HILLSIDE ADVISORS LLC

November 24, 2014

# Hybrid Vigor℠

The Hillside Convertible Advisory Letter

Volume 1 Issue 27

# A Turkey Happy Meal

## Inside

Features
2 The Ugly 20: A Tale of Two HARPs
5 HOCS 20

Investment Ideas
7 New Issue: NXPI
8 InvenSense
11 TESLA

Other
14 The On-Deck Circle
16 Hillside Alerts (HA!)

Dear Friends,

Welcome to a fairly short edition of Hybrid Vigor, befitting a fairly short week. In this, our 27th issue, we provide the second installment of both the HOCS 20 and the On-Deck Circle. We hope you find these features enjoyable and useful.

The convertible market, for now, seems to have gotten past a very difficult October, as the average Ugly 20 score keeps pushing higher. It's a cause, paradoxically, for both relief and concern. We expect to see an active new issue calendar beginning next week and pushing into mid-December, at which time things usually begin coasting into the holiday season.

Speaking of holidays, have a wonderful Thanksgiving!

Bill

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November 24, 2014

# A Tale of Two HARPs

Bill Feingold and Curt Peters

The Ugly 20 continues to be a very close race with the usual suspects from recent weeks sitting in pretty much the same positions in regards to Hillside Risk Adjusted Points (HARP). And that means Lam Research 1.25%'s remains with the yellow jersey for which now seems like an eternity. Little brother Lam Research 0.5%'s fell off the scoreboard weeks ago, but big brother's racing enhancements continue to defy the natural order. We'll dig a bit deeper into this unnatural phenomenon at bit later in the letter.

But first, the week's top stories. Although the average HARP continues to inch up very slowly (now at 9.3 from 9.1 last week) for the past few weeks, there are always outliers. This week is no exception.

Salesforce.com 0.25%'s fell backwards in more ways than one, though not all bad. With the company giving downward 4th quarter guidance, the stock fell 9%. This translated into a 5.25 point drop in the bond, which settled on Friday around 113. With the falling stock and bond, although the premium on the bond expanded about 6% to 28.9%, the HARP decreased 1.26 HARPs to 8.34, and Salesforce.com 0.25%'s dropped from 5th to 16th in the Ugly 20. Why? Partly because the HARP of the bond universe increased while CRM fell – the old relativity frame of reference logic. But also because the CRM bond at 113 is at a more convex part of the profile and thus some higher premium is justified – that is HARP should be less, and it is. In other words for those of us who think we speak some Greek, the gamma of the CRM bond moved from 0.59 to 0.63. So with the decrease in HARP, should CRM celebrate? Hardly. For one thing, the bonds are down. A falling HARP means it was a good idea to be careful. Moreover, if CRM stock increases down the road, the bond will have to climb up into that tricky zone once again where premium becomes less and less justified and HARP increases.

Welcome home On Semiconductor 2.625% of 2026. It's been a while since ONNN was with us in the rarified air of the Ugly 20, most notably due to the sharp decline in the stock during the second week of October. After a month of slowly making up the lost ground, with a 4% increase in the stock this past week and a 1.25 increase in the bond price to 111.25, the ONNN bond made the quick journey from 39th to 20th on the Ugly 20. What happened? Well, an increase of 1.17 HARPs to 8.08 HARP is enough to show for the Ugly 20. Like so many of the bonds on the Ugly 20 list, ONNN has now entered the danger zone of high premium, decreasing gamma, and increasing delta. The zone where all the fun is for convertible bond investors. With a 35.7% premium at the current price, the bond has a long journey in front of it to burn through all the premium to get near the safer zone of the 140's. Given the premium, the bond only participates in about 26% of the movement in the stock – not as sensitive as the hedgers' delta of 35% would have you believe at first glance. Enjoy the ride ONNN! Ramble on, ramble On, ramble ONNN.

Another revert squeaked through the door and onto the Ugly 20 at #19 this week. Alon USA Energy 3%'s were last with us three weeks ago, and have now returned for what we hope is only a brief visit. The visit is focused around ALJ's stock price decline of about 3% which brought the bond back into the death zone area with a price decline from 126.25 to 124. The price decline combines with premium expansion from 13.3% to 14.6%, which all taken together bumps up the HARP enough (7.89 to 8.15) to make the show for this week. If the stock climbs even a small amount, it should be enough to yank the bond out of the tricky area of the profile and off the Ugly 20 for good. ALJ bonds continue to look decent optically--it's that pesky dividend that puts them on the list.

