HILLSIDE ADVISORS LLC

November 16, 2015

Hybrid Vigor℠

The Hillside Convertible Advisory Letter
Volume 2 Issue 44

Continuer

We normally use this space for a light-hearted introduction to the week's commentary. Today we'll refrain in tribute to those killed or wounded in Paris and their friends and families.

We will take this opportunity, though, to make an assertion. Those of us who have made our careers in the financial world are frequently accused of making nothing tangible and doing little, if anything, to benefit the real economy. There are, of course, huge flaws in this argument, as anyone who tries for even a minute to imagine an economy without a financial sector must realize. Indeed, I think one constructive definition of "finance" might be "the use of monetary instruments and securities to bridge the present with the future."

It's particularly important, when faced with an act of unimaginable violence designed to undermine the vibrant daily life of a modern economy, to send a message of belief in the future. One of the best ways to do this is to keep the financial markets active. Their functioning bespeaks a confidence that things will continue despite the terrorists' efforts.

I will never forget my return to downtown Manhattan on September 17, 2001. The air was rotten and the faces were stark and cold. But we were there, reopening the markets and keeping the faith. I was never, before or since, so proud to be doing my part, so proud of my chosen profession. We at Hillside salute everyone doing their part to move forward, those pricing all manner of risk, and those keeping us safe. There are no easy answers to the problem of terror, but we are reminded of Winston Churchill's words. "When you're going through hell, keep going."

Next week we will not be publishing ***Hybrid Vigor*** because of Thanksgiving. ***Hybrid Vigor*** will return on November 30. We wish all our readers a good holiday. Indeed, recent events show just how much we have to be thankful for.

Bill
bill@hillsideadvisors.com

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

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 November 30, 2015.

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November 16, 2015

On the Lam

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.

One might think that unch'ed would be a rare occurrence with the Ugly 20, but in fact it happens rather frequently. Look at all the flat spots on the graph below for confirmation. This week was another to add to the list – average HARP standing still at 9.56. And yet, the prices of securities themselves were not inactive. The average of the underlying stocks was down 3.7%, while the average bond was down 3¼ points. How do we square this circle? Only two of the 20 bonds posted price gains for the week, and of the 18 that posted non-trivial losses, almost all were delta-neutral and parity-above-par situations. In other words, delta-neutral moves for in-the-money bonds typically have little impact on HARP.

Within the HARP calmness of the Ugly 20, there were a few big movers, though in different directions cancelling each other out in the aggregate. Before we get on to the movers, it's notable to point out that we've had a return to the top by Lam Research 1.25% of 2018, achieved with a 0.07 HARP decline to 12.84 – the old 'just have to run faster than the slowest competitor to escape the bear' argument. In this case, LRCX ran just a bit faster than RPM 2.25% of 2020, to squeeze out the competition.

The biggest HARP loser, and to be congratulated no doubt, was Priceline 0.35% of 2020 with a 1.20 HARP decline to 11.54. It made no change to PLCN's ranking, but it does take a bit of risk off the table. Think of it like surgery: if you owned these bonds, it certainly did not feel pleasant as the risk reduction was accomplished by a price decline of 10.5% in the stock and nine points in the bond. For what was a 68 delta bond, the out-sized bond price decline pared back the risk. Still, the bond now sits with a 121 handle and parity at 98¾, meaning that the bond is dead center of the most dangerous place on the price curve. Hence the 11.54 HARP and fourth place.

Playing on the same side of the Ugly 20 tug-a-war this week was Citrix Systems 0.5% of 2019. Moving from 8th to 17th with a 1.14 HARP decline to settle at 7.83, Citrix took a lot of risk off the table. The 5.01% decline in the stock was the tailwind which pushed the bond down 3 points to 111. With parity far below par at 86½, the entire bond price decline went straight to HARP reduction. But why not a 1-to-1 relationship between the bond price decline and HARP reduction? Because of volatility. With almost 3½ years of life left till the end of call protection and a nearly 40 volatility in the stock, HARP normalizes the bond price move to account for this volatility advantage. In other words, the Citrix HARP score of last week was already lower than it would have been had the volatility been closer to the norm for convertibles.

