

# Taking Stock with Steele

Your Monthly Newsletter

*The purpose of this newsletter is to share insights and expertise. Our goal is to ensure that our clients are well informed of changes affecting local business decisions and our investment recommendations.*

*We believe Knowledge Pays and we want our knowledge to help pay for you.*

## ARE SPACS SPACTACULAR OR DESPACABLE? A REVIEW OF SPACS

A **Special Purpose Acquisition Company (SPAC)** is a type of investment fund that allows public stock market investors to invest in private equity (PE) transactions. SPACs have existed in their current form for over two decades in the US but became available just two years ago in Canada. Over those inaugural two years six SPACs were created. The four that targeted private companies successfully completed acquisitions while the two that targeted publically traded companies did not.

A **SPAC raises capital in a public stock offering that it will use to purchase an attractive private company.** If a SPAC does not make a deal in approximately two years after the SPAC's formation, it must return the capital plus interest to SPAC shareholders. SPAC shareholders get to review any deals SPAC management proposes. While SPACs were designed to allow the investing public to invest in private companies, they do not have a restriction against buying a publically traded company.

Below are the key **advantages** of SPACs relative to traditional PE funds:

- **Payoff Timing:** Private companies typically trade at a 20%-40% discount to similar publically traded companies. SPACs can trigger the gains of "going public", which are effectively spread between the SPAC and private company shareholders. Traditional PE funds typically wait several years before unlocking this value.
- **Liquidity:** Investors in traditional PE funds have their investment locked-in, typically for at least five years, while SPAC units can be traded freely on a stock exchange from day one.
- **Capital Management:** Traditional PE funds often have small amounts of capital sitting idle as they are continuously raising capital, while SPACs raise capital all at once and hold that capital in escrow until a deal closes.

Below are the key **drawbacks**:

- **Dilution Upon Deal Execution:** Investors in traditional PE funds typically pay annual fees of 2% plus a percentage of profits, while SPAC investors pay no annual fees but give the SPAC management team 18%-20% equity in the company following a deal.
- **Lock-Up Period Liquidity:** While SPAC units are liquid during the initial two-year hunt for a buyout, liquidity is limited and units could trade at a discount to their net asset value.
- **Acquisition Visibility:** SPAC investors have low visibility about future acquisitions at the IPO date.

SPACs will likely become more and more prevalent in Canada. We will keep you up to date about whether SPACs begin to look attractive as investments.

### Current Rates & Data

#### Govt of Canada

90 day	0.52%
1 year	0.79%
2 year	0.92%
5 year	1.14%
10 year	1.51%
30 year	2.05%

#### U.S. Treasury

90 day	1.00%
1 year	1.20%
2 year	1.36%
5 year	1.76%
10 year	2.16%
30 year	2.79%

#### Canada Prime Rate

2.70%

#### U.S. Prime Rate

4.25%

#### Exchange Rates

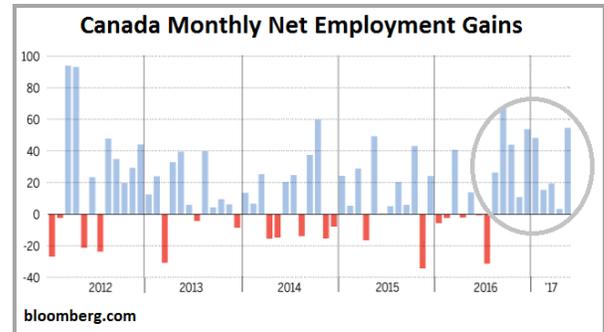
CAD/USD	0.752
USD/EUR	1.114
JPY/USD	110.6

## ECONOMIC TIDBITS BRITONS VOTE AGAINST HARD BREXIT & BLOCKBUSTER CANADIAN EMPLOYMENT GAINS

• On June 8, Britons went to the polls for the 2017 general election. UK PM May initially called the snap election to solidify support for her Brexit platform but ended up losing her majority government. May is now attempting to form a coalition government with the far right-wing Democratic Unionist Party of Northern Ireland. The parties agree on many Brexit principles but disagree on many core positions.

PARTY	SEATS	+/-	PARTY	SEATS	+/-
Conservative	318	-13	Plaid Cymru	4	+1
Labour	262	+30	Green Party	1	0
Scottish National Party	35	-21	UKIP	0	-1
Liberal Democrat	12	+4	Social Democratic & Labour Party	0	-3
Democratic Unionist Party	10	+2	Ulster Unionist Party	0	-2
Sinn Fein	7	+3			

• The Canadian economy added a net 55,000 jobs in May versus expectations of 15,000. This is the third biggest monthly gain of the past five years. While organizations around the world have been busy highlighting the risks in the Canadian financial sector and housing market, the Canadian employment keeps growing, creating new demand for housing and credit that helps perpetuate the current state.



## LE JIT A “JUST-IN-TIME” RUNDOWN OF OUR CURRENT INVESTMENT THEME

### Canadian Industrials Lagging Their Peers for No Good Reason

- **SNC-Lavalin Group (SNC)** and **TFI International (TFII)** are two ideas related to this theme.
- **SNC** trade at a material discount to peers following the 2011-2012 bribery scandal. We believe SNC’s recent acquisition of UK-based Atkins will help the company regain its premium valuation. After removing the value of SNC’s interest in the 407 ETR, SNC’s engineering and construction (E&C) business trades at a ~25% discount to peers looking two years out on an EV/EBITDA basis, based on analyst estimates. SNC historically traded at a 10%-30% premium to E&C peers so SNC has plenty of upside should it shake off its bad reputation. Ultimately, SNC should earn its way out of its bad reputation as its discount valuation means higher than average returns for SNC shareholders.
- **TFI** is one of the largest transport and logistics companies in North America. After the US election, TFI shares benefitted from improving North American economic sentiment but the shares have since retraced those gains. TFI currently trades in line with its trucking peers at ~14x trailing normalized earnings. Most industrials companies outside of the trucking segment trade at the high end of their historical valuation range while truckers remain at the low end of their historical valuation range. We do not think it makes sense for other industrial companies to trade at historic premiums to the trucking segment when they all rely on the same economic growth outlook.

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**This newsletter has been brought to you by Steele Wealth Management**

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