HILLSIDE ADVISORS LLC

November 10, 2014

Hybrid Vigor

The Hillside Convertible Advisory Letter

Volume 1 Issue 25

Calm Before The Storm?

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Dear Friends,

Welcome to a milestone, the 25th edition of ***Hybrid Vigor***. Thanks for all of your support and encouragement in helping us get here.

Wow. That's been some bounceback over the last few weeks, accompanied by a VIX retreat to the bottom teens. Doubtless market participants are expecting more of the same, with the last two months of the year being generally favorable, and with conventional wisdom saying that Republicans leading both houses will be good for share prices. We'll see.

Anyway, it makes sense to look for a modest deluge of new issuance between now and year-end, with most earnings now out of the way, with stocks near all-time highs, with rates heading up in recent weeks and QE over, with bankers wanting greater league-table standings…we could go on.

The convertible market is clearly cheaper than it was when we began publishing in July. The average Ugly 20 HARP has fallen from 11 to just over 9. Still, the average dropped below 8 last month when the world temporarily came to an end. So some caution with the secondary market might be prudent here.

Still, let's not be too much of a wet blanket. Let's take a look at some of the big, important new companies participating in the convertible market. We've got Yahoo, Twitter, and LinkedIn, just to name a few. Who knows, if I keep rattling my saber, maybe even Netflix and—perish the thought—Facebook will come along for the ride. We're intrigued by the buzz that Uber may do a billion-dollar pre-IPO convertible. Our asset class makes a lot of sense these days, no matter how jaded we may have become.

I wish you all a good week—and as Sergeant Esterhaus always used to say on Hill Street Blues, hey! Let's be careful out there.

Bill

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November 10, 2014

A Price-Point Priceline Exchange

Bill Feingold and Curt Peters

The week was a relatively subdued affair with little overall movement in the HARPs of the constituent members. A small gain here offset by a small loss there. Two performers made a big HARP impression while a third added to its already fat position. The few big movers were able to move the needle of the average HARP up from 9.00 to 9.21.

Dear old Lam Research 1.25% continues with its vice-like grip on top spot of the Ugly 20. The stock continued to march upward this week with a 1.4% gain which translated into a 1.25 point move in the bond; exactly what the old schoolbooks would predict. Similar to last week, despite the commanding lead in HARP score, Lam did contract 0.17 HARPs to 11.52. With the bond now at a price of 140.75, as predicted last week the bond now requires deletion from a major index which is contributing to a few investors heading for the exit as well. For big Lam fans restricted to convertibles for expressing themselves, the bonds aren't too despicable. They're like the story of the two bums who spot a cigar lying on the sidewalk. One picks it up and starts to light it, but the other stops him, saying, "How can you smoke that? You don't know where it's been." The first proceeds to lean toward a trash can to toss the cigar in, whereupon the second grabs it from him and lights it up. "But you don't know where it's been," the first bum protests. "Sure I do—you had it," replies the second. Similarly, these Lam bonds have looked worse, if you're looking for reasons to own them. The Hillside Overall Convertible Score (HOCS) array for this bond, 41 Overall/46 Growth/30 Safety, is certainly not something you'd be eager to buy—but maybe not quite nasty enough to put on or maintain a short either.

RPM International 2.25% continues to play junior partner France to Lam Research's Britain in the great game, pulling in another consecutive 2nd place; albeit appropriately distant enough to score 10.82 HARPs. RPM stock gained 2.5% while the bond climbed 1.25 points in line with models of old. Worth noting is that RPM gained 0.69 HARPs this week as the bond price increased while credit loosened; not particularly what one likes to see for a bond which still very firmly resides in the option part of the profile. It ain't a stock yet, chaps. Thank goodness the small issue size keeps these errors unnoticed. Moreover, it's all a theoretical exercise, as these bonds showed nary an institutional TRACE print all week. Stalemate. Shareef don't like it and neither do HOCS, with a 28 Overall/23 Growth/38 Safety rating.

Last week's SanDisk's 0.5% sly climb up to 3rd from 5th turned out to not be a fluke as SanDisk held 3rd for a consecutive week with a HARP of 9.87 despite a 0.20 HARPs decline. Kudos to the many SanDisk fans out there. The stock fell 1.4% and the bond contracted 1 point in symbiotic response. At their tricky price point, the bonds come in with a blah, if not awful, HOCS array of 46/48/42.

The rarefied air at the top of the charts this week saw a lowly backbencher leap from 20th last week to sit among the elite of the Ugly 20 at 4th. Welcome and greetings to Omnicare (Exchange) 3.25% of 2035. To accomplish such a feat Omnicare handed the biggest HARP gain of the week with 1.72 HARPs to settle at 9.73. This bond specimen is attached to a mid-teen volatility stock. But this week, the stock's 2% gain while the bond was outdone by an oversized 2.5 gain to 111.25. Perhaps the company's pricing of 10-year straight debt at 4.75% produced renewed enthusiasm for the credit. These bonds don't look bad to the naked eye, but they don't bear up well under greater scrutiny given the stock's minuscule volatility and non-trivial dividend. Too much bond action for not enough stock action is a surefire path to richness in more ways than one. HOCS despises this bond, giving it an awful 28/23/36 array. Ugh—downright RPM-ish.