On the plus side of the ledger this week of HARP contributors was the new entrant Molina Healthcare 1.625% of 2044, up from 36th to 20th on a 1.15 HARP gain to settle at 7.51. A cursory glance at the price moves – a 6.62% loss on the stock and a 5¼ point loss on the bond – for what a 72 delta bond, doesn't seem to warrant such a large HARP move. However, the HARP gain can be traced to two items. First, the bond picked up about a ½ point of extra premium. Second, the bond moved dead center into the multi-dimensional risk zone, as evidenced by the gain in gamma from 0.39 to 0.44. This is all attributable not just to the bond price change, but most importantly to where on the price curve the change occurred. A price change from 128¼ to 123 puts the bond directly into the zone where par starts to exert upward pressure on the bond, since parity is now at 106¼, which means that as the bond price falls, premium expands at an ever increasing rate. We have often spoken positively about Molina in this publication, though we were not impressed with the most recent earnings and conference call. That said, the nearly 25% pullback from recent highs could suggest an attractive entry point, and the 1.625%'s HARP score should not be considered a major impediment.

Adding to the plus column was Illumina B's 0.5% of 2021. With a 6.29% gain in the stock, thanks to the underlying shares' upcoming inclusion in the S&P 500, one would think Illumina B-bonds would be on a tear, but in fact the high-premium, above-par issue gained only 1 ½ points. Ok, but then why the HARP gain for a bond which clearly undershot its delta-neutral target? Parity, my dear Watson, parity. Risk on this bond is all about the difference between price and par, since parity is in the 70's. Even the 1½ point gain went straight to the HARP bottom-line, all the way from 17th to 11th on a 0.89 HARP gain to settle at 8.79. And just like Citrix, the reason for the lack of 1-to-1 correlation of HARP to bond price move is that Illumina stock sports a mid-40's volatility, softening the blow. We remind readers that HARP is intended to be a multipurpose risk measure, bridging the gap between the "rich/cheap" of arbitrageurs and the "price point/absolute risk" of outright investors. While Illumina's bonds have been hideously overvalued theoretically since the company received an unsolicited investment-grade rating (and have put those daring to short them at frequent buy-in and funding risks), the HARP scores have been useful warning indicators for outright investors. Similarly, Illumina's HOCS scores, while far too low to recommend purchase, have sent warning signals to those considering shorting the bonds, especially in light of the technical issues.

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November 16, 2015

Hillside Ugly 20 List (Prices as of November 13, 2015)

	Convertible	Price	Stock	Premium (%)	Premium (pts)	HARP
1	Lam Research Tranche B 1.25% 2018-05-15	138.75	75.57	13.70	16.72	12.84
2	RPM International 2.25% 2020-12-15	115.00	45.21	34.50	29.50	12.75
3	Red Hat 0.25% 2019-10-01	126.25	77.83	19.20	20.34	12.48
4	Priceline.com 0.35% 2020-06-15	121.00	1297.75	22.70	22.39	11.54
5	Air Lease 3.875% 2018-12-01	134.25	32.84	22.80	24.93	11.23
6	Emergent BioSolutions 2.875% 2021-01-15	132.25	36.55	17.20	19.41	11.21
7	BioMarin Pharma 1.5% 2020-10-15	137.25	107.44	20.40	23.25	9.95
8	BioMarin Pharma 0.75% 2018-10-15	133.00	107.44	16.50	18.84	9.87
9	Euronet Worldwide 1.5% 2044-10-01	124.25	77.07	16.50	17.60	9.08
10	Trinity Industries 3.875% 2036-06-01	125.00	25.53	22.30	22.79	8.81
11	Illumina Tranche B 0.5% 2021-06-15	111.50	165.65	71.30	46.41	8.79
12	ServiceNow 0% 2018-11-01	125.25	82.88	11.60	13.02	8.68
13	Workday Tranche 2 1.5% 2020-07-15	119.25	78.91	23.60	22.77	8.62
14	Salesforce.com 0.25% 2018-04-01	126.75	75.60	11.30	12.87	8.43
15	Workday Tranche 1 0.75% 2018-07-15	115.00	78.91	21.40	20.27	8.20
16	Alon USA Energy 3% 2018-09-15	126.75	16.36	10.90	12.46	7.86
17	Citrix Systems 0.5% 2019-04-15	111.00	77.91	28.20	24.42	7.83
18	Palo Alto Networks 0% 2019-07-01	151.00	156.64	6.40	9.08	7.79
19	Standard Pacific 1.25% 2032-08-01	114.50	39.42	17.30	16.89	7.76
20	Molina Healthcare Ex 1.625% 2044-08-15	123.00	61.76	15.60	16.60	7.51

Sources: Bloomberg, Kynex

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November 16, 2015

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.