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Lam Research 1.25%'s and Ryland Group 1.625%'s are a tale of two HARPs. A tale which does a very good job of explaining a particular aspect of the HARP calculation. Ryland stock was up about 4% and the high dollar price bonds up from 133 to 136.50; exactly what one would expect given the bond's characteristics. As the Ryland bond has risen in price, its HARP has started to fall. This week the Ryland HARP contracted 0.46 HARPs and the bond moved from 7th to 12th on the Ugly 20. Why? Because as the Ryland bond moved up and out of the tricky death zone around 110-120, its premium began to decline at a faster rate. This is exactly what HARP was built to capture. Ryland's performance in the HARP metric is what one would expect.

Lam Research on the other hand is not. LCRX has about the same bond price as Ryland (141.25 vs 136.50), similar premium (13.0 vs 12.7). So why are the two bonds so different in HARP scores (12.12 vs 8.70); and LCRX increasing while Ryland is decreasing? Because LCRX is not playing by the rules. The price of LCRX is much higher than it should be, which makes its Hillside Risk Adjusted Points much higher. Too much risk all else being equal. Why is this? Very simple, LCRX is a rare beast in the world of convertibles, an investment-grade bond. So the LCRX – Ryland (BBB vs BB-) divide is what the demand dynamics of arbitrary investment mandates can do; play a HARP very well.

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November 24, 2014

## Hillside Ugly 20 List (Prices as of November 21, 2014)

| | Convertible | Price | Stock | Premium (%) | Premium (pts) | HARP |
|---|---|---|---|---|---|---|
| 1 | Lam Research 1.25% 2018-05-15 | 141.25 | 78.65 | 13.0 | 16.25 | 12.12 |
| 2 | RPM International 2.25% 2020-12-15 | 113.25 | 47.64 | 25.9 | 23.30 | 11.44 |
| 3 | Omnicare (Exchange) 3.25% 2035-12-15 | 114.25 | 70.63 | 26.0 | 23.58 | 11.05 |
| 4 | SanDisk 0.5% 2020-10-15 | 122.50 | 100.83 | 12.0 | 13.13 | 10.30 |
| 5 | BioMarin Pharma 0.75% 2018-10-15 | 117.50 | 85.83 | 28.8 | 26.27 | 9.65 |
| 6 | BioMarin Pharma 1.5% 2020-10-15 | 120.00 | 85.83 | 31.6 | 28.81 | 9.64 |
| 7 | Standard Pacific 1.25% 2032-08-01 | 115.50 | 7.58 | 23.2 | 21.75 | 9.57 |
| 8 | NVIDIA 1% 2018-12-01 | 115.75 | 20.45 | 14.0 | 14.21 | 9.37 |
| 9 | Illumina 0.5% 2021-06-15 | 114.00 | 185.83 | 55.9 | 40.88 | 9.37 |
| 10 | CSG Systems 3% 2017-03-01 | 119.75 | 25.25 | 11.8 | 12.64 | 8.98 |
| 11 | Cubist Pharmaceuticals 1.875% 2020-09-01 | 118.25 | 73.60 | 32.6 | 29.07 | 8.97 |
| 12 | Ryland Group 1.625% 2018-05-15 | 136.50 | 38.81 | 12.7 | 15.38 | 8.70 |
| 13 | Workday 0.75% 2018-07-15 | 129.75 | 93.00 | 16.1 | 17.99 | 8.63 |
| 14 | Cubist Pharmaceuticals 1.125% 2018-09-01 | 114.75 | 73.60 | 28.6 | 25.52 | 8.57 |
| 15 | Priceline.com 0.35% 2020-06-15 | 111.75 | 1151.46 | 27.8 | 24.31 | 8.53 |
| 16 | Palo Alto Networks 0% 2019-07-01 | 119.00 | 108.93 | 20.5 | 20.24 | 8.42 |
| 17 | Salesforce.com 0.25% 2018-04-01 | 113.00 | 58.19 | 28.9 | 25.34 | 8.34 |
| 18 | Yahoo! 0% 2018-12-01 | 114.25 | 51.04 | 19.6 | 18.72 | 8.26 |
| 19 | Alon USA Energy 3% 2018-09-15 | 124.00 | 15.96 | 14.6 | 15.80 | 8.15 |
| 20 | On Semiconductor 2.625% 2026-12-15 | 111.25 | 8.62 | 35.7 | 29.27 | 8.08 |

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# HOCS℠ 20

Bill Feingold

Three names, HomeAway 0.125%, 51job 3.25% and Blucora 4.25% fell off the HOCS 20 in its first week. Taking their places are Qihoo 360 1.75%, Anacor 2% and Digital River 1.25%.  Qihoo probably should have been on the list in the first place but was overlooked in a production glitch. Ahh, the fun of introducing a new list!

