HILLSIDE ADVISORS LLC

November 17, 2014

Hybrid Vigor

The Hillside Convertible Advisory Letter

Volume 1 Issue 26

Who Says (Baseball Is Over?)

Inside

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Dear Friends,

We mark issue number 26—the beginning of our second quarter, as it were—with two new features in ***Hybrid Vigor.***

By popular request we have provided, for the first time, the HOCS (Hillside Overall Convertible Score) 20, a list of twenty attractive bonds you may look at as a sort of foil to the Ugly 20. You'll see a lot of recent names, as we've designed the HOCS 20 to favor newer issues and issues around—and especially slightly below—par. We hope you find this list useful. In future issues we may provide other subgroups using HOCS, such as the most attractive bonds in higher price ranges for those seeking more aggressive equity exposure.

We're also introducing the On-Deck Circle, in which we suggest candidates for new issuance. It's no secret that the market's been hungry for new paper, though perhaps not quite as much now as earlier in the year. We hope the On-Deck Circle serves as a useful conversation starter and perhaps leads to some new winning deals down the road.

We wish you all the best in the last full week before Thanksgiving!

Bill

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The next issue will be published on November 24, 2014.

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November 17, 2014

Yahoo's HARP—Lilliputian No More!

Bill Feingold and Curt Peters

Aside from a bit of upsies and downsies intraday Thursday, the equity and credit markets ended the week pretty much where they started, which is exactly what can be said for the notorious Ugly 20. The rank order and HARP changes of the Ugly 20 were essentially unchanged with three notable exceptions; few improved and few got much worse.

Omnicare's 3.25% of 2025 bond got a little boost because the company's 2042 bonds were called unexpectedly, so some holders of those probably swapped into the 2035 bonds. The bond price moved up about ¾ of a point in excess of where a delta-neutral price would place it given the demand independent of the stock's 3% move up. In rankings, it only moved up from fourth to third, but the greater than expected move in the bond price translated into a 1.32 HARPs increase to 11.04. This bond is securely in the 'richness zone' with a 27% premium and a 114 price, a pairing that would be fine with a more combustible underlying, but one that's hard to justify with a teenage volatility stock—and a young teenager at that.

Yahoo! You finally made it! The Yahooligans have finally got something in the top 20; 19th to be precise. That lovely long dated option + escrow account (AKA Yahoo 0% convertible bond of 2018) climbed 1.2 HARPs to settle in at 8.22 HARP and 19th up from 37th. YHOO stock ripped up 6.59% for the week to put it above $50 for the first time in two years. That is a 200% gain from the start of Ms. Mayer's tenure. Many folks also thank Jerry Wang and Jack Ma as they think Yahoo's 15% stake in Alibaba justifies a stock price well above $60. As much as YHOO may trade as a proxy for Alibaba, YHOO is slowly but surely closing the discount to the BABA exposure as it did this week independent of BABA's sideways trading. How does that all shake out in the convert? Well, the bond is up now almost 15% since being issued a year ago, with the stock up something like 45%, so about 1/3 participation. This is essentially what theory predicted for a bond issued with a 50% premium, since hedge deltas on new deals are typically (100%-premium). So hedgers used about a 50% delta. But remember that the hedge only covers the "stock portion" of the convertible. If a bond is trading with a 50% premium, to estimate how much it will participate with the stock, you take the hedgers' delta (50%) and divide by (1 + premium), since the stock move does not affect the premium portion. In this case, 0.5/1.5=0.33--just about exactly what Yahoo's convert has done over the past year. You could quibble about time decay, gamma, yada yada yada, but this is basically what's happened.

