M|A|M MONACO ASSET MANAGEMENT

Global Equity
Investment Strategy

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Tech - What's Next and Where to Look?

In this Issue

The Covid-19 pandemic brought numerous industries key to the global economy to their knees (i.e. Travel, Hospitality, Luxury, Automotive). Yet, it also brought forward years of technological transition forcing millions, if not billions, of people to think differently and adapt. Today, we do not shop nor do we consume the same way we did a year ago and the number one beneficiary in this swift transition has undoubtedly been the tech sector. In this section, we will discuss the current trends driving the industry after an impressive six months rally, the level of specialization needed to truly have a grasp on the companies' technologies, whether the industry is as overvalued as countless suggest, what investment vehicles to chose from when investing, and what thematic we currently favour and seek to invest into.

The Current Trends

For a growing number of segments of the economy, it has become increasingly blurry and difficult to discern what does and does not fall under the tech umbrella. Arguably, we are in the midst of a fourth industrial revolution with technology transforming the job market, daily tasks, and our interactions with people. With the pandemic, a lot of this transition has been accelerated with changes even more noticeable in some segments. In payments, we have seen a rapid move away from cash towards contactless payments. Banks have raised the standard limits on contactless card payments from €20 to €50 / transaction. Since January, retailers have reported a 69% increase in contactless transactions and 94% of them anticipate more growth over the next 18 months. We are in the early stages of a move towards a cashless society.

Technology has also been powering communication, enabling people to stay in touch with their close ones as the pandemic struck. We all got accustomed to Zoom and Teams calls whether it is for work or even in our personal life. The way we interact will remain impacted by the pandemic for the foreseeable future with more and more businesses already planning to include remote conferencing tools in the future.

Already a growing industry before the crisis, revenue for many gaming companies and platforms have increased significantly throughout the pandemic boosted by higher user engagement in video games and e-sports during lockdowns. Verizon saw a 75% increase in gaming traffic during peak hours. That compares to a 12% increase in digital video and 20% in web traffic. Data from Comcast shows new games downloads have increased by 80%, compared to a rise of "only" 50% in total gaming downloads.

Surely, these are only some of the segments in tech who benefited. Semiconductors, cloud service providers, and many more industries felt the tailwind. The global Tech sector index, as defined by S&P, is up 67% since March lows and this classification does not include Amazon, Tesla, Netflix, and more in the mix.

Chart 1. Global Info Tech Sector Index (Daily)

Source. Bloomberg, MAM Research

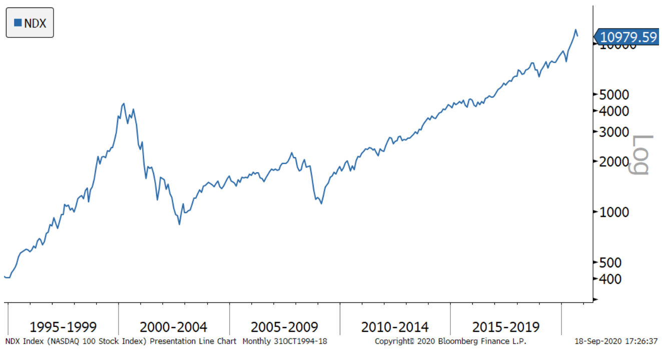
A Highly Specialized Sector

Warren Buffet once famously said "buy a stock the way you would buy a house. Understand and like it such that you'd be content to own it in the absence of any market". The boom in new technologies, sometimes referred to as the fourth industrial revolution, has brought a whole new set of complexities. It requires a progressively higher level of specialization to truly understand the underlying technology behind a product. Investors seeking to diversify or move away from the well-covered and sometimes overly crowded large cap tech companies into smaller, less known companies, are better off when they have a good understanding of the underlying technology. The true edge now comes from one's ability to identify how disruptive a product can be, how long the company can carry the competitive advantage, how long it can capitalize on it. We continue to ask ourselves the question in light of tech companies' valuations: "Are they truly overvalued if their technology allows them to grow their top line by the double or triple digits for the better half of a decade still?"

Is Tech Really Overvalued?

