HILLSIDE ADVISORS LLC

November 3, 2014

Hybrid Vigor

The Hillside Convertible Advisory Letter

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Welcome To The Jungle

Inside

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Dear Friends,

It's been an exciting few weeks in the market. There are probably lines outside the offices of CTCA (Convertible Traders' Chiropractors of America), as whiplash cases are on the rise among market participants watching things go this way and that. We've tried to capture some of the recent wildness in this edition. There's a lot going on.

It's also an exciting time here at Hillside Advisors. We're thrilled to announce that John Anderson—no, not the guy who lost the Republican nomination to Ronald Reagan, but the convertible-bond salesman—has joined us as Director of Business Development. John's product knowledge, contact network and market instincts, developed during his service as a two-decade convertible pro at several leading firms including UBS and Wells Fargo, will serve us and our clients well. John looks forward to speaking with as many of you as possible in the near future about our upcoming plans and the services we look forward to offering. We feel remarkably fortunate to have John on our team.

And it doesn't end there. We're just as thrilled to tell you that Kathy Schick has joined us as Head of Credit Research. Kathy also brings many years of experience, most notably with KBC and Daiwa, breaking down and writing about credits. We're very lucky to have set up shop just a few minutes from Kathy's Westchester home, making the Hillside platform and lifestyle appealing for her.

As we enter the final two months of 2014 we continue to develop our proprietary measures, product offerings and systems. We're grateful for the remarkable support we've received in the convertible community, and we look forward to making ***Hybrid Vigor*** the voice of convertibles for many years to come. In the upcoming weeks John will hopefully be speaking with you about how you can be a part of what we're doing here.

Bill

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November 3, 2014

The Cubists Are Here! The Cubists Are Here!

Bill Feingold

In a major risk-on re-rallying week, it's no surprise that HARP numbers continued their recent surge. The average score again exceeds nine—a good way from the 11 average when we started HARP, but a substantial gain off the lows of a few weeks ago.

Lam Research's 1.25% remains at the top of the charts this week. The bond rose 2.2%, an appropriate gain given its parameters and the stock's seemingly inexorable 3% rise. Despite its commanding lead, Lam "B"'s HARP actually fell a bit, from 11.97 in the previous week to 11.67 this week. This was to be expected, as the bond verging on surpassing the 140 level that requires deletion from a major index. Expect further contraction in these bonds if the stock keeps marching north, inciting a European exodus. The absolute premium has declined to the point where the bonds do not look horrific to the naked eye and only come up several points rich on conventional models.

The spiritual Ugly 20 favorite, RPM International 2.25%, held onto its coveted second place this week. The small issue continues to trade by appointment, with a mere 2.5 million posted on TRACE for the week. As investment-grade (it pains us just to say those words) deals go, it's small. Too small, though perhaps we should be grateful that the size keeps its overvaluation from doing too much harm to portfolios. We'll never understand why RPM didn't reopen this issue for an add-on in mid-July, when the HARP was nearly 18 (versus the current 10-ish). The bond was 10 points higher than its current price and the stock was actually marginally lower. While the bonds no longer turn heads in the wrong direction the way they once did, and reside only a few points above the 105-107 range where many current holders probably made their initial purchases, they still carry a lot of undeserved premium given the stock's remarkable lack of anything resembling volatility.

SanDisk's 0.5% crept up from 5th place to 3rd place with a big boost in its HARP score from 9.18 to 10.07. The bond's 3.5% gain versus the common's 6% jump was about right—you can attribute the HARP jump to the newfound proximity to the 120/130 "death trap." These bonds were right in the middle of that leakage zone when we began the ugly 20, prompting their original inclusion with HARP of 11.26. We have to concede that the outcry in defense of these bonds following our initial critique has been supported by reasonably strong performance. Shedding only one HARP over the past several months is to be admired. The stock's had a nicely tradable journey, from 104 to 83 to 94, and the bonds have gone along for the ride. Good for them.