The HOCS 20 put in a solid first week, returning 0.80%.  The underlying shares gained 1.40%. Solar components of the index were particularly strong, with TrinaSolar, Solar City and SunPower all contributing.  The controversial Herbalife also rallied slightly from its beaten-down level, while new issue Isis performed well. On the downside were bellwethers Tesla 1.25% and LinkedIn 0.50%, each seeing its underlying shares fall over 6%.  The Tesla bonds participated in half the stock's decline, while LinkedIn's bonds held up better, only taking a third of the shares' hit.  We continue to think these are two of the most attractive bonds out there, good ways to play companies of definite, but difficult-to-measure, value.

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November 24, 2014

## Hillside HOCS 20 List

| | Description | Convert | Stock | HOCS Overall | Growth | Safety | Yield | Premium |
|---|---|---|---|---|---|---|---|---|
| 1 | Tesla Motors 1.25% 2021-03-01 | 95.25 | 242.78 | 77.3 | 85.0 | 61.9 | 2.06% | 41.19% |
| 2 | Qihoo 1.75% 2021-08-15 | 89.25 | 69.36 | 73.0 | 84.1 | 50.8 | 4.29% | 55.41% |
| 3 | Solar City 1.625% 2019-11-01 | 93.50 | 55.05 | 72.8 | 82.6 | 53.2 | 3.05% | 41.87% |
| 4 | LinkedIn 0.50% 2019-11-01 | 103.00 | 219.09 | 71.9 | 70.0 | 75.6 | -0.11% | 38.47% |
| 5 | Renewable Energy 2.75% 2019-06-15 | 101.50 | 10.60 | 71.3 | 81.7 | 50.3 | 2.40% | 27.00% |
| 6 | Web.com 1% 2018-08-15 | 89.25 | 17.76 | 70.6 | 75.7 | 60.5 | 4.15% | 75.89% |
| 7 | Invensense 1.75% 2018-11-01 | 93.50 | 15.01 | 69.5 | 81.0 | 46.3 | 3.54% | 36.36% |
| 8 | ISIS Pharmaceuticals 1% 2021-11-15 | 100.50 | 50.94 | 68.3 | 78.2 | 48.4 | 0.93% | 31.80% |
| 9 | Allscripts 1.25% 2020-07-01 | 96.50 | 12.43 | 69.4 | 71.4 | 65.3 | 1.91% | 33.48% |
| 10 | Twitter 1% 2021-09-15 | 90.00 | 40.03 | 68.7 | 75.8 | 54.6 | 2.61% | 74.57% |
| 11 | Trina Solar 4% 2019-10-15 | 96.75 | 10.93 | 68.0 | 67.2 | 69.6 | 7.97% | 20.94% |
| 12 | Herbalife 2% 2019-08-15 | 77.25 | 40.85 | 67.4 | 72.1 | 57.9 | 7.86% | 63.15% |
| 13 | KEYW Holding 2.50% 2019-07-15 | 92.25 | 10.68 | 67.0 | 82.9 | 35.2 | 4.36% | 28.14% |
| 14 | SunPower 0.875%2021-06-01 | 93.25 | 29.41 | 66.8 | 62.2 | 75.9 | 1.98% | 54.61% |
| 15 | Shutterfly 0.25% 2018-05-15 | 96.50 | 42.43 | 66.2 | 66.8 | 64.9 | 1.28% | 45.93% |
| 16 | Cornerstone OnDemand 1.50% 2018-07-01 | 93.50 | 31.07 | 65.4 | 77.6 | 41.0 | 3.43% | 62.63% |
| 17 | Anacor 2% 2021-10-15 | 116.50 | 32.23 | 63.1 | 71.8 | 45.9 | -0.36% | 12.23% |
| 18 | Digital River 1.25% 2024-01-01 | 98.25 | 25.18 | 62.9 | 49.9 | 88.8 | 1.69% | 71.93% |
| 19 | Priceline 0.9% 2021-09-15 | 95.25 | 1151.46 | 62.4 | 50.7 | 85.8 | 1.64% | 70.03% |
| 20 | TiVo 2% 2021-10-01 | 98.50 | 12.95 | 62.7 | 63.4 | 61.4 | 2.24% | 35.56% |