Rounding out the top 5 was BioMarin Pharmaceuticals' 1.5%. It maintained its position with a slight increase in HARP score by 0.18 to 9.65. The stock increased 1.7% and the bond did as predicted up a point. The other BioMarin twin (0.75%) held onto its 11th place position with pretty much identical HARP and bond price moves. HOCS, you ask? 43/49/31, we answer. Next…

Priceline.com made sure to represent in the Ugly 20 this week with both a winner and a loser. As the 0.35% fell out of the Ugly 20 all the way to 42nd with a HARP of 7.00, benefiting from HARP's bias in favor of par-halo issues, the 1% issue blasted up from 39th last week to 14th this week with a 1.62 HARPs increase to 8.77. Despite a 9.25% decrease in the stock on negative outlook from the CEO, the bond collapsed 8.75 points to 130. That is, about 1 point worse than a conventional model would predict, though not enough for what the HARP model predicts, though HARP followers do expect bonds to get uglier in the 120-130 "death trap" where this issue now lives. Interestingly, on our other measure, HOCS, both the departing 0.35% and the entering 1% get respectable overall scores of 55. The difference, unsurprisingly, is that the higher-priced, higher-delta 1%'s rating is biased toward growth, with a 58 Growth/51 Safety pairing, while the 0.35% gets only 47 for Growth but 70 for Safety, thanks to its substantially lower price point. We will give Priceline 1% this—51 is a heckuva Safety score, Brownie, for a bond at 130. Credit that big market cap even with the big stock pullback.

Finally, the late Bob Fosse would be glad to know we now have at least some of that jazz in the Ugly 20—Jazz Pharmaceuticals 1.875% of 2021 is on the list for the first time, coming in 19th. We actually feel a bit vindicated here—we liked this deal initially and got pilloried by readers who cited its lethargic grey-market start as evidence of its unattractiveness. Nyah-nyah. This bond has probably outperformed theoretical expectations by at least three or four points on the upside as the stock continues to press higher. Even now, HARP-shMARP, we still think these bonds look ok, though obviously not as good as at issuance. Our other measure, HOCS gives the Jazz bond an array of 60 Overall/69 Growth/41 Safety, a solid rating and an especially good one for a bond in the Ugly 20. All that said, don't kid yourself—in a weakening market these bonds could certainly contract a handful of points.

Oops—we almost forgot. One of the more controversial names around, Salesforce.com, has advanced all the way to 8th, with 9.54 HARP, with the company's next Kabuki presentation due in just over a week. We meant, of course, the company's next uber-promotional earnings announcement. These bonds typically get bid up in advance of earnings—or what passes for earnings at Salesforce.com—and this go-around appears to be no exception. The HOCS are rather subdued, at 47/51/38. Subdued—now that's a word you don't often hear in conjunction with this company. We don't care for these bonds or the company, but we've been wrong for quite a few years now.

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November 10, 2014

Hillside Ugly 20 List (Prices as of November 7, 2014)

	Convertible	Price	Stock	Premium (%)	Premium (pts)	HARP
1	Lam Research 1.25% 2018-05-15	140.75	78.93	12.2	15.30	11.52
2	RPM International 2.25% 2020-12-15	112.00	46.41	27.6	24.23	10.82
3	SanDisk 0.5% 2020-10-15	117.00	92.83	16.1	16.22	9.87
4	Omnicare (Exchange) 3.25% 2035-12-15	111.25	67.97	27.4	23.93	9.73
5	BioMarin Pharmaceuticals 1.5% 2020-10-15	119.25	83.91	33.7	30.06	9.65
6	Salesforce.com 0.25% 2018-04-01	118.00	63.97	22.6	21.75	9.54
7	Standard Pacific 1.25% 2032-08-01	114.50	7.45	24.2	22.31	9.34
8	Ryland Group 1.625% 2018-05-15	131.50	36.72	14.8	16.95	9.28
9	NuVasive 2.75% 2017-07-01	121.50	41.75	22.5	22.32	9.17
10	Illumina 0.5% 2021-06-15	113.75	186.35	55.1	40.41	9.14
11	BioMarin Pharmaceuticals 0.75% 2018-10-15	115.75	83.91	29.9	26.64	9.07
12	CSG Systems 3% 2017-03-01	120.50	25.58	11.2	12.14	8.84
13	Workday Inc 0.75% 2018-07-15	131.50	94.56	15.9	18.04	8.79
14	Priceline.com 1% 2018-03-15	130.00	1094.61	12.2	14.14	8.77
15	NVIDIA 1% 2018-12-01	113.25	19.79	15.4	15.11	8.72
16	Cubist Pharmaceuticals 1.875% 2020-09-01	115.75	70.38	35.6	30.39	8.56
17	Cubist Pharmaceuticals 1.125% 2018-09-01	113.00	70.38	32.2	27.52	8.12
18	Palo Alto Networks 0% 2019-07-01	117.50	107.02	21.2	20.55	8.07
19	Jazz Pharmaceuticals 1.875% 2021-08-15	115.50	170.80	35.1	30.01	8.06
20	On Semiconductor 2.625% 2026-12-15	110.50	8.25	40.8	32.02	7.95

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The Week That Was…

Bill Feingold

In addition to last week's LinkedIn megadeal, Tesla earnings, and continued ARCP action, some other names were in the news.