Why is the Yahoo bond ratcheting up the Ugly 20? As careful readers will have figured out, with the continuous rise in the stock price the bond has now entered that tricky part of the convertible profile where there's still a decent chunk of premium and yet a substantial negative yield. This is the danger zone where there is the greatest risk should you buy the bond now is stock ending its ascent (or, perish the thought, start to fall). As the pros call it, the bond is now in the "chewing through the premium" process that all converts have to go through on the upside. If YHOO were to rise to $70, the price many think is implied by the current BABA valuation, then the bonds will begin to move out of the danger zone as the premium contracts and the delta rises. Using the participation formula from above and the premium and delta figures of today, we would expect the bond to participate in about half the stock's percentage gain, which would translate to somewhere around 20% on the bond, putting it in the high 130's. That makes the upside/downside look about neutral for the Yahoo convert, not the greatest of profiles—except that it doesn't account for further upside in Alibaba. Taking that into account, the bond seems reasonably enough priced at current levels, though it's hardly cheap.

The Negotiator at Priceline took two steps forward and two steps back over the past two weeks. Last week the stock fell almost 10% which caused the 1% PCLN bonds to swap places with the 0.35% bonds on the Ugly 20. This week the stock more or less made up most of the prior week's loss and as expected the two bonds swapped back to their original HARP positions. Why? As the stock rises, the higher delta 1%s become more like stock as they move beyond the "death trap" 120-130 zone. The decrease in conversion premium in this range tends to reduce HARP more than the rising bond price lifts it. When the stock was lower, the 1%s were in the "death trap", hence more HARP. The 0.35%s have a higher conversion price and thus a lower delta than the 1%s at a given stock price. This week as the stock rose, the 0.35% bond moved closer to the "richness zone" (we don't want to be too morbid) as the 1% moved above it. Last week when the stock was lower, the 0.35% were in the sweet spot--plenty of delta but not too far above par. Thus, outright accounts trying to catch the upward wave responsibly probably favored the 0.35%. It's not surprising, then, to see that the 0.35%s punched in an extra 1.69 HARPs to settle at 8.67 HARPs, putting the 0.35%s back on the Ugly 20 at number 12.

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November 17, 2014

Hillside Ugly 20 List (Prices as of November 14, 2014)

	Convertible	Price	Stock	Premium (%)	Premium (pts)	HARP
1	Lam Research 1.25% 2018-05-15	142.25	79.81	12.1	15.35	11.64
2	RPM International 2.25% 2020-12-15	112.75	47.05	26.9	23.90	11.24
3	Omnicare (Exchange) 3.25% 2035-12-15	114.00	70.07	26.8	24.09	11.04
4	SanDisk 0.5% 2020-10-15	119.00	96.19	14.0	14.61	9.93
5	Salesforce.com 0.25% 2018-04-01	118.25	63.91	22.8	21.96	9.60
6	BioMarin Pharma 1.5% 2020-10-15	118.00	82.85	34.2	30.07	9.38
7	Ryland Group 1.625% 2018-05-15	133.00	37.30	14.2	16.54	9.16
8	BioMarin Pharma 0.75% 2018-10-15	115.25	82.85	31.0	27.27	9.03
9	Standard Pacific 1.25% 2032-08-01	113.75	7.42	23.9	21.94	8.98
10	CSG Systems 3% 2017-03-01	120.75	25.65	11.2	12.16	8.90
11	Illumina 0.5% 2021-06-15	112.50	180.50	58.7	41.61	8.71
12	Priceline.com 0.35% 2020-06-15	112.50	1172.96	26.2	23.36	8.67
13	NVIDIA 1% 2018-12-01	113.00	19.79	15.3	14.99	8.65
14	Workday Inc 0.75% 2018-07-15	131.75	95.29	15.2	17.38	8.56
15	Palo Alto Networks 0% 2019-07-01	120.00	110.78	19.5	19.58	8.50
16	Cubist Pharmaceuticals 1.75% 2020-09-01	115.50	70.52	35.0	29.94	8.38
17	NuVasive 2.75% 2017-07-01	123.25	43.78	18.7	19.42	8.33
18	Jazz Pharmaceuticals 1.875% 2021-08-15	116.50	174.57	33.4	29.17	8.33
19	Yahoo! 0% 2018-12-01	114.75	51.75	18.4	17.83	8.22
20	Cubist Pharmaceuticals 1.125% 2018-09-01	113.00	70.52	32.1	27.46	8.18

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November 17, 2014

HOCS 20

Bill Feingold

It's a week of firsts here in ***Hybrid Vigor***. In addition to our new "On-Deck Circle" feature, we're also introducing the long-awaited counterpoint to the Ugly 20. We'll just call it our HOCS Top 20—or maybe the HOCS 20—for now.