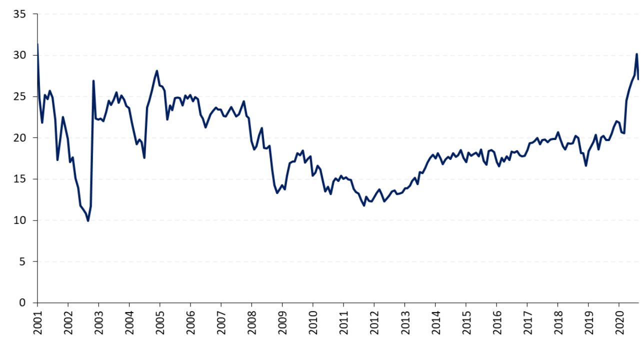
Obviously, the answer to such question is not as clean-cut or straightforward as we would like it to be. Surely in comparison to the tech-bubble **(Chart 2)** of the early 2000s, we are approaching some highly extended and somewhat risky levels of valuation **(Chart 3)**. However, there are some key differences versus back then. Nowadays, the leading companies are highly profitable and carry a dominant position in their respective industries and markets. If anything, the frenzy is coming from underneath which is why we encourage investors to make educated decisions when investing in such stocks. Earlier this week, we saw Snowflake's IPO. Initially, the company was set to price in the $75-85 per share range. At the open, the company was already trading at $245 per share. That's more than 3.0x the mid-point IPO range! In the first hour, the share price was as high as $319.0... That's simply too risky and unjustified, in our view. Then, despite companies in the tech sector having rather resilient earnings during the pandemic, we are looking at multiples as high as those from the early 2000s today; this has mostly been driven by multiple expansion. That's 2 standard deviations expensive on a P/E and multiple other valuation metrics. As we highlighted in our note on inflation, tech companies are very long duration assets, highly sensitive to changes in interest rates. The key driver of valuations, beyond the hype for the technology, is a historically low discount rate. It is stretching terminal values, the value attributed to long-term cash flows discounted to today, to the limit in analysts' fundamental valuation models. Complacency and crowding is running high. As a result, we believe quality stock picking and active portfolio management are key elements to successfully navigate today's market environment.

Chart 2. Nasdaq 100 Index (Monthly)



Source. Bloomberg, MAM Research

Chart 3. Nasdaq 100 Index 12M Forward P/E (Weekly)

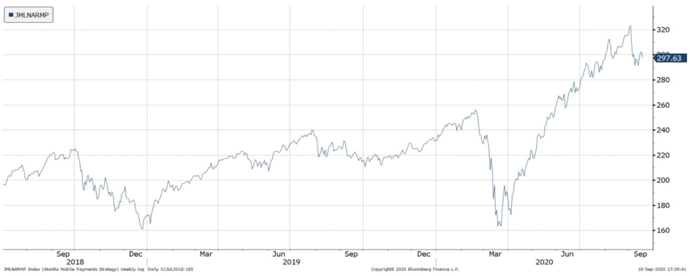


Source. Bloomberg, MAM Research

Fund Strategy

We strongly believe that technology is no different to other sectors and that mostly specialists can truly have an "edge" when it comes to investing in technology. While we are focused on key direct opportunities (listed and private markets) we like to identify fund managers able to invest in the future winners of the industry. For instance, we have been investing in technology funds managed by Atonra, a Geneva-based tech specialist manager, since 2017. Initially attracted by the thematic offered by Atonra's funds (mobile payments, bionics..) we have appreciated their ability to decipher some key winners in the industry. We intend to continue searching for such managers able to generate alpha in an increasingly sophisticated sector over the coming months.

Chart 4. Atonra Mobile Payments Fund (Weekly)



Source. Bloomberg, MAM Research

Chart 5. Atonra Bionics Fund (Weekly)

Source. Bloomberg, MAM Research

Our Favourite Themes

As you can certainly deduct from our current and recent research, we have been keenly looking at some specific segments of the economy which can either directly or indirectly be tied to the tech sector. First, we firmly believe in the move towards a cashless society. As such, we take a strong interest in established legacy market players in the payment industry such as Visa and MasterCard, but we also like to look at online payment players to the likes of PayPal, and some more disruptive players in the Seller's business segment with companies like Square **(Chart 6)**.