Illumina's 0.5% "B" tranche held firmly onto its 4th place position from last week to this week with a half point uptick in HARP from 9.4 to 9.9. We doubt many arbitrageurs found the internal fortitude to put these illuminated uglies into reverse position. We acknowledge this is a tricky short—last week we advised prospective reverse hedgers to wait until the HARP approached 11. It's getting there. Still, Illumina "B"'s HOCS array of 47 Overall/43 Growth/56 Safety aren't quite the stuff of a reverse hedge yet. The bond looks more like a simple "avoid" at this point.

Rounding out the top 5 was BioMarin Pharmaceuticals' 1.5% jumping from 7th place last week with a sizey HARP move from 8.75 to 9.47. The other BioMarin twin (0.75%) fell in at 10th place with a less egregious HARP move from 8.53 to 9.01. BioMarin "B" definitely fattened up this week on a relatively trivial stock move—its HOCS array of 43 Overall/47 Growth/35 Safety screams an even louder "avoid unless you really love the stock and have no other way of expressing that love."

The Most Improved Award goes to Incyte's 0.375%, which ran against the pack with a HARP score falling from 9.40 to 8.05. The bond fell from 3rd place to 20th. The bond now lives above the magic 140 line of demarcation, so it may be on the way out of portfolios that automatically toss bonds above this price point. The mildly collapsing premium could make a historically ugly bond into an interesting setup. Indeed, the overall HOCS for this bond is a decent-enough 52, thanks to its 70 Growth rating. It's not the right bond for cautious outrights, of course, with a Safety score of only 17.

The big news of the week of Ugly Top 20 is that the long-awaited Cubists are here! Followers of the Ugly 20 have been asking since the inception of the list why these bonds were not included. The answer, as we've detailed previously, was price point. HARP and HOCS are designed to bridge the gap between theory and practice, and as such, they are built to acknowledge the par-area halo that often dictates convertible pricing. But after threatening and just missing to make the cut last week on the back of a rally from 60 to 70 in the shares following an earnings beat, Cubist Pharmaceuticals' 1.875% and 1.125% bonds both arrived at the ugly show this week, placing 15th and 16th respectively. These bonds certainly give Señor Picasso a run for the money on the ugliness scale, though the horror of buying them at current levels isn't quite reminiscent of Guernica yet. Not surprisingly, both of these bonds score poorly on the HOCS meter. The 1.875% get an array of 41 Overall/50 Growth/24 Safety, while the 1.125% come in with a similar-ish 40 Overall/44 Growth/32 Safety. Maybe they do look like a battlefield after all.

There was one other big piece of Ugly 20 news. Noticeable by its first absence from the ugly 20 is Helix Energy's 3.25%, which began the countdown in July at #2. Trading at 130 then, with shares just below 25, the Helix bond carried 14.58 HARP. Although the shares have actually risen about 10% from July's level the bond has fallen several points, thus seeing its HARP fall to just over 7—a very reasonable score for the bond's price point. We've seen far worse entry points—indeed, the bonds look halfway decent to the naked eye. HOCS is not so forgiving, though, scoring the name in the mid-30's. We think that's a little harsh, despite the unappealing price point, but HOCS is also penalizing the company for its middling market capitalization and so-so balance sheet.

HILLSIDE ADVISORS LLC

November 3, 2014

Hillside Ugly 20 List (Prices as of October 31, 2014)