In this list we use our proprietary HOCS (Hillside Overall Convertible Rating) system to list the 20 highest rated bonds in our universe. Note that we exclude long-dated bonds without puts, preferreds, financials, and high common dividend payers, as we do with the Ugly 20.

Elon Musk is a busy and extraordinarily successful guy. He probably doesn't have time to read ***Hybrid Vigor***. But if he did, he'd be proud—he's responsible for the top two names on the first HOCS 20. We imagine he'd be proud to know that he's bringing value to the convertible market.

Unlike with the Ugly 20, where we try to advise readers of bonds trading in precarious spots, we don't allow an issuer to appear more than once in the HOCS 20. If not for that rule, you'd see two Tesla and Twitter bonds each. But since the two tranches tend to be relatively similar, we thought we'd be giving you more value by including other names.

It's no surprise that Tesla heads the list. It's in many ways the perfect convertible issuer—a far safer credit than stock, thanks in large part to the stock's valuation itself. We'd have a hard time convincing ourselves to go buy Tesla shares anywhere near today's price, but we'd be just as uncomfortable telling someone to sell them. Hence, the convertible. Perhaps we have a soft spot for this name since we got lucky and predicted the issue in Forbes in the spring, getting our fledgling business some much-appreciated attention.

You'll notice that the list is heavily slanted toward bonds near, and often slightly below, par. This is no accident. Going back to our sell-side experiences, which taught us never to get taken short a bond in the low-to-mid 90's, we have designed HOCS to favor that price point. We also tend to favor recent deals—we've quoted a very wise convertible trader as saying that you get most value out of bonds in their first six to nine months of life. You'll also note that many of the bonds, as you'd guess by the price point, are from out-of-favor issuers. We've long believed in the "get paid to wait," mean-reverting aspect of convertibles.

The list is not without controversy—specifically Herbalife. We have made a point of remaining neutral on this one and simply trying to be a source of information. Now, there's no disputing the bond's cheapness or value relative to the underlying shares. We concede that the bond makes us nervous, although as much as we admire Bill Ackman, we're not crazy about an investment thesis dependent on strong government action. That said, the stock has performed horribly of late, and the bond hasn't done much better. While we know he won't do it—it is, after all, inconsistent with his thesis and overall strategy—Mr. Ackman could do worse than hedge some of his Herbalife short by buying a few of the convertibles.

