Capital Bridge OnTarget

CapitalBridge's monthly newsletter focusing on institutional targeting and investor relations

OnTarget – Best Practices

The Convertibles Market – The Long and Short of It

Convertibles have represented a very popular method of financing for growth companies of all sizes over the last several years, allowing companies to raise capital based on the promise of solid growth (producing equity returns) at relatively low costs. While accounting for convertibles has caused some consternation within accounting standards boards, the FASB decision in early 2007 to back off on a project with the potential to change guidance for convertibles accounting lifts a concern for companies looking to raise capital through convertibles. Investors will therefore continue to see new convertible issues flowing onto the market to take advantage of from both the long and short sides – according to CapitalIQ, $76 billion of convertible debt was issued by US-listed companies in 2006, with over $22 billion issued already in 2007 (outpacing last year's issuance rate). As a current or potential issuer of convertible debt, you'll need to be aware of the investors involved, both from your role in the original roadshow on to the post-issuance effects on your equity.

The Long of It...

Several strategies exist for trading convertible debt that are worth being aware of, as convertibles are rarely ever listed as held-to-maturity securities by managers; large-enough convertibles can have effects on trading in your equity, even beyond the obvious potential for dilution of your equity shareholders. Convertibles represent an income investment appropriate for both high-yield and growth-and-income portfolios. Of particular note, Canadian issuers in the hot market for mining companies and income trusts (referred to previously in the February 2007 OnTarget Newsletter) in 2006 dipped heavily into the convertible market, with 39 issues totaling $2.4 billion; high spreads, with coupons for these securities averaging 6.7%, attracted plenty of interest in the institutional market from high-yield and growth-and-income managers.

Top 10 US Holders of Corporate Convertible Debt – "The Longs"

Investor	# of Converts Held	Converts Held ($M face)	Total Assets ($M)	Style
Deutsche Bank Trust Company Americas	181	2,585.3	150,000	Index
Oaktree Capital Management, LLC	147	2,117.1	31,111	Distressed Debt
Lord Abbett & Company, Inc.	108	2,050.3	112,000	GARP
Froley, Revy Investment Company	178	1,828.3	3,960	Growth
Van Kampen Investments	83	1,677.7	112,000	Growth
Capital Research & Management Company	25	1,652.4	972,000	Value
Columbia Management Advisors, LLC	180	1,483.1	293,863	Value
Franklin Templeton Investments (CA)	36	1,293.1	170,005	Growth
T. Rowe Price Associates, Inc.	38	1,254.7	284,495	Growth
Fidelity Investments	62	986.2	1,100,000	Growth

Oaktree Capital Management, LLC is one of the larger players in the high-yield corporate bond market, and in particular is a significant investor in many "busted" convertibles (that have only a small likelihood of converting prior to a convert date, and therefore trade at yields similar to non-convertible debt and can be purchased at deep discounts). Sectors such as autos and auto parts, as well as some tech companies, tend to be effective "busted" convertibles – with so many fixed income investors locked into ratings systems, often downgrades of the issue force sales of a convertible and "break" the market for the issue, allowing for large mispricing opportunities for investors.

Finally, traditional distressed debt managers tend to avoid lower-ranked convertible issues, but there are also a few situations where companies with only a convertible as part of the debt structure, or very little senior debt, will attract distressed-debt managers looking to profit from getting involved in a potential reorganization. Distressed debt investing is an entirely different topic, but needless to say firms such as Satellite Asset Management do tend to get involved in particularly tough situations for corporates.

And the Short of It…

While it may not always represent the top-performing hedging strategy, convertible arbitrage (and other capital structure arbitrage) strategies command a huge chunk of assets of institutional investors, and often do produce excellent returns. A Financial Times piece on February 14th noted that a Deutsche Bank survey found that convertible arbitrage had moved from the "least-liked strategy among investors to the fourth-most popular in the space of 18 months." The CS/Tremont Convertible Arbitrage Index showed a 14.2% return for 2006, after several years of underperformance relative to other hedging strategies.