	Convertible	Price	Stock	Premium (%)	Premium (pts)	HARP
1	Lam Research 1.25% 2018-05-15	139.75	77.86	12.8	15.86	11.69
2	RPM International 2.25% 2020-12-15	110.75	45.30	29.4	25.16	10.13
3	SanDisk 0.5% 2020-10-15	118.00	94.14	15.5	15.84	10.07
4	Illumina 0.5% 2021-06-15	115.25	192.58	52.3	39.58	9.90
5	BioMarin 1.5% 2020-10-15	118.25	82.50	34.9	30.59	9.47
6	Ryland Group 1.625% 2018-05-15	129.50	35.81	15.9	17.77	9.41
7	Salesforce.com 0.25% 2018-04-01	117.50	63.99	22.1	21.27	9.30
8	Priceline.com 0.35% 2020-06-15	114.00	1206.21	24.2	22.21	9.17
9	NuVasive 2.75% 2017-07-01	120.25	40.90	23.8	23.12	9.05
10	BioMarin 0.75% 2018-10-15	115.25	82.50	31.5	27.61	9.01
11	Standard Pacific 1.25% 2032-08-01	113.50	7.40	23.8	21.82	8.84
12	NVIDIA 1% 2018-12-01	113.25	19.54	16.9	16.37	8.81
13	CSG Systems 3% 2017-03-01	123.75	26.51	10.3	11.56	8.74
14	Workday 0.75% 2018-07-15	132.25	95.48	15.3	17.55	8.65
15	Cubist 1.875% 2020-09-01	116.50	72.29	32.7	28.71	8.37
16	Cubist 1.125% 2018-09-01	113.75	72.29	29.7	26.05	8.27
17	Palo Alto Networks 0% 2019-07-01	117.50	105.70	22.6	21.66	8.24
18	Alon USA Energy 3% 2018-09-15	124.50	16.04	14.9	16.14	8.15
19	Incyte 0.375% 2018-11-15	143.50	67.06	10.7	13.87	8.05
20	Omnicare (Exchange) 3.25% 2035-12-15	108.50	66.59	26.9	23.00	8.00

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The Week That Was…

Bill Feingold

A few highlights, or lowlights, from last week:

ARCP: Oops. The company admitted to an accounting error and, even worse, a coverup leading to some big management resignations. On the conference call (which had some embarrassing technical delays and glitches) highly regarded new CEO David Kay, who had just joined the company, assured investors that he was at ARCP to stay. He said that the mistakes, while evidence of poor judgment by the departed managers, were not borne of deceitful intent. Hmmm.

Anyway, the company has new troubles this morning, as its deal to sell private REIT manager Cole Capital appears in jeopardy, and ARCP stock is indicated down over 15%. The bonds are quoted around 80 as we write this.

Industry sources have told us that ARCP's troubles are not particularly surprising, as insiders viewed the company as a rollup that was growing too fast to be managed properly. We tend to avoid financial names because downward spirals feed on themselves. To paraphrase Keynes, if a banker must prove his creditworthiness, he is already toast. That said, yields approaching 10% may look awfully tempting, and current levels could prove a terrific entry point. Indeed, as we plow on toward publication, the bonds have already lifted a few points.

AEGR: Aegerion made owners of its bonds feel just stupid, reporting disappointing revenues from its Juxtapid cholesterol treatment and guiding lower. The company could probably do without any more bad news, with the financial shortfall coming hard on the heels of a rather lurid revelation that unfamiliar readers can look up on their own, ***Hybrid Vigor*** being a family-values kind of publication.

All that said, the company once had a market cap well over $2 billion. Weakened biotechs rarely die—they usually get snapped up. With Aegerion's equity now a bit on the shallow side for defending the convertible, we'd think the big-cap pharmaceuticals might be circling soon. We learned long ago that even when a biotech's products fall on difficult times, its research and Rolodex are often more than enough to justify the price of acquisition.

EPAY: Bottomline's bottom line evidently wasn't good enough. The bonds seem to have, unsurprisingly, caught a nice bid as they approached par from above. Settling now in the 105-106 range with the stock just below 25, the bonds are zeroing in on a perfect 55 in HOCS terms across the board: Overall, Safety and Growth. Now that's some ***Hybrid Vigor*** for you.

MOH: Quite a ride after earnings, with an initial selloff proving a trading-buy opportunity as analysts came out to defend the company against its own caution. We continue to think the new 1.625% convertible, the result of an exchange offering, is one of the more attractive hybrid plays out there*. At 106 ½ versus Friday's close of 48.64, the bond's HOCS array of 56 Overall/52 Growth/65 Safety speaks to its balanced appeal.

TWTR: It's getting awfully lonely defending this name, but in spite of the rather boldfaced upsize, rocky earnings report and management upheaval, we still think there's value here. Moreover, we think it's good for the convertible market to be able to show issuers what Twitter was able to do—even if we hope future issuers are a bit gentler with us. HOCS aficionados will lean toward the 1% bonds, trading at a marginally lower price with two years more for a long-term turnaround, since this is clearly a growth play with good safety support, not the other way around. Trading just above 90 with the stock around 40 ½ this morning, Twitter's 1% gets a HOCS array of 69 Overall/76 Growth/55 Safety, with the 0.25%, priced half a point or so higher, coming in at 67/72/58.