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Hillside HOCS 20 List

	Description	Convert	Stock	HOCS Overall	Growth	Safety	Yield	Premium
1	Tesla Motors 1.25% 2021-03-01	98.25	258.68	77.6	85.5	61.9	1.54%	36.7%
2	Solar City 1.625% 2019-11-01	91.50	53.02	72.5	82.5	52.4	3.80%	42.2%
3	Renewable Energy 2.75% 2019-06-15	100.50	10.14	72.4	81.7	53.9	2.63%	31.5%
4	LinkedIn 0.50% 2019-11-01	105.25	233.89	71.0	70.0	72.0	-0.55%	32.5%
5	Web.com 1% 2018-08-15	87.00	16.63	69.9	75.0	59.9	4.84%	83.1%
6	Twitter 1% 2021-09-15	91.25	41.85	69.0	77.3	54.6	2.40%	69.3%
7	Allscripts 1.25% 2020-07-01	98.25	12.45	69.0	70.9	65.3	1.58%	35.7%
8	Invensense 1.75% 2018-11-01	90.00	13.84	68.8	80.8	44.7	4.54%	42.3%
9	ISIS Pharmaceuticals 1% 2021-11-15	98.00	49.01	68.2	77.8	48.8	1.30%	33.6%
10	Shutterfly 0.25% 2018-05-15	96.00	42.48	67.5	68.8	64.9	1.43%	45.0%
11	KEYW Holding 2.50% 2019-07-15	92.25	11.09	67.4	83.4	35.5	4.36%	23.4%
12	Trina Solar 4% 2019-10-15	94.50	9.73	66.6	66.1	67.7	6.11%	42.6%
13	HomeAway 0.125% 2019-04-01	94.00	30.97	65.8	69.0	59.4	1.55%	58.3%
14	Herbalife 2% 2019-08-15	74.75	38.50	64.8	67.5	59.4	8.59%	67.5%
15	Cornerstone OnDemand 1.50% 2018-07-01	93.25	29.90	64.3	76.2	40.4	3.50%	66.3%
16	SunPower 0.875%2021-06-01	92.75	27.52	64.2	59.1	74.5	2.07%	64.3%
17	Priceline 0.9% 2021-09-15	94.75	1172.96	64.1	53.3	85.8	1.72%	66.0%
18	TiVo 2% 2021-10-01	99.00	13.17	63.4	64.3	61.5	2.16%	34.0%
19	51job 3.25% 2019-04-15	105.00	35.74	63.3	71.6	46.9	2.06%	25.6%
20	Blucora 4.25% 2019-04-01	97.50	14.59	62.9	66.3	56.3	4.89%	44.7%

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The Week That Was…

Bill Feingold

It was an active week—far too active to include everything in a short space.

FCAU: Fiat Chrysler announced plans to issue a $2.5 billion mandatory deal before Christmas. We've been surprised that more companies haven't been issuing mandatories—perhaps this deal will be the wakeup call to the rest of the market. We again warn potential issuers that failing to bring a mandatory now could mean a missed opportunity, as it's entirely possible that the final results of negotiations surrounding IRS Section 871(m) could make future mandatory issuance more difficult. While we certainly hope this does not come to pass, our understanding is that mandatories could be Wall Street's sacrificial lamb to the Treasury and IRS. We believe, as we have written, that Treasury's view in Section 871(m) drafting that convertible holders economically receive dividends paid to stockholders is fundamentally well intentioned but misguided.

Enough of that. What else happened last week?

DNDN: Well, Dendreon finally went bankrupt. Hardly a shocker—the convertibles were in the 60's before the announcement and they're in the 50's now. ARCP bonds seemed to find their level in the low 90's as further details slowly emerged, then weakened to finish several points lower, perhaps creating a good yield opportunity for patient holders. Herbalife bonds continued to trade in the mid-70's. LinkedIn kept pushing higher.

ISIS: On the primary front, Isis Pharmaceuticals was the headliner, bringing a $425 million deal and some wild stock activity. Arbitrageurs had to drive the stock higher to cover their big short positions against bonds they were selling back to the company, and that higher price seemed to lead to an inflated conversion price, forcing the new bond to come at the cheap end of price talk. Even the cheap end wasn't cheap enough to keep the new deal from breaking bad below par as the stock quickly approached its previous level. It seemed things would stay this way for a couple of hours, and then the stock surprisingly roared back. By the end of the week, though, the stock was back closer to its pre-deal level, and the bonds were back well below par, where they look pretty decent. (The new Isis bond made our inaugural HOCS 20 list).

OCR: There was Omnicare call, and there was Invensense trying to stop the freefall that began two weeks earlier with an earnings miss. In the 120s and 130s over the summer, the bond now has a new home around 90—and in the HOCS20. The company still has a market cap more than five times the convertible's face value—this, to our minds, is the magic number.

