HILLSIDE ADVISORS LLC

August 3, 2015

Hybrid Vigor℠

The Hillside Convertible Advisory Letter
Volume 2 Issue 31

Bond Breeding

Inside

Our Team

Bill Feingold
Managing Principal

George Chuang
Managing Principal

Jeffrey Alton, CFA
Head of Equity Research

Kathy Schick
Head of Credit Research

George Lynch
Senior Analyst

Roman Terekhin, CFA
Senior Analyst

Curt Peters
Senior Analyst

John Anderson
Director of Business Development

Sue Wu
Associate

Two of my great loves, as readers of these pages know, are horse racing and convertible bonds. Yesterday I made up for missing the Belmont Stakes in person by taking my family down to the Jersey Shore to see American Pharoah win the Haskell Stakes. What a magnificent horse. He doesn't look spectacular before the race—average size and remarkably calm. But let the starting gate open and he's all business. He made some good horses look very bad yesterday. His jockey, my friend Victor Espinoza, was virtually standing up on him the last eighth of a mile, making it look like to the untrained eye that second-place Keen Ice might catch him. Not a chance.

What makes the horse so great? He's what horse people call "push-button." He gets himself into position to win the race on his own and then just waits for his jockey to let him know when to take off—usually with about a quarter of a mile left in the race.

Convertible bonds are, for the most part, push-button instruments, at least when you use them correctly. True, you can't buy or sell a convertible by clicking on a link in an online trading account. Well, maybe you can, but I wouldn't advise it. Then again, one of the few things American Pharoah can't do is put on his own equipment and find the way into the starting gate on his own. So maybe that's the right analogy. Buying the bond is like getting the horse into the starting gate. From that point on, it's pretty automatic.

What's the equivalent of the jockey saying "go" on the far turn? I guess it's when the convertible gets to that tricky point in the 120's or 130's where there's still plenty of premium to chew up. As Robert Plant sang, "there are two paths that you can go by, but in the long run, there's still time to change the road you're on." Do you ride on for the big win, deciding the premium is just a necessary evil en route to much greater gains? Or do you take the cautious road, selling and moving on to the next trade? It's up to the convertible jockey, the portfolio manager, to have a feel for how much run the horse still has. We like to think HARP and HOCS can be useful tools in mapping out your ride.

Of course, the ideal convertible jockey has the option to switch horses mid-race. If you still like the upside of the story but no longer favor the convertible's profile, you can switch into stock, or options, or some mix thereof. If you think the premium is too low, but you're worried that the horse is tired, hedging by shorting stock makes the most sense.

In horse racing, they say, "breed the best to the best and hope for the best." American Pharoah's breeder, who still owns him, bred very good to pretty good and got the best. His father ran second in the Kentucky Derby. His mother only raced twice and did not win, but was bred to be fast. With convertibles, you breed a healthy credit to a volatile stock and hope for the best. You can win, of course, with other recipes, but it's not as likely. Either way, the jockey is mostly along for the ride, except for one or two critical decisions. May the horse be with you.

Bill
bill@hillsideadvisors.com

Hillside Advisors, LLC
400 Columbus Ave., Suite 240E
Valhalla, NY 10595
+ 1 (646) 712-9289
www.hillsideadvisors.com

Contact us:
info@hillsideadvisors.com

Hybrid Vigor is published every week on Mondays.

The next issue will be published on August 10, 2015.

August 3, 2015

Protection

Bill Feingold
bill@hillsideadvisors.com

Curt Peters
curtp@hillsideadvisors.com

A quick refresher. HARP, or Hillside Adjusted Risk Points, is best thought of as a warning measure for bonds exposed to a blend of absolute price decline and premium decay. The higher the HARP, the more dangerous the bond. HARP tends to be highest for bonds in the 120-130 "death trap" range.

Since late March of this year, the average HARP of the Ugly 20 has been range-bound between 9.50 and 10.00. As the second quarter turned into the third, the range tightened up to limit movement between 10.00 and 9.70. This past week was no exception. Starting the week at the bottom of the range suggested that the average HARP was likely to increase, and it did, by 0.15 HARP to 9.85. Risk on, sort of. The increase was rather broad based, with most bonds participating and only a few bonds outlying. The modest HARP increase seems to correspond to the equally modest stock (1.6%) and bond (1 point) gains. Even the rank order saw only a slight amount of movement – letting in only two new entrants.

Before we get to the meat of this week's column, let's nod our heads at that persistent Ugly 20 top scorer – RPM 2.25% of 2020. The bond snuck up from 5th to 2nd this week with a 0.38 HARP increase driven by a single point increase in the bond's price. Priced at 114 with parity at 88¾, those sorts of moves increase risk.

We hand out praise when deserved. In this case it was both Illumina B's and A's which deserve a little praise for trimming their risk sails with a slightly heavier than dollar neutral price reduction (1½ and ½ respectively). From a dizzying starting point, the B's dropped 0.70 HARP, while the A's dropped 0.16 HARP. Both are still terrible, but perhaps it's the start of a trend.

While the HARP calculation accounts for the amount of life left in a bond, either to maturity or to the end of call protection, it's worth spending a bit of time understanding how 'life left' is distributed among the Ugly 20 participants. There is one bond in the Ugly 20 and one bond currently just at the margins, though a frequent participant, which are running very short on life left.

Starting with the marginal participant, only marginal this particular week to be sure, is the future-looks-so-bright Green Plains Renewable 3.25% of 2018. Hard call protection on the bond ends in 14 months and parity is 108¼, and yet the bond trades with a price of 126. On the face of it, this sounds like trouble and deserving of a top shelf HARP score. Yet, GPRE is just a middling Ugly 20 participant. What gives? Details, details, details. The call protection expiration isn't so straightforward – it actually gives way only if the stock trades in excess of 140% of the conversion price ($20.85). So as long as parity never gets above 140, investors have until 2018 to wait for crude prices to escalate and hopefully cash them out at some place before 140. As we've mentioned before, we're big fans of GPRE's CEO, Todd Becker. He can't do much about oil prices, but we're confident he does everything he can to put his company in the best possible position.

