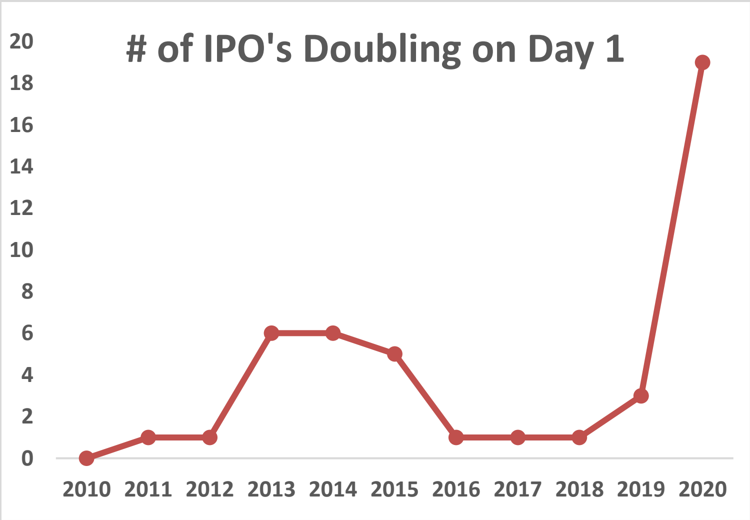
IPOs & SPACs

As we discussed in last quarter's newsletter (click here), the SPAC (special purpose acquisition companies) and IPO (initial public offerings) markets are "on fire." According to Dealogic, 2020 was a record year for the US IPO market, as companies raised $167 billion through 454 offerings. The prior full-year record was set in 1999, during the Dot Com era at $108 billion. Capital raised by SPACs last year more than quintupled, across over 200 offerings (per S&P Global data). January 2021 was the best January for IPOs in more than 25 years, with 116 companies raising $39 billion. Over the last 3 months of 2020, 39 SPACs announced transactions. These SPACs climbed an average of +5.4% on the day of their announcement and were an average of +16% higher over the next month (per Dow Jones market data).

Affirm (ticker AFRM) is a BNPL (buy now, pay later) company that we will discuss later in the newsletter. After the enormous success of its early January's IPO, which more than doubled from its initial offering price, we envision the 2021 market for FINTECH IPOs should remain strong.

Other FINTECH companies are taking the SPAC route, with Social Finance or SoFi as a recent example. SoFi agreed to be acquired by a SPAC (Social Capital Hedosophia Holdings), with an implied valuation of $8.65 billion. The SPAC purchasing SoFi immediately advanced +63% upon the annuncement. SoFi has 1.8 million members and started as a student-loan refinancing business. It has received preliminary approval from the US Office of the Comptroller of the Currency to receive its much sought-after national bank charter and has branched into mortgages, personal loans, credit card refinancing, insurance and investing accounts.

The banks that manage the IPO process are supposed to equally weigh supply and demand dynamics to ensure the company going public raises as much money as possible. However, brokerages are signficantly underpricing these deals and have underappreciated retail interest. By underpricing the initial price, these brokerages are doing a disservice to the newly public company by not raising as much capital as it should have received.



Nineteen IPOs have doubled on their first day of trading this year, significantly more than in any year over the last decade. It looks like these banks have significantly underestimated demand, to the detriment of their now public company clients.

Two of 2021's potentially largest IPOs are both in our FINTECH space – Robinhood and Coinbase.

Let's now discuss digital currencies, Bitcoin and and the upcoming Coinbase IPO.

FINTECH Trend: Digital Currencies

Are digital currencies really currency? We have written on this subject in the past (click here and here) explaining that we believe a currency has to satisfy two key issues to be considered a viable currency. First, it needs to be a ***"medium of exchange"*** and one needs to be able to use it as a payment mechanism. Second, it needs to be a ***"store of value.***" In our opinion, Bitcoin fails as a payment mechanism for legitimate commercial transactions, but it is gaining traction as a store of value.