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November 17, 2014

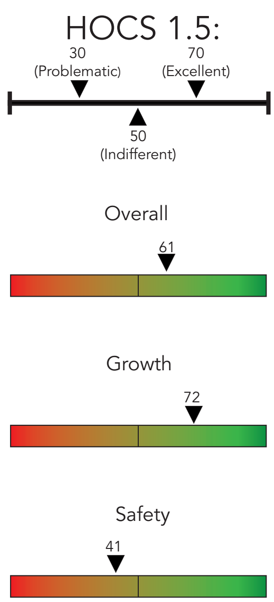
Jazz Pharmaceuticals - Just the Prescription to Keep You Up

Kathy Schick

JAZZ

1.875%, 2021/08/15
Price (Bond): 116.25%
Stock: $174.57
YTM: -0.49%
Premium: 33.0%
HOCS-Overall: 61
HOCS-Growth: 72
HOCS-Safety: 41

As of November 14, 2014



Jazz Pharmaceuticals (JAZZ) is one of the newest members of the biotechnology community to tap the convertible bond market after issuing $575mm of 1.875% convertible senior notes due 8/15/21 in early August. We had written about this back in August in Issue 8 of ***Hybrid Vigor***. The proceeds were used to pay down the revolver, which was drawn down to fund the billion-dollar acquisition of Italian rare-disease treatment company Gentium in January, and to bolster liquidity for future business development (more acquisitions perhaps).

Jazz is a specialty biopharmaceutical company based in Ireland with a major US presence in Palo Alto, CA. The company has product offerings in four therapeutic areas: narcolepsy, hematology/oncology, pain management, and psychiatry. Its lead product is Xyrem, a narcolepsy treatment approved for cataplexy (muscle weakness associated with narcolepsy) and excessive daytime sleepiness. Full year 2013 sales were $569mm and accounted for 66% of total sales. For 3Q14 sales were $204mm up from $154mm in the prior year quarter, accounting for 66% of sales for both periods.

The company's number two product is Erwinaze, a treatment for acute lymphoblastic leukemia (ALL). Sales were $52mm in 3Q14 up 18% from $44mm in the year earlier period and accounted for 17% of total sales.

Defitelio, Gentium's flagship drug, was approved in the EU earlier this year for the treatment of veno-occlusive disease (VOD), a rare liver disorder. This product was part of the Gentium acquisition. Sales for 3Q14 were $19mm and accounted for 6% of total sales. Jazz is working on an NDA (new drug application) and expects to have it filed with the FDA by mid-2015. The remaining 10% of sales are comprised of Prialt (non-opioid, severe chronic pain management), a psychiatry portfolio (treatment-resistant schizophrenia), and several smaller drugs.

Jazz has experienced strong revenue growth, fueled by both organic growth and acquisitions. Sales have increased 521% since year-end 2010 from $174mm to $1.081bn for the last twelve months. The company financed the Gentium acquisition with an expansion of its senior secured credit facilities. The term loan was increased from $554mm to $904mm and the revolver was increased to $425mm from $200mm. In August management issued the 1.875% convertible notes due 2021, which allowed for the repayment of the revolver in full. The company has a history of successful acquisitions and we expect more to come.

One of the largest risks facing Jazz is its heavy reliance on the lead product, Xyrem, for revenue. Xyrem continues to account for 66% of total sales even following the Gentium acquisition.

While patents are not set to expire until the 2019-2024 timeframe (and new patents continue to be issued), management has been facing ongoing litigation with generic pharmaceutical companies attempting to file ANDAs (abbreviated new drug applications) dating back to 2010. All of the patent challenges have been stayed by the courts to date, but they continue to come. Roxane was the initial ANDA filer and the remaining patents not subject to the current stay could come up for trial in 2Q15. In the meantime, Jazz has the potential successor to Xyrem in its pipeline: JZP-386 is in Phase 1 development. Data could be available as early as 1Q15.

The pipeline also includes JZP-110, a treatment for excessive daytime sleepiness associated with narcolepsy, which was acquired from Aerial Biopharma in January for $125mm in cash and potential future milestone payments of up to $270mm. Phase 3 trials are expected to be initiated 1H15.

As discussed above, the company is working on an NDA for Defibrotide in the US. It expects to file with the FDA by mid-2015. It also has a Phase 3 trial underway for the prevention of VOD. There is another Phase 3 trial underway on Erwinaze to treat ALL in the young adult population.