The number six position of the Ugly 20 is held by Emergent BioSolutions 2.875% of 2021 – a bond with only 1½ years of call protection left. Parity is at 101¼, while the bond is pricing at 123¼. Even after subtracting the 1½ years of coupons, it's still a very big mouthful of 17¾ points of premium. Kinda nasty, and only 18 months to close the gap. Similar to GPRE, EBS has the safety of needing the stock to remain in excess of 130% of the conversion price in order that call protection be removed. The bond is scratching very close to that upper bound of 130 right now. Put another way, paying 123¼ to have a bond that in less than 18 months will be capped at 130 for the four subsequent years seems rather steep. Of course, if you get some big-enough moves in the next year and a half, we'll eat our words.

Before we leave you this week, we'd like to bring your attention to the Akamai Technologies 0% of 2019 bonds which just landed on the Ugly 20 at 20th, up from 29th. We rarely see bonds with prices below 115 on the Ugly 20, so this must be a special case. The bond has the lowest parity (85¾) of any of the Ugly 20, yet maintains a price of 109¼ - that makes for a very steep 23½ points of premium. No coupons to soften the blow either. Toss in teenage volatility, and you have the makings of an awful bond. The only thing keeping this bond from scoring worse than a 7.91 HARP is the support that par is providing. Here's hoping that the Akamai bond can clean up the premium a bit before it attempts to run the gauntlet of the 'death zone'. Akamai's history makes for a compelling story—we wrote a series about it for a major financial site when the convertible was issued last year. That doesn't make the bonds a good buy, sadly.

HILLSIDE
ADVISORS
LLC

August 3, 2015

Hillside Ugly 20 List (Prices as of July 31, 2015)

	Convertible	Price	Stock	Premium (%)	Premium (pts)	HARP
1	Illumina Tranche B 0.5% 2021-06-15	122.75	219.30	42.3	36.49	14.03
2	RPM International 2.25% 2020-12-15	114.00	46.87	28.8	25.49	11.76
3	Red Hat 0.25% 2019-10-01	125.75	79.08	16.7	18.00	11.75
4	Lam Research Tranche B 1.25% 2018-05-15	137.25	76.87	10.9	13.49	11.31
5	Illumina Tranche A 0% 2019-06-15	116.75	219.30	35.5	30.59	11.25
6	Emergent BioSolutions 2.875% 2021-01-15	123.25	32.83	21.7	21.98	10.66
7	Jazz Pharmaceuticals 1.875% 2021-08-15	122.00	192.24	26.9	25.86	10.64
8	Priceline.com 0.35% 2020-06-15	116.50	1243.57	23.3	22.02	10.35
9	Medidata Solutions 1% 2018-08-01	119.00	53.80	28.4	26.32	9.81
10	Salesforce.com 0.25% 2018-04-01	126.00	73.30	14.2	15.67	9.62
11	SanDisk 1.5% 2017-08-15	132.50	60.29	11.3	13.45	9.12
12	NVIDIA 1% 2018-12-01	114.75	19.95	16.1	15.91	9.08
13	Euronet Worldwide 1.5% 2044-10-01	117.25	68.50	23.4	22.23	9.02
14	Workday Tranche 1 0.75% 2018-07-15	119.50	84.33	18.0	18.23	8.71
15	Workday Tranche 2 1.5% 2020-07-15	124.25	84.33	20.5	21.14	8.70
16	ServiceNow 0% 2018-11-01	123.50	80.50	13.3	14.50	8.68
17	Synchronoss Tech 0.75% 2019-08-15	115.50	47.80	28.4	25.55	8.25
18	Rambus 1.125% 2018-08-15	124.25	13.09	14.7	15.92	8.24
19	Clovis Oncology 2.5% 2021-09-15	156.50	84.43	14.7	20.06	8.21
20	Akamai Technologies 0% 2019-02-15	109.25	76.71	27.5	23.56	7.91

Sources: Bloomberg, Kynex

HOCS℠ 20

Bill Feingold
bill@hillsideadvisors.com

A quick refresher. HOCS, or Hillside Overall Convertible Score, measures the attractiveness of a bond, taking into account both upside potential and downside protection. HOCS is not a theoretical model but a rating system that assigns points to a number of different characteristics of each convertible. HOCS can theoretically lie anywhere from 0 to 100. In practice the average score for a broad group of convertibles is typically around 50. 60 is a good score, 70 is excellent, and 80 is exceptional.

We all probably wish we didn't have to hear "risk-on" and "risk-off," at least as much as the clichés seem to have taken over the financial media and more. In the land of HOCS, recent weeks have had their own variant: China-on, China-off.

Two weeks ago, including Chinese names kept portfolios from taking a bigger hit. Last week was the opposite. We kind of suspected it when we were preparing the previous issue of ***Hybrid Vigor***, since the Chinese stock market had just experienced an overnight mini-crash. True, investing in the convertible bonds of US-listed Chinese companies is a far cry from trading Chinese stocks in a market resembling TEGWAR (The Exciting Game Without Any Rules, from the book and movie "Bang the Drum Slowly.") Forgive me if I've used that reference before—it's a great old movie. Nonetheless, there's always going to be some impact, if for no other reason than it makes flight from a US listing to a Chinese one seem less likely.

To the videotape. Last week, the China-free HOCS 20 scratched out a marginally positive week, returning 5 basis points. We know, it's not much, but it was a rocky week. A few solid pharmaceutical names (notably ANI and ISIS) helped offset a nasty mix of energy pain, an unusually candid negative call from Twitter management, and an ultimately disappointing LinkedIn report. The "traditional" HOCS 20 had a more difficult time. It lost 31 basis points on the week, dragged down by Chinese names led by the Qihoo triad as well as Ctrip, Soufun and 51job.

