Constantia Capital Merger-Arbitrage Strategy
December 2022 Commentary

Our composite returned 0.08% in December, bringing returns to 0.96% year-to-date, 3.97% annualized for the past 5 years and 5.01% annualized in 11+ years since inception.

Most of us will be relieved that 2022 is over from an investing point of view. Equities, as measured by the S&P 500 and the MSCI All-World Index both fell approximately 18%, including a 6% drop in December. Bonds, which everyone suddenly realized are not so safe, had their worst year ever, with the Bloomberg US Aggregate Bond Index returning -13%. High Yield Bonds posted similarly negative returns. The classic 60/40 Equity/Bond benchmark (All World Index, Bloomberg US Aggregate Bond Index) returned –15.8% for the year.

In aggregate we were happy to post positive returns for the year, despite lagging our benchmark, given the headwinds of falling equities and rising interest rates. We estimate is that those headwinds impacted returns by 400 bps compared to flat equity and bond markets, but we are not complaining since in 2021 and most other years our returns have benefited from the prevailing market environment. Our returns were almost 200 bps ahead of an index of Merger-Arb mutual funds and ETF’s that we track. In addition, the regulatory environment is a further headwind, notably in the US and the UK. Aside from well publicized anti-trust concerns, bank deals seem to be taking excessively long to be reviewed by regulators, causing two deals to be terminated. Tension between the US and China continues to cause delays in deals that require Chinese approval. Those issues are frustrating, but the vast majority of deals continue to be completed. We believe the market is adequately pricing in the risk so that the opportunity for Merger-Arb investors to earn above average risk adjusted returns remains high.

For the year, our strategy invested in 434 different deals. Some of those were leftover deals from 2021 and some will continue into 2023. We made money in approximately 66% of deals. The worst detracting deal for the year was Rogers Corp, costing 62 bps (see November commentary). The best contributing deal was Adtran’s purchase of German company Adva Optical, contributing 36 bps. About 4% of deals cost 10 bps or more, while a slightly higher percentage contributed more than 10 bs.

In general, investors were reminded of the benefits of true diversification. Truly uncorrelated assets are difficult to find as investors can now attest. Merger-Arb has a positive correlation to equities, but it is much lower than traditional diversifiers such as High Yield bonds and Real Estate. Further, the correlation of Merger-Arb with bonds is effectively zero.

Looking forward we are optimistic about the prospect for strong returns in 2023 in the 7% to 8% range. That projection reflects that each deal is priced based on short term interest rates plus a risk premium -

now that 3-month Treasuries are yielding above 4% annualized and our historical outperformance over short-term rates is in the 3% to 4% range. See our short paper titled "Merger-Arbitrage Returns in a Higher Interest Rate Environment"

Some of the highlights and lowlights of the month:

- As noted above, the market is pricing in a healthy risk premium on deal announcement. Three new deals in particular traded at reasonably wide spreads on deal announcement and narrowed fairly soon thereafter, notably Amgen's purchase of Horizon Pharmaceutical, Advent's purchase of satellite communications operator Maxar Technologies and medical device maker Berkely Lights merger with Isoplexis. In all cases we were able to satisfy ourselves reasonably quickly that anti-trust risks were low and build our desired position. The contributions were 5, 4 and 8 bps respectively.
- South Jersey Industries, a New Jersey gas utility, is being purchased by JP Morgan's infrastructure Private Equity group. As usual for utility deals, the process takes longer than average but is nearing the finish line, contributing 5 bps for the month and 13 bps overall.
- Forgerock, a software security developer, is being purchased by Thoma Bravo, a Private Equity firm that specializes in technology buyouts. The spread had widened on fears of a Department of Justice extended review, but the stock popped above the deal price on the filing of the preliminary proxy statement which indicated there may a be counter-bidder. We took the opportunity to sell the bulk of our position, contributing 8 bps. Shortly thereafter the companies noted that the DoJ did indeed request additional information.
- In one of the weirdest deal stories in our many years of managing this strategy, early-stage biotech F-Star Therapeutics acquisition by Hong Kong based Sino Biopharmaceutical has been delayed three times by CFIUS (Committee for Foreign Investments in the United States) restarting its 45-day review period. It is unusual for CFIUS to even review biotech deals. Eventually the companies announced an amended agreement to close in the absence of a CFIUS objection, as opposed to CFIUS affirming the deal. CFIUS did object, and issued another 45 day review period. We had been reducing our position over time down to 70 bps of the portfolio, and at that time made a decision to liquidate the bulk of our remaining position, resulting in a negative impact of 28 bps for the month and 46 bps overall. In a final chapter, the company announced on the last day of the month that CFIUS has proposed mitigation measures, increasing the likelihood that the deal will be approved.
- BM Technologies, a fintech company, and small-cap First Sound Bank mutually agreed to terminate their merger after failing to see progress on the regulatory approval process, resulting in a negative contribution of 15 bps.
- JNJ purchased heart pump maker Abiomed for $380 in cash plus $35 in 3 contingent value rights based on Abiomed sales and FDA approvals over the next seven years. Our average price for Abiomed was $378.70, effectively implying that we purchased the CVR's for close to zero even

taking the cost of capital for our seven week holding period into account. If all three CVR's meet their milestones the impact will be approximately 25 bps (that may not sound like much, but we typically expect to earn 3 bps from each deal, repeating that hundreds of times a year).

New deal announcements were 16 for the month (it is normal to see a slowdown in December), while 22 closed and 2 were terminated. Diversification in the portfolio remains high at 88 deals. Leverage remains approximately 0% ($100 of long positions for every $100 of capital). Note that Interactive Brokers currently pays an interest rate of 3.8% on dollar balances above $10,000 and even though we may be fully invested, we invariably have dollar balances since many deals are in foreign currencies.

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

Benchmark	Reporting Period	Returns (Net)[2 3]	Bench-Mark[2]	Excess (Net)	Volatility	Sharpe Ratio
LIBOR	Latest Year	**0.96%**	2.47%	-1.51%	N/A	N/A
3-month USD	Latest 3 Years	**3.13%**	1.07%	2.05%	6.68%	0.31
	Latest 5 Years	**3.71%**	1.57%	2.14%	5.36%	0.40
	Latest 10 Years	**4.77%**	1.07%	3.70%	4.69%	0.79
	Since Inception[1]	**5.01%**	1.01%	4.00%	4.53%	0.88

[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