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Virtual Event Series

The SPAC ETF Unwrapped

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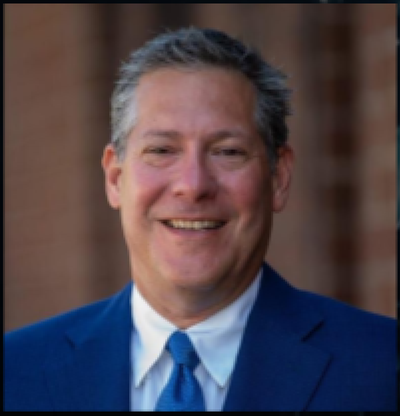
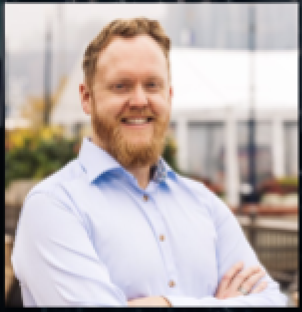


David Sherman
President
Cohanzick Management

Hosts:



Kenny Estes
CEO and Founder
Diffuse

Ayla Kremb
COO and Co-Founder
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DiffuseTap: The SPAC ETF Unwrapped

Last time on DiffuseTap, David Sherman, President of Cohanzick Management, talked to us about the inner workings and dynamics of a SPAC, golden profit opportunities in a SPAC deal, and the value that a SPAC ETF brings to the market.

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DiffuseTap

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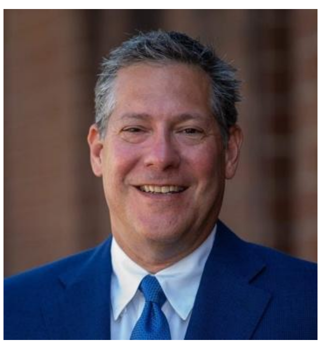
Meet the Speaker



David Sherman is the Founder, President, and Portfolio Manager of Cohanzick Management and CrossingBridge Advisors. With over 25 years of experience in investment management, Sherman was a senior executive at Leucadia National Corporation (now Jefferies Financial Group) as head of corporate investments and acquisitions and Treasurer of the holding company's insurance operations.

LinkedIn: @david-sherman

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KENNY ESTES: Today you're all going to hear from David Sherman. David, would you mind giving a little introduction to the crew here?

DAVID SHERMAN: Sure. First of all, I'm David Sherman. I run Cohanzick Management and CrossingBridge Advisors. We've been around since 1996. We have approximately $3 billion in assets under management. Prior to starting Cohanzick (when I was a child), I spent 10 years as a real child at Leucadia National and left there as a senior executive. And before that, I was a mere student at Washington University.

In addition to owning and running CrossingBridge and Cohanzick, I also am now an adjunct professor at NYU Stern Business School, and we're always looking for really great speakers in our global value investing class for MBAs.

I just sent everybody my email and phone number if anyone needs to follow up questions. Obviously, we're always happy to answer product questions as well. I'm going to try to keep this meeting very specific to SPACs in general, instead of putting on my tin cup and promoting skills. That's my introduction. Should I go into SPACs?

AYLA KREMB: We will. We'll just kick off with the questions. How did you get into SPACs in the first place?

DAVID: Almost everybody in the SPAC market including myself comes from either credit opportunities, which primarily means stressed or distressed, or capital structure arbitrage. They come from convertible bond arbitrage, closed end fund arbitrage, or from the likes of that. It's really the sharpest elderly group in the community.

The first SPAC I got involved in was in 2005. The reason I got involved, as is the same reason we're all meeting here, is that there are SPACs that are really interesting because there are lots of different ways to think about investing in them, depending on what your goals and risk parameters are. And more importantly, it's a nice way of getting a principally protected piece of paper with some yield, and a free call option on the upside. That's the simplest way to think about SPACs before they close a transaction. There are SPACs, and then there are deals that are closed.

Deals that are closed are an equity. You're buying a company that has merged. For instance, if you like Rover.com[1] at that price, you should buy it. And if you don't like Rover.com at that price, you should not own it. Rights in SPACs have both a liquidation date and a redemption date, but the shareholder has the right to redeem the shares. And so, you basically have a convertible bond with a zero coupon, and a two year maturity or less. SPACs typically have a life of two years or less. You're getting no coupon, but you're typically buying it at or below your collateral value that is protecting you, and that you're entitled to.