Top 10 US Hedge Fund/Convertible Arbitrage Holders of Corporate Convertible Debt – "The Shorts"

Country	# of Converts Held	Converts Held ($M face)	Total Assets ($M)	Style
Calamos Advisors, LLC	172	11,601.6	47,601	Growth
Highbridge Capital Management, LLC	187	3,599.8	17,000	HF: Global Macro
AQR Capital Management, LLC	188	2,823.8	26,500	HF: Market Neutral
Fore Research & Management, LP	173	2,539.1	2,915	HF: Arbitrage
Aristeia Capital, LLC	94	2,122.0	3,106	HF: Arbitrage
SAC Capital Advisors, LLC	104	1,835.8	12,000	HF: Long/Short
Lydian Asset Management, LP	53	1,807.0	2,600	HF: Arbitrage
Whitebox Advisors, LLC	119	1,771.3	3,227	HF: Arbitrage
Advent Capital Management, LLC	193	1,635.2	3,400	HF: Arbitrage
Ferox Capital Management, Ltd.	49	1,468.6	1,210	HF: Niche

Without getting too deep into the trades involved, the strategy for most convertible arbitrage players is to take advantage of a mispriced convertible, traditionally by shorting the (more-liquid) equity while holding a long position in the (less-liquid and often mispriced) convertible security. Depending on the pricing, convertible arbitrage players may look to get involved in the initial allocation, or get in on the secondary market after the post-issuance "flip" liquidity. If you've got an outstanding convertible, familiarizing yourself with some of the larger players in the convertible arbitrage space is a requirement – an investor demanding access to management that is likely shorting your equity is probably not worth expending as much in the way of time on, compared with other investors.

Consider three different types of convertible arbitrage players for IR purposes: traditional investors engaging in convertible arbitrage, multi-strategy hedge fund managers, and pure-play hedge funds. Nick Calamos, who wrote the book on convertible arbitrage (literally – 2003's *Convertible Arbitrage: Insights and Techniques for Successful Hedging*, chock full of great bedtime stories for your children...), is involved with managing the largest US-based stake in the convertible arb space at Calamos Advisers. Over $11.6 billion face in convertibles were held by the firm as of the end of 2006 (with market value totaling almost one-fourth of the firm's overall assets), with a majority held in one form or another of convertible arbitrage plays. This total accounts for almost one-quarter of the more-traditional manager's overall asset base. Many large multi-strategy hedge fund managers run one or more convertible arbitrage funds – most full-service managers such as SAC Capital, Pequot Capital, and D.E. Shaw offer the strategy to their clients, as many hedge fund clients look to play the hot strategy when allocating new capital to these firms. Pure-play convertible arbitrage managers such as Aristeia Capital and Fore Research make up the other component of this group.

From the Top Down...

While there's no true way to track short-sellers of your stock, investment managers holding long positions in convertibles (considered to be an equity equivalent) are required to file their holdings with the SEC. It's a fairly safe assumption, therefore, that any managers with a history of convertible arbitrage that show up as convertible holders are most likely short your equity. Also, any trading in your convertible issues is required to be reported through the NASD TRACE System like any other corporate debt, which means you'll be able to monitor volume traded in your convertible through Bloomberg, Reuters, or other data services to keep an eye on any unusual transactions. As an IRO, giving your convertible holders the same "buy-in" as your equity holders with respect to your investment story can give you opportunities to change your capital structure through buybacks, exchanges, or swaps down the road, and in that way can directly help lower your cost of capital.

For help in tracking your convertible security's trading, contact us at targeting@cap-bridge.com.

OnTarget – Weightings

Subprime Fallout

While many of the largest investment managers (Fidelity, T. Rowe Price, and Wellington included) already held underweight positions in the subprime mortgage space prior to the collapse it saw in March, managers that either didn't mind the level of risk seen in the industry or didn't believe the collapse was possible were caught in a downward spiral in March.

Ohio-based manager Eubel Brady & Suttman reported on April 9th that it had disposed of most of its stake in Accredited Home Lenders (LEND), with just 760 shares remaining out of an over seven million share stake previously reported. Given the filing timing, it was clear that at least some of the liquidation took place in March in the midst of the subprime equity collapse. While the industry is generally small enough to only represent a certain percentage of most equity portfolios, the magnitude of the collapse could have a nasty effect on the results of portfolio managers exposed to it, and may lead them to seek less risky investments as replacements.