The broader HOCS 100, which has Chinese names but in a more diluted form than the traditional HOCS 20, also managed to return 5 basis points on the week. Well, it beats losing. But in the relative-performance derby, HOCS 100 got spanked by its rival, the CWB exchange-traded fund. CWB had a good week, returning 1.22%. For the year, HOCS 100's lead over CWB is all but gone: 3.38% to 3.31%.

Many of the growth-y, tech-y names in the HOCS 100 struggled—we mentioned the problems with Twitter and LinkedIn already. KEYW Holding, Quidel and Shutterfly were some of the other offenders. Offsetting those losers was a Hillside favorite, Molina Healthcare, as well as unlikely hero AK Steel.

LinkedIn and Trulia, aka Zillow, both join the "traditional" HOCS 20 this week in addition to holding their places in the China-free version. Jeff Alton discusses the controversial Trulia/Zillow (in addition to issues surrounding fundamentals and management, stock borrow is getting very tough) elsewhere in this issue.

The "China penalty" remains around 3 ½ HOCS rating points: the China-free version of the HOCS 20 scores 68.8 overall while the traditional list comes in at 72.3. With Zillow Trulia making both lists, the profile differential has shrunk somewhat, though it remains meaningfully different. The China-free version is still more aggressive, yielding 1.85% with a 40% conversion premium, while the traditional HOCS 20 profiles out at 2.88% up 48%.

HILLSIDE ADVISORS LLC

August 3, 2015

Hillside HOCS 20 List

	Description	Convert	Stock	HOCS Overall	HOCS Growth	HOCS Safety	Yield	Premium
1	QIHOO 0.50% 2020-08-15	91.00	62.01	81.1	75.9	91.4	5.22%	83.9%
2	QIHOO 2.50% 2018-09-15	96.25	62.01	79.5	74.6	89.4	6.26%	71.8%
3	QIHOO 1.75% 2021-08-15	88.25	62.01	77.5	79.0	74.6	5.00%	71.9%
4	CTRIP.COM INTER LTD. 1.99% 2025-07-01	95.00	71.58	77.2	88.5	54.8	3.10%	41.9%
5	INVENSENSE 1.75% 2018-11-01	97.25	13.10	77.0	74.8	81.4	2.64%	62.5%
6	IGI 3.50% 2019-12-15	97.00	8.80	75.0	82.7	59.5	4.26%	24.4%
7	WEB.COM 1.00% 2018-08-15	99.00	24.89	74.4	78.6	65.8	1.34%	39.2%
8	E-HOUSE 2.75% 2018-12-15	93.75	6.30	72.2	63.5	89.7	7.44%	124.8%
9	LINKEDIN 0.50% 2019-11-01	100.75	203.26	71.3	66.0	81.9	0.32%	46.0%
10	CTRIP.COM INTER LTD. 1.00% 2020-07-01	95.00	71.58	71.0	79.6	53.8	2.80%	44.4%
11	CALAMP 1.625% 2020-05-15	93.00	17.11	70.9	74.9	62.7	3.22%	50.0%
12	ENVESTNET 1.75% 2019-12-15	102.00	45.29	70.3	69.1	72.7	1.28%	41.6%
13	RESTORATION 0.00% 2020-07-15	102.00	101.46	70.2	68.0	74.5	-0.40%	18.8%
14	TESLA 1.25% 2021-03-01	97.75	266.15	69.8	76.0	57.4	1.67%	32.2%
15	FIREEYE 1.63% 2035-06-01	104.00	44.49	69.5	82.2	44.3	1.02%	42.0%
16	HERBALIFE 2.00% 2019-08-15	86.00	50.49	68.9	70.4	66.1	5.88%	47.4%
17	RENEWABLE 2.75% 2019-06-15	99.00	10.20	68.8	72.2	62.0	2.89%	29.4%
18	TESLA 0.25% 2019-03-01	98.50	266.15	67.4	70.5	61.4	0.68%	33.2%
19	GOGO INC 3.75% 2020-03-01	98.75	18.23	67.3	81.6	38.6	4.05%	29.2%
20	TRULIA INC 2.75% 2020-12-15	121.25	81.50	66.5	84.6	30.2	-1.08%	20.4%

Sources: Bloomberg, Kynex

Disclaimer: A principal of Hillside Advisors has positions in Molina Healthcare, Twitter and Zillow.

