

## **Constantia Capital Merger-Arbitrage Strategy August 2023 Commentary**

Our composite returned 1.60% in August, bringing year-to-date returns to 3.88%, 4.18% annualized for the past 5 years and 5.06% annualized in almost 12 years since inception.

World equities were slightly negative for the month, giving back some of their strong gains for the year. The MSCI World Index posted returns of -2.75%. The S&P 500 outperformed other world indices on average, returning -1.59%. Recent inflation data continues to show signs of moderation, but the US Federal Reserve appears to be leaning toward another rate hike. That caused the Bloomberg Aggregate Bond Index to post slightly negative returns, returning -0.64%. The classic 60/40 Equity/Bond benchmark (All World Index, Bloomberg US Aggregate Bond Index) returned -1.9% for the month.

We have been clear that our goal is to exceed short-term interest rates. The year started slowly primarily due to the prevailing negative anti-trust environment in the US and internationally. However, regulators suffered a string of defeats in court, and it appears they are softening their position (see below). After the strong third quarter (so far) returns of our composite, we are now ahead of our benchmark year-to-date (and strongly outperforming the various Merger-Arb fund averages as well as the Bloomberg Aggregate Bond Index).

For our Merger-Arb strategy, some of the highlights and lowlights of the month were:

- The US Federal Trade Commission withdrew their previously scheduled in-house trial with Amgen of their takeover of Horizon Therapeutics. It was our opinion that the FTC would lose the case since Horizon's lead drug currently has no competitors, and that would not change after the merger. The resulting contribution was 13 bps for the month. Seagen, being acquired by Pfizer, rose in sympathy, contributing an additional 5 bps. (Postscript: As of September 1, the FTC and Amgen resolved their differences. Amgen expects to close the deal within two months).
- Johnson and Johnson's splitoff of Kenvue contributed 33 bps for month and 26 bps overall, after being a detractor in July. An advantage of the separate account format is that we can take advantage of the odd-lot guarantee (holders of 99 shares or fewer are not pro-rated in the case the offering is oversubscribed) more effectively than a comingled hedge fund or ETF.
- The conversion of AMC's APE shares into AMC stock contributed 16 bps. This was a strange saga where AMC shareholders sued to block the conversion and won. However, a second ruling allowed the conversion to proceed, and at that point AMC announced the deal would close within two weeks. The spread between AMC and APE was huge but that reflected that the cost of shorting AMC was over 500% annualized, and very difficult to borrow. We were able to hedge most of our APE position. The resulting contribution was 15 bps, even taking stock loan fees into account.

- Sculptor Capital Management, a hedge fund operator founded by Dan Ochs, agreed to be acquired by Rithm Capital. The firm gained notoriety for a bribery scandal when known as Och-Ziff. A number a high-profile fund managers including Bill Ackman have made a bid at price that is 14% higher than Rithm’s price, but Sculptor still sees the original deal as superior, and as a result Sculptor’s stock price is only a few percent higher than Rithm’s bid. The contribution for the month was 11 bps.
- Emis Group, a British provider of medical information systems is in a deal to be acquired by United Healthcare that was announced more than a year ago. In another sign of how the regulatory environment has changed recently, British anti-trust authorities had indicated in May they would likely block the deal, only to approve it earlier this month. The contribution for the month was 8 bps, but zero overall since we had reduced our exposure at a loss after the initial anti-trust announcement.
- Velan, a Canadian pump manufacturer is being acquired by Flowserve of the USA. France is looking to block the deal based on security issues relating to Velan’s nuclear business in France. This was our largest detractor for the month, costing 15 bps.
- Spirit Airlines, being acquired by JetBlue. The market is already skeptical of deal approval based on anti-trust issues, and our position is a relatively small 50 bps. News leaked that JetBlue plans to raise prices on Spirit flights (while at the same time reducing seats per airplane in line with JetBlue practice), causing Spirit to fall 10% for the month and detracting by 7 bps.
- Tower Semiconductor had been in a deal to be acquired by Intel, awaiting Chinese anti-trust approval. Intel terminated the deal after the contractual “walk date” passed, resulting in a negative contribution of 4 bps for the month and 22 bps since inception.

New deal announcements were 30 for the month, while deals 27 closed. Diversification remains well above average with the number of deals rising to 110. Leverage is slightly above zero (approximately \$100 of long positions for every \$100 of capital).

### Constantia Capital Merger-Arbitrage: Performance as of August 31, 2023

| Benchmark                 | Reporting Period             | Returns (Net) <sup>2 3</sup> | Bench-Mark <sup>2</sup> | Excess (Net) | Volatility | Sharpe Ratio |
|---------------------------|------------------------------|------------------------------|-------------------------|--------------|------------|--------------|
| LIBOR/SOFR<br>3-month USD | Year-to-date                 | 3.88%                        | 3.38%                   | 0.50%        | N/A        | N/A          |
|                           | Latest 3 Years               | 5.57%                        | 2.02%                   | 3.55%        | 3.04%      | 1.17         |
|                           | Latest 5 Years               | 4.18%                        | 1.95%                   | 2.23%        | 5.34%      | 0.42         |
|                           | Latest 10 Years              | 4.27%                        | 1.39%                   | 2.88%        | 4.54%      | 0.64         |
|                           | Since Inception <sup>1</sup> | 5.06%                        | 1.23%                   | 3.82%        | 4.43%      | 0.86         |

<sup>1</sup> Returns annualized, since inception date 11/1/2011

<sup>2</sup> Returns annualized for periods in excess of one year

<sup>3</sup> Net returns after performance fee, which three qualified clients have elected as of the date above