November 24, 2014

# New Issue (Pending): NXPI Semiconductor NV

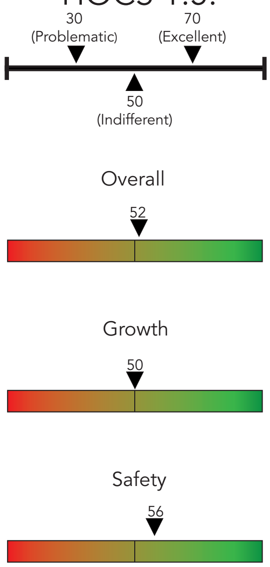
Bill Feingold

**NXPI**

0.75%, 2019/12/01
Price (Bond): 100%
Stock: $74.85
YTM: 0.75%
Premium: 37.5%
HOCS-Overall: 52
HOCS-Growth: 50
HOCS-Safety: 56

As of November 24, 2014

HOCS 1.5:




This morning, the Dutch semiconductor maker NXP announced a $1 billion convertible deal. Our preliminary HOCS rating, based on midpoints of 0.75% coupon and 37.5% premium, is 52 Overall/50 Growth/56 Safety. This fairly weak rating for a new issue comes about because of the company's mix of erratic growth and a fairly heavy debt load. That said, recent trends have been generally positive, so the HOCS rating may not do the issue complete justice. But for a new deal, this is a weak slash line.

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November 24, 2014

# InvenSense, Inc.: Another Rotten Apple? HOCS says Probably Not

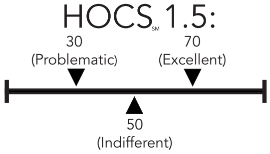
Jeffrey Alton, CFA

INVN

1.75%, 2018/11/01
Price (Bond): 93.5
Stock: $15.01
YTM: 3.54%
Premium: 36.4%
HOCS-Overall: 69
HOCS-Growth: 81
HOCS-Safety: 46

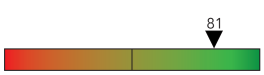
As of November 24, 2014

HOCS℠ 1.5:




Overall


Growth




Safety


HOCS: 69 Overall/81 Growth/46 Safety

InvenSense is a member of the HOCS top 20 and recent weakness in the company's convertible bond price could offer investors an attractive entry point.

**A Tough Quarter**

First, why the weakness?

InvenSense released earnings after the close on October 28, missing consensus net income per share estimates badly, and the stock fell 25% to $16.08 the next morning. On the ensuing conference call, new company revenue guidance of $108 million to $115 million for Q3 was also narrowly below analyst expectations. Since then, the stock has fallen further to $15 per share. That is off a high of $26.78 reached in July.

A summary of the recent quarterly return numbers for InvenSense follows:

*Revenue in $ millions*

| | Actual 9-30-14 | Consensus Estimated 9-30-14 | Percent Difference Act. V. Est. | Previous Year Actual 9-30-13 | Percent Change Y-O-Y |
|---|---|---|---|---|---|
| Revenue | $90.2 | $90.4 | (0.00) | $70.9 | 27.1% |
| Adjusted EPS | $0.05 | $0.16 | (68.8%) | $0.15 | (66.6%) |

The InvenSense convertible bonds reacted similarly to the stock. Priced at 113 before earnings, the bond currently trades around 93 1/2. The convertible bond summary is:

| | |
|---|---|
| Coupon | 1.75% |
| Maturity Date | 1-Nov-18 |
| Amount Outstanding | $175 million |
| Current Price | 93.5 |
| Yield to Maturity | 3.54% |
| Conversion Premium | 36.4% |
| Conversion Price | $21.89 |
| Stock Price | $15.01 |

InvenSense just added Apple as a client and the company reported that lower selling prices to larger customers played a role in the earnings estimate miss. Investors may feel a chill as they hearken back to GTAT's experience as an Apple supplier, though InvenSense's technology is a proven one. Still, one wonders what price a company must pay to work with Apple? Analysts are concerned that other InvenSense clients will insist on similar discounts, driving down margins.