HLF: Herbalife took it in the gut, with disappointing earnings, as the company has clearly been affected by Bill Ackman's relentless insistence that it is a criminal enterprise. We have no opinion there, but we do say that if you think the company is legitimate, you should be in its convertible bonds. Quoted around 74 cents on the dollar, the bonds score 66 Overall/70 Growth/57 Safety on our HOCS scale. That said, the stock's decline could soon become problematic given the company's debt load—the lukewarm 57 Safety score given the busted price point testifies to this. It's not our kind of situation, but it's hard to make a case for owning the common when you can own the converts. We say that knowing the borrow challenges full well—the bonds could certainly get cheaper, and we recommend neither for nor against a position in the name. But the converts clearly trump the common.

CLVS: Clovis Oncology has made a terrific move in the two months since its convertible came to market. The stock took a mild breather surrounding last week's report, but despite a nominal miss the company claims its major initiatives, including a 2015 new drug approval (NDA) submission for its rociletinib lung cancer treatment. The convertible, trading around 119, gets a still-acceptable HOCS array of 50/68/13, with an unsurprisingly strong bias toward growth.

AOL: AOL reported in-line earnings. Yes, it appears, some people still do use AOL. And we continue to think the convertibles look ok. Trading around 102 with the stock just below 43, they have a nicely balanced 56/52/64 array.

Dendreon Bankruptcy

Kathy Schick

Dendreon Corp (DNDN) today filed for Chapter 11 bankruptcy protection. Management reached an agreement with ~84% of the 2.875% convertible senior note holders yesterday and entered into a plan support agreement. A stand-alone plan of reorganization will be undertaken which would allow the convertible note holders to receive new common stock in the reorganized company.

The agreement also provides for a concurrent bidding process to sell substantially all of the assets of the company. A minimum sales price of $275mm has been established, which equates to about 1x trailing twelve month sales.

Dendreon is a one-product biotechnology company. It launched Provenge, an immunotherapy used to treat asymptomatic or minimally symptomatic, metastatic, castrate-resistant prostate cancer, in 2010 with much fanfare. At the time consensus estimates were for peak sales to exceed $4bn. Unfortunately, the drug never got anywhere close to those numbers and the company is still burning cash today, more than four years post-launch. The lackluster results have been attributed to increasing competition in the prostate cancer space and a chilly reception from patients to the infusion technology Provenge employs.

The company is doing pre-clinical work on DN24-02 for solid tumors, but has no pipeline to speak of. Sales of Provenge for the last twelve months were $294mm with cash burn of $111mm. The company had $112mm of cash as of 9/30/2014 and feels confident it does not need to raise additional funds to continue operating during the reorganization period.

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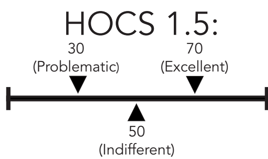
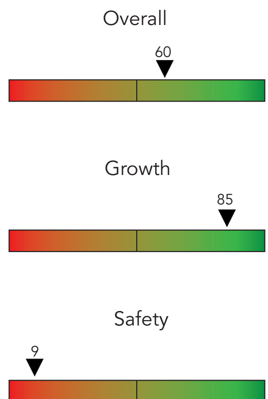
Salix Pharmaceuticals and the Inventory Bombshell

SLXP

1.5%, 2019/03/15
Price (Bond): 155.00%
Stock: $94.00
YTM: -8.67%
Premium: 8.5%
HOCS-Overall: 60
HOCS-Growth: 85
HOCS-Safety: 9

As of November 10, 2014





Kathy Schick

Salix Pharmaceuticals announced 3Q14 results on November 6th. Shareholders in the digestive-treatment giant could have used a giant antacid. The company revised down its full-year revenue guidance from $1.6bn to $1.4bn, but more noteworthy was its revised estimates for wholesaler inventory levels. It had previously indicated wholesaler levels were at about three months, but it now estimates nine months for its flagship product XIFAXAN 550; nine months for APRISO (ulcerative colitis); seven months for GLUMETZA (type 2 diabetes); and five months for UCERIS (another ulcerative colitis treatment). Management has formulated a plan to reduce the levels to approximately three months for XIFAXAN, APRISO, and UCERIS. GLUMETZA, which will be facing generic competition in 2016, will be reduced to approximately a one-month supply. It plans to work towards these reduced levels over a two-year period so as not to disrupt the market. Make no mistake: these adjustments will be offset in lower sales and management admitted as much on the conference call.