Medium of Exchange: In the month of November, according to Chain analysis, there were less than $270 million of global purchase transactions using Bitcoin. In comparison, just in the US, retail sales were nearly $550 billion. On the payment front, Visa processes close to 150 million transactions per day, which averages to roughly 1,700 transactions per second. On its payment network, it has the capability to handle 65,000 transactions per second, which represents spare capacity of nearly 40x. In comparison, how many transactions can the Bitcoin blockchain network process per second? An unimpressive 7. Why? As the number of Bitcoin users grows, it takes longer and longer for those transactions to process over its blockchain platform (by its miners). As its public blockchain gets longer, transaction times will only lengthen.

However, everyday additional merchants are mentioning the interest in accepting Bitcoin. On February 8th, 2021, Tesla's Elon Musk tweeted about accepting Bitcoin for automobile purchases. This theoretically makes sense, but we believe it will be harder to implement. Merchants simply cannot manage or handle the massive volatility of Bitcoin.

Store of Value: The store of value concept is very different from digital currency as a payment mechanism. The total market capitalization of gold is roughly $12 trillion, while the total value of Bitcoin is closer to $750 billion. Some naysayers state that Bitcoin depends on the faith of investors and nothing more. Others believe it can act as a hedge against inflation and against declines in other financial assets, like stocks, bonds or the US dollar.

Opinions on Bitcoin are changing every day. Back in 2018, the CEO of Blackrock (Larry Fink) called Bitcoin a currency "for money launderers." A year earlier, JP Morgan CEO, Jaime Dimon called Bitcoin a "fraud" and threated to fire any bank employee who dealt with the currency. Fast forward to today: Blackrock (in January 2021) enabled two of its mutual funds to purchase Bitcoin, and a JP Morgan analyst recently published that he thinks Bitcoin could rise to $146,000.

Bull vs Bear

If you want a bearish perspective on Bitcoin, the UK Financial Conduct Authority called cyrpto assets "high risk, speculative investments" where investors "should be prepared to lose all their money." If you want a bullish perspective on Bitcoin click on this presentation from Skybridge Capital. It recently launched a dedicated Bitcoin fund and they made a compelling case for the digital currency. If you want an interesting perspective of how digital currencies may or may not replace fiat currencies, click on this article recently published in Digital Transactions. This quick read discusses the likelihood of digital currencies replacing traditional payment systems and highlights Amara's Law. That thesis, from Stanford computer scientist Roy Amara, states how we tend to overestimate the impact of new technology in the short-term, but underestimate it in the long-run.

Is Bitcoin poised to climb higher, or will it crash? We simply don't know. What we do know is that we prefer to own the medium where these "assets" trade. We would compare this to the Gold Rush of the mid-1800's. Back in 1849, owning Levi Strauss made a fortune selling picks, pans and shovels to '49ers looking for gold. Back then, some would say, "There's gold in those mountains." Nowadays, there's a huge opportunity in the collection of data and information. From our perspective, we truly have no idea what the price of Bitcoin will do, except we know that it will be very volatile. As we know, volatility leads to trading, which should equate to profits for the exchanges. Speaking of exchanges, let's now discuss another upcoming FINTECH IPO.

Coinbase

Crypto currencies are hot right now, with Bitcoin increasing by over 300% in 2020 and over 45% already in 2021. To capture some of this excitement, Coinbase has filed preliminary regulatory paperwork with the SEC to become a public company.

Today, Coinbase supports trading for over 40 crypto assets on its exchange, and it provides custody services for over 90 different crypto assets. With new digital currencies created daily, the directive to list every possible compliant asset is a challenge. Unlike the stock market, where data comes from centralized exchanges like the NYSE or Nasdaq or the CME, digital currencies are traded across hundrends of different marketplaces. This results in a situation where no one price or exchange has definitive information. The race to become the de-facto reference rate for Bitcoin has emerged, with S&P Global (ticker SPGI), the manager of the S&P 500 and DJIA (Dow Jones Industrial Average), announcing its plans to launch a Bitcoin index this year. Offering transparency and standardized pricing is critical for the proper functioning of a traditional asset, as this improves liquidity and lowers costs for investors.