Despite revenues growing rapidly, second quarter gross margin came in at 37%, 13 points below Q1. Eight percent of the drop was from inventory writedowns from an earlier generation, which should not be repeated next quarter. Three percent resulted from an increase in sales to larger customers and sales of older products. Finally, two percent came from manufacturing costs of newer products that were higher than expected.

InvenSense fans would call the lower gross margins an aberration. Long-term, InvenSense expects gross margins to average in the mid-50% range. Still as revenues tilt toward large clients such as Apple and Samsung, margins may remain under pressure.

**Company Overview**

InvenSense makes motion tracking systems and audio sensors "on a chip" primarily for electronic devices such as smart phones and tablets. One example is using motion in games on a smart phone. Imagine a race car game in which you turn the car by tilting the smart phone to the left or right. In geek speak, InvenSense combines micro-electro-mechanical systems (MEMS), mixed-signal integrated circuits (ICs) and proprietary software with sensors to power third party software applications.

The sensors in InvenSense devices include:

• Accelerometers (G Sensors) which measure linear acceleration and tilt angle.

• Gyroscopes (Gyros) which measure the angular rate of rotational movement about one or more axes.

• Magnetic Sensors (Compasses) which detect magnetic fields such as the Earth's magnetic north.

• Pressure Sensors (Barometers) which measure absolute altitude through changes in atmospheric pressure.

• Audio Sensors (Microphones) which detect audible sound and ultrasound in some cases.

InvenSense designs its products and performs critical test and calibration functions at its facilities. However, InvenSense uses a fabless business model for basic manufacturing functions, outsourcing wafer fabrication and assembly packaging services.

Over the last five years, InvenSense revenue has grown at a screaming 54% compound annual rate. Once designed into a product, InvenSense chips are sticky because of the high cost of redesign. Customers typically continue to use InvenSense systems across future products and generations. InvenSense products are used in all of the top 10 mobile phones and every leading brand worldwide.

The Apple win should reassure investors that InvenSense enjoys a technological lead over competitors such as STMicroelectronics. STMicroelectronics offers similar MEMs chips, but InvenSense chips have a smaller form factor and are as much as nine axes for more precise calibration versus three axes for STMicroelectronics.

Catalysts for future growth also include optical image stabilization (OIS) for digital cameras in cell phones. This holds the image steady when a picture is taken. Consumers expect a premium camera experience in smart phones, but OIS is only used in 10% of premium smartphones currently. InvenSense has a fourth generation OIS package in production to take advantage of this trend.

New software development should also spur future sales. InvenSense completed the Movea and Trusted Positioning acquisitions during the quarter to strengthen InvenSense's sensor algorithms and software functions. Movea software enhances a sensor's ability to determine a person's activity and energy usage. Trusted Positioning creates sensor assisted navigation software.

Other catalysts include audio sensors for voice command and increased smartphone adoption in China. While analysts expect total revenue growth to decelerate from 42% in fiscal 2015 to 22.8% in fiscal 2016, InvenSense is clearly poised for continued growth.

**Valuation**

While the equity share price has dropped significantly, valuation as measured by the price/earnings ratio has actually increased slightly. Consensus per share adjusted net income estimates for fiscal 2015 dropped from $0.78 to $0.45 and fiscal 2016 estimates dropped from $1.14 to $0.75. EBITDA multiples have also blown out as the company has struggled to show GAAP profitability.

Unfortunately for InvenSense investors, they have grown accustomed to earnings misses over the last year, missing in three of the last four reports. To shore things up, InvenSense hired new CFO Mark Dentinger, a former CFO at KLA-Tencor. That experience will be important in inventory management and returning gross margins back to the 50% level. In some ways, InvenSense is a CFO play.

For investors unwilling to jump in to InvenSense common shares before clarity returns, we think the convertible security offers an intriguing alternative. The relatively short four-year maturity horizon minimizes technology risk and refinance risk seems manageable with analysts expecting increasing revenue and net income. The conversion price of $21.89 seems attainable over the next four years with the downside to the convertible bond appearing to be the bond's 3.54% yield to maturity. Should InvenSense return to rapid growth, the convertible bond could appreciate significantly.