Unless you owned almost exclusively low-delta, high-rho convertibles last week, you probably didn't do too well. The HOCS family followed perhaps its best week since we created the measure with a stumble that was largely reflected in many other convertible indicators.

In the groups of top-ranked HOCS bonds, the traditional HOCS 20 once again outperformed the China-free version. The original version of the HOCS 20 lost 2.10% for the week that ended on what proved to be a tragic Friday the 13th with losses, unlike financial ones, that cannot be recovered. The China-free HOCS 20 took a bigger hit, giving up 2.55%.

The ever-volatile Horizon Pharmaceuticals 2.50% continued to require investors to look to its name and beyond the short-term movements. Horizon's stock, which had been mounting a strong earnings-based turnaround, got crushed after leading pharmacy-benefit-manager Express Scripts terminated its relationship with Linden Care, a pharmacy whose business consists primarily of dispensing Horizon drugs. The Horizon convertible lost 8.4% with shares down 14.3%. Also suffering a big decline was SunPower 0.875%, one of the many solar names declining in sympathy with SunEdison's problems. The SunPower bond also took an 8.4% nosedive, though it took a nearly 19% stock downturn to produce it. The other big loser was Gogo's 3.75% issue (7.1%) which wentwent back down the larger part of the previous week's earnings gains. Gogo shares fell 12.7% without any notable reason. Finally, long-time HOCS 20 stalwart Tesla Motors gave back all of the previous week's gains, lending further credence that traders had set up generally short into Tesla's last "earnings" report and left themselves vulnerable to covering higher on the mildest of good words from Elon Musk. Tesla's 1.25% and 0.25% issues fell 4.6% and 3.7%, respectively, with shares down 10.8%.

In a sad irony, the top-performing HOCS 20 name last week was the unfortunately named Isis Pharmaceuticals 1%. The convertible rose 6.7% with shares gaining 12.1%, thanks to a slight earnings beat and improved guidance. Isis' 1% gains cost it four overall HOCS points (down from 72.3 to 68.3), but the convertible remains in both lists. Its growth score was virtually unchanged, but its safety rating fell from 62.0 to 50.1. Remember that HOCS is, above all, a countercyclical measure designed to capture the essential risk/reward benefits of balanced convertibles.

Speaking more broadly, Hillside's flagship HOCS 100 index dropped 2.48% on the week, lowering year-to-date performance to 1.76%. This weekly loss was virtually identical to that of the rival CWB, which gave up 2.50% to fall back into the red (down 82 basis points) on the year.

Recent issue Aceto 2% joins the HOCS 20 this week.

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Hillside HOCS 20 List

	Description	Convert	Stock	HOCS Overall	HOCS Growth	HOCS Safety	Yield	Premium
1	HORIZON 2.500% 2022-03-15	90.25	17.99	82.4	84.9	77.4	4.28%	43.8%
2	QIHOO 0.500% 2020-08-15	93.75	62.30	79.5	73.4	91.8	4.27%	88.6%
3	VIPSHOP 1.500% 2019-03-15	101.00	13.60	78.3	72.0	90.9	0.74%	49.4%
4	ENVESTNET 1.750% 2019-12-15	90.00	31.56	76.8	75.9	78.5	4.46%	79.3%
5	QIHOO 1.750% 2021-08-15	92.25	62.30	75.3	77.2	71.5	4.00%	78.8%
6	ANI 3.000% 2019-12-01	97.25	42.77	75.2	79.1	67.3	3.74%	58.0%
7	RESTORATION 0.000% 2020-07-15	97.25	92.57	73.5	69.6	81.3	0.60%	24.1%
8	TELIGENT 3.500% 2019-12-15	92.75	7.61	73.4	81.2	57.6	5.51%	37.6%
9	CTRIP.COM 1.990% 2025-07-01	116.50	97.25	72.0	92.7	30.7	-1.45%	28.0%
10	ECHO 2.500% 2020-05-01	93.00	22.94	70.3	75.3	60.4	4.24%	58.7%
11	51JOB 3.250% 2019-04-15	101.50	32.08	70.3	62.9	85.0	2.16%	35.2%
12	HERBALIFE 2.000% 2019-08-15	87.75	53.89	70.2	70.8	69.1	5.68%	40.5%
13	E-HOUSE 2.750% 2018-12-15	95.50	5.91	69.9	60.4	89.0	7.18%	137.1%
14	HOMEAWAY 0.125% 2019-04-01	100.75	35.77	69.6	64.3	80.3	-0.10%	46.9%
15	CALAMP 1.625% 2020-05-15	96.00	18.58	69.6	73.2	62.4	2.57%	42.6%
16	INVENSENSE 1.750% 2018-11-01	95.50	11.41	69.3	62.8	82.2	3.36%	83.2%
17	ISIS 1.000% 2021-11-15	115.25	62.65	68.4	77.6	50.1	-1.43%	22.9%
18	RESTORATION 0.000% 2019-06-15	100.75	92.57	67.8	61.0	81.3	-0.21%	26.3%
19	TESLA 1.250% 2021-03-01	87.75	207.19	67.3	73.0	55.9	3.83%	52.4%
20	ACETO 2.000% 2020-11-01	99.00	24.87	67.2	66.7	68.4	2.21%	32.2%