Top 10 Investors with Significant Overweight Positions (>200% Weighting in Subprimes versus Overall Equity Market)

Firm Name	Subprimes Owned 12/06 ($MM)	4Q06 Net Change in Subprimes ($MM)	Total Global Equity ($MM)	% of US Equity in Subprimes	Investment Style
Eubel Brady & Suttman Asset Mgmt.	88.2	21.5	2,811.3	3.14	Value
Greenlight Capital, Inc.	64.9	(0.5)	2,709.8	3.30	HF: Long/Short
Goldman Sachs Asset Management (US)	56.2	(7.1)	157,310.2	0.04	Value
Earnest Partners, LLC	54.8	(3.4)	19,686.0	0.28	Value
Ruane, Cunniff & Goldfarb, Co., Inc.	47.4	0.3	13,351.1	0.36	Value
Farallon Capital Management, LLC	39.7	(4.7)	10,900.1	0.53	HF: Arbitrage
Putnam Investments, LLC	37.9	(7.2)	108,308.3	0.04	Growth
Owl Creek Asset Management, LP	37.8	37.8	1,507.1	2.96	HF: Distressed Debt
Hotchkis & Wiley Capital Management	34.1	(14.6)	32,193.0	0.11	Value
Wells Capital Management	33.7	(0.9)	41,212.0	0.09	Growth

Of note, while many of the largest active managers may have escaped the direct path of the subprime equity storm, they may be in for some aftereffects. For example, NWQ Investment Management held $1.0 billion in mortgage insurers, such as PMI Group, at the end of 2006, with other investors such as Fidelity, ClearBridge, Putnam Investments, and Goldman Sachs Asset Management all holding over $500 million in the related sector. And, obviously, the effects on the structured finance and fixed-income markets may spread well beyond just equity managers as well.

For more on investors' exposure to subprimes, mortgage insurers, and prime-level mortgages, contact us at targeting@cap-bridge.com.

Equity Coverage Structures (...and you thought you were overworked...)

IROs have often bemoaned the rapid increase in the number of institutional investor relationships they're required to handle. Obviously this is largely due to the rapid expansion of the hedge fund community and to the faster and cheaper dissemination of information (if you've been in the business for a while, think back to the days of the "blast fax" list – remember the list of bouncebacks from your fax vendor?). A typical IRO of a mid-cap company is now expected to maintain relationships with dozens of institutional investors, and to be available at a moment's notice to keep up with the demands of in-depth analysis.

But what about the buy-side analysts on the other side of the table? In the old days (prior to the research settlement), the buy-side analyst could rely on models from multiple sell-side analysts, have complete access to granular coverage from sell-siders who each covered just 5-10 securities, and do it all on soft dollars. Now, most buy-side analysts have little access to the sell-side (see the March 5th Bloomberg article *Mutual Funds Get the Busy Signal from Analysts Chasing Hedge Funds*), are uncoupling their soft-dollar arrangements, and are seeing their coverage universes increase, along with added pressure on returns provided by the hedge fund community and tighter scrutiny of expenses by, well, Eliot Spitzer and his successors.

With this in mind, an interesting exercise is to look at the average overall coverage universe for each buy-side analyst / portfolio manager at a particular firm. While there's plenty of other variables in the equation, odds are you'll find a pretty good proxy for how much "load" is on any individual analyst at any firm by looking at positions held per individual (CapitalBridge uses distinct equity positions held over a 12-month period to approximate overall coverage) and dollars managed per individual. If you're one of 100 companies covered by an individual analyst, you're probably going to see a difference in the depth of analysis this individual needs to produce, while if you're one of 10 companies covered, the odds of the analyst making follow-up calls and requiring more detailed information is higher.

Large Granular Coverage Investors – Tier 1

These investors (defined as firms with over 75 decision-makers on staff) have the manpower to provide detailed coverage at the industry or sub-industry level, and many can maintain models on nearly any security within an industry or cap range using internal resources. There's a pretty big range of coverage universes, however – Lord Abbett and Neuberger Berman average 15 positions per analyst, with the "blue chips" such as Fidelity, Wellington, and Capital Research coming in at 17 positions per analyst. At the other end of the spectrum, BlackRock, AllianceBernstein, and T. Rowe Price all average over 40 positions per analyst, suggesting they may not be able to go "as deep" with their in-house resources.

Tier 1 – Highest # Securities/Analyst			Tier 1 – Lowest # Securities/Analyst		
Firm	Securities / Analyst	Equities ($M) / Analyst	Firm	Securities / Analyst	Equities Managed ($M) / Analyst
BlackRock, Inc.	45	1,050	Neuberger Berman	15	664
AllianceBernstein, LP	43	3,108	Lord Abbett & Co.	15	1,025
Columbia Management Advisors, LLC	42	1,455	Capital Research & Management Company	17	6,470

Industry-Coverage Level Investors -- Tier 2

At the next level of investor size (40-75 analysts/portfolio managers), most shops are able to still specialize to the industry level, but are more likely to use individual sell-side models or "consensus" models as starting points for generating their own work on a security. Some investors such as Munder Capital have a smaller-cap focus and will require less overall work to cover each position (diversification is more important in a small-cap portfolio than a large-cap one); Munder averages 85 positions per analyst. Larger firms such as Jennison, TCW, and Templeton are still able to maintain 15-20 positions per analyst coverage.