We are also firmly convinced in the move towards electric vehicles (EV) and believe current trends are only going to accelerate with EV penetration set to accelerate in the near future. Nonetheless, we remain cautious when looking at the different segments of the EV market. For instance, we prefer to stand relatively careful when looking at companies like Tesla, or even stay away from excessively hyped start-ups such as Nikola, against which there might be a case of potential fraud. Instead, we prefer to look at companies set to disrupt the EV business by bringing new products as part of the supply chain to market that will benefit the whole industry. In that regards, we like firms developing new battery technologies, such as QuantumScape. We are also keen to consider current car OEM such as VW, Renault, or Porsche who work towards expanding their base offering in the EV segment since they already have the infrastructure in place to scale up production more rapidly than other emerging players.

We continue to believe in the transition towards a green hydrogen economy which has seen an increase in government support lately. The hydrogen sector is set to benefit extensively from the shift in mentality and commitment to transition from a carbon intensive to a more responsible and sustainable economy, *please refer to our early August MAM Insight for more details*.

Lastly, we have been taking a strong interest in special purpose acquisition companies (SPACs), which we discuss at length in the second part of our research, for their attractive risk-reward as they work towards bringing private companies to the public market.

Chart 6. Square Historical Spot Prices (Weekly)

Source. Bloomberg, MAM Research

SPACs - Wall Street's New Blank Check

Special purpose acquisition companies (SPACs) are the hot new ticket on Wall Street. Big-name dealmakers, small-name money managers, tech entrepreneurs, and even Paul Ryan, the former speaker of the house, all seek to raise millions, or even billions, through these blank-check companies by promising to find and acquire one or more unidentified private business post SPAC-IPO. Half-way between an M&A transaction and a more traditional IPO, SPACs are becoming increasingly popular among companies and individuals looking to raise capital and pursue merger opportunities, and private companies seeking to raise capital, procure liquidity to existing shareholders, and become publicly listed. In this note, we seek to educate investors on the history, structure, opportunities, and risks associated with this increasingly popular vehicle as well as some of the recent deals we have been tracking and analyzing.

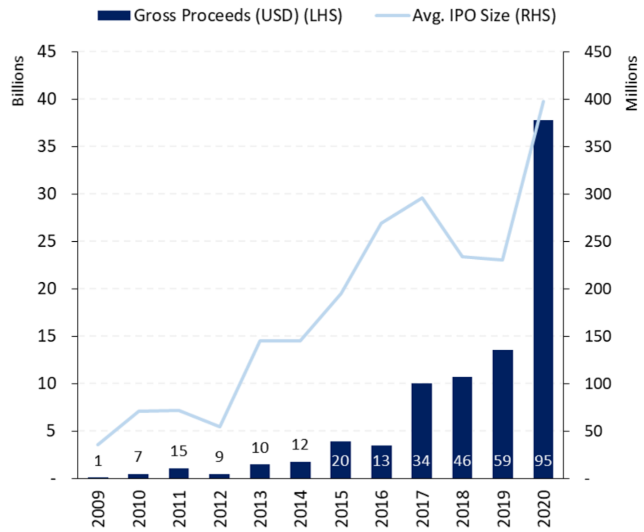
A Brief Background and History

To present it simply, a SPAC is a blank-check company created to raised capital via an initial public offering (IPO) to finance a merger or acquisition within a pre-defined timeframe, typically two years. The target company, which must not yet be identified at the time of the SPAC's IPO, will become public as a results of the transaction (usually referred to as the "business combination" or "De-SPAC transaction").

SPACs have somewhat of a rocky history. Yet, they have been a part of financial markets for the best of four decades now, longer than most people imagine, with their origins traced all the way back to the 1980s. Unfortunately, back then, they were a relatively unregulated group of open-ended offerings with vague business plans and no specific target companies in sight. Naturally, the lack of a regulatory environment comparable to today's meant fraud was widespread. However, SPACs have evolved considerably since then with institutional investors popularizing the structure given its relatively attractive risk-reward profile.

So far this year, a total of $38 billions in capital has been raised by SPACs through no less than 95 IPOs, a record. Indeed, that's more than 80% the total amount raised by SPACs in the past decade. The average size of a SPAC IPO has also grown considerably, from approximately $36 million in 2009, to $200 million in 2015, and nearly $400 million so far this year **(Chart 7)** as billion dollar offerings emerge at the top of the league tables.