As a result of the inventory disclosures, the CFO was ousted and the Audit Committee has hired outside council to conduct a review relating to the wholesaler inventory levels. Assuming this was mismanagement and not fraud, it should be a bad, but survivable, setback for the company. The good news in the earnings report was greatly overshadowed by the inventory disclosures. Sales of the flagship product XIFAXAN 550 increased 23% in the third quarter from the prior year period. The company received FDA approval for three new products from July through early October - RUCONEST, RELISTOR SI, and UCERIS rectal foam. Salix has several products in its pipeline as well. It is awaiting an FDA review of the sNDA (supplemental new drug application) for XIFAXAN 550 tablets for irritable bowel syndrome. The FDA has committed to a completion date of no later than 2/28/15. An approval could greatly expand the market for XIFAXAN 550. There are two phase 3 studies underway on RIFAXIMIN for the treatment of active moderate Crohn's disease. Management expects to file an NDA for oral RELISTOR by the end of 2Q15.

Salix has already faced some headwinds this year before being slammed by the inventory disclosures. After closing the Santarus acquisition in January, turnover of the sales force was much higher than expected and necessitated hiring additional staff and devoting significant time to training. The Cosmo Technologies merger that was called off in October, also consumed large amounts of time. There has been a lot of speculation about Salix being acquired itself this year. With the stock down so much, those odds may have increased.

For the record, Salix's 1.5% convertibles' HOCS array after the fall is 60 Overall/85 Growth/9 Safety, based on a price of 155 with the stock at 94. In other words, it's suitable for arbitrageurs and for aggressive outright accounts trying to play a bounceback in the stock. It's still very much an equity trade, with conversion premium below 10%.

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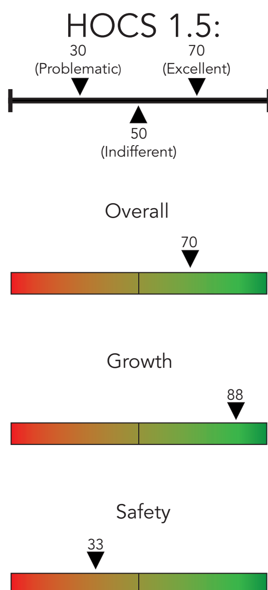
Theravance: Theoretically Awesome

THRX

2.125%, 2023/01/15
Price (Bond): 79.50%
Stock: $14.27
YTM: 5.24%
Premium: 17.5%
HOCS-Overall: 70
HOCS-Growth: 88
HOCS-Safety: 33

As of November 7, 2014



Jeffrey Alton, CFA, and Kathy Scick

Last June, Theravance Inc. (THRX) spun out its drug research and development business under the name Theravance Biopharma, Inc. to focus on its license with GlaxoSmithKline plc (GSK). GSK licensed two drugs from THRX to treat chronic obstructive pulmonary disorder (COPD) and asthma. These prescription drugs, called Breo and Anoro, have already been approved for sale in the US and several other countries. Management felt that isolating the drugs from the company's other ongoing drug development platforms would reduce volatility for the common shares. Sounds great in theory, but the stock has dropped from about $30 in July to $14.27 recently, as the drugs missed initial sales targets.

Reports indicate that second quarter Breo global sales were $18 million versus analysts expectations of $25 million and Anoro sold only $8 million versus expectations of $12 million. Those results spooked the market and Theravance is now trading at $14.27 versus $30 in July. The disappointment has held GSK stock back as well, falling from $54 in the summer to $44.91 on Friday. GSK is counting on Breo and Anoro to replace its older Advair drug. Advair's patent expired in 2010 and European protection expired in 2013. GSK currently owns about 28% of Theravance.

The most common COPD conditions are emphysema and chronic bronchitis. Breo is a once-a-day treatment that combines a corticosteroid and a bronchodilator and Anoro combines two bronchodilators to open a person's airways. The market for COPD and Asthma was around $21 billion in 2013 and the market is expected to grow in developing countries with the increased use of tobacco. That makes Theravance fans believe that these drugs have blockbuster potential. However, investors should remember that Theravance is a one trick pony. Revenue will be based solely on the GSK royalty payments associated with the marketing of these drugs. For Breo, Theravance receives a 15% license fee on the first $3 billion of annual global net sales and 5% after that. For Anoro, Theravance receives an upward-tiering 6.5% to 10% on global net sales.

Theravance has a current annual burn rate of about $164 million, but has targeted a $1 annual dividend on the common equity based on the royalty payments from GSK. The burn rate includes dividend payments of about $113 million, debt service of $41 million covering a senior note and the convertible security and another $10 million in administration expenses. To meet that cash outflow, annual sales of Breo and Anoro must be over $1 billion at a minimum. Theravance had $268 million in liquid assets on their September 30, 2014 balance sheet. That doesn't provide much margin for error in ramping up drug sales.