($mm)	30-Sep-14	Debt Cumulative Balance	EBITDA Multiple	Net Debt Cumulative Balance	EBITDA Multiple
JAZZ Stock Price 11/14/14	174.57				
LTM EBITDA	483				
Cash	575				
Senior Secured Debt					
Revolver due 6/12/17(L+250)	0				
Term Loan due 6/12/18 (L+250)	892				
	892	892	1.8	317	0.7
Senior Unsecured Debt					
Other	2				
1.875% Senior Exch Notes due 2021	575	1,469	3	894	1.9
Total Debt	1,469	1,469	3	894	1.9
Common Stock (Mkt)	10,560	12,029	24.9	11,454	23.7

Liquidity is good with the full $425mm revolver available, $575mm of cash on hand, and a history of positive and growing free cash flow. For the last twelve months the company generated $321mm of free cash flow. Leverage is moderate at 3x through the senior convertible notes and 1.9x on a net basis.

Jazz stock is up 20% since the convertible notes were issued in August and 37% since the beginning of the year. The bonds are now trading at 116.25 versus the stock's Friday close of 174.57. We feel L+400 is an appropriate spread to use on the convertible notes, reflecting their subordinated status to the secured bank facility and their seven-year maturity. Using this spread will make these bonds look at least a couple of points rich on conventional models. But The HOCS (Hillside Overall Convertible Score) slash line is 61 Overall / 72 growth / 41 safety and even though the converts made an appearance in the Ugly 20 last week (not surprising, given the price point and the conventional modeling), we think they still look pretty good overall. There are a lot of biotechs that might keep you up, but with Jazz you just might need a prescription to do the job.

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HomeAway Takes a Vacation

Jeffrey Alton, CFA

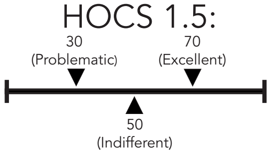
HomeAway (AWAY), the online vacation home rental marketplace for property owners and travelers, reported quarterly earnings on November 5. The results reflect the company's rapid growth and beat expectations. However, the market was less than impressed. Summary stats for the quarter are as follows.

AWAY

0.125%, 2019/04/01
Price (Bond): 94.00%
Stock: $30.97
YTM: 1.55%
Premium: 58.3%
HOCS-Overall: 66
HOCS-Growth: 69
HOCS-Safety: 59

As of November 14, 2014

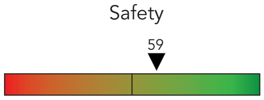
HOCS 1.5:



Overall

Growth

Safety



Revenue in $ millions

	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	$117.1	$115.4	1.47%	$90.1	29.97%
Adjusted EPS	$0.20	$0.16	25%	$0.19	5.26%

Before earnings, the stock was trading as high as $35, but fell to a low around $29 per share after the release. It has been an even longer journey down from its high of $48.90 reached last February. Currently the stock is at $31 per share.

The market reacted to reduced guidance provided by the company outlined below.

Category	New Guidance	Previous Guidance
Q 4 2014 Revenue	$107 - 109 million	$110 – 113 million
Full Year 2014 Revenue	$444 - 446 million	$444 - 449 million
Q 4 2014 EBITDA	$25 – 28 million	$28 - 32 million
Full Year 2014 EBITDA	$116 - 119 million	$118 - 123 million

Analysts swiftly responded to the lowered guidance by…….raising consensus net income per share estimates by a few pennies to $0.61 for 2014 and $0.73 for 2015. But unfortunately for shareholders, analysts do not control valuation multiples and that is where the market decided to enact its own revenge. The drop in the stock price reduced the 2015 forward earnings p/e from 48.6x before the report to 42.5x after the announcement. 42.5x still seems a bit pricey to us, especially when revenue growth is expected to decelerate from 28.8% in 2014 to 19.4% in 2015.

Other valuation measures also seem a bit stretched. Price to sales is currently 6.8x and enterprise value to EBITDA is 37.14x.

Perhaps it is time for the stock to take a breather. After all, the company just turned 10 years old and the middle school years bring uneven growth for many.

