



Constantia Capital Merger-Arbitrage Strategy July 2021 Commentary

Our composite returned -0.76% in July, bringing returns to 4.11% year-to-date, 4.18% annualized for the past 5 years and 5.17% annualized since inception. That is significantly ahead in all periods of an average of 7 other Merger-Arb mutual funds and ETF's that we monitor.

The solid start to the year took another breather. Politics from multiple avenues gatecrashed the Merger-Arb party. We had American politicians commenting on mergers in general. What started with criticism of large tech companies such as Apple and Google has evolved, and there is now an increased focus on bank and rail mergers. Additionally, we had Chinese politicians threatening to block their companies from listing on US exchanges, and basically outlawing a whole industry (After School Education). Coupled with increased tension between the US and China over Human Rights and trade, we saw pressure on China related deals (either the target is a Chinese company typically trading in the US, or Chinese approval for a deal is required, or a Chinese acquirer of a Western domiciled company).

China and the U.S. have had many friction points (beyond commerce) for decades, but the interdependence of our economies is too strong to push tensions past the breaking point. We are confident that is still the case. Similarly, within the US, we've seen politicians make threats before, but the anti-trust process has clear rules that have stood the test of time and those are unlikely to change much despite political noise. And clearly, those statements have not dampened the appetite for companies to do deals as a way to strengthen their financial positions in an increasingly fast moving and competitive business environment.

Some of the highlights and lowlights of the month:

- The biggest detractor was Canadian National Railway's acquisition of Kansas City Southern. Rail takeover rules are complicated, and politicians voicing concern over this deal caused a negative impact of -23 bps. Meanwhile the downside on this deal appears limited since Canadian Pacific is waiting to resuscitate their original deal should this one fail. (You may recall that Canadian National outbid Canadian Pacific in a bidding war that was quite profitable for us.) Note that despite their names, both Canadian companies are publicly traded entities with little or no explicit ownership by the Canadian government or related entities.
- Two semiconductor deals awaiting Chinese approval together cost 25 bps, namely AMD's purchase of Xilinx and Two-Six's purchase of Coherent. Both have received most if not all other approvals, and a recent interview with Investor Relations at AMD strongly implied that she did not see any change over time in the Chinese antitrust approach to their deal.

- A third semiconductor deal, Magnachip Semiconductor of South Korea, being acquired by a Chinese private equity firm also saw its spread widening on increased tension between the US and China, costing 12 bps. In this case, US and South Korean approvals are required. We've reduced our position to about 70 bps.
- Aon and Willis Towers Watson terminated their merger in the face of US objections. We had always regarded this deal as risky due to the two companies being so dominant in insurance brokerage. As a result, we had a very small position and the negative impact was only 5 bps. Some have interpreted the rejection as a sign of stricter US antitrust enforcement, and it may have increased nervousness in the Merger-Arb market, but as noted, this was always a problematic deal.
- We liquidated our position in Tarena International, a private education company, just before the new ruling by the Chinese government effectively outlawing private After School Education. The impact was 5 bps, but could have been worse.
- The best positive contributor was Salesforce's acquisition of Slack which closed during the month and contributed 10 bps.
- Two small biotechs that are merging, Xeris Pharmaceuticals acquisition of Strongbridge BioPharma, saw its spread contract as the deal moves closer to completion, contributing 9 bps.
- Another high-profile deal closed, namely AstraZeneca's acquisition of Alexion, contributing 5 bps.

Despite all the background noise, deal flow continues to be as strong as ever, with 40 new deals announced in July, while 28 deals closed and two were terminated. Diversification in the portfolio continues to be extremely high. The number of deals has risen to 135, and leverage is close to 135% (\$135 of long positions for every \$100 of capital).

Constantia Capital Merger-Arbitrage: Performance as of July 31, 2021

Benchmark	Reporting Period	Returns (Net) ^{2 3}	Bench-Mark ²	Excess (Net)	Volatility	Sharpe Ratio
LIBOR 3-month USD	Year-to-date	4.41%	0.10%	4.31%	N/A	N/A
	Latest 3 Years	3.99%	1.35%	2.63%	6.53%	0.40
	Latest 5 Years	4.18%	1.40%	2.78%	5.21%	0.53
	Since Inception ¹	5.17%	0.89%	4.27%	4.70%	0.91

¹ Returns annualized, since inception date 11/1/2011

² Returns annualized for periods in excess of one year

³ Net returns after performance fee, which three qualified clients have elected as of 1/31/2021