HILLSIDE ADVISORS LLC

August 3, 2015

Hillside HOCS 20 List ex China

	Description	Convert	Stock	HOCS Overall	HOCS Growth	HOCS Safety	Yield	Premium
1	INVENSENSE 1.75% 2018-11-01	97.25	13.10	77.0	74.8	81.4	2.64%	62.5%
2	IGI 3.50% 2019-12-15	97.00	8.80	75.0	82.7	59.5	4.26%	24.4%
3	WEB.COM 1.00% 2018-08-15	99.00	24.89	74.4	78.6	65.8	1.34%	39.2%
4	LINKEDIN 0.50% 2019-11-01	100.75	203.26	71.3	66.0	81.9	0.32%	46.0%
5	CALAMP 1.625% 2020-05-15	93.00	17.11	70.9	74.9	62.7	3.22%	50.0%
6	ENVESTNET 1.75% 2019-12-15	102.00	45.29	70.3	69.1	72.7	1.28%	41.6%
7	RESTORATION 0.00% 2020-07-15	102.00	101.46	70.2	68.0	74.5	-0.40%	18.8%
8	TESLA 1.25% 2021-03-01	97.75	266.15	69.8	76.0	57.4	1.67%	32.2%
9	FIREEYE 1.625% 2035-06-01	104.00	44.49	69.5	82.2	44.3	1.02%	42.0%
10	HERBALIFE 2.00% 2019-08-15	86.00	50.49	68.9	70.4	66.1	5.88%	47.4%
11	RENEWABLE 2.75% 2019-06-15	99.00	10.20	68.8	72.2	62.0	2.89%	29.4%
12	TESLA 0.25% 2019-03-01	98.50	266.15	67.4	70.5	61.4	0.68%	33.2%
13	GOGO INC 3.75% 2020-03-01	98.75	18.23	67.3	81.6	38.6	4.05%	29.2%
14	TRULIA INC 2.75% 2020-12-15	121.25	81.50	66.5	84.6	30.2	-1.08%	20.4%
15	FIREEYE 1.00% 2035-06-01	104.00	44.49	65.4	73.5	49.2	0.17%	42.0%
16	ISIS PHARMACEUTICALS INC 1.00% 2021-11-15	106.75	54.93	65.3	79.5	37.1	-0.07%	29.8%
17	HOMEAWAY 0.13% 2019-04-01	95.00	30.04	65.2	57.8	79.9	1.53%	65.0%
18	INSULET 2.00% 2019-06-15	100.25	33.89	65.1	73.6	48.0	1.80%	38.3%
19	WHITING 1.25% 2020-04-01	87.25	20.49	64.2	69.4	53.7	4.30%	66.1%
20	SHUTTERFLY 0.25% 2018-05-15	96.75	43.25	64.0	55.1	81.7	1.45%	43.5%

Sources: Bloomberg, Kynex

Disclaimer: A principal of Hillside Advisors has positions in Molina Healthcare, Twitter and Zillow.

HILLSIDE
ADVISORS
LLC

August 3, 2015

Euro Gang of 20

Roman Terekhin, CFA
roman@hillsideadvisors.com

HARP made me do it

Is the proverbial August lull upon us already? On the back of the essentially flat European markets last week, the average stock underlying the Euro Gang of 20 did not move much either. The average HARP score, however, decreased to just below ten for the first time in its admittedly short history. Eye-balling the list, we see the same names in about the same order, which pretty much has been the case for the past few weeks. Boring.

Yet, there were two big equity movers on the top 20 register – Buzzi Unicem SPA was up 6.8% and Fresenius Medical Care dropped 5.6% for the week. Buzzi Unicem SPA, the Italian construction materials maker that we profiled in Hybrid Vigor last week, advanced on the news that HeidelbergCement entered into a purchase agreement to buy a 45% stake in Italcementi at over a 60% premium to the July 28 closing price. The Buzzi Unicem SPA 1.375% convertible advanced almost five points and its HARP score increased by almost a point. Yet, we think that along with the bond price its risk went up as well. Now at 12 the HARP is quite high but apparently believers in the stock story made money holding the bonds anyway. Is that why they call it gambling? Oh wait, I think I am thinking about something else. The stock price of Fresenius Medical Care, the German kidney dialysis company dropped as the company announced an earnings miss. The HARP score of its 1.125% convertibles due 2020 increased by 0.1 which was enough to put it in the second place on our infamous list. Apparently, the runners-up keep churning but still no one can beat the Rag-Stiftung 0s' 15-point HARP.

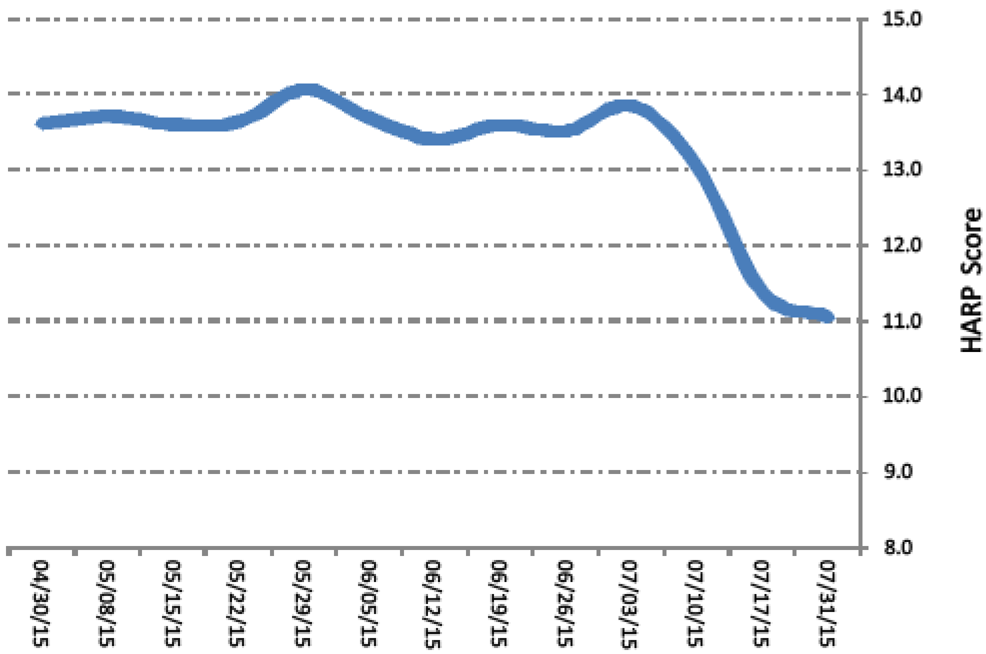
Nexity SA 0.625% of 2020 was the only bond with a HARP move of over one point – it dropped 1.6 to 11.6. As the stock declined 2.8% for the week the bonds traded down on around a 115% delta. Not pretty. Over the past week, there were three names in total that moved down on deltas in excess of 100% - the other two being SAF-Holland Group 1% of 2020 and Acciona S.A. 3% of 2019.

