THE GLOBE AND MAIL | WEDNESDAY, JANUARY 19, 2022

GLOBE INVESTOR

Bill Ackman's latest investment vehicle is a low-risk proposition for bargain hunters

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OPINION

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Bill Ackman is a polarizing figure. Some investors love him, others hate him.

It can be easy to see why. The U.S. hedge-fund manager's activism has produced significant returns in years past for shareholders in companies such as Canadian Pacific Railway Ltd. and Chipotle Mexican Grill Inc. He also made US$2.6-billion for investors using derivatives to short the stock market in response to the emerging COVID-19 pandemic, according to a letter to his clients in March, 2020. But he also ran into some well-publicized difficulties with several holdings, such as Valeant Pharmaceuticals International (now called Bausch Health Cos. Inc.) and Herbalife Nutrition Ltd.

It's this polarization of opinion that has opened up an opportunity to buy shares in Mr. Ackman's latest investment vehicle at a discount to its underlying value. Consider it a low-risk proposition for bargain hunters everywhere.

In the summer of 2020, Mr. Ackman launched a special-purpose acquisition company (SPAC) called Pershing Square Tontine Holdings Ltd. (PSTH-N). With PSTH, Mr. Ackman raised US$4-billion at US$20 a unit, giving him a significant pool of capital. Like other SPACs, PSTH's purpose is to find a private company and essentially take it public by acquiring it.

While searching for a suitable acquisition, SPAC funds are kept in trust, primarily invested in U.S. Treasury securities. Once a deal is pending, investors can either remain invested or redeem their shares for their pro-rata portion of the trust account. SPACs often trade at a small premium to this "liquidation" value until a deal is announced. In contrast, PSTH is trading at a discount to this liquidation value, currently fetching US$19.89 a share.

With any investment, I consider four things: Why is it cheap, what is it worth, what are the negatives, and are investors' interests aligned with the insiders? Here are the answers to each question.

WHY IS IT CHEAP?

In the spring of 2021, PSTH entered into a rather complex transaction to acquire 10 per cent of Universal Music Group NV. While this transaction may have been an interesting investment for shareholders, PSTH involvement with Universal Music quickly unravelled owing to Securities and Exchange Commission concerns and shareholder litigation. In July, 2021, PSTH terminated its involvement. The result was PSTH was left, as they say, "at the altar."

Investor excitement for the deal had driven the shares to almost US$33. Clearly this was a disappointing outcome and many sold. Adding further investor apprehension was the announcement that PSTH was contemplating converting to a special-purpose acquisition rights company, or SPARC, a new type of proposed security that is simply the right to participate in a future deal – kind of like having an option to buy into an initial public offering. The SPARC structure has yet to receive SEC approval and currently no SPARCs exist.

Finally, in the late fall there was tax-loss selling as investors who paid more than US$20 decided to take a capital loss and apply it to taxable gains earned elsewhere.

WHAT IS IT WORTH?

I figure there are four potential outcomes.

The first two of these would involve investors receiving about US$20 a share, which is their pro-rata share of the trust account.

For example, if Mr. Ackman does not find a transaction by July 24, PSTH will be wound up and net proceeds of US$20 a share plus a small amount of interest on the assets held in trust will be returned to investors.

Alternatively, Mr. Ackman may find a transaction. If an investor doesn't like it, he or she can redeem shares and receive US$20.

The third outcome is Mr. Ackman finds a good transaction, and presumably the shares appreciate well beyond US$20.

The final outcome would be PSTH gets permission to convert to a SPARC. Investors would then receive US$20 in cash plus a new SPARC share. As this new SPARC share would be similar to existing SPAC warrants, I suspect a SPARC warrant would be worth north of US$2 a share.

WHAT ARE THE NEGATIVES?

As my former boss, value guru Peter Cundill, used to say, when you buy a cash-rich company there is always the risk of management doing something stupid with the cash or stealing it from you. In PSTH's case, if an investor does not like the transaction, they can redeem. The more likely negative is an investor's ability to redeem is delayed either owing to litigation or perhaps shareholder approval to extend the life of the SPAC. In either case, I do believe an investor's downside continues to be protected.

ARE INVESTORS' INTERESTS ALIGNED WITH INSIDERS?

Unlike some structures, directors did not receive discounted founders' shares. With PSTH, directors purchased units and out-of-the-money warrants (an exercise price higher than the current price of the underlying shares) worth approximately US$9-million and, together with Mr. Ackman's other funds, have additional share purchase commitments of US$1-billion at the time of a transaction. The bottom line is insiders do have "skin in the game."

I realize this is a somewhat complicated situation. As a value investor, the first question always is, what is my downside? In PSTH's case, an investor will either receive their investment plus a modest return back by midsummer or have the potential for outsized returns. It's a financial markets equivalent of heads I win, and tails I get my money back.

In an accident-prone and expensive market, PSTH is a comfortable holding.

Full disclosure: McElvaine Value Fund has approximately 7 per cent of its net asset value invested in Pershing Square Tontine Holdings.