

Constantia Capital Merger-Arbitrage Strategy May 2022 Commentary

Our composite returned -1.40% in May, bringing returns to -1.22% for the year-to-date, 3.86% annualized for the past 5 years and 5.07% in 10.5 years annualized since inception.

The market stress finally caught up with our merger-arb strategy. In general, target companies (of cash-only deals) trade at the present value of the deal price multiplied by the probability of the deal being approved plus the market's best guess of the target price if the deal fails multiplied by the probability of the deal failing. With the market falling into bear market territory early in the month, the market's estimate of the target price on deal failure was falling and the estimate of the probability of deal failure was rising. However, as is very often the case, the market had overreacted and by the end of the month some measure of stability had returned.

Some of the highlights and lowlights of the month:

- The month started with Spirit Air rejecting JetBlue's counter bid, and much of our gains from April evaporated. Spirit is convinced that a deal with JetBlue would very likely be rejected on anti-trust grounds. The impact for the month was -15 bps, but we had taken some profits during April so that this deal is a positive contributor since inception.
- Elon Musk's purchase of Twitter continued to hurt performance. Facing buyer's remorse, he said the deal was "on hold" pending his own investigation into the percent of bots on Twitter. That statement scared the market, and the stock dropped. Respecting the market, we reduced our position from approximately 2% to 0.5% of the portfolio, resulting in a negative contribution of 26 bps for the month and 38 bps since inception. We've reviewed the merger agreement closely and believe that Musk will be forced to close the deal at the agreed upon price. That opinion is shared by many analysts. Further, according to Twitter's preliminary proxy statement, Musk had waived his rights to due diligence. A Bloomberg legal expert puts the odds of Twitter prevailing if the dispute ended up in court at 60%.
- Healthcare Realty Trust had agreed to merge with Healthcare Trust of America. However, we exited our position on news that a third company, Welltower, had bid for the acquirer on condition that the original merger not be completed. That resulted in a negative contribution of 22 bps.
- Dutch bicycle manufacturer Accel, being acquired by private equity firm KKR, is the deal that has been most affected by the market negativity outlined in the second paragraph, costing 13 bps for the month. Other noteworthy negative contributors suffering the same fate were retail REIT

Cedar Realty Trust, First Horizon Bank, Nielsen Holdings (best known for broadcast ratings) and auto parts manufacturer Tenneco.

- Positive stories were few during the month. South African gold miner Gold Fields announced the acquisition of Canadian miner Yamana Gold. The merged company will become the world’s fourth largest gold producer. Timely trading resulted in a contribution of 7 bps.
- Small-cap biotech Entasis Therapeutics agreed to an increased bid by its majority shareholder, Innovia, as the proposed deal became definitive, resulting in a contribution of 6 bps.
- Chicken producer Sanderson Farms is an acquisition target that would combine the third and sixth largest chicken producers. The deal has frequently been mentioned by President Biden as an example of an anti-competitive merger that would be inflationary. However, by our analysis, the merger would not cause a level of industry concentration that has historically resulted in an anti-trust ruling. Nevertheless, the U.S. anti-trust regulator has requested more information in its second round of review (an “HSR second request”). During the month, the company announced extremely strong quarterly results and the spread narrowed to within two percent of the deal price, contributing 5 bps. The positive price movement was likely due to a combination of a higher estimate of the price at which Sanderson Farms would trade if the deal failed and progress on the regulatory front.

New deal announcements continued at a strong pace with 31 new deals announced in May, while 20 closed. Diversification in the portfolio continues to be considerably above average, with the number of deals increasing slightly to 119. Leverage is currently 130% (\$130 of long positions for every \$100 of capital).

Constantia Capital Merger-Arbitrage: Performance as of May 31, 2022

| Benchmark | Reporting Period | Returns (Net) ^{2 3} | Bench-Mark ² | Excess (Net) | Volatility | Sharpe Ratio |
|----------------------|------------------------------|------------------------------|-------------------------|--------------|------------|--------------|
| LIBOR 3-month USD | Year-to-date | -1.22% | 0.39% | -1.61% | N/A | N/A |
| | Latest 3 Years | 3.63% | 0.79% | 2.85% | 6.59% | 0.43 |
| | Latest 5 Years | 3.86% | 1.32% | 2.53% | 5.31% | 0.48 |
| | Latest 10 Years | 4.84% | 0.89% | 3.96% | 4.65% | 0.85 |
| | Since Inception ¹ | 5.07% | 0.87% | 4.21% | 4.60% | 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