Sources: Bloomberg, Kynex

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November 16, 2015

Hillside HOCS 20 List ex China

	Description	Convert	Stock	HOCS Overall	HOCS Growth	HOCS Safety	Yield	Premium
1	HORIZON 2.500% 2022-03-15	90.25	17.99	82.4	84.9	77.4	4.28%	43.8%
2	ENVESTNET 1.750% 2019-12-15	90.00	31.56	76.8	75.9	78.5	4.46%	79.3%
3	ANI 3.000% 2019-12-01	97.25	42.77	75.2	79.1	67.3	3.74%	58.0%
4	RESTORATION 0.000% 2020-07-15	97.25	92.57	73.5	69.6	81.3	0.60%	24.1%
5	TELIGENT 3.500% 2019-12-15	92.75	7.61	73.4	81.2	57.6	5.51%	37.6%
6	ECHO 2.500% 2020-05-01	93.00	22.94	70.3	75.3	60.4	4.24%	58.7%
7	HERBALIFE 2.000% 2019-08-15	87.75	53.89	70.2	70.8	69.1	5.68%	40.5%
8	HOMEAWAY 0.125% 2019-04-01	100.75	35.77	69.6	64.3	80.3	-0.10%	46.9%
9	CALAMP 1.625% 2020-05-15	96.00	18.58	69.6	73.2	62.4	2.57%	42.6%
10	INVENSENSE 1.750% 2018-11-01	95.50	11.41	69.3	62.8	82.2	3.36%	83.2%
11	ISIS 1.000% 2021-11-15	115.25	62.65	68.4	77.6	50.1	-1.43%	22.9%
12	RESTORATION 0.000% 2019-06-15	100.75	92.57	67.8	61.0	81.3	-0.21%	26.3%
13	TESLA 1.250% 2021-03-01	87.75	207.19	67.3	73.0	55.9	3.83%	52.4%
14	ACETO 2.000% 2020-11-01	99.00	24.87	67.2	66.7	68.4	2.21%	32.2%
15	RENEWABLE 2.750% 2019-06-15	81.00	7.66	66.4	72.5	54.2	9.10%	40.3%
16	INSULET 2.000% 2019-06-15	99.50	33.27	66.2	75.0	48.7	2.15%	39.1%
17	TESLA 0.250% 2019-03-01	91.00	207.19	66.1	69.4	59.5	3.16%	58.1%
18	GOGO 3.750% 2020-03-01	91.75	15.54	66.1	76.9	44.5	5.96%	40.8%
19	ARIAD 3.625% 2019-06-15	102.50	6.57	65.5	80.0	36.3	2.88%	45.1%
20	SUNPOWER 0.875% 2021-06-01	84.50	23.36	64.9	61.7	71.2	4.03%	76.4%