TSLA: We know from experience—if you want to get a lot of hits on a financial website, just write "Tesla" a few times. Last week's edition of "Everybody Loves Elon" saw the stock dip to its lowest level since mid-July before bouncing back 20 points are so. When it comes to Tesla, what's 20 points, anyway?

But Tesla is the perfect convertible bond issuer—a strengthening credit, supported by a big market capitalization—with a highly volatile stock and no other public debt. Accordingly, Tesla's two hybrid deals have been among the leaders since we started developing HOCS. As with Twitter, Tesla is a backstopped growth story, so HOCS prefers the longer-dated issue (it likes both quite a bit). The 1.25% come in at 77/85/60, while the shorter 0.25% score 73/78/64. We wouldn't argue with traders choosing either bond—or both, for that matter.

*Disclosure: The author has a position in Molina Healthcare securities.

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Cobalt International Energy, Inc. (CIE) Gets Dumped

Jeffrey Alton, CFA

What do you call a company that:

1. Has been served a Wells Notice for a possible Foreign Anti-Corruption Act violation
2. Has no revenues
3. Has just enough cash to get it to revenue generation
4. Produces a commodity, the price of which has dropped 23% in the last six months
5. Produces a commodity where vast new deposits have been discovered and are coming online?

You would call it speculative.

And that is what the market is finally calling Cobalt International Energy, Inc. (CIE).

The price of Cobalt's $1.38 billion 2.625% convertible bonds due 12/1/2019 and $1.3 billion 3.125% convertible bonds have cratered over the last few weeks to $74.5 and $79.6 respectively. The 2.625% 2019 bonds now yield 8.99% to maturity and the 3.125% bonds yield 8.68% to a 5/15/2019 call date.

Mr. Market dumped Cobalt with the classic "It's me, not you" break-up line.

Cobalt is still the same company it was six months ago when it issued the 3.125% convertible to strong demand.

It is still the same company that went five for five in discovery wells in West Africa. The last discovery was its biggest, dubbed GOLD (Greater Orca Lontra Development Project) and could hold from 650 to 1,200 million barrels of oil.

It is still the same company that estimates its exploration cost is a low $2 per barrel of oil discovered to date.

And it is still the same company that successfully raised $2.68 billion dollars to fund development through first production. Cobalt's Gulf of Mexico Heidelberg project expected to begin operation in 2016.

But what is different is the price of oil, which that has plunged. Now the market is questioning Cobalt's long-term ability to generate significant profits with deepwater oil in West Africa when easier oil is available through fracking in the United States. After all, the US is expected to become the largest producer of oil this year.

Cobalt's bottleneck will be refinancing when it begins production in 2016. The first project is small in scope and may prove that Cobalt is capable of generating revenue. However, that revenue stream will be small in comparison to the large funds needed to develop its bigger discoveries. To complicate the situation, the 2019 convertible bonds will come due in the middle of that major development.

Cobalt can sell a portion of interests in its discoveries to raise funds, but that changes the math for investors reading the headline estimated barrel count that Cobalt currently counts in its discoveries.

Suddenly for the market, there are more questions regarding Cobalt than answers. For investors bullish on oil, Cobalt presents an opportunity to get paid handsomely while you wait. For more conservative investors, it makes sense to look elsewhere in the oil patch.

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November 3, 2014

A Tale Of Two Solars: China Trina Solar (TSL) Looks Appealing Versus US Sunpower (SPWR)

Jeffrey Alton, CFA, Bill Feingold, and Sue Wu

Are Chinese solar company securities trading at too high a discount compared to their US cousins? To answer the question, we examine the SunPower 0.875% convertible security due June 1, 2021 and the Trina Solar 4.00% convertible security due October 15, 2019.