November 24, 2014

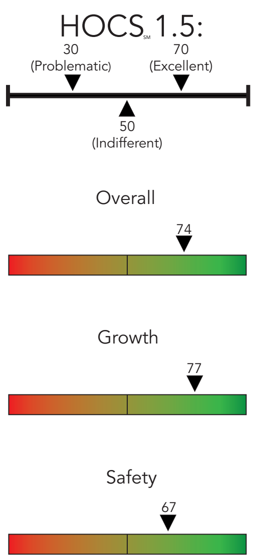
# Tesla Motors - Supercharged for Growth

Kathy Schick

TSLA

0.25%, 2019/03/01
Price (Bond): 96.25%
Stock: $242.78
YTM: 1.15%
Premium: 42.7%
HOCS-Overall: 74
HOCS-Growth: 77
HOCS-Safety: 67

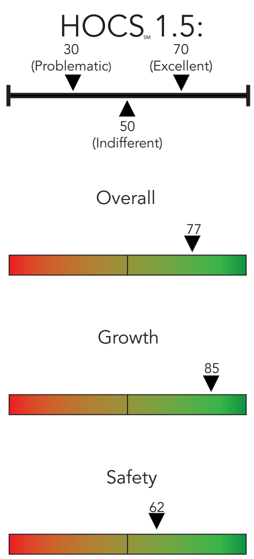
As of November 24, 2014




TSLA

1.25%, 2021/03/01
Price (Bond): 95.25%
Stock: $242.78
YTM: 2.06%
Premium: 41.2%
HOCS-Overall: 77
HOCS-Growth: 85
HOCS-Safety: 62

As of November 24, 2014




Tesla Motors (TSLA) had the honor of being number one on the first-ever HOCS 20 list published in last week's Hybrid Vigor with the 2019 and 2021 convertible notes both making the list. With such a lofty position, Tesla deserves a little more attention in this space, even if it has become one of the most actively traded and followed names in the convertible universe.

Tesla is a new automotive company that focuses on high-performance fully electric vehicles and advanced electric powertrain components. Sales have been growing rapidly from $413mm in FY12 to $2,857mm in the last twelve months - a staggering 592% increase in less than 2 years. The company is currently producing the model S, a high-performance 4-door sedan, which it launched in June 2012 in the US. That was followed by launches in Europe in August 2013 and China in April 2014. Tesla began deliveries of powertrains to Daimler in 2Q14 for the Mercedes-Benz B Class electric drive. Management expects to deliver approximately 33,000 vehicles for FY14, a 50% increase from FY13, though slightly behind the original goal of 35,000 vehicles this year.

In order to meet growing demand, Tesla is expanding its Fremont, California factory. As part of the expansion, the plant was closed for two weeks during the third quarter. The plant is now producing close to 1,000 vehicles per week and should ramp up to a 100,000 vehicle annual production rate by the end of 2015. The expansion ramp has been delayed by the complexity of introducing of a dual motor option and autopilot hardware, which led to the slightly lower delivery estimates for 4Q14.

Tesla has been ramping up its capital expenditures. For FY13 it spent $264mm and burned only $6mm of cash for the year. For the first 9 months of 2014, the company has spent just over $600mm and has burned $572mm of cash. For FY14, management estimates total cap-ex of $950mm, at the top of management's $750mm to $950mm guidance, which had previously been revised up. So it's likely we'll see more Tesla convertibles down the road.

The heavy capital spending is being driven by capacity expansion to accommodate growing Model S demand, the launch of the Model X in 2015, Gigafactory construction for batteries, continuing vehicle development (including Model 3), global expansion, and the continued build-out of the supercharger network (free global network of high-speed charging stations). That is a lot of projects to be juggling and a lot of cap-ex to be funding.

The capacity expansion at the Fremont facility has not been problem free, but management appears to have that under control and has stated it feels confident production capacity will continue to increase at a 50% rate for the next several years. The launch of the Model X has been pushed out from the spring of 2015 to 3Q15 to accommodate more validation testing time. There was some disappointment in the market at this announcement, but it really is the Tesla way to forgo revenue to insure bringing a satisfactory product to market .

Tesla broke ground on the Gigafactory in June and construction accelerated in the third quarter. The factory will be a large-scale integrated producer of lithium-ion cells and finished battery packs for vehicles. The plant is at the core of the company's mass-market production plans. Panasonic has signed on to be a partner in the plant. Tesla expects to have additional partners as well. The total cost of the plant is estimated at $4bn to $5bn, of which Tesla expects to fund approximately $2bn. The factory is expected to begin production in 2016 with cells being used for the Model S and X and later for the Model 3, its mass-market mid-priced car. Full production capacity should begin in 2020.