To move the ball down the field, GSK is focusing on expanding the number of health plans that accept the drugs. For example, GSK expects Anaro Part D coverage to have been over 50% through October, up from 30% in the summer. Breo Part D coverage is

now over 70%. The planned marketing period is actually through 2016, so there is still plenty of time for the drugs to prove their blockbuster potential.

Still, we consider Theravance's financial situation risky and would rate the company as speculative albeit with potential. Given the pressure for the company to start generating significant revenues to service the dividend payments, there is room for the equity to adjust further despite the current 7% dividend yield.

The convertible bond offers an alternative way to invest.

	2023 Convertible Senior Notes
Coupon	2.125%
Maturity Date	January 15, 2023
Amount Outstanding	$255 million
Current Price	79.50
Current Yield	2.67%
Yield to Maturity	5.24%
Conversion Premium	17.5%
Conversion Price	$21.083

For investors interested in the story, our counsel is to take an initial nibble rather than a bite. While we might typically suggest the convertible in a situation like this in order to "get paid while you wait", we are concerned about the getting paid part. While waiting to invest might mean missing the initial surge should revenues start meeting expectations, there should be plenty of upside in the coming months if momentum starts to build.

Disclaimer: A principal of Hillside Advisors has a position in Theravance Biopharma.

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November 10, 2014

A House Divided: ARCP vs. RCAP

Jeffrey Alton, CFA

It should be a pretty interesting interoffice holiday party on the 15th floor at 405 Park Avenue this year. Sister companies American Realty Capital Properties (ARCP) and RCS Capital Corp. (RCAP) share the office space and like quarreling siblings, they are locked in a dispute over RCAP's agreement to buy private REIT manager Cole Capital Advisors Inc. from ARCP for $700 million. RCAP announced last week that it was backing out from the deal as a result of accounting irregularities at ARCP. Dad, in this case Nicolas Schorsch, chairman for both companies, is trying not to play favorites. He's letting the independent board members of each company duke it out, at least publically.

The whole mess began with ARCP's announcement that its financial statements for the first six months of 2014 and the entire 2013 year could no longer be relied upon. The controversy centers on an erroneous calculation of adjusted funds from operations (AFFO). In the first quarter 2014, the calculation did not exclude a portion attributable to non-controlling interests, effectively pumping up the AFFO number. When the mistake was discovered, it was covered up instead of being corrected. Additional financial statement errors were also made in the second quarter, artificially increasing GAAP income and AFFO.

The net result of the restatement was a four cent decrease in AFFP and a one cent decrease in GAAP earnings for the first six months of 2014. The CFO and chief accounting officer have resigned.

Since the scandal hit, ARCP stock has dropped almost 30% to $8.79 per share. This brings us back to RCAP. Why is it so bent out of shape over a scandal that doesn't include them? Its stock has fallen even more: 42% to $11.32 per share. Probably out of desperation and perhaps a little spite, RCAP has unilaterally cancelled the Cole Capital Advisors acquisition. Anything to stop the bleeding. Looks like it will be up to Dad in the end to settle this dispute behind closed doors.

So is there value left for ARCP security holders? As we mentioned last week in Bill's "The Week That Was…." column, ARCP can be viewed as a roll-up that has grown too fast to be managed effectively. Since going public three years ago, ARCP has completed a number of acquisitions, spending $2.5 billion alone in 2013. Revenue increased 595% year-over-year to $382 million in Q2 2014. That kind of rapid expansion through acquisitions has been known to lead to implosion. Worldcom, Enron and Tyco come to mind quickly.

Still, ARCP has more in the way of hard assets than those flame outs. The company lists net real estate investments of $17.4 billion versus total liabilities of $10.5 billion. That compares favorably with competitor Realty Income Corporation (O) which lists net real estate of $9.7 billion to $5.4 billion in total liabilities. ARCP compares reasonably well with Realty Income Corporation in other aspects as well.

	ARCP	Realty Income Corporation (O)
Number of Properties:	4,429	4,284
Occupancy:	99.80%	98.30%
Number of Tenants:	541	231
Number of Industries:	94	47
% Investment Grade:	46%	46%
Nebt Debt to Adjusted EBITDA:	6.3x	5.9x
Weighted Average Remaining Lease Term:	12.2 years	10.4 years
Property Type:	62% Retail & Restaurants 23% Office 15% Industrial	78.2% Retail 10.3% Industrial & Distribution 6.7% Office

A major difference between the two companies is goodwill. ARCP lists $2.3 billion of goodwill on its balance sheet while Realty Income lists only $15.5 million. Large goodwill balances can sometimes mean overpayment, signaling cash flow problems in the future. That is a red flag for ARCP.

Before word of the restatement broke, ARCP guided to an AFFO run-rate of $1.18 to $1.20 per share. However, the market now is clearly worried about the company's ability to generate enough cash to continue the dividend at $1.00 per share annually. The current equity yield of 11.6% leaves plenty of room for a dividend cut without having an effect on the current equity share price. On the other hand, an all-clear from the company could easily send ARCP stock much higher. Realty Income Corporation common equity currently yields 4.70% which would equate to a share price of $21.28 for ARCP.