After some consideration, we decided that the OCI NV 3.875% convertibles due 2018 no longer qualify for the HARP analysis. Since the talks about a potential combination with CF Industries began our formula simply cannot capture the new valuation drivers properly. Thus, unless the transaction falls apart the bonds will not appear on the Euro Gang of 20. That is a promise.

Today, we are going to take a quick look at the Cap Gemini 0% of 2019. It is a French convertible and since over the last couple of weeks we looked in some detail at German and Italian bonds we thought we really should be equal opportunity offenders. Cap Gemini 0s are rated BBB and we suppose that this is where our analysis could actually end. However, we are thorough people here at Hillside Advisors and we noticed that the bonds' richness ranking have declined over the last couple of weeks with its HARP score coming down from 14 all the way to 11. Still pretty rich though in our book. The bonds are soft-callable in October of next year meaning investors are paying over 11 normalized points for an option that's barely longer than a year. Realized 90-day volatility is in the 27-28% area and option market points toward a 25-26% range. We suppose, these days these are respectable numbers especially for an investment-grade name. Still, given the premium investors are paying, the stock needs to advance 9% for them just to break-even. So one has to really (as we mean really) like the equity story to hold this instrument. At the same time, trading at around a 22 P/E, the Cap Gemini stock looks fairly valued. The company did beat top-line estimates recently and management raised its 2015 outlook, but that seems to have been priced in already. So if the stock does not cooperate enough or at all, convertible investors are in for some pain. We would also note that the

HARP score would need to come down a lot for the arbs to step in. Sorry to be so negative but it's the nature of the HARP analysis that forces us to flash out valuations that just don't make much sense.

Cap Gemini 0% 2019 Historical HARP Score



HILLSIDE ADVISORS LLC

August 3, 2015

Euro HARP 20 (Prices as of July 31, 2015)

	Convertible	Price	Stock	Premium (%)	Premium (pts)	HARP
1	Rag-Stiftung 0% 2021	120.37	36.28	22.23	21.89	14.92
2	Fresenius Medical Care A 1.125% 2020	122.47	74.35	21.29	21.49	13.43
3	Suez Environnement 0% 2020	21.97	17.46	25.87	4.52	13.07
4	Rag-Stiftung 0% 2018	117.84	36.28	22.59	21.71	12.90
5	Buzzi Unicem SPA 1.375% 2019	124.38	15.55	27.87	27.11	11.94
6	Nexity SA 0.625% 2020	50.31	40.15	19.00	8.03	11.61
7	SAF-Holland Group 1% 2020	126.98	13.73	14.02	15.62	11.26
8	Cap Gemini 0% 2019	94.65	87.05	8.73	7.60	11.05
9	Fresenius Se & Co KGAA 0% 2019	135.47	62.70	7.30	9.22	10.76
10	Adidas AG 0.25% 2019	116.12	74.21	28.31	25.62	10.74
11	ACS Actividades Fin 2 1.625% 2019	114.06	6.42	13.97	13.98	9.76
12	ACS Actividades Finance 2.625% 2018	123.08	6.42	9.09	10.26	9.29
13	Deutsche Post AG 0.6% 2019	136.61	27.47	2.60	3.46	9.01
14	NH Hotel Group SA 4% 2018	129.49	5.52	15.39	17.27	8.68
15	Prysmian SPA 1.25% 2018	113.48	20.89	21.22	19.86	8.50
16	Acciona S.A. 3% 2019	131.07	73.61	8.99	10.81	7.95
17	Parpublica 5.25% 2017	109.63	10.55	56.90	39.76	7.48
18	Societa Iniz Autostradal 2.625% 2017	112.62	10.69	10.62	10.81	6.34
19	Astaldi SPA 4.5% 2019	127.37	8.76	7.59	8.99	5.79
20	Nexans SA 2.5% 2019	77.65	37.04	86.33	35.98	5.38

Sources: Bloomberg

HILLSIDE
ADVISORS
LLC

August 3, 2015

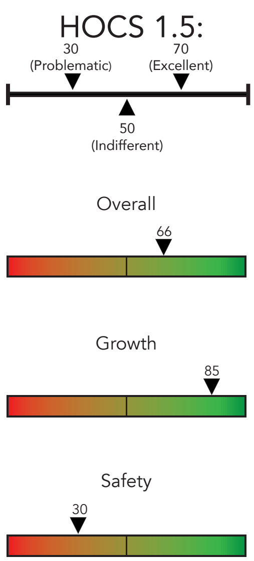
Zillow (Z): HOCS Safety Score Points to Conservative Approach for Now

Jeffrey Alton, CFA
jeffrey@hillsideadvisors.com

Z

2.75% 2020/12/15
Price (Bond) = 121.25
Stock = $81.50
YTM = -1.08%
Premium = 20.4%
HOCS-Overall = 66
HOCS-Growth = 85
HOCS-Safety = 30

As of July 31, 2015



The Trulia Inc. (read Zillow) 2.75% 2020-12-15 convertible bond landed on the HOCS 20 ex-China list last week. We say landed because metaphorically speaking it has come down from the heavens above to join the list. The stock price has been chopped in half, from $160/share almost one year ago to the low 80s today. In other words, the stock and the convertible bonds are finally priced reasonably enough to make the HOCS list.

But "getting cheap enough" to appear on the HOCS 20 can make for a bumpy ride. Momentum is against you, at least for now, and that can be doubly tough when the company is an internet darling with no earnings. Just take a look at Yelp. Zillow's HOCS score of 66 overall/ 85 growth/ 30 safety against a convertible bond price of 121.25 lays out the situation well: swift, but unprofitable growth over the last few years. With earnings due tomorrow, HOCS is suggesting that only the most aggressive investors should consider putting in an order this afternoon.