Sources: Bloomberg, Kynex

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November 16, 2015

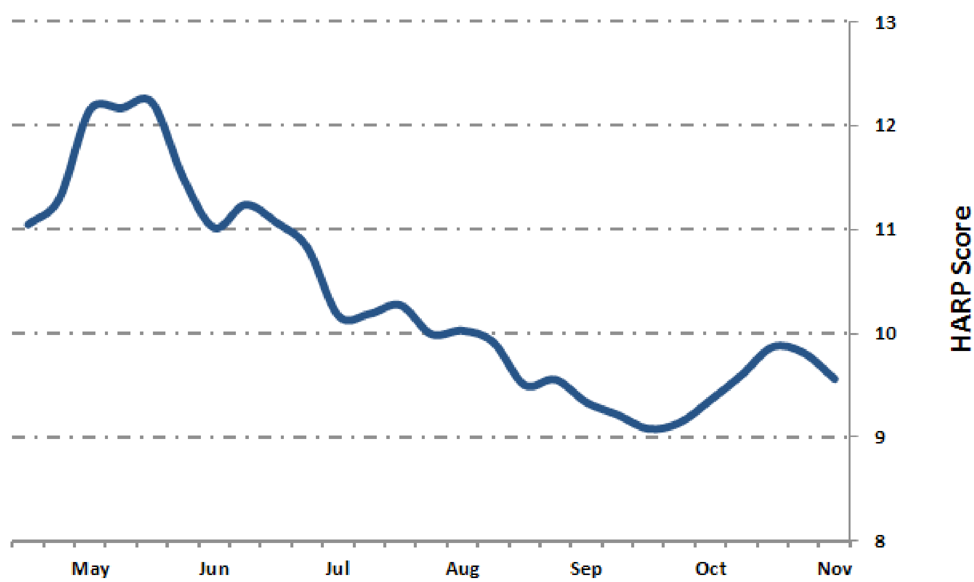
Euro Gang of 20

Roman Terekhin, CFA
roman@hillsideadvisors.com

The market has had a chance to digest the horrific events that took place in Paris last Friday and mostly shrugged them off, at least for now. It would have been logical to expect some volatility, but Mr. Market decided otherwise. As of this morning, the majority of the European equity indices are flat to slightly up.

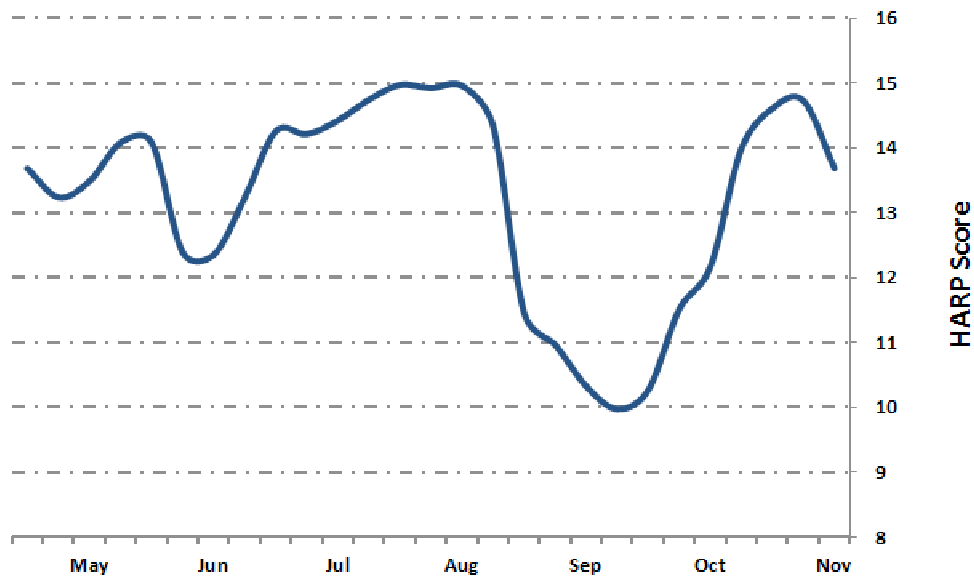
For the week ending Friday the 13th, the DAX index lost 2.54% and the CAC 40 dropped 3.54% as commodity prices declined amid global growth concerns. Given the equity market performance it is not surprising that the average stock underlying the Euro Gang of 20 dropped 3.1%. More interestingly, the average HARP score declined a quarter of a point, which is significant, indicating lower than expected premium expansion for a number of names. There were a few issues that experienced small declines in the HARP measure and a couple that dropped by over a point. As a result, the average HARP score as of the end of last week stood at 9.56, thus suggesting that the subset of the convertible universe we look at continued to cheapen.