Chart 7. SPAC IPOs (2009-Present)



Source. SPAC Insider, MAM Research

Overview of the SPAC Life-Stages

The average lifespan of a SPAC is two years, as per legal requirements. Ahead of its offering, the blank-check company will go through the typical IPO process by filling a registration with the SEC and undertake the road show process before a firm commitment underwriting. IPO proceeds will then be held in a trust account until they are released to either fund the acquisition or used to redeem shares sold in the IPO. Operating expenses, including the up-front portion of the underwriting discount and small amount of working capital, are funded by the entity forming the SPAC (the "sponsor"). After the IPO, the SPAC will look for a target acquisition and begin to negotiate the merger/purchase agreement (the "business combination"). Should the SPAC need additional capital to carry the business combination or pay other expenses, the sponsor can loan funds to the SPAC. Before signing an acquisition agreement, SPACs often arrange committed debt or equity financing, such as a private investment in public equity ("PIPE") commitment, to finance a share of the acquisition price and thereafter publicly announce both the business combination and committed financing. After the signing announcement, SPACs initiate a mandatory shareholder vote or tender offer process. In either case, public investors have the right to return their shares to the SPAC in exchange for an amount of cash roughly equal to the IPO price paid, plus carried interests. If the business combination is approved, and financing and other conditions from the acquisition agreement are satisfied, the business combination is consummated ("De-SPAC transaction") with the SPAC and target combined into a publicly traded operating company as a result.

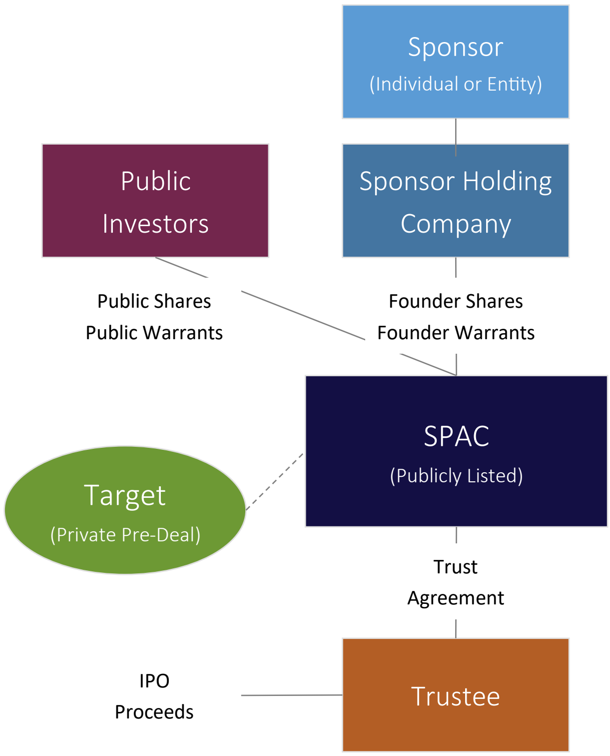
The Difference with Traditional IPOs

The SPAC financial statements in the IPO registration are very short and can be prepared in as little as eight weeks since there are no historical financial results to be disclosed, assets to be described, and business risk factors are minimal. This compares to the months it takes for an operating business to register for an IPO.

Arguably, SPAC IPOs have a rather unusual underwriting discount structure. However, it does have the merit of aligning investors' interests by incentivizing sponsors to find a target. In a traditional IPO, underwriters received a fee of 5-7% on the gross proceeds withheld from delivered proceeds at closing. In a SPAC IPO, the underwriters receive 2% of gross proceeds to be paid at closing while another 3.5% is deposited into the trust account. This portion is payable to the underwriters upon closing of the De-SPAC transaction. Should there be no De-SPAC, the deferred 3.5% will never be paid out to the underwriters and instead be used along the rest of the trust account balance to redeem public shares upon SPAC liquidation.

In traditional IPOs, sponsors and directors enter into a 180 days lock-up agreement from the IPO pricing. For SPAC IPOs, the lock-up period extends to one year from closing of the De-SPAC transaction. However, it is often subject to an early termination clause if common shares trade above a fixed price (usually $12 per share), for 20 out of 30 trading days starting 150 days after closing of the De-SPAC transaction.

Figure 1. SPAC Capital Structure, *Illustrative Purpose Only*



Source. Harvard Law, MAM Research

SPAC Capital Structure

In a traditional SPAC IPO, ownership is split between the public investors and sponsors. The public investors are sold pubic units comprised of one share of common stock and a fraction of a warrant to purchase a share of common stock in the future. The price per unit is almost always $10.00, post-IPO, the units become separated so public investors can either trade units, shares, or whole warrants with each securities listed separately.