Company Description

Zillow Group is the umbrella company over a portfolio of real estate brands on the web covering everything from its flagship Zillow site for new home sales to other web sites for rentals, mortgages and home furnishings. Zillow completed its largest acquisition earlier this year, buying competitor Trulia for $3.5 billion in stock that's worth a lot less these days.

Zillow divides its revenues into two main categories. The first is marketplace revenue which is derived from real estate professionals, including advertising for lead generation and a suite of tools for brokers such as Zillow site performance analytics and customer relationship management tools. Real estate agents purchasing Zillow's premier platinum product are highlighted as featured agents for listings in a given zip code. The second revenue category is advertising on the site. Advertising clients may be real estate professionals, but also include home builders, mortgage lenders, telecommunications companies, etc. Prior to the Trulia acquisition, Zillow revenue trends are:

($ millions)	2014	2013	2012
Market Place:			
Real Estate	239	133	76
Mortgages	28	22	11
Total Market Place:	267	155	87
Display Revenue:	59	43	30
Total Revenue:	326	198	117

Source: Company filings

These trends continue: Zillow experienced strong growth in the first quarter of 2015. Total revenue was $127.3 million, including Trulia's contribution in the second half of the quarter when the acquisition was finally completed. Marketplace revenue in the first quarter was a strong $109 million. Display revenue was $18.3 million.

What is to Love…..

What is behind Zillow's growth? The company has continued to expand its reach to real estate agent subscribers, and, once those agents become customers, they have steadily increased their spending on Zillow over time. While the law of larger numbers is beginning to kick in, Zillow still put up a strong 29% growth rate in agents using the service and 27% growth rate in average account billings in 2014.

	Agents	YOY Growth Rate	Avg Monthly Rev/Advertiser	YOY Growth Rate
2014	62,305	29%	$338	27%
2013	48,314	64%	$267	1%
2012	29,473	87%	$266	5%

Source: Company Filings

After including Trulia, agent clients totaled 103,000 at the end of the first quarter and average monthly revenue per advertiser grew to $354 by the end of the first quarter 2015. Results were particularly strong for advertisers using Zillow more than one year, increasing spending by 50%.

Zillow has also been successful in increasing direct feeds from Multiple Listing Services (MLS). Zillow receives direct listings feeds every few minutes from 235 MLSs, including 105 new MLSs that joined in a six week period after the end of the first quarter. The direct feeds improve Zillow's listings quality which contribute to audience growth and provide more ad impressions.

What's Not to Love….

With a blistering growth rate and a recovering housing market as a tailwind, what's not to love about Zillow? The first is swelling expenses dwarfing revenue growth and resulting in accelerating net losses. In addition to a net loss of $58 million on revenues of $127 million in the first quarter of 2015. Zillow had losses of $43.6 million in 2014 and $12.5 million in 2013. EBITDA has also been a negative $55 million over the last twelve months, though adjusted for share-based compensation and restructuring costs gets the company to a positive adjusted EBITDA.

Channeling its inner Amazon, management is steadfast in investing for the future, despite short-term red-ink. Don't expect that mindset to change. Zillow Co-founders Rich Barton and Lloyd Frink own Class B shares with super voting rights of 10 votes per share, giving them majority control of the company. That majority was further entrenched last month when the company announced it would issue Class C shares to all Class A and Class B shareholders on a one-to-one basis. Class C shares have no voting rights, are the shares quoted under the "Z" stock symbol and will be the class issued in the future to fund any company expansion.

Another management question arose when CFO Chad Cohen announced his resignation early in July. In a sanitized press release, Mr. Cohen was thanked for his service as the company began searching for a new CFO. Not even a line about wanting to spend more time with the family. Some have cited the protracted and underwhelming way the Trulia acquisition was handled as a reason for the departure. While not devastating, Mr. Cohen's resignation does leave one with an uneasy feeling about management in the short-term. Some may not find it encouraging or even credible that CEO Spencer Rascoff recently said in the press release detailing the stock dividend, "Our Board, management and the shareholders who have chosen to invest in Zillow, view the company in terms of decades, not quarters or years."

Investors should also be aware of Rupert Murdoch's News Corp "moving" into the online real estate space. In December 2014, News Corp bought competitor Move.com which operates a number of real estate sites including realtor.com - the official site of the National Association of Realtors. Zillow has 140 million monthly users versus Move.com's 30 million per month, but News Corp's financial assets and distribution should not be discounted.

Valuation is another consideration for investors. Though the stock price has basically been cut in half over the last 12 months, it still trades at a steep 7 times 2015 projected sales of $666 million. Consensus estimates are for a loss this year, but a profit of $1.50/share in 2016. That puts the stock at a 2016 p/e of about 55 times. Priced to perfection, but not completely off the charts when it comes to fast growing internet companies. Any miss in estimates, however, means further swift punishment for investors and therein lies the low HOCS safety score.

Conclusions

The easiest thing to say about Zillow securities is that they should continue to be volatile. Zillow sits in an industry with the wind at its back (or at least a breeze), but faces continued steep expectations. The 2016 $1.50/share consensus earnings estimate seems particularly ripe for disappointment in our view after years of heavy losses. That volatility bodes well for convertible arbs looking to short the stock, especially given the absence of a dividend, if they can get their hands on any. Borrowing can be difficult and is reportedly getting quite expensive (we are hearing 9-10%) in front of the recapitalization. Cynics might wonder if that wasn't part of the company's strategy when the shares appeared to be in free-fall.

Longer-term investors should be more attentive to the HOCS safety score and perhaps wait until after earnings before making any bets. (Some may object to the word "bet" as it relates to investing, but what else can you call buying shares or their equivalents the day before an earnings report?)