Euro Gang of 20 Average HARP Score



Overall, however, the list looked painfully familiar as only one security dropped off the list (and what a drop that was – see below). In addition, there was very little reshuffling. In other words, it's déjà vu all over again. Two bonds saw declines in their HARP scores of over one point. Rag-Stiftung 0% exchangeable of 2021 seems to have cheapened as Evonik Industries stock declined 4.75%. "Cheapened" is of course a relative term as the current HARP score of 13.7 indicates that the bond is only somewhat less outrageously expensive than at the end of the week prior when this measure stood at 14.73. It has to be the relatively long hard call protection (3.3 years) and some distance remaining to the 130% trigger that make the bond attractive in the eyes of some investors. Oh yes, that and the solid credit quality. But still, paying 30 points in premium looks quite excessive given the level of volatility of the underlying (mid 20's at best) and dividend yield (3%).

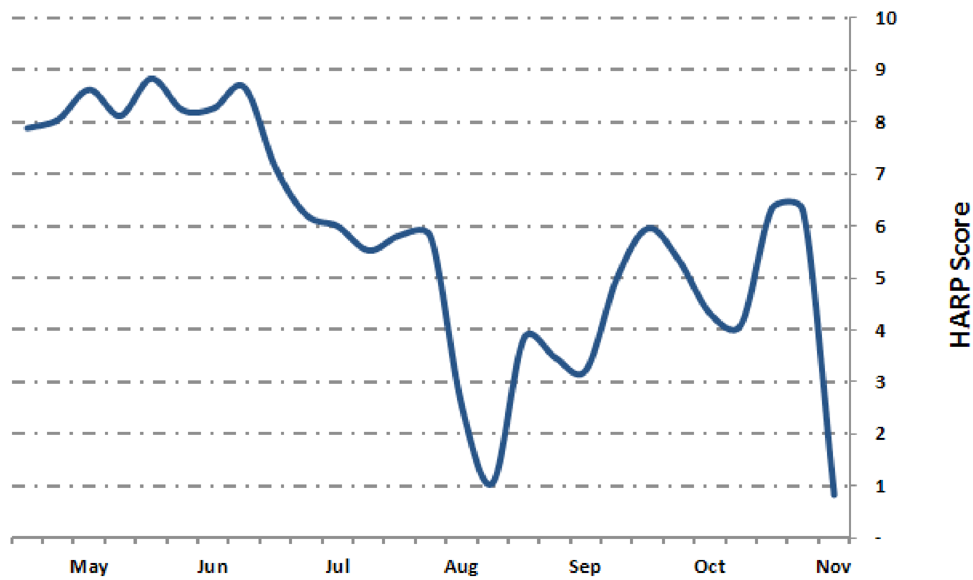
Rag-Stiftung 0% 2021, Historical HARP Score



The other security that cheapened on the HARP scale was Air France-KLM 2.03% of 2023. Its underlying was down 5.4% for the week and the bond expanded 0.2 points in terms of premium - not what you would expect of a bond at the current price point. As a result, its HARP score ended the week 1.5 points lower at 4.8.

But the really interesting action was in Astaldi SPA 4.5% of 2019. After Astaldi reported on Wednesday, its stock went on a rather brutal slide that resulted in a nearly 34% decline for the week. The bonds fell from 115.3 to 99.7 as the premium expanded by almost 19 points to 32.4. Now that the bond is below par, it is off our HARP radar as the score is a meager 0.8. Note that the bond had a similar HARP score back in mid-August when it was trading around 140. We would argue that it was easier for the bond to regain HARP points on the way down and that the road back to the Euro Gang of 20 will now be perilous and probably long. It does not mean, though, that the security cannot be expensive based on other measures (how's that credit looking?).

Astaldi SPA 4.5% 2019, Historical HARP Score



The largest stock decliners last week were Galp Energia and Nexans whose stocks lost 7.2% and 6.1% respectively. Their corresponding bonds - Parpublica 5.25% of 2017 and Nexans SA 2.5% of 2019- cheapened losing around 0.3 HARP points each. Nexans 2.5s rejoins the list after a two-week hiatus. Historically, this bond periodically hangs out at the bottom of the list before dropping out. We'll see if the pattern holds this time.