Creating an industry-recognized standard is potentially a very lucrative opportunity, which many firms are trying to capture. There are tons of competitors in this nascent market attempting to grab a piece of the potential enormous future growth. For example, in 2013, CoinDesk was founded, and it began to publish a Bitcoin price index and reference rate. Just a few weeks ago, Intercontinental Exchange (ticker ICE), which owns the NYSE, permitted its Bakkt asset to merge with a SPAC and enter the public markets. In addition, in October of 2020, both Square (ticker SQ) and PayPal (ticker PYPL) enabled their millions of users to trade and store digital currencies on their mobile apps and wallets. On January 6th, 2021 Nomics showed that crypto-asset trading on PayPal set a record at $129 million. A few days later, on January 11th, trading volume was up 88% to $242 million.

The Cash app from Square has over 30 million users, and PayPal has 325 million active users. The dramatic increase in user engagement and prices helped spur revenue for both companies, but the bigger question is what will happen if Bitcoin were to suddenly drop. That's the key question in our opinion. Did these retail Bitcoin investors book a profit or are they are simply considering it a buy and hold investment?

Both PayPal and Square have plans to allow Bitcoin to be used as a payment method at their millions of their small-to-mid sized merchants. This essentially would *close-the-loop* and really advance the concept of Bitcoin as a commercial payment method. We actually think that volatility (either way) will drive transaction volumes and build top-line growth. But as you can tell from our digital currency discussion, there is still significant uncertainty in this emerging digital currency ecosystem.

DISCLAIMER:

Firm: Manole Capital Management LLC is a registered investment adviser. The firm is defined to include all accounts managed by Manole Capital Management LLC. **In general:** This disclaimer applies to this document and the verbal or written comments of any person representing it. The information presented is available for client or potential client use only. This summary, which has been furnished on a confidential basis to the recipient, does not constitute an offer of any securities or investment advisory services, which may be made only by means of a private placement memorandum or similar materials which contain a description of material terms and risks. This summary is intended exclusively for the use of the person it has been delivered to by Warren Fisher and it is not to be reproduced or redistributed to any other person without the prior consent of Warren Fisher. **Past Performance:** Past performance generally is not, and should not be construed as, an indication of future results. The information provided should not be relied upon as the basis for making any investment decisions or for selecting The Firm. Past portfolio characteristics are not necessarily indicative of future portfolio characteristics and can be changed. Past strategy allocations are not necessarily indicative of future allocations. Strategy allocations are based on the capital used for the strategy mentioned. This document may contain forward-looking statements and projections that are based on current beliefs and assumptions and on information currently available. **Risk of Loss:** An investment involves a high degree of risk, including the possibility of a total loss thereof. Any investment or strategy managed by The Firm is speculative in nature and there can be no assurance that the investment objective(s) will be achieved. Investors must be prepared to bear the risk of a total loss of their investment. **Distribution:** Manole Capital expressly prohibits any reproduction, in hard copy, electronic or any other form, or any re-distribution of this presentation to any third party without the prior written consent of Manole. This presentation is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use is contrary to local law or regulation. **Additional information:** Prospective investors are urged to carefully read the applicable memorandums in its entirety. All information is believed to be reasonable, but involve risks, uncertainties and assumptions and prospective investors may not put undue reliance on any of these statements. Information provided herein is presented as of December 2015 (unless otherwise noted) and is derived from sources Warren Fisher considers reliable, but it cannot guarantee its complete accuracy. Any information may be changed or updated without notice to the recipient. **Tax, legal or accounting advice:** This presentation is not intended to provide, and should not be relied upon for, accounting, legal or tax advice or investment recommendations. Any statements of the US federal tax consequences contained in this presentation were not intended to be used and cannot be used to avoid penalties under the US Internal Revenue Code or to promote, market or recommend to another party any tax related matters addressed herein.