The SunPower 0.875% trades similarly to an investment grade security because Total S.A. owns 60% of the company. The Trina Solar trades like a high yield bond as investors apply the regular "Chinese discount" plus further credit penalties for a weaker balance sheet and the recent recession, complete with bankruptcies, that rocked the Chinese Solar Industry.

Convertible Bond Overviews

	TSL	SPWR
Coupon	4.00%	0.88%
Maturity Date	15-Oct-19	1-Jun-21
Amount Outstanding	$115 million	$400 million
Current Price	95	102.5
Yield to Maturity	5.12%	0.49%
Yield to Put	5.82% (10/15/17)	No put
Conversion Premium	32.30%	56.95%
Conversion Price	$14.69	$48.76
Stock Price	$10.56	$31.84

In an analysis of the companies, SunPower (SWPR) probably wins the beauty contest. But when price is thrown into the mix, Trina (TSL) starts to turn some heads as well, with the Trina convertible yielding 5.12% to maturity in five years and an even better 5.82% yield-to-put in three years. Given that SunPower has a longer maturity and no put, the additional 463 basis points offered by the Trina convertible bond appear attractive considering both companies are currently profitable and compete in the same geographical markets. The spread also compensates Trina bond holders for less than stellar balance sheet issues discussed below.

The Hillside HOCS also make the Trina bond look appealing considering the discount that the market currently demands.

	TSL	SPWR
HOCS Overall	68	62*
HOCS Growth	67	58
HOCS Safety	71	71*

*Does not give effect to implied Total backstop. Readers may want to adjust higher as suggested below.

We begin by noting that SunPower's Safety score is overly literal, as it gives no credit for the implied backstop from Total but conservatively assumes that SunPower itself is wholly responsible for making good on bond payments. If we were to give SunPower full credit for the Total backstop, the safety rating would probably be in the high 80's to low 90's, where top credits trading around par typically reside atop HOCS pantheon. The truth is probably somewhere in between, so if you're scoring at home, you might decide you want to activate the asterisk in the above chart and tack on another 10 points or so in the SunPower Safety dance. This translates to a handful more points overall. Even after making such an adjustment, you'll find SunPower is not substantially ahead of Trina on the Safety front, while on the Growth side, the Trina convertible offers better opportunity for multiple expansion. Trina common shares trade like a value stock at 11.2x the 2014 consensus EPS estimate of $0.94 and 7.5x the 2015 estimate of $1.40. SunPower is more in the growth camp at 24.9x the 2014 consensus estimate of $1.28 and 18.8x the 2015 estimate of $1.36. Yet while Trina faces a dumping tax in the US, both companies should grow with the solar industry in the coming years.

Company Overviews

1. Trina Solar Limited

<u>Business Overview</u>

While Trina's business has rebounded from the Chinese solar recession a few years ago, some balance sheet issues raise eyebrows. As of June 30, Trina had short-term borrowings of $669.5 million and accounts payable of $728.7 million, together representing over 70% of total liabilities of $1.95 billion. The large sum of short-term debt does increase refinancing risk should things get ugly for solar again, especially against a backdrop of cheap oil. Further, the accounts payable number has risen at a somewhat alarming rate from $476.5 million as of December 31, 2013. The company maintains that the growth in accounts payable is part of the normal course of business and that the growth expanded on advantageous payment terms.

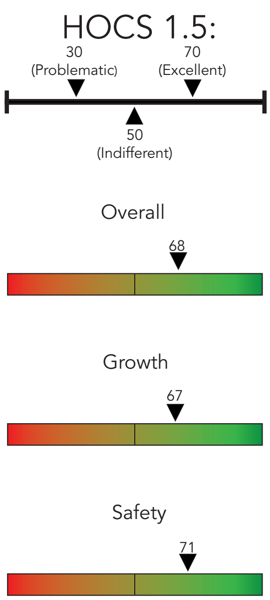
Trina is a vertically integrated solar module manufacturer producing silicon ingots, silicon wafers, solar cells and solar modules. The company is following what it terms an "asset light" strategy, partnering with vendors in each step of the production process for additional manufacturing capacity. Trina is adding one gigawatt of module production capacity in 2014 to reach 3.8 gigawatts and plans to reach 4.8 to 5.0 gigawatts of module capacity in 2015. However, the company is being less aggressive in other production segments, keeping wafer production capacity steady in 2014 and 2015 at 1.7 gigawatts and increasing solar cell production by only 500 megawatts this year to 3 gigawatts. Last quarter, Trina missed guidance slightly, shipping 943.3 megawatts (MW) versus a forecast of 950 MW to 1,010 MW. Total Q2 2014 shipments increased 59.1% over Q1 2014 shipments of 558.0 MW and increased 45.8% over shipments of 647 MW in the second quarter of 2013.

