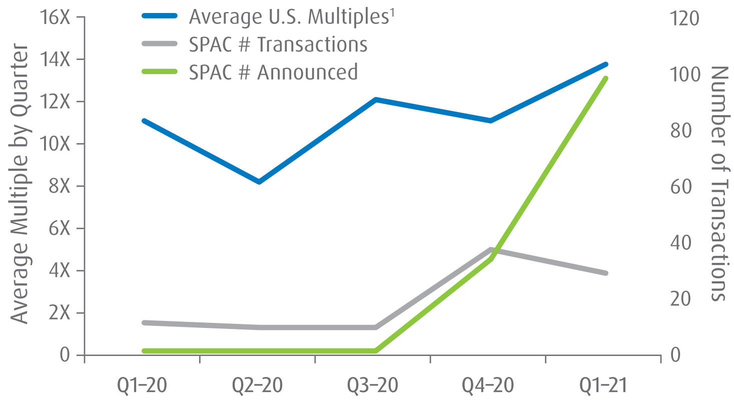
Upward trends in multiples can also be correlated to the high growth business transactions where SPACs are regularly participating.

While the number of announced de-SPAC transactions jumped significantly in Q1-2021, it is yet to be seen how the increasing complexity of these transactions, as well as increased regulatory attention will affect the number that ultimately reach close, and in what time frame.

It is interesting to note that the completed number of SPAC transactions decreased in Q1-2021, which may be attributed to the increasing scrutiny and regulatory complexity that is being observed in the current SPAC environment.

While the impact of SPACs is only one factor driving overall transaction multiple increases, it is something we will continue to watch carefully.

Avg. U.S. Transaction Multiples vs. SPAC Activity Trends
(Q1–2020 – Q1–2021)



	SPAC # Transactions	SPAC # Announced[2]	Total	Avg. U.S. Multiples
Q1-21	27	96	123	13.5x
Q4-20	36	32	68	10.9x
Q3-20	8	0	8	11.8x
Q2-20	8	0	8	8.0x
Q1-20	10	0	10	10.8x

Let's connect

Whether you're expanding through acquisition or are ready to transition the business, our middle-market mergers and acquisitions experts are ready to help you take your company to the next phase.

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[1] Average of all U.S. Transaction values during the period (all TEV sizes).

[2] Announced SPAC transactions represent signed and publicly announced transactions pending close due to regulatory and other necessary approvals.