

Constantia Capital Merger-Arbitrage Strategy June 2023 Commentary

Our composite returned 1.14% in June, bringing year-to-date returns to 1.82%, 3.92% annualized for the past 5 years and 4.95% annualized in 11 1/2 years since inception.

World equities posted strong returns in June, with the MSCI World Index returning 5.84%, led by US stocks (the S&P 500 returned 6.6%). The Federal reserve is likely to raise US rates again as inflation remains above desired levels, even though it is far below levels seen at the start of the year. The Bloomberg Aggregate Bond Index returned -0.36%. The classic 60/40 Equity/Bond benchmark (All World Index, Bloomberg US Aggregate Bond Index) returned 3.36% for the month.

Merger-Arb posted a strong month as we benefited from deal spreads that are wider than the historical average. As a reminder, deal spreads are a combination of the prevailing risk-free rate plus a risk premium. The former has risen as the Fed and other central banks have raised short-term interest rates. Risk premiums are higher than average as the market remains nervous about the regulatory environment. We are of the opinion that the market is being excessively risk-averse, which will result in enhanced returns looking forward. Further enhancing returns was the sudden reappearance of a specific bidding war situation.

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

- The above-mentioned bidding war was KKR's acquisition of valve maker Circor International. The original deal price was \$49. Another private equity firm, Arcline, bid \$57 for Circor, causing KKR to increase their bid to \$56 and the promise of a smoother regulatory approval process. Our position in the deal was 1.5% of the portfolio, resulting in a contribution of 25 bps.
- Iveric Bio, a biotech working on a drug for Age-related Macular Degeneration, an eye disease, is being acquired by Astellas, a Japanese company. The aptly chosen ticker symbol is ISEE. This deal is an example where the deal started out at a wider than historic level, but the spread has narrowed to about 1% after the companies reported the expiration of the HSR anti-trust waiting period. We expect the deal will close shortly after the shareholder vote in early July, which is ahead of the August FDA meeting date on their most important pipeline drug. The contribution for the month is 8 bps and 12 bps since inception.
- iRobot, being acquired by Amazon, has seen its deal spread widen on concerns over deals involving the very largest companies. As the risk has increased, we have reduced our position, now down to less than 0.5% of the portfolio. British anti-trust authorities surprised the markets by announcing approval of the deal, resulting in an 8-bps contribution. US approval remains pending.

- Last month's best contributor, Office Properties Income Trust's acquisition of Diversified Healthcare Trust, was a positive contributor again in June. Both companies are REITs. The deal is trading well above the deal price as investors have concluded that Diversified Healthcare Trust is undervalued – the stock rose 65% in June, resulting in a 10 bps contribution.
- The worst detractor was Wentworth Resources, a British listed Tanzanian natural gas company. The company co-develops a gas field with French company Maurel & Prom, which had agreed to acquire Wentworth in December 2022. In a surprise move, the Tanzania Petroleum Development Corp is attempting to block the deal, and negotiations are ongoing. The negative impact was 16 bps.
- Chinook Therapeutics, (ticker symbol KDNY), is developing a drug for two rare kidney diseases and has agreed to be acquired by Novartis for \$40 in cash plus \$4 in CVR's. The spread widened shortly after we acquired our position in another example of the current risk averse environment, resulting in a negative contribution of 6 bps.
- In the largest ever CVR deal, Eli Lilly is acquiring micro-cap pre-clinical Sigilon Therapeutics, a biotech company with a Type-1 diabetes drug in development. The deal price is \$14.92, but 3 successive CVR's have a combined potential payout of \$110. Our analysis based on historical probabilities of drug approvals at various Phases is that the CVR plus deal price is worth \$35, but the stock is trading at \$22.50. We bought a position representing 0.25% of the portfolio at an average purchase price of \$25.8, resulting in a 4 bps mark-to-market loss.

New deal announcements were 17 for the month, while 21 closed. Diversification remains high and the number of deals remains at approximately 100. The portfolio is back at approximately zero leverage (approximately \$100 of long positions for every \$100 of capital).

Constantia Capital Merger-Arbitrage: Performance as of June 30, 2023

Benchmark	Reporting Period	Returns (Net) ^{2 3}	Bench-Mark ²	Excess (Net)	Volatility	Sharpe Ratio
LIBOR/SOFR 3-month USD	Year-to-date	1.82%	2.48%	-0.66%	N/A	N/A
	Latest 3 Years	5.39%	1.73%	3.65%	3.01%	1.21
	Latest 5 Years	3.92%	1.85%	2.07%	5.32%	0.39
	Latest 10 Years	4.28%	1.31%	2.97%	4.54%	0.65
	Since Inception ¹	4.95%	1.17%	3.77%	4.45%	0.85

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 the date above