[1] As of February 16th, 2022, Cohanzick and its affiliates do not own a long or short position in Rover.com.

If you keep the warrants, you have a convert. If you sell the warrants to increase your yield, you have a busted convert. Those dynamics make it very interesting. And then of course, how do they raise money after they announce a deal from a PIPE? And how do you get sponsor capital risk shares? Or do you build a portfolio of warrants that make an interest? There are all these other dynamics. We got involved because there are so many pieces. And it's so deal-dynamic, which makes it exciting.

KENNY: That's great. Some of this is a little definitional. There are a lot of terms the audience might not be aware of. So, let's dig in a little bit. Aaron Winkler has a question. What percentage of SPAC investors pull back from the deal?

Also tying into that question, you mentioned the PIPE. What is the PIPE? How does it play into the SPAC dynamics? How much money is raised through the SPAC itself? How much money goes through the PIPE? Maybe you could talk a little bit about after you announce the deal, when you have all these investors lined up. What are the dynamics there?

DAVID: Sure. Let me first make a caveat. Most of you are familiar with SPACs because of what I call the meme SPAC period, effectively from Labor Day of 2020 to St. Patrick's Day of 2021. That's when all these SPACs traded at ridiculous prices, even when they hadn't announced the deal. They were trading at more than the trust value that was in the collateral, which you had the right to if you decide you want to move forward with a transaction. That's when all of these companies that merged into deals and that are now trading at 2, 3, or 5 dollars a share, were up at 30.

You could look at something like RMG acquisition,[2] which stands for Riverside Management. Their stock went all the way up to 33. Their biggest client was Nikola trucks. And today, it's three bucks. So, let's ignore the meme period when we talk about SPACs because those times were not normal.

Going back, think of the IPO and secondary purchase of a SPAC before they close a deal as no different from bridge financing. They're putting up capital for targets to know that there's capital there, and the market perceives the deal as a good deal. Either it's a good price, or it's a good company. The people actually want to own it, like DraftKings or Latch or Navitas,[3] or one of Bill Foley's deals. People will actually not redeem their shares. They'll actually either sell them to people that want to own that stock, like a pre-IPO. Or they'll hold on to the IPO. The secret there is to do a good deal, in which case, you wouldn't need a PIPE. I'll talk about that in a second.

The secret there is you have to do a good deal, which does happen. But when they do deals that are perceived as overvalued, or not institutional, you get a lot of redemptions. Gores, for instance, has a very good habit of getting low redemptions. They're a sponsor that does deals. They did Utz potato chips. So, it

[2] As of February 16th, 2022, Cohanzick and its affiliates do not own a long or short position in Romeo Systems.

[3] As of February 16th, 2022, Cohanzick and its affiliates do not own a long or short position in DraftKings, Latch or Navitas.

really depends on a deal-by-deal basis. Generally, cash flow deals that are companies who are coming from subsidiaries of public companies that generate cash flow, or private equity, get out lower redemption levels than venture capital, like greenfield operations. And that makes sense.

So, what the business is will depend on how much a PIPE is, and even if a pipe is necessary. The more a company doesn't need money, the more it gets lower redemptions. Right now, you're getting very, very high redemptions, which is typical of the market. That means SPAC investors such as myself will say, “I don't want to own the merged company. Give me my interest in the collateral trust, thank you very much.” In order to compensate for redemptions, often companies either announce when they do the transaction with the call type (private investment, public equities, etc., which many of you are probably familiar with), or they wait until after they announce the deal. And then, they raise money.

For those who focus on the cannabis industry, we actually back stopped a $30 million financing for Leafly in a convertible bond. It was after the deal was announced. The purpose of that money is one, we have to pay the investment bankers and lawyers because they seem to not be very forgiving and charge egregious amounts of fees. And two, a lot of companies want to know that there's a certain amount of money that will be there, either to pay dividends, to pay off shareholders, to fund expansion plans, etc., and they want that PIPE as a minimum cash. That's in case there are a lot of redemptions.

A SPAC’s best-case scenario is they raise a pipe with a lot of people rolling the deal, in which case they have excess cash. And for a SPAC that's going public, or any company that's going public, getting too much cash is generally a high-class problem. So, that answers the PIPE situation. There's one other nuance called back stop arrangements. There are various terms. The one that is most well-known is either the Nomura structure or the Adelaide structure, based on the people that were the first ones to issue it.