While significant debate continues at Hillside over the quality of Zillow management, real estate bulls probably want to own Zillow to round out their portfolio. Zillow recently acquired DotLoop, an electronic signatures company for brokers, so growth in tangential areas to listings does exist. The convertible notes, while trading at a 20% premium to the stock, offer a more conservative way to invest, guarding against a sharp decline in the equity should Zillow fail to deliver. The bond includes a soft call (triggered with parity at 130) after December 2018 which could potentially cap gains if the equity can start working its way back, although more than three years can be an eternity for names like this even though Mr. Rascoff tells us the world sees the company in terms of decades. On the other hand, the company's strong liquidity position should support the convert through volatile times.

HILLSIDE
ADVISORS
LLC

August 3, 2015

Credit Waterfall

Zillow (Z) (Dollars in Millions)	3/31/2015	Total Debt (Cum. Bal.)	Adj. EBITDA Multiple	Net Debt (Cum. Bal.)	Adj. EBITDA Multiple
Current Share Price	$81.50				
Shares Out. (Millions)	58.7				
<u>Latest Twelve Months:</u>					
EBITDA (Adj.)	58				
Free Cash Flow	(2)				
Cash & Cash Equivalents	308				
<u>Senior Unsecured Debt</u>					
2.75% Cvt. Senior Notes (2020)	230	230	4.0x	-78	-1.4x
Total Debt	230	230	4.0x	-78	-1.4x
Equity Market Cap.	4,784	---	---	---	---
Enterprise Value	4,706	---	---	---	81.8x

Source: Bloomberg/Company Filings

Financial Summary

Z (Dollars in Millions)	Fiscal Years Ended 31-Dec-10	31-Dec-11	31-Dec-12	31-Dec-13	31-Dec-14	LTM 31-Mar-14	31-Mar-15	Quarter Ended 31-Mar-14	31-Mar-15
Revenues	30	66	117	198	326	225	387	66	127
Y / Y Change	----	116.8%	76.9%	69.1%	65.0%	----	72.1%	----	92.1%
Gross Profit	25	55	103	179	296	204	351	60	114
Operating Profit	(7)	1	6	(17)	(45)	(20)	(96)	(6)	(58)
EBITDA	(2)	8	19	6	(9)	7	(55)	2	(44)
EBITDA (Adj.)	0	12	26	30	50	34	58	9	17
Interest Expense	--	--	--	0	0	0	1	0	1
Income Tax Expense	0	0	0	(4)	0	(4)	0	0	0
Capital Expenditures	5	8	16	22	33	24	35	8	10
% Revenues	16.1%	11.6%	13.7%	11.2%	10.0%	10.7%	9.1%	11.9%	8.1%
Free Cash Flow	(3)	7	20	9	13	19	(2)	6	(9)
Total Debt	0	0	0	0	0	0	230	0	230
% Total Debt							-1.0%		-3.9%
Gross Margin	83.7%	84.0%	88.0%	90.5%	91.0%	90.7%	90.6%	90.7%	89.8%
Operating Margin	-22.4%	1.5%	5.0%	-8.6%	-13.7%	-8.7%	-24.8%	-9.8%	-45.5%
EBITDA (Adj.) Margin	0.5%	18.0%	22.6%	15.2%	15.2%	15.0%	14.9%	13.2%	13.1%
EBITDA (Adj.) / Interest	NM	NM	NM	NM	NM	NM	78.8x		22.8x
EBITDA (Adj.) - Capex / Interest	NM	NM	NM	NM	NM	NM	30.8x		8.7x

Source: Bloomberg/Company Filings

HILLSIDE
ADVISORS
LLC

August 3, 2015

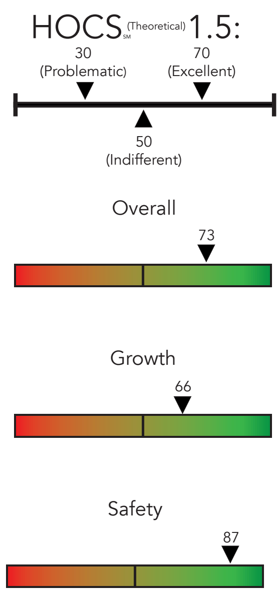
The On-Deck Circle:
TripAdvisor (TRIP) - Closing the Loops

Kathy Schick
kathy@hillsideadvisors.com

Theoretical Bond Pricing
TRIP

0.125% 2020/08/03
Price (Bond) = 100.00
Stock = $79.38
Premium = 45.0%
HOCS-Overall = 73
HOCS-Growth = 66
HOCS-Safety = 87

Stock Price as of July 31, 2015
*Estimated HOCS Scores



TripAdvisor reported results on June 23 that missed the adjusted EPS estimate by a cent and revenue by $8 million. For a high-flying growth company, this news led to a steep sell-off in the stock. The miss was attributed to the strong US dollar, which led to both currency translation losses and less international travel by those outside of the US. In spite of the miss, TRIP remains clearly in growth-mode. Total revenues increased 25% (35% on a constant currency basis). Average monthly unique visitors to the site grew to 375 million, a 30% increase compared to the prior year quarter. The flagship website now has 250 million traveler reviews and opinions.

The stock is volatile and despite the recent drop, is still up 20% from the 52-week low in mid-January. TRIP is an excellent credit, remains in growth mode, and has a volatile stock - a great combination for a convertible issuer. While the company has good liquidity, management could issue a convertible bond on a fairly high conversion premium and a small coupon with the proceeds used to pay down the revolver. TRIP's acquisition activity has slowed this year, but we expect activity to increase and the revolver would be fully available to use for attractive opportunities later this year and in the future.

TRIP is the world's largest travel website. In addition to the flagship site, TripAdvisor.com, the company manages 24 additional travel media brands. Revenue comes from three sources: click-based advertising, display-based advertising, and subscription/transaction/other revenue. Click-based advertising accounted for 66% of revenue in the first quarter and was up 13% from the prior year period. Click-based advertising partners are predominantly online travel agencies and direct suppliers in the hotel, airline, and cruise product categories.