Tier 2 – Highest # Securities/Analyst			Tier 2 – Lowest # Securities/Analyst		
Firm	Securities / Analyst	Equities ($M) / Analyst	Firm	Securities / Analyst	Equities Managed ($M) / Analyst
Credit Suisse Asset Management, LLC (US)	94	828	TCW Group, Inc. (The)	16	764
Munder Capital Management	87	299	Jennison Associates, LLC	18	1,383
RiverSource Investments, LLC	85	1,377	Templeton Investment Counsel, LLC (TIC)	20	1,260

Sector- or Niche-Coverage Level Investors -- Tier 3

With 15-40 analysts on staff, sector specialization is possible, but individual industry specialization becomes much tougher for firms that want to maintain wide coverage. Small-cap shop Royce & Associates has its analysts manage over 100 positions per year, but is free from the demands of segment-level analysis needed in the large-cap range. PRIMECAP Management, traditionally holding very large concentrated positions, and Cramer Rosenthal, a value shop, each has its employees looking at just 15 stocks, by focusing on a particular fundamental range.

Tier 3 – Highest # Securities/Analyst			Tier 3 – Lowest # Securities/Analyst		
Firm	Securities / Analyst	Equities ($M) / Analyst	Firm	Securities / Analyst	Equities Managed ($M) / Analyst
Royce & Associates, Inc.	106	1,421	Pzena Investment Management, LLC	11	1,330
Van Kampen Investments	91	3,279	Cramer Rosenthal McGlynn, LLC	15	358
Allegiant Asset Management Company	90	913	PRIMECAP Management Company	15	3,428

Specialists or Generalists – Tier 4

Most investors with less than 15 analysts on staff are either "generalist shops" (with each analyst seeking their own investment ideas across a universe of securities) or extremely specialized investors such as OrbiMed Advisors or RREEF that cover just a particular industry or investment type. Dreyfus Corp. is one of a few that covers a huge range of all-cap securities with just a tiny staff of analysts (nearly 300 positions per analyst). Many hedge fund managers fall into this space, focusing on just a small number of strategies. Given the preponderance of one- or two-person firms, it becomes tougher to analyze this group with relevant data, but a glance at the portfolio of the investor can give you an idea which type of decision-maker you face and allow you to tailor your pitch to them.

Keep the coverage level of the investor you're talking to in mind when telling your company's investment story; if the person on the other end of the videoconference looks a little frazzled, don't be surprised if you're dealing with someone with a hefty coverage universe and not enough time to go through your operational offering product-by-product. Use the "bite-size" pieces of your story for these investors. On the contrary, if a buy-sider is only responsible for ten or fifteen positions, odds are they probably won't need to carry away a separate copy of the first dozen PowerPoint slides of your presentation; instead, they'll want to know a lot more than your mission statement and your full-year guidance.

For more details on analyst coverage loads, simply drop us a line at targeting@cap-bridge.com.

OnTarget – Firms

Target Firm: Atlanta Capital Management Company, LLC

Targeting Profile
The firm is a niche player in the (fairly crowded) mid- to large-cap growth equity space; it looks for steady-state growth investments at all ranges of the equity spectrum. While it's a bit out-of-the-way to go to Atlanta for a top-tier non-deal roadshow, you may choose to package up a visit to the "capital of the New South" with other local players such as INVESCO, Trusco Capital, and Earnest Partners to fill up a good day of meetings in front of strong purchasing power.

How to Approach
Of particular note, the firm's largest single mandate, accounting for over 20% of its equities managed, is the management of the Calvert Social Investment Equity Portfolio, which is done with an overlay of Calvert Asset Management's work on social and corporate responsibility screens. Assume your social responsibility will be judged by Calvert analysts, but make sure to present your story to Atlanta Capital in order to improve your positioning with Calvert to attract a larger investment. Otherwise, expect the firm to dig deeply into its favorite sectors (currently financials and technology) and buy solid growth. The firm has a propensity to keep its sector weightings similar while trading towards individual growth securities (hence a hefty sell of Walgreens and buy of CVS, or a Texas Instruments buy coupled with an Intel sell, both during 4Q06).