But make no mistake; the quibble is with valuation, not the quality of the company. HomeAway is a growing, global company that is busy innovating and improving its product offering.

The value proposition of the HomeAway marketplace for a property manager continues to remain intact. HomeAway estimates a 27x ROI for property owners using the service, with listings fees $473 per year and estimated annual rental income of around $13,000.

HomeAway also generates significant amounts of cash. Free cash flow for the trailing 12 months ended Q3 2014 was $117 million. The balance sheet is strong with $800 million in cash and cash equivalents and the only long-term debt is a $403 million convertible note. That gives AWAY the fire power it needs for additional acquisitions, continued product development and marketing.

The HomeAway website growth is also impressive. Combined paid listings on the company's websites were 1,034,847 at the end of the third quarter, up 33.8% from a year earlier. Total site visits in the last quarter were 232 million, up 17% from Q3 2013.

The company plans to build on this growth. HomeAway hired a new chief marketing officer recently and has announced plans to significantly increase marketing initiatives in the coming years to enhance their position in the lodging market.

HomeAway has also rolled out additional product enhancements for property managers.

• Property owners can choose between a subscription-based service starting at $349 per year, or choose the new pay per booking alternative consisting of a 10% fee charged only when a transaction is closed. Using the subscription service, home owners can pay additional fees to rank higher in searches.

• HomeAway introduced a payment system for renters to use when paying property owners. In addition to increasing revenue, the payment system can be used to introduce other products such as trip insurance.

• The company is working to make the majority of listings online bookable by 2016. In conjunction with that initiative, HomeAway will enhance the internet site for property owners to improve calendar accuracy.

Earlier in the year, HomeAway launched a pilot program with Expedia.com in which Expedia is offering a limited number of HomeAway's vacation rentals in its searches. While an initial step, the pilot program brings HomeAway's marketplace closer to a mainstream lodging alternative for vacationers.

However, there have also been some headwinds for the company as of late, and that is why the market has begun to challenge valuation. As a global organization generating 40% of its business overseas, HomeAway is on the wrong side of the appreciating dollar. Europe has also been a disappointment for the company as the economy at large sputters. While overall renewal rates were stable in the US, European renewal rates dropped.

EBITDA for the quarter was $31.6 million, up 8.8% over Q3 2013. That is a significantly lower growth path compared to revenue and subscription growth. A large chunk of that underperformance was due to a significant increase in sales and marketing expenses as per the company's long-term strategy. While those expenses bring some short-term pain to the bottom line, they represent an investment in the company's future.

Momentum in the stock market, like attraction to a member of the opposite sex, can be fleeting and difficult to regain once doubt starts to creep in. With the market expecting decelerating growth, the momentum that brings high multiples may be gone for now. HomeAway equity shares trade well below 50 and 200 day moving average support and it is difficult to see the immediate catalyst to reignite momentum.

For fans of HomeAway, the convertible security may offer a more constructive manner in which to invest in the company. The bond trades in the 94 context, a level that boosts the security's fine HOCS slash line of 66 Overall/69 Growth/59 Safety. While HomeAway's convertible bond premium conversion is elevated at 58%, a bond trading in the low 90s provides safety support if the underlying equity loses value, but also allows for respectable upside. With over four years left in the life of the convertible bond, there is ample time for HomeAway to grow into a higher equity valuation. In the meantime, the yield to maturity is 1.55%, closer to the current dividend yield on the S&P 500 of 1.92%.

HILLSIDE ADVISORS LLC

November 17, 2014

The On-Deck Circle

Hillside Staff

We want to introduce a new feature called "The On-Deck Circle." Many of our friends in the community have called us and wondered out loud "this company would be great as a convertible issuer!" Well, wonder no more! Going forward, we will feature one candidate company each week. We hope to persuade you and perhaps ultimately the company itself.