Tesla bolstered its cash balances earlier this year when they issued two new convertible bonds following on the heels of its first convertible bond offering in 2013. Cash balances totaled $2.4bn at 9/30/14. Cash burn is accelerating and will remain elevated, but the company is funded through the intermediate term. While the leverage numbers in the attached coverage waterfall are not particularly relevant for a company with minimal EBITDA, we wanted to provide a summary of the important financials.

| ($mm) | 30-Sep-14 | Debt Cumulative Balance | EBITDA Multiple | Net Debt Cumulative Balance | EBITDA Multiple |
|---|---|---|---|---|---|
| TSLA Stock Price 11/21/14 | 242.78 | | | | |
| LTM EBITDA | 76 | | | | |
| LTM FCF | -532 | | | | |
| Cash | 2,371 | | | | |
| <u>Senior Unsecured Debt</u> | | | | | |
| Cap Leases | 22 | | | | |
| 1.5% Senior Convertible Notes due 2018 | 660 | | | | |
| 0.25% Senior Convertible Notes due 2019 | 920 | | | | |
| 1.25% Senior Convertible Notes due 2021 | 1,380 | 2,982 | 39.2 | 611 | 8 |
| Total Debt | 2,982 | 2,982 | 39.2 | 611 | 8 |
| Common Stock (Mkt) | 30,440 | 33,422 | 439.8 | 31,051 | 408.6 |

It is important to remember that Tesla is a start-up company. EBITDA has turned positive, but it is quite small. Cash burn is ramping up and will be around for a good while. The company is still years away from a mass-market produced car (Model 3). The traditional credit-volatility approach to valuation doesn't really fit this highly speculative company. However, the convertible bonds are an attractive and much safer alternative to the equity. While the stock is 16% below its all-time high, it is still up 63% from the start of 2014. Tesla's market cap is over $30bn, providing a significant amount of room beneath the convertible bonds. The 0.25% Senior Convertible Notes of 2019 and 1.25% Senior Convertible Notes of 2021 both made the HOCS (Hillside Overall Convertible Score) inaugural Top 20 list last week. The 0.25% of 2019 has a slash line of 74 Overall / 77 Growth / 67 Safety and the higher-delta1.25% of 2021 has 77/85/62. These are excellent scores. For those who like the Tesla story and want to take a spin, we recommend both of these convertible notes as an alternative to the stock.

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November 24, 2014

# The On-Deck Circle: Rentrak Corporation: In Living Rooms Everywhere

Hillside Staff

Think of Rentrak (RENT) as a hipper Big Brother monitoring your viewing habits where ever you may happen to be: watching TV, viewing video on demand, using the internet through your computer or television, or even at the movie theater. Rentrak then marries the viewing data with demographic data obtained from other data bases to provide advertisers with granular information about viewers and their shopping habits. A little scary, but pretty cool, right?

Part of Rentrak's success is its vast reach. The company monitors 100% of the video on demand market (VOD) through 110 million television sets. Rentrak also monitors scheduled, interactive and DVR television in 210 local markets through agreements with cable providers. The company has another business measuring viewing numbers for movie theaters on a global basis.

Rentrak common shares are pretty thinly traded at a recent price of $81.80, up over 100% year-to-date. Earnings are growing dramatically. EPS last fiscal year ending March 30 was a loss of ($0.59). Consensus estimates call for a loss of ($0.18) in current fiscal 2015 and profit of $0.95 in fiscal 2016. The market cap is just over $1 billion.


Source: Bloomberg

Behind the profit numbers, operating performance is growing at a fast clip. In the most recent quarter, revenue was up 44.5% year-over-year to $25.2 million. EBITDA grew from $100,000 in FY 2013 to $5 million in FY 2014. Liquidity is good with $23 million in cash and cash equivalents as of September 30, 2014 and a $15 million undrawn line of credit. Capital expenditures were about $10 million last fiscal year. Rentrak has no long-term debt on the balance sheet.

Optics for a convertible note from Rentrak should be good, providing RENT with low-cost capital to do additional acquisitions and grow internationally. Rentrak offers arbitrageurs high volatility based on the stock's huge move this year. Hedge funds should be able to trade around the stock. Greater daily volume above the current three-month average of 200,000 shares may be needed for traders to take a position confidently, but volume is on the rise and the future is promising.