Display-based advertising accounted for 10% of first quarter revenue and grew by 8% year-over-year. This advertising also comes from primarily the same sources as click-based but also includes other destination marketing organizations, casinos, resorts, and attractions. Subscription/transaction/ other revenue accounted for 24% of first quarter revenue and grew by 94% year-over-year. This business allows hotels, and other lodging properties to list their website URL, email address, and phone number as well as special offers.

TRIP has been focused on growing the business through acquisitions and launching new products. In 2014 the company acquired seven businesses for total cash of $331 million. The largest of those companies was Viator, the leader in global attraction bookings, which was acquired for $132 million in cash plus stock. Historically TRIP has been focused primarily on the hotel segment of the travel business, which accounted for 85% of first quarter revenues. The other segment accounts for the remaining 15% and is primarily comprised of restaurants, attractions, and vacation rentals. The Viator acquisition is helping to expand that other category.

For the first half of 2015 TRIP acquired three additional companies for $28 million. Two of these acquisitions were online restaurant booking websites and the third was a log app for travel activities. These acquisitions are boosting the other revenue category, which grew by 210% in the first quarter compared to 13% growth in the much larger hotel segment.

TRIP launched instant booking for hotels in 2014. In the second quarter of 2015, the company added Marriott and Hyatt to its list of participating hotels. This addition is allowing the company to close the loop on the hotel booking process. Travelers can now do their research, price compare, and book a hotel all on the TripAdvisor website. The company continues to talk to other hotel operators to increase the number of instant booking offerings.

Liquidity is quite good with $746 million of cash at June 30, free cash flow of $326 million for the first half of 2015, and $708 million available on the $1 billion revolver. On June 25, 2015 TRIP entered into a new five-year credit facility with a total revolving line of $1 billion. The $290 million term loan was repaid with the new facility. At June 30 there was $290 million drawn on the revolver at a rate of L+125. There was also $2 million used for letters of credit. The only additional debt was $1 million drawn on a $50 million Chinese credit facility.

The company should keep the revolver in place to fund future acquisitions, but we feel management should take advantage of a still high (though not as high) stock price. Yelp, whose stock is trading for less than a third of where it was this time last year, is a good case in point of raising capital when you can and not when you need it, as Bill Feingold pointed out in his Forbes piece last week after the company's abysmal earnings report. We are proposing TRIP issue a $300 million convertible bond to repay the revolver in full. This can be done on very attractive terms with a stock conversion price above the 52-week high.

Table 1: Projected Cash Interest Savings

	Issue Amount	Annual Estimated Coupon	Annual Estimated Cost
5 Year Bullet Straight Debt	$300 million	3.750%	$11.3 million
5 Year Convertible	$300 million	0.125%	$0.4 million
Estimated Savings		3.625%	$10.9 million

Assuming a $300 million convertible senior notes offering, key financial statistics for TRIP would look like this:

Pro Forma Cash:	$759 million
Pro Forma Debt:	$301 million
Last 12 month EBITDA:	$472 million
Last 12 month FCF:	$327 million
Leverage	0.6x
Net Leverage	NA
Mkt Cap	$11,510 million

*The proceeds from the new convertible deal will be used repay the revolver in full with the small balance put in cash for general corporate purposes.

Using a credit spread of 150 basis points and a volatility of 38%, we estimate that the convertible bond would look like this:

Issue Price	100.0
Issue Size	$300 million
Maturity	5 years
Coupon	0.125%
Premium	45%
Call	non-callable
YTM	0.125%

Sources: Bloomberg, Company Filings, Kynex

This hypothetical convertible bond receives a HOCS slash line of 73 Overall / 66 Growth / 87 Safety - a very good score for a new issue with a particularly strong safety score due to the good credit fundamentals.

For more information regarding TRIP and a potential convertible issue, please contact John Anderson at 646-665-4025.

HILLSIDE
ADVISORS
LLC

Disclaimer

Hillside Advisors LLC is a financial publisher, publishing information about markets, industries, sectors and investments in which it believes subscribers may be interested. The information in this letter is not intended to be personalized recommendations to buy, hold or sell investments. Hillside is not permitted to offer personalized trading or investment advice to subscribers. The information, statements, views and opinions included in this publication are based on sources (both internal and external sources) considered to be reliable, but no representation or warranty, express or implied, is made as to their accuracy, completeness or correctness. Such information, statements, views and opinions are expressed as of the date of publication, are subject to change without further notice and do not constitute a solicitation for the purchase or sale of any investment referenced in the publication.

Readers should do their own research before trading in any investments referenced herein. Investing in convertible bonds and related securities, such as stocks, bonds and options, is speculative and may carry a high degree of risk. Readers may sustain significant losses in these securities.

Advisors to Hillside serve as investment advisers to clients, including limited partnerships and other pooled investment vehicles. The affiliates may give advice and take action with respect to their clients that differs from the information, statements, views and opinions included in this publication. Nothing herein or in the subscription agreement shall limit or restrict the right of affiliates of Hillside to perform investment management or advisory services for any other persons or entities. Furthermore, nothing herein or in any subsequent agreement between Hillside and subscribers or other readers shall limit or restrict advisors to or affiliates of Hillside from buying, selling or trading securities or other investments for their own accounts or for the accounts of their clients. Advisors to or affiliates of Hillside may at any time have, acquire, increase, decrease or dispose of the securities or other investments referenced in this publication. Hillside shall have no obligation to recommend securities or investments in this publication as result of its affiliates' investment activities for their own accounts or for the accounts of their clients. If you have received this communication in error, please notify us immediately by electronic mail or telephone. This disclaimer applies to all versions of Hybrid Vigor, Hillside Intra Day Updates, and The Week That Was in Converts.