The common stock included in the units sold to the public are usually referred to as "Class A" while sponsors purchase "Class B" or "Class F". For ease of reference, shares and warrants of units sold to the public are referred to as "public shares" and "public warrants" while shares and warrants sold to the sponsors are referred to as "founder shares" and "founder warrants" (**Figure 1**).

The sponsors will purchase founder shares at the onset of the SPAC filling and pay a nominal consideration for a number of shares resulting in a 20% ownership stake in outstanding shares post-IPO. These shares are meant to compensate the management team who is not allowed to perceive salary or commission from the company until an acquisition transaction is completed. At the time of the De-SPAC transaction, the founder shares will automatically convert into public shares on a one-to-one basis, in most cases. However, if additional public shares or equity linked securities were issued in connection with the closing of the De-SPAC transaction, the exchange ratio will be adjusted to gross founder shares up to 20% of the total shares outstanding.

In recent years, warrants have been friendlier to both issuers and public investors. Now, most SPACs include a "crescent term", which is an anti-dilution adjustment. If additional securities are issued below a pre-established threshold in connection with the business combination, adjustments to the warrant's strike price can be made. The founder warrants represent the at-risk capital of the sponsor and tends to align the sponsors' interests. The public warrants can be seen as call options here to compensate IPO investors for investing in a blind pool. Warrants essentially dilute any PIPE investors and equity retained by the seller of the target business.

The bottom line. Founder shares and public shares are identical, expect for the founder shares' anti-dilution adjustment and voting agreement/redemption waiver. The founder warrants and public warrants are identical, except for founder warrants' cashless exercise and lack of redemption (e.g. forced exercise) provisions.

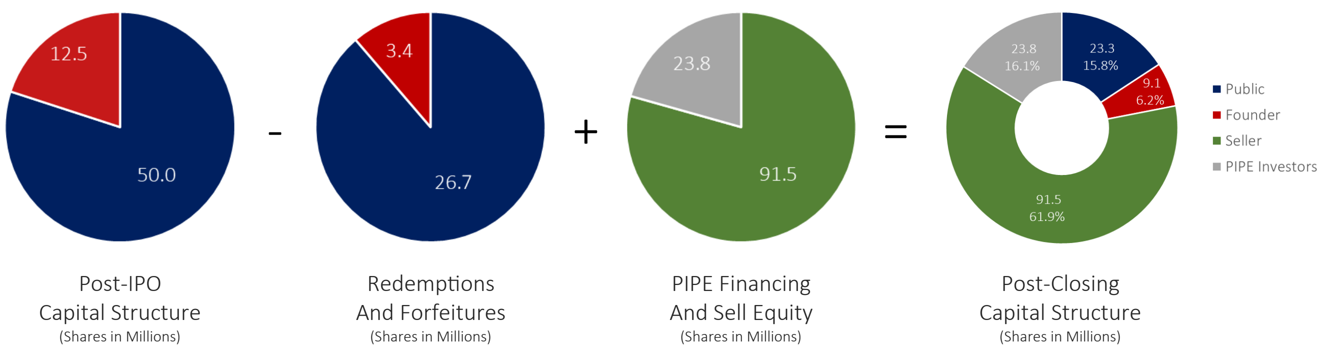
De-SPAC Transaction

Each SPAC and operating companies will present unique considerations. Not every SPAC is a suitable acquisition candidate for the operating company, and vice-versa. Although there is no maximum size set for a target company, there is a minimum requirement: the fair market value of the target company must be 80% or more of the SPAC's trust account **(Figure 2)**. As a result, the risk of excess redemptions can influence each steps of the deal process up until closing. Unless SPAC shares are trading at or above the redemption price at the time of closing, the business combination is unlikely to succeed. However, because SPAC units, shares, and warrants are all separate and publicly traded securities there often is a significant investor rotation biding up prices allowing the deal to proceed. If it is an attractive deal and opportunity, of course.

The specifics of a SPAC's post De-SPAC capital structure and contractual agreements are also very important things to consider for all stakeholders because of the dilutive effect of founder shares, notably when applicable to a backstop or PIPE investment. In some recent transactions, the dilutive effect of founder shares was in fact too large. As a result, SPAC sponsors forfeited a portion of the founder shares or relinquished them subject to specific earn-in rights.