The public bickering with RCAP also strikes us as odd. While we understand the need for RCAP to shore up its share price, we would think the conflict could be addressed in a conference room at the companies' shared headquarters. Is it possible RCAP knows something that we don't?

Given the situation, our thought is that ARCP's convertible bonds offer a good balance of safety and potential return, insulating investors to some extent from headline risk. ARCP has two convertible bonds summarized below.

ARCP Convertible Bond Overview

	2018 Convertible Senior Notes	**2020 Convertible Senior Notes**
Coupon	3.00%	3.75%
Maturity Date	1-Aug-18	15-Dec-20
Amount Outstanding	$597 million	$403 million
Current Price	91.5	91.25
Current Yield	3.28%	4.11%
Yield to Maturity	5.56%	5.46%
Conversion Premium	74.10%	55.60%
Conversion Price	$16.55	$15.00

ARCP does not have significant refinance obligations until 2017-2018 when a $1.9 billion credit facility is due, $1.3 billion in corporate bonds mature and $598 million in convertible bonds are due. That gives the company a rather long runway to navigate through the crises and benefits convertible bond holders from a credit perspective. Should the controversy blow over and no additional financial restatement be necessary, convertible bondholders will participate in an equity share price surge as well.

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November 10, 2014

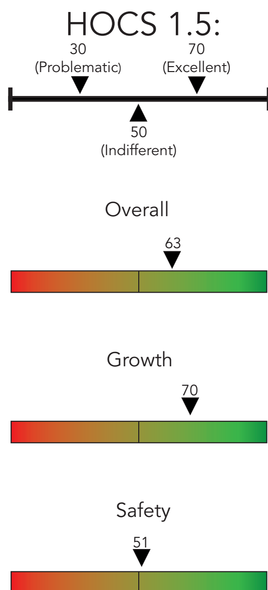
Earnings Update: 51job, Inc. (JOBS): 3.25% Convertible Senior Notes 2019-04-15

Jeffrey Alton, CFA

JOBS

3.25%, 2019/04/15
Price (Bond): 102.75%
Stock: $34.07
YTM: 2.59%
Premium: 28.9%
HOCS-Overall: 63
HOCS-Growth: 70
HOCS-Safety: 51

As of November 7, 2014



	Actual 9/30/2014	Consensus Estimate 9/30/2014	Percent Difference Act. V. Est.	Previous Year Actual 9/30/2013	Percent Change Y-O-Y
Revenue	$77.2	$73.3	5.32%	$68.6	12.5%
Adjusted EPS	$0.41	$0.36	13.89%	$0.38	9.3%

Quarterly Earnings Highlights

51job beat internal top line guidance of US$73.3 million - $75.8 million and bottom line guidance of US$0.36 to $0.39. Both the online recruiting business and the other human resources business grew double digits.

Despite the implementation of a 6% VAT tax (value added tax), online recruitment services revenue grew 13.6% in the third quarter 2014 compared to Q3 2013. Unique employers increased 19.4% to 283,651, up from 237,526 last year.

The other human resources related revenues increased 18% in the third quarter 2014 compared to Q3 2013.

The company's print business decreased to US$300,000, essentially winding down the business. That ends a transition period where decreases in print business revenue were a drag on growth.

Outlook

Category	Q3 2014 Guidance	
Revenue	RMB515 – 530 million (US$83.9 - $86.3)	
Non-GAAP EPS	$RMB2.60 – 2.80 (US$0.42 - $0.46)	

The mid-point of JOBS guidance calls for a 9.1% increase in revenues over Q3 2013 and a 3.5% in earnings per share for the fourth quarter.

While the online recruitment business continues to grow at a strong pace, we are also excited about the faster growing human resources related business. In particular, payroll services which has yet to catch on to the extent it has in the US. That business alone offers 51Job a new growth driver over the medium- and long-term.

Equity Comments

After the earnings release, the stock jumped over 5% to close at $34.07 on Friday. The stock now sits above its 50 day moving average of $31.30. The 200 day moving average is resistance right at $34.08. That resistance could prove difficult to break. Analysts have dropped the 2015 consensus earnings per share estimate to $1.75 from $1.80 over the last week. So while we like the company, it still trades on the rich side at almost 20 times the 2015 estimate.

Convertible Security Comments

As we have advised in the past, convertible bond fund managers may want to take a close look at the 51Job, Inc. 3.250% convertible bond due 4/15/2019. With a 3.16% current yield and trading a few points above par, the bond also offers a 2017 put and an attractive premium of 29%. The bond gets an excellent HOCS array of 63 Overall/70 Growth/51(ironically) Safety. Note that our proprietary system applies a "credibility discount" for Chinese issuers. We view 51Job, Inc. as a quality company with a bright future, so we fully expect the equity attributes of the bond to kick in over the long term. However, as always, we alert you to the structural risks of the Chinese VIE ownership.