Average equity holding period: 2.9 years

How Not to Approach
If you're heavily-leveraged, you'll probably fall outside this investor's profile (only a 30% debt/capital average across the full portfolio); in this case, make sure to display your active balance sheet management outlook.

Largest Portfolios Managed
Calvert Social Investment Equity Portfolio ($1.2 billion equity) – Daniel Boone III, (404 876 9411, dwb@atlcap.com)

AssetMark Large Cap Growth Fund ($720 million equity, multi-managed w/Wellington & TCW) – Team Managed

Investment Potential
Average holdings for the firm at each market cap range:
Giant-cap: ~$55mm
Large-cap: ~$35mm
Mid-cap: ~$15mm
Small-cap: ~$15mm
Micro-cap: ~$12mm

OnTarget – Funds

Target Fund: American Century Ultra Fund

Managing Firm:
American Century Investment Management – Tom Telford (816 340 7449, thomas_telford@americancentury.com)

Targeting Profile
Ultra is the largest of American Century's massive mutual fund base (it currently manages over 50 mutual funds, along with dozens of other variable annuities and other portfolios). Keep in mind that a fairly "siloed" structure by the firm (four analysts assigned directly to the fund) may mean a separate "pitch" to Ultra Fund from other mutual funds there, but be aware that the hefty purchasing power from the fund makes it well worth your time to tell your investment story.

How to Approach
Lead off your presentation with discussion of your long-term track record; keep in mind that the firm tends to buys companies that are in the top of their group with respect to long-term earnings (over 25% 5-yr CAGR) and revenue (over 18% 5-yr CAGR) growth. It's traditionally willing to pay more for these companies, and conversely it's more likely to sell if these fundamentals don't remain strong over more than a quarter or so (as evidenced with by sales of Motorola and Lowe's during 4Q06). Clear operational barriers to entry are also exhibited by many of the firm's largest holdings, including Stryker, Danaher, Baxter, and Harley Davidson, among others; make sure to show your margin lock-in.

How Not to Approach
Your "valuation vs. competitors" chart in your presentation will probably have little effect on the fund's managers, who are well used to paying a premium on a company (20x cash from operations across the portfolio) as long as they can see strong growth being purchased. Stick to the operational advantages. The fund's exposure to overseas companies is limited and shrinking (with net buys of just two non-US securities in the last quarter); while discussion of a global customer base may be helpful, you're generally just competing against other US companies for investment here.

Investment Potential
Average holdings for the firm at each market cap range:
Giant-cap: ~$225 mm
Large-cap: ~$170 mm
Mid-cap: ~$120 mm

Average equity holding period: 1.4 years

OnTarget – Contacts

Recent notable contact moves:

Stefan Bain (Director of Japanese Equities and Portfolio Manager) joined F&C Asset Management PLC in March 2007. He was formerly a portfolio manager at Royal London Asset Management.

Chris Burling (Head of Japanese Equities and Portfolio Manager) at New Star Asset Management Ltd. began managing the New Star GIF-Japan Recovery Fund in January 2007.

Mary-Ann Chang (Equity Analyst) from Hablis Capital Management UK Ltd. is currently on maternity leave and will be returning in July 2007.

Kathleen De Wandeleer (Investment Director and Portfolio Manager) at Scottish Widows Investment Partnership, returned from maternity leave in March 2007. She will resume her responsibilities as co-manager of the SWIP Pan-European Smaller Companies Fund.

To keep an eye on other major contact moves, subscribe to CapitalBridge's IRxtras monthly newsletter containing research updates on movements from contacts, firms, and funds. There is no charge for this newsletter. To subscribe, simply email IRxHelp@cap-bridge.com.

OnTarget – Conferences

Conference activity is a bit light in April around the height of earnings season, but May will be a different story.

Conferences – April 2007

Mon	Tues	Wed	Thurs	Fri
2	3	4 Prudential Equity Group Metals & Mining Conference – NYC Morgan Stanley Global Automotive Conference – NYC	5	6
9	10 SunTrust Robinson Humphrey 36th Annual Institutional Investor Conference – Atlanta Credit Suisse 2007 Real Estate Conference – NYC	11 CIBC World Markets Biotechnology & Specialty Pharmaceuticals Conference – NYC CIBC World Markets Commodity Products Conference – Sonoma, CA	12	13
16 AG Edwards Media & Entertainment Conference – Las Vegas	17	18	19	20
23	24	25	26	27
30				

This calendar shows a sampling of investment community events held around the world during the month. Source: FactSet CallStreet, LLC

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