In the end stages, the availability of capital is one of the most important considerations. SPAC IPO proceeds are generally unavailable for the SPAC to pay deposits, break-up fees, and such since those proceeds are held in the trust account. Although it may have a small amount of cash on hand post-IPO, it is very likely to be insufficient. Hence, a key differentiator among SPACs is whether the blank-check firm has an affiliate willing to commit to backstop redemptions and purchase additional equity to the extent necessary to fund the cash purchase price for the De-SPAC transaction.

Figure 2. Post-Closing Ownership Structure Assuming a $500mn SPAC IPO at $10 per share. *Illustrative Purpose Only*



Source. Harvard Law, MAM Research

New SPAC Barons & Opportunities

As highlighted earlier in our note, SPACs are the new hot ticket on Wall Street and we now expect to see the first listing of a blank-check firm in London sometime this year. As a result, it is no surprise to see high-profile investors participating and surfing the SPAC wave with some having been in the game long before SPACs gained popularity. Sir Martin Franklin has raised six SPACs in the US and across the Atlantic since 2006. Some of the businesses he has taken public include Nomad Food and GLG Partners, once the largest hedge fund in Europe. Franklin is said to be working on a seventh one now. Hollywood executives turned investors Harry Sloan and Jeff Sagansky also raised six blank check companies. Their latest firm, Eagle Acquisition, raised $690 million in March and announced a merger with the mobile-game company Skillz in a deal valuing it at $3.5 billion. However, one of the most recent and notable investor to get back into the SPAC business is none other than the "go big or go home" activist investor Bill Ackman. The founder of Pershing Square Capital Management raised $4 billion in July, the largest SPAC ever, and committed to invest at least another $1 billion when a target is identified. The blank check company will be seeking to merge or acquire what Ackman refers to as "mature unicorns", a business valued at $10+ billion. Considering the minimum target size requirement aforementioned, we need to look at companies with a fair market value at or above $20 billion (excl. additional $1 billion commitment), not a very long list. As of now, this list includes some of the following names **(Figure 3)**: Airbnb, Stripe, and Epic Games or Flipkart. The last two companies were included in the names because while their fair value was estimated at $15 billion in the latest round of financing, it could potentially be re-valued at a higher valuation in a SPAC deal negotiation.

Figure 3. Potential Targets for Pershing Square (Size Based)

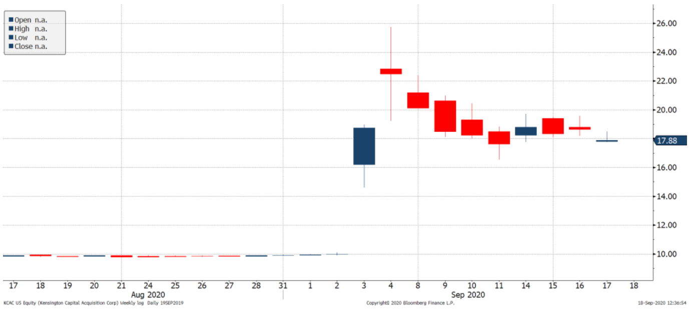
stripe	airbnb	EPIC GAMES	flipkart.com
Est. Val. $35.3Bn	Est. Val. $31.0Bn	*Est. Val. $15Bn*	*Est. Val. $15Bn*