The company's major markets include China, the United States, Germany and Japan. China is the company's main market, accounting for one-third of sales in 2013. Europe was next with 30.9% of sales in 2013 followed by the United States at 17% and Japan at 8.3%. While the US reached 38% of sales in 2014 Q2, that number is expected to fall to 17% as Trina faces a second round of anti-dumping measures in the US.

TSL

4.00%, 2019/10/15
Price (Bond): $95.00
Stock: $10.56
YTM: 5.12%
Premium: 32.3%
HOCS-Overall: 68
HOCS-Growth: 67
HOCS-Safety: 71

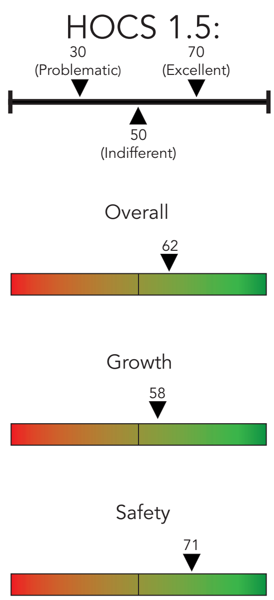
As of October 31, 2014



SPWR

0.88%, 2021/06/01
Price (Bond): $102.50
Stock: $31.84
YTM: 0.49%
Premium: 57.0%
HOCS-Overall: 62
HOCS-Growth: 58
HOCS-Safety: 71

As of October 31, 2014



Trina has also become a utility scale solar developer, similar to other solar manufacturers including SunPower. The trend among solar manufacturers is to hold the solar developments on their balance sheet for a longer period than in the past because completed solar projects are significantly less risky than ones in the construction phase. Developers can therefore receive a higher price at sale. Solar manufacturers such as NRG Yield are now establishing holding companies for these completed projects, and Trina is likely to follow at some point in the near future.

In Q2 2014, net revenues were $519 million, up 18.5% from Q1 2014 revenues of $444.8 million and up 18.0% from Q2 2013 revenues of $440.7 million. Gross margin decreased to 15.4% compared to 20.6% in Q1 2014 and increased compared to margins of 11.6% in Q2 2013. Compared to Q1 2014, Q2 margins decreased because of an increase in the price of silicon and higher sales in the Chinese market where prices are lower. Margins increased year-over-year as the company leveraged its manufacturing capacity was leveraged further with increased sales. Net income was $10.3 million in Q2 2014, a decrease of 61.1% from $26.5 million in Q1 2014 and compared to a net loss of $33.7 million in Q2 2013.

Equity Valuation

Trina common shares broke through support since its last earnings announcement as the froth has come out of solar shares. Trading at $13.37 before its most recent earnings announcement on August 26, Trina shares closed at $10.56 on Friday. The stock's 200 day moving average is $12.80 and its 50 day moving average is $12.09.

As mentioned, Trina trades like a value stock compared to its US counterparts. We believe that the discount will narrow as solar growth continues globally and the Chinese overcapacity problems of the past fade.

2. SunPower Corporation

Business Overview

SunPower manufactures solar cells and solar modules for commercial and residential installations. As is the trend in solar, SunPower also develops utility-scale solar projects, either selling them or keeping them on the balance sheet.

The Company is expected to create a separate entity to purchase and house completed projects next year. Of the 640 megawatts (MW) under contract at the end of last quarter, 203 MW were residential, 116 MW were commercial and 322 were utility scale. Of SunPower's installation midpoint guidance of 1.28 gigawatts for 2014, about 58% is expected to be in the Americas, 13% in Europe and the Middle East and 29% in Asia Pacific.