Our ideal candidate is trading within 20% of (and preferably much closer to) its 52 week high, has a low debt-to-capital ratio, and has a compelling usage for new capital. Generally, these companies will be convert rookies. Feel free to let us know if you want to nominate a particular company. If we agree with you and publish your nomination, you will receive an honorable mention in the newsletter!

Boise Cascade (BCC)

While investors (including convertible players) have been familiar with the Boise Cascade (BCC) name for decades, the current iteration of the company's operations is based on the forest products assets of Office Max, which the company acquired in 2004. BCC's current product line is focused on wood-based building materials. It is one of the largest producers of plywood and engineered wood products in North America. Having survived the housing market debacle of recent years, the company did an IPO in February of 2013 based on those.

Last month, BCC beat consensus per share profit estimates by $0.13, reporting $0.82. Since the market hit a recent bottom in mid-October, the stock has been on a tear, up over 30% and settling at $38.03 on Friday. BCC stock has gained 25% year to date.

Operating performance is also improving. Revenue and EBITDA are on the rise, up 25% and 89% respectively over the last two years. The company has good liquidity with cash of $170mm, revolver availability of $328mm (nothing drawn, $8mm letters of credit, L+150), and positive free cash flow of $43mm for the last twelve months. The only debt is the $300 million, 6.375% senior notes of 2020. Leverage is moderate at 1.6x. US demographics are favorable to ramping housing starts as household formation has been depressed in recent years, and Boise Cascade is poised to benefit as housing starts return to historical norms.

With the stock on a tear and the housing market poised for what we think will be Act II of the home builder recovery, it makes sense to us for BCC to issue a convertible bond in the near future to fund expansion. One suggestion: the 6.375% senior notes are callable in November, 2015, teeing up a perfect situation to issue a convertible aimed at refinancing the debt at a significantly lower rate. We think Boise Cascade could issue a new five-year convert with a 2% coupon and a low-to-mid-30's premium, with the resultant conversion price nearing $50 and comparing favorably with the $21 IPO price from last year.

HILLSIDE ADVISORS LLC

November 17, 2014

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

Hillside Alerts (HA!)

NEW ISSUE: $425 MILLION ISIS PHARMACEUTICALS (ISIS) 1% CONVERTIBLE SENIOR NOTES OF 11/15/2021

November 12, 2014 / Bill Feingold

With ISIS' new deal pricing at the cheap end of the price talk--the right thing to do given that the stock was temporarily a bit overextended from hedgers repurchasing shares--the bond was ultimately priced to yield a Hillside Overall Convertible Score (HOCS) array of 68 Overall/78 Growth/49 Safety, slightly better than the preliminary slash line we provided yesterday. After an unsurprising selloff this morning, the stock has returned to the level of last night's close, and the bonds are back to par. Since buyers had opportunities to add to positions below par this morning, the bonds may contract a bit here, but we think the final pricing, as the HOCS final slash line shows, was fairly attractive.

NEW ISSUE (PENDING): $425 MILLION ISIS PHARMACEUTICAL (ISIS) CONVERTIBLE SENIOR NOTES

November 11, 2014 / Bill Feingold

Based on price-talk midpoints believed to be 0.75% up 32.5% on a seven-year bullet, our preliminary HOCS (Hillside Overall Convertible Score) array is 67 Overall/77 Growth/48 Safety. While 50 is an average score for the universe, we expect new deals to score considerably higher, as this one does. By way of reference, last week's LinkedIn deal was ultimately (and generously, we felt) priced at a HOCS slash line of 80 Overall/77 Growth/86 Safety. So this deal is comparable to LinkedIN on the growth line but far behind on safety--which should not be a huge surprise.

Clearly this deal is most advantageous for holders of the old bonds who will be taken out at a premium to recent levels. However, the upward pressure on the stock caused by arbs repurchasing shares will be a disincentive to other buyers. If we assume the stock retreats to its previous close after the deal is priced, the revised HOCS slash line becomes 63/70/48--still acceptable but fairly modest for a new issue. We estimate that the repurchase may cause as many as four million shares to be bought on balance--two or three days' volume--so it makes sense to expect a pullback after the deal is priced.

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