Source. SharePost, MAM Research

Recent High Profile SPAC Deals

The hype surrounding SPACs today is very real. In early September, QuantumScape (QS) agreed to merge with Kensington Capital (KCAC) which raised $200 million in a June IPO. QS is a tech company which has spent the last decade developing next generation solid state batteries - a disruptive alternative to conventional lithium-ion batteries used in EV and other applications. QS's technology has been tested by leading automakers, including Volkswagen, which publically acknowledged that it successfully tested the target's technology at automotive power levels, an industry first. As per the business combination agreement and the investor presentations, the firm was valued at a fair market equity value of $4.5 billion. Last year, QS raised $500 million in funding from VW, Bill Gates, and Kleiner Perkins valuing its at $2.3 billion. Following the news, KCAC shares rose to $22,50 **(Chart 8)**, implicitly valuing the post-merger firm's equity at more than $10 billion. That's more than a two fold increase from the original equity deal value. While we are keen to gain exposure to SPACs for their attractive risk-reward profile, we get cautious when it comes to holding onto them over time and carefully look at valuations. In that case, while the technology has seen a proof of concept, the company is still 3-years away from producing batteries and will only start generating revenues from 2024. The company is estimating 2028 revenues of $6.4 billion which we do not challenge considering the opportunity set but it is indeed far away. How does the valuation metric compare to say Tesla? Tesla is estimated by 26 analysts to generate $42bn of revenues in 2021. Assuming a constant revenue growth rate of 25% for the foreseeable future, 2028e revenues for Tesla could reach $200 billion (31x more than QS). Currently Tesla is trading at a current EV of $350 billion, meaning current 2028e EV/ Sales ratio is 1.75x. Ascribing a similar ratio to QS we would get a fair EV of $11.2 billion, implying $27.6 per share (+54% vs spot price). Should we choose a more conservative approach ($27.6 per share target), then we'd like to buy the shares when they offer 100% upside potential which is c. $13.8/share (-25% from spot).

Chart 8. KCAC Historical Share Price (Daily)



Source. Bloomberg, MAM Research

Chart 9. SPAQ Historical Share Price (Daily)

Source. Bloomberg, MAM Research

In light of the disruptive impact of the pandemic, many governments are gearing their fiscal stimulus financing towards a greener economy. As a result, it now comes to no one's surprise to see renewable energy, EV, and hydrogen exposed companies' prices being bid up quite rapidly. Since March lows, Tesla's market cap soared by a whopping 492% while Nio, a Chinese EV manufacturer rose by more than 800%, just to name a few. Although valuations are extensively stretched in the eyes of many, including us, fact of the matter is those type of companies are benefiting from strong tailwinds supported by a wave of participating retail investors. One of the most recent example we can look at is the reverse merger announced in July between Fisker, an EV startup outsourcing almost everything, and Spartan Energy Acquisition (SPAQ) **(Chart 9)**, which raised $400 million in its IPO back in August 2018. We view this as a very interesting opportunity that could well be the next Tesla, but with a higher margin potential thanks to its unique business model. At a $3 billion valuation in the deal, we found this opportunity relatively attractive. However, investing in SPACs and such stories does carry a fair amount of risks. The company has yet to sign a formal agreements to secure supply and manufacturing with an OEM, which is in our view the key risk here. Nonetheless, talks with Volkswagen should be entering the closing stages with an announcement by Q1 2021. Then, it still carries some time to market risk with the first car not expected to come off the production line until at least 2022. Yet, current business plan, if properly and diligently executed, could see a rapid production ramp up, thanks to the OEM contract. Indeed, production would start at 8,000 cars in 2022, and ramp up to produce 175,000 vehicles by 2024, and generate as much as $10.6 billion in revenue by 2024.

Risks & Opportunities in SPACs

"You have people who are buying business with no revenue, no earnings, and a story. […] We are in silly season SPAC-land. […] This is going to end badly." said Sir Martin Franklin. We do not disagree which is why we are cautious and thoroughly analyse management teams (sponsor-side), look at the type of businesses they are searching for, and the target companies when we seek to invest (if already announced). However, we recognise that investing in SPACs before merger news can be a profitable undertaking. As per the table below, most SPACs have rallied substantially after the news in a short period of time. We intend to take advantage of this trend and identify the future SPAC winners.

SPAC Name	M&A Target	Sector	Announcement	Perf. Since News
TORTOISE ACQUI-A	Hyliion	Gas Powered Trucks	Jun-20	395%
SPARTAN ENERGY-A	Fysker	Electric Vehicles	Jul-20	51%
KENSINGTON CAP-A	QuantumScape	Electric Batteries	Sep-20	81%
PIVOTAL INVESTME	XL Fleet	Electric Systems	Sep-20	12%
SOCIAL CAPITAL-A	Opendoor	Online Real Estate	Sep-20	32%

Investment Implication

We are considering building a relatively concentrated portfolio of +/- 20 SPACs which have yet to announce a business combination (i.e. Pershing, Social Capital) for investors to gain exposure to a very attractive market.

As always, please feel free to reach out to us should you have any questions or comments regarding this research.

Kind regards,

MAM Investment Team

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