The company is known for its technology with an industry high efficiency of 21.5% for its solar cells. However, this lead will probably fade over time as other industry players advance their own solar technology. SunPower has also developed a low-concentration photovoltaic (LCPV) technology which is says is particularly suitable for China. SunPower expects to build 3 gigawatts of power using LCPV in China over the next five years.   This is a new avenue of growth for the company and allows SunPower to participate in the booming Chinese solar industry. SunPower has established a manufacturing joint venture and another marketing joint venture with Chinese companies for that market.

Last quarter, non-GAAP revenue of $704 million beat guidance of $600 to $650 million, but margins of 16.7% were below company guidance of 17% to 19%. Net income of $0.30 per share beat analyst guidance of $0.24.

Industry observers generally see SunPower as capacity constrained. Fab capacity will likely only grow to 1.7 gigawatts in 2016 from 1.3 gigawatts in 2014, perhaps limiting upside in revenue.

<u>Equity Valuation</u>

SunPower shares have fallen from a high of $42 earlier in the summer to $31.83 last Friday. As we noted previously, solar shares have been under pressure with the entire energy complex, and investors were disappointed with the margin miss last quarter. The stock has broken support and now faces the infamous death cross with the 50 day moving average right at the 200 day moving average of $34.17.

Given the possibility of a shrinking technology lead and potential capacity constraints, SunPower could be still be trading rich despite the recent drop in price.

Concluding Thoughts

Convertible investors in the Trina bonds are compensated for the Chinese origin of the security and the blemishes on its balance sheet. Another consideration is Trina's $150 million 3.5% convertible bond due June 15, 2019 which scores similarly on HOCS. HOCS for that bond is 66 overall, 67 for growth and 66 for safety.

For solar believers that want exposure to the industry with diversification, some blend of the Trina and SunPower bonds may make sense.

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November 3, 2014

Hedged /Special Situation Trade: It's The Circle Of Life: Horizon Pharma (HZNP) 5% 2018

Roman Terekhin, CFA (Contributor)

Back in August, we wrote about a potential special situation in Horizon 5% convertibles. At that time, the bonds were deep in the money, trading at around 13-14 points over conversion value on a full hedge (100% delta). We opined that it made sense for the company to flush bonds into equity thus improving its balance sheet and saving cash on coupon payments.

Over the past couple of weeks it became clear that some of the market participants shared our view. Starting on October 23, the company entered into several privately negotiated transactions with convert holders swapping around $70 million in face value of the bonds for equity. Ignoring bifurcation trickery the convertible is the only long-term debt on Horizon's balance sheet. Given original issue size of $150 million the company essentially halved its leverage by doing the swap. Per recent 8-K more swaps are in the pipeline. This is a clear win for Horizon Pharma and we congratulate its management team on a great deal!

On the other side of the transaction, investors received 21 points in premium over parity which looks like four points over recently quoted levels, and seven to eight points over where the most recently posted trades had taken place (the last TRACE prints were in late September). Since the swapping convertible holders were most likely 100% hedged, all of the shares they received were used to return the stock borrow. Thus, carrying no equity risk, the investors were able to make a "quick" four points. They may have been "quick" but they were certainly not free: the position had to be accumulated at reasonable prices while carry was negative due to a relatively high stock borrow rate. Thus, the investors had to move quickly and also had to know what they were doing as far as approaching the company's management to pitch the deal. This was definitely one of those "don't try this at home"-kind situations.

What about the equity holders? Well, they should benefit from the aforementioned stronger balance sheet and lower cash burn. In addition the higher share count will dilute the bottom line loss improving EPS. Note that the shares underlying the 5% convertible were not previously included in the fully diluted share count precisely because of the negative net income line. Post-swap, however, we believe that the company will have to include the newly issues shares into the overall count.

Well, it seems like it's a win-win situation all around. We are glad our opinion was in sync with that of the activist-type convert players out there. And that's what we call constructive activism. It is not the kind that makes headlines (outside Hybrid Vigor that is) but it is a vital part of a truly functional capital market. We salute this type of approach.