We have called for Netflix to do a convertible on several occasions and we feel the same way about Rentrak in the media space. With a surging stock price, strong growth and rapid expansion, it's time for Rentrak to beam in on the convertible market. We estimate Rentrak could issue a five-year convert with a 3.5% coupon and a 40% premium. The 3.5% coupon compares very favorably to high yield debt which we estimate would come wider than L+550, assuming the company could float straight debt at any price. Management should take advantage of the high stock price by issuing a convertible bond to fund future growth.

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

# Hillside Alerts (HA!)

## A FUTURE FLUSH CANDIDATE?

November 20, 2014 / Jeffrey Alton, CFA

Lexicon Pharmaceuticals (LXRX) announced a $75 million 144A convertible note issue due 2021 in conjunction with a $50 million common stock offering.

HOCS Score: 48 overall, 56 growth, 33 safety

Despite the optical cheapness of the issue, the low HOCS score points to the speculative nature of the this biotech company. LXRX common shares trade for $1.25 and the market cap is $640 million. The company currently has no long-term debt outstanding.

Lexicon Pharmaceuticals is burning through about $25 million in R&D expenditures per quarter. At the end of last quarter, Lexicon had just under $58 million in cash and cash equivalents listed on their balance sheet. The drug furthest along the pipeline is Telotristat Etiprate, currently in a phase three trial for the treatment of Carcinoid Syndrome. Carcinoid Syndrome strikes cancer patients and results in extreme diarrhea and flushness due to the excessive production of serotonin. The company estimates a $350 million market in the US for the treatment and has signed a licensing deal with Ipsen for markets outside of North America and Japan.

Other treatments under development include:

-Sotagliflozin, or LX4211, for treating diabetes 1 & 2 patients entering a phase three trial

-LX1033 for the  treatment for irritable bowel syndrome in phase 2 trials

-LX2931 for the treatment of Rheumatoid Arthritis in phase 2 trials

-LX7101 for the treatment of Glaucoma in phase 1 trials

## NEW ISSUE: $75 MILLION LGI HOMES (LGIH) 4.25% CONVERTIBLE SUBORDINATED NOTES OF 11/15/2019

November 18, 2014  / Kathy Schick and Bill Feingold

**HOCS (Hillside Overall Convertible Score)**

The new LGIH convertible received an acceptable HOCS slash line of 58 Overall/61 Growth/52 Safety. While these are fairly good scores for an aged piece of paper they are ordinary at best for a new issue. We generally look for new issues to score in the mid-60's or higher.  While the bond is very attractive optically its scores are penalized for the company's small market capitalization and leverage.

HILLSIDE ADVISORS LLC

November 24, 2014

**Company Overview**

PF Cash: $102mm  PF Debt: $235mm LTM EBITDA: $35mm

LTM FCF: $(161)mm  Leverage: 6.7x  Mkt Cap : $345mm

LGI Homes (LGIH) is a small homebuilder with operations in Texas, Arizona, Florida, Georgia, New Mexico, Colorado, and South Caroline. The company has been involved in land development since the mid-1990s and began building homes in 2003. However, it just went public last November, so there is very little public history. The company is expanding rapidly with 557 homes closed in 3Q14 an increase of 132% from the year earlier period. Revenues increased 149% over the same period. The average sales price increased 7.6% to $166,097.

LGIH is currently involved in 34 active communities. It is expanding geographically with construction started this year in Denver, Colorado and Charlotte, North Carolina. The company is also looking to expand their price points.

All of this growth has required significant cash to fund working capital, primarily inventory. For the last twelve months the company has burned $161mm. This was funded with $103mm of net proceeds from the IPO and a secured revolver. The company entered into a new bank commitment in April. The line was recently increased to $200mm. Availability is tied to a borrowing base of assets, which totaled $175.4mm at 9/30/14. The company has $160.2mm drawn on the line, leaving them with availability of $15.2mm. LGIH is paying L+275 and the line matures on 4/28/17.

The company is planning to buy back up to 1mm shares of stock with the proceeds and use the rest for general corporate purposes. It obviously needs to bolster its cash balances with a cash burn of $161mm over the last year. The converts will be subordinated to the secured bank line. Pro-forma leverage is elevated at 6.7x. LGIH may need additional liquidity in the not so distant future.

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