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November 10, 2014

This piece originally appeared on November 5, 2014 on Forbes.com

LinkedIn Connects With A Big New Convertible Bond. Is Netflix Tuned In?

Bill Feingold

Mark Twain supposedly once said that history may not repeat itself, but it rhymes.

We like rhymes because they satisfy our need for resolution and closure. And in an interesting way, the convertible bond market is getting closure today. At least that's how I see it.

Back in February, Netflix NFLX -0.83% came through with an outstanding earnings report. The stock rocketed-from 333 to 388 just like that. Within an hour or two of the report I was calling, in this space, for the company to raise a lot of money with a new convertible bond issue.

Convertible bonds let companies monetize their high-flying stocks without shooting down the plane. They create a new, more sensible avenue to invest in big growth. Get it right? A triple in the stock means a double in the convertible, no disgrace there. Get it wrong? As long as it's not really, really wrong—like Enron or GM wrong—you get your money back, with a sliver of interest.

Netflix needed to raise money. It did, but it did so with a traditional bond. 5 3/8% interest for 10 years, nothing really wrong with that. But the company could have done better. It could have raised money nearly interest free, maybe not for 10 years but at least five and probably seven, and the only catch would have been giving up some stock 40-50% above a big new all-time high. Having been forced into selling some really cheap stock a few years earlier, and having given away the store in a private convertible bond then to boot, Netflix's directors apparently wanted nothing to do with an equity-based financing, even if it made all the sense in the world.

Roll the calendar ahead nine months. Comes now the social-networking company for business, LinkedIn LNKD +0.03%. I make no bones about it. I love LinkedIn. I've been using it ever since a friend I first met on a horse-racing trip to Kentucky eight years ago told me about it. LinkedIn is a remarkably effective networking and career-management tool, a perfect fit for today's economy. I use it every day. It's been invaluable in building my convertible research firm.

But now I love LinkedIn even more. The company announced a $1.15 billion convertible deal Tuesday after the close. It's the deal Netflix was supposed to do. By the way, it's the deal Netflix still can do—as luck would have it, Netflix has taken the scenic route to almost the identical stock price it had in February after that earnings report.

LinkedIn picked the right day to announce better-than-expected earnings last week. The market was rallying back something fierce and took the company along, setting a higher watermark than we might have seen on an ordinary day. And to the company's credit, it hasn't messed around. It's taken what the market gives with a smile. IPO at $45 in May 2011, follow-on at $71 six months later, a big follow-on at $223 nearly two years after that. And now, following a rocky year, the stock is finally back above that $223 level. How do you keep with tradition and sell more stock at a much higher price than last time?

Simple. You do a convertible. And if you're a big company like LinkedIn, with a big market capitalization and no debt, the convertible will cost you next to nothing—maybe nothing—in cash interest. Meanwhile, LinkedIn won't be issuing stock, according to the preliminary terms, unless the stock gets at least 40% above its current perch. Call it 330-ish.

And what's more, LinkedIn is actually going to cut the kind of side deal that's become almost customary in big convertible issues. It will use a portion of the deal to buy back stock—or, if you want to be technical, to enter an option trade that has the joint economic effects of buying back some stock now and raising the effective conversion price of the bond to something more like 400. This "anti-dilution" step comes at a cost, but trust me: it's a very reasonable cost. This is very cheap and very smart financing by a very smart company.

To my friends at Netflix: I love your service. Without you I couldn't have binged—twice–on Breaking Bad, the greatest show ever. But as long as you guys don't raise money with a convertible, you're pulling a Jesse Pinkman, throwing cash out the window. Thanks in part to Mark Cuban, your stock has already regained half the ground it lost recently. It's in the right spot. Heck, with a convertible, you can effectively issue stock higher than it's ever traded—above 500, in fact. Do I need to spell it out any more? Heck, don't ask me. Ask your buddies over at LinkedIn. I'm from the East Bay, so my South Bay geography's not what it might be, but I'm pretty sure you guys know each other. Grab a beer or two and talk convertible bonds. Yeah, Mr. Twain! Yeah, finance!

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November 10, 2014

These pieces originally appeared as Hillside Alerts (HA!) last week on Hillsideadvisors.com.

Hillside Alerts (HA!)

TESLA (TSLA)-UPDATE ON THE 0.25% AND 1.25% SENIOR CONVERTIBLE NOTES

November 6, 2014 / Bill Feingold

With Tesla (TSLA) common trading around 245, we used prices of 96 1/4 and 95 1/2 on the 0.25% and 1.25%, respectively. These have been among our highest-ranking bonds on our HOCS (Hillside Overall Convertible Score) rating system. Currently the 0.25% land at 75 Overall/79 Growth/68 Safety and the 1.25%, which we prefer, score 78/85/63. Both are excellent scores, rewarding the bonds for their distinctive blends of market capitalization, hybrid price point, volatility and growth potential.