Think of it as a firm saying, “I will buy all the redeem shares up to a certain amount to guarantee that a certain number of shares will roll into the deal. I'll buy $50 million of the SPAC to guarantee we're going to roll. But I want you to protect my downside. Either stick cash in a SPV that I can have access to or protect my downside through various mechanisms.” Let's say they do the cash. What happens is in the back stop, the guy who provides the back stop buys the shares and rolls into the deal. And he has the right to the cash in a year or two years, at a guaranteed rate of return that he can put his interest into. And you can also sell his shares in the open market, if you want.

For instance, if you use $10 as par, he's going to sell if the stock goes above $10. And if it's below $10, he's not going to sell. He's going to put it back in the company. Think of it as an extension of a SPAC’s life, but it sits on restricted cash. Those are generally not-so-great economics for the sponsors and the merged company, because they're letting somebody get a free upside. And they can have their cash taken away from them if the stock doesn't go up. But the reason they make sense is, they provide liquidity to allow institutional investors to buy stock. Because if there's no float, they lose interest. Now, I've covered a bunch of different pieces and probably made it more complicated. I'm sorry. We also do back stops.

AYLA: Beautiful. Now that you've dug into the why and the what of the SPAC itself and the mechanics behind it, how did the whole idea of an ETF come about? Why is that a better approach? I mean, obviously it's more difficult to chase these individual opportunities because they're deal centric, but how did you guys come up with the ETF idea, and how are you executing it?

DAVID: I'll answer that in a sec, but the other thing we didn't talk about is warrant. So let me just go back before we answer that. When SPACs get issued, they typically get issued in a unit, which means you get a common stock, and you get warrants and or rights. Those rights and warrants are typically separable so that you can keep the rights or warrants or choose to hold the unit. You can keep the stock and sell the warrants. Or you can just buy the warrants and sell the stock. Think of it this way before there is a closed deal.

The stock is a principal-protected, short term yielding piece of paper with a zero coupon, where if the stock goes above 10, you get that upside. The warrants have a five-year life and are stuck at 12.50 a share and can be taken away from you at 18.50 as a portfolio of venture capital interests. That's something we need to acknowledge.

I'm going to your question. We've been involved in SPACs since 2005 because there are a really good, ultra-short duration, fixed income-like security that gives you a decent yield, and gives you call options. Previously, the industry was not big enough to do a standalone product. But with the meme period, institutional sponsors and institutional buyers started entering the market. Now, the market is big enough to create a standalone product.

If you go to spacinformer.com,[4] which is a free website, you can see that as of February 10, there were actually 708 listed SPACs in the U.S. market, excluding Canada and Europe, which is about ready to positively explode. There is $187 billion in it as an asset class. So, it's a real class.

And by the way, you can go to SPACInformer and sign up for free so that every week, you can get all the SPACs, their symbols, their last traded price, when they were liquidated and how much they have in trust, what their yield to liquidation is, and whether they have a deal or not and who's the sponsor. Those are things most people charge for, and we're giving it to you for free. You can do this on your own and be a fisherman, or you can buy our fish in retail.

In our mutual funds, we specialize in independent financial advisors and family offices. And a lot of them are looking for short term, low duration, fixed income alternatives or opportunistic fixed income alternatives. And we realized that SPACs are typically issued as an IPO with 12 to 15 months of a life, in terms of venture maturity. Some of them have the right to extend, but they have to pay you 4% a year to extend another three, six, or nine months. When you sell off the warrants, they're over collateralized, and you get a yield.

Yesterday, we bought a SPAC which had $10.20 in trust. We paid at $10. That's a 2% gross yield that we're going to make either at liquidation or at redemption date, if that comes first. On top of it comes a full

[4] SPACInformer is an affiliate of Cohanzick Management.

warrant. Warrants today trade at around two and a half to 2%. I think they should trade around 1%. I think they're generally overvalued. But let's use 2%. Let's say we sell those warrants when they separate at 2%. Now we're making 4% gross. The maturity on it was 12 months, and they had the right to extend for another three months twice for a total of six months. But they'd have to put 10 cents in the trust each time. So, if they extend to an 18-month deal, they're going to put 20 cents in, which is still 4% annualized.

Therefore, I'm looking at a 4% simple yield on a SPAC, backed by T-bills, to liquidation. And if they announce the deal sooner than that one year, for instance, they close and announce in nine months, I'm going to make 4% divided by .75 because I'm going to redeem, which is a higher yield. And when they announce a great deal like Donald Trump's media empire, I'm not going to sell it for 40, 50, 60, or 70 dollars a share because I'm not that smart. I'm going to sell (which we did) at $18 a share, which is still 80% higher than I thought I was going to get.