But wait, there is more. The 5s were issued only in November of last year and of course we always feel saddened when we see a bond will substantial call protection go so soon. (OK, that was an over-dramatization). However, now that the company is nearing completion of this deleveraging exercise, perhaps it is time for them to consider doing a new convert. The terms could be significantly better: perhaps a lower coupon and a conversion price at least three times as high as the current one. Will the investors bear a shorter call protection? We don't root for this, but given the stock volatility it should be entirely possible.

Can the new bond expect to see significant demand? No doubt, especially if it is reasonably priced and the deal size kept at 20% or so of the equity market capitalization. We also would like to postulate that the additional issued shares issued in debt-for-equity swaps might alleviate the pressures on the stock borrow. This would make the potential new deal ever more attractive for the arbitrage community.

It also looks to us that the company will continue to need cash as they plow ahead with the strategy of acquisitions of additional innovative medicines or entire companies. Perhaps, this is something for bankers to think about. As we say at Hillside Advisors, raise money while you can.

HZNP can thus be a gift that keeps on giving.

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November 3, 2014

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New Issue: $350 Million (+$52.5 Shoe) Euronet Worldwide (EEFT) 1.5% Senior Convertible Notes Of 10/1/2044

Kathy Schick and Bill Feingold

Euronet Worldwide (EEFT) is a leading electronic payments provider. The company is involved in three business segments - electronic funds transfer (EFT) processing, epay, and money transfer.

Euronet Worldwide's business is doing well with revenue and EBITDA trending up. The company recently announced 3Q14 results. Revenue was $453.4mm up 26% year-over-year and adjusted EBITDA was $73.1mm up 36% from the prior year quarter. Adjusted cash EPS for 3Q14 were $0.83 up 43% year-over-year. EEFT operates in three business segments: EFT processing (19,808 ATMs), epay, and money transfer. All three segments experienced growth in revenue and EBITDA for the quarter.

The new convertible appears likely to see its green shoe exercised for aggregate gross proceeds of $402.5 million. The proceeds will be used to buy back $80mm of stock and pay down the revolving credit facility.

We have assumed the company will pay down the entire $296mm outstanding on the revolver, leaving $550mm of the $600mm facility available ($50mm in letters of credit outstanding, L+ 137.5 to 237.5, matures 4/9/19). EEFT is a consistent and positive free cash flow generator. The company has good liquidity with pro forma cash of $414mm and $550mm available on the secured revolver.

Euronet used cash for the acquisition of HiFX, a UK money transfer company, earlier this year. The total purchase price was $242mm comprised of $185mm of cash and $57mm of stock.
The senior convertible bonds will rank behind the secured term loan A ($73mm outstanding) and future borrowings on the secured revolver.

The new convertibles score fairly well on our proprietary HOCS 1.5 (Hillside Overall Convertible Score) scales. With the bonds trading up to around 103 versus a stock price of about $55.50, the score array is now 58 Overall/61 Growth/52 Safety. A score of 50 is considered average, while a score of 70 is superior.

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Meet the Pros

Hillside Advisors welcomes John Anderson to our growing ranks as Director of Business Development. John will be responsible for ***Hybrid Vigor*** subscription sales and business development at Hillside. He brings 14 years of convertible product experience to the firm.

John was most recently a Director of Convertible Bond Sales at UBS Securities where he was responsible for covering more than 30 accounts with total assets under management of over $100 billion. Prior to UBS, he held various convertibles sales and trading positions at William Blair, Knight-Libertas, and Wells Fargo Securities.

John holds Series 7, 55, and 63 licenses and is an active member of the Connecticut Hedge Fund Association. He also maintains active registrations with FINRA and with the State of Connecticut Department of Insurance. He has three children and resides in Weston, CT. In his spare time, he is an active member of Weston Field Club and has coached youth baseball and basketball. He has also volunteered with the Hidden Acres Therapeutic Riding Center, which is a non-profit, volunteer-supported organization, dedicated to providing the benefits of therapeutic riding and other equine-assisted activities to children and adults with special needs.

John received a B.A. in Communications from Marist College. He can be reached at 646 712 9289 x 107 and janderson@hillsideadvisors.com.

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