NEW ISSUE UPDATE: $1.15 BILLION LINKEDIN (LNKD) 0.5% CONVERTIBLE SENIOR NOTES OF 11/1/2019

November 6, 2014 / Bill Feingold

Not surprisingly, this deal's optics as initially discussed, combined with its size and the poor initial performance of Twitter's convertibles, drove a repricing, with the coupon coming at the cheap end (0.5%) and the premium reduced to 35%.

As priced, the deal received an outstanding HOCS (Hillside Overall Convertible Score) array--the best we've seen yet in HOCS' brief history. The deal terms led to a HOCS array of 80 Overall/77 Growth/86 Safety. With the bonds expanding significantly and currently quoted around 103 with the stock around 222, the updated HOCS array is 75 Overall/72 Growth/81 Safety, still an excellent rating. (For purposes of comparison, our preliminary HOCS array based on the midpoint of the initial price talk was 76 Overall/71 Growth/87 Safety.)

We continue to favor these bonds as a major core holding.

Speaking of the Twitter convertibles, the blended score of the two bonds (we slightly favor the longer-dated, higher coupon 1%, which trade at a marginally lower price) is 68/74/56--a strong array but not nearly as attractive as LNKD.

NEW ISSUE (PENDING): $1.15 BILLION LINKEDIN (LNKD) CONVERTIBLE SENIOR NOTES

November 5, 2014 Hillside Team
Kathy Schick and Bill Feingold

LinkedIn's blend of big market capitalization, volatility, growth, and solid financials all contribute to one of the best HOCS (Hillside Overall Convertible Score) ratings we have seen for a new deal. At the price-talk midpoints, the deal gets a HOCS array of 76 Overall/71 Growth/87 Safety. These are strong numbers despite the mediocre optics.

The deal rates more strongly in our approach than it does in traditional models, which seem to make the bond a borderline buy. Who is right? Only time will tell.

Company Review

LinkedIn is the world's largest professional network on the Internet. As of 3Q14 it had 332mm members located in more than 200 countries and territories. The company operates in three business segments: (1) Talent Solutions which provides recruiter products and job postings; (2) Marketing Solutions which provides ads to the website; and (3) Premium Subscriptions which provides additional online services to members.

LinkedIn is issuing $1.15bn of convertible senior notes due 2019. Proceeds will be used for a convertible notes hedge and warrants transaction and for general corporate purposes. The company is opportunistically raising capital on very attractive terms. Prior to the offering, cash balances were $2.264bn bolstered by a $1.3bn follow on stock offering in 2013. Pro-forma for the deal the cash balance will be $3.4bn. The company does generate positive free cash flow with $158mm generated over the latest twelve months. The new convertible bonds will be the only debt outstanding. Leverage (debt/LTM EBITDA) is a modest 2.2x based upon LTM EBITDA of $524mm.

The company announced 3Q14 earnings last Thursday. It continues to experience strong growth with revenue up 45% in the third quarter year-over-year with all three business segments participating. Talent solutions accounted for 61% of revenue for the quarter, followed by premium solutions at 20% and marketing solutions at 19%. Management has indicated it plans to continue expanding their product offerings and their international presence. Sales in the EMEA regions (Europe, Middle East and Africa) grew by 55% year-over-year and in the Asia-Pacific region by 60%.

LinkedIn has been using some cash for small acquisitions. So far in 2014 it has acquired six companies for $221mm in cash (plus some additional stock). Bizo, a social advertising program company, was acquired in August for $154mm of cash. Bright, a San Francisco-based online job board, was acquired in February for $51mm cash plus $50mm stock. The other four transactions were very small and totaled $16mm cash plus $7mm stock.

The company is well positioned to fund additional growth initiatives and make additional tuck-in acquisitions.

Meet the Pros

Kathy Schick

Kathy will be responsible for credit research at Hillside. She brings 19 years of convertible bond research experience to the firm. Kathy was most recently the Director of Convertible Bond Research at Daiwa Capital Markets and KBC Financial Products. She was responsible for writing credit research on the new issue and secondary markets as well as supporting the convertible bond trading desk. She has also held convertible bond research positions at D. E. Shaw & Co and Cresvale International. Prior to working in the convertible bond market she held positions at IBM as a systems analyst and accountant.

Kathy holds Series 7, 63, 86, and 87 licenses. She resides in White Plains, NY with her husband, Robert, and their four children. In her spare time she is active in Girl Scouts serving as a Junior Troop Leader and a Troop Leader Coordinator as well as organizing events within the White Plains Girl Scout community.

Kathy graduated from Purdue University with a B.S. in Accounting and a minor in Computer Science. She graduated from New York University with an M.B.A. in Finance and International Business.

HILLSIDE ADVISORS LLC

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Erratum: Horizon Pharmaceuticals

Roman Terekhin, CFA

Last week, in the article on Horizon Pharmaceutical's debt for equity swap we compared apples to oranges. We mentioned that the premium was 13 – 14 points in August and that the company ultimately paid 21 points. Regretfully, we neglected to back out the accrued interest from that number. The issuer actually paid just under 19 points in premium and thus true expansion was "only" 5 – 6 points.

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