This is something where you have very limited downside. You have a short maturity in a rising rate environment, and you can lock in a really good return by that. You can also leverage it. I'm not advocating leverage, but you can. And in fact, the biggest risk to your SPAC market is that you don't hold it, and you force yourself to sell during market drawbacks. So, there's not a principal risk, but there is market exposure. And the one thing that people don't talk about that you should be aware of, is the SPAC market has always been levered by hedge funds.

It typically was levered two to four times. Today, it's levered six to eight times. So, what's going to happen in a rising rate environment for some is, their cost of capital is going up, their portfolio is going down, and they're going to get a tap on the shoulder. And what do hedge funds do? They sell the thing that has the least amount of loss with the least amount of recapture, which means they tend to become divested off of SPACs. And when that happens, even when you can buy SPACs at 6 to 8% yield to liquidations, the opportunity goes away. And it goes away very short.

You can see this because most hedge funds can only lever U.S.-listed SPACs. They can't leverage Canadian SPACs. We're buying a Canadian SPAC right now at 7% yield to liquidations, which matures this year. That's because they can't get leverage on it. And the same thing is happening in Europe. Europe is starting to really become what the U.S. was two years ago, before the meme period of issuing SPACs.

Now, they're denominated in USD, and they trade in either Amsterdam or London. Or they're denominated in euro, and they trade in Amsterdam and London. There are some nuances. In Amsterdam when they announce a deal, the regulators halt trading until they approve the deal, which is a big nuance if you need liquidity. Nobody can get leverage on the European stuff, so that's all cheaper than the U.S.-issued stuff. Don't worry, the Europeans will forget to put leverage on.

So anyway, to answer your question, those kinds of dynamics are why we brought the product to market. We think there's a huge opportunity for people who don't want to worry about missing redemptions. In our ETF (our symbol is SPC), we specifically say in our prospectus that we will buy at or below trust value, which is unlike any of the other SPAC ETFs. We're never paying a premium. And we specifically said that we will always sell or redeem. Others say they're going to do that, but it's not in their prospectus.

There are some competitive SPACs. One just came out under the symbol CSH, which is cash without the “a”. I think it’s a really bad marketing idea. I would never call this a cash alternative because of the volatility aspects. You also have Robinson SPAC, or SPAX. Those are the two that are most similar to the one we did. We're larger than both of them. Our bid-ask spreads a penny, by the way, as opposed to theirs, and it's about a $50 million fund that we launched in September. For those who are really anxious to get leverage, we can tell you how you can leverage our ETF.

That's why we did it. We think there's a need for people to have money on the sidelines when they want to be defensive. And this is a good instrument. When the market gets washed out, or they have a great private opportunity, or they want to invest in your fund when it's up and running, they just sell it, redeem it, and they go do something else. In the meantime, they earn a yield while they're waiting.

KENNY: Great context. Love the framing. Very thorough answers, too. There's a whole lot of detail.

DAVID: Can I answer one question?

KENNY: Sure.

DAVID: Caitlyn asks if the fund's portfolio includes an exposure to founder shares. The answer is yes, that is true if you get founder shares as an anchor for free. And because we're big enough, because we're on the lower half of the top 100 issuers, we anchor deals. And yes, the SPAC ETF will get founder shares for free if we anchor a deal on their pro rata interest. I just wanted to answer that because that also separates us from other SPAC ETFs.

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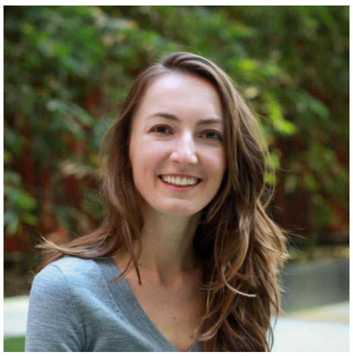

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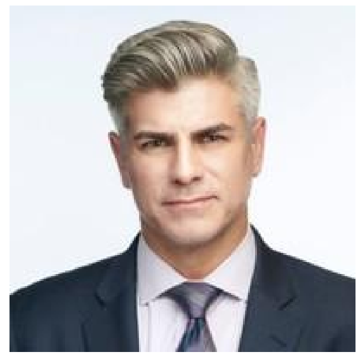

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