Euro HARP 20 (Prices as of November 13, 2015)

	Convertible	Price	Stock	Premium (%)	Premium (pts)	HARP
1	Suez Environnement 0% 2020	22.36	17.00	31.58	5.37	14.15
2	Rag-Stiftung 0% 2021	116.62	31.91	34.62	29.99	13.68
3	Adidas AG 0.25% 2019	126.48	88.02	17.84	19.15	13.56
4	Fresenius Medical Care A 1.125% 2020	127.64	79.58	18.10	19.56	13.03
5	Buzzi Unicem SPA 1.375% 2019	124.49	15.95	24.77	24.72	11.29
6	Cap Gemini Sogeti 0% 2019	89.95	81.20	10.78	8.75	11.07
7	Nexity SA 0.625% 2020	49.93	39.25	20.81	8.60	11.06
8	Rag-Stiftung 0% 2018	112.61	31.91	33.17	28.05	10.62
9	SAF-Holland Group 1% 2020	118.45	12.34	18.31	18.33	10.01
10	OCI NV 3.875% 2018	117.98	24.48	37.21	31.99	9.93
11	ACS Actividades Fin 2 1.625% 2019	114.66	6.39	13.90	14.00	9.63
12	NH Hotel Group SA 4% 2018	127.16	5.44	15.09	16.67	9.11
13	Fresenius Se & Co KGAA 0% 2019	142.50	67.25	5.23	7.08	8.81
14	ACS Actividades Finance 2.625% 2018	122.45	6.39	7.86	8.93	8.12
15	Prysmian SPA 1.25% 2018	111.18	19.15	29.56	25.37	7.98
16	Acciona S.A. 3% 2019	133.30	75.79	7.65	9.47	7.37
17	Societa Iniz Autostradal 2.625% 2017	110.72	10.16	14.42	13.96	6.54
18	Parpublica 5.25% 2017	107.13	9.25	72.30	44.95	5.67
19	Air France-KLM 2.03% 2023	10.90	6.79	60.47	4.11	4.79
20	Nexans SA 2.5% 2019	76.96	34.50	98.29	38.15	4.79

Sources: Bloomberg

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November 16, 2015

SunEdison (SUNE): SUNE Goes Down

Jeffrey Alton, CFA
jeffrey@hillsideadvisors.com

Most Hybrid Vigor readers are familiar with the SunEdison debacle as outlined in our August article, "SunEdison: Total Eclipse of the Sun." Things have not improved for the company since then with convertible bond prices collapsing further and the stock closing at $4.93 last Friday. The following HOCS chart of SunEdison's outstanding convertible bonds offers a window into what ails the company: Growth with a complete disregard for safety, otherwise read as a debt explosion.

	HOCS						Size
	Overall	Growth	Safety	Price	YTM/C	Premium	($ million)
SUNE 2.75% 2021/01/01	47	62	18	53.50	16.58%	58.7%	$300
SUNE 2.0% 2018/10/01	46	57	24	57.25	23.25%	69.8%	$300
SUNE 2.375% 2022/04/15	42	56	13	43.75	17.20%	124.0%	$460
SUNE 3.375% 2025/06/01	41	55	12	39.50	15.92%	209.7%	$450
SUNE 0.25% 2020/01/15	40	52	14	44.00	21.17%	139.8%	$600
SUNE 2.625% 2023/06/01	39	53	12	40.00	17.07%	213.6%	$450

All seemed to be going well for SunEdison until July when it announced its planned acquisition of residential solar installer Vivint for $1.6 billion. Vivint is the number two domestic solar installer behind SolarCity. At first, the market seemed excited about the acquisition (SunEdison's stock hit a multi-year high of $33.45), but doubts soon crept in, led by questions regarding SunEdison's decision to enter the residential solar market. SunEdison's focus had been building larger-scale solar projects for industrial and commercial clients and in fact had been quite successful in penetrating markets throughout the globe thus offering adequate diversification to investors.

The Vivint acquisition appeared to be a domestic residential play at a time when US solar investment incentives were scheduled to be reduced at the end of 2016, raising eyebrows at the change in end-market focus for SunEdison. Investors sensed that the residential market is less predictable than SunEdison's traditional market of larger-scale projects with commercial off takers at a specified rate under a long-term power purchase agreement (PPA). The acquisition marked the beginning of the swift slide in SunEdison's stock price.

As the stock came under pressure, questions about SunEdison's heavy debt load and frantic deal making began to surface. SunEdison's increasing reported EPS losses and negative cash flow in the name of growth magnified these concerns.

A Market Darling One Year Ago

How different things seemed one year ago when David Einhorn made the case for SunEdison at the 2014 edition of the Robin Hood Investor Conference, bringing the name to the forefront of the investment community at large. At the time, he commented favorably on the solar industry because the price of solar energy was falling relative to other fuels. Mr. Einhorn argued that solar stocks had been unfairly punished by the drop in oil prices. As favorable attributes, he cited SunEdison's 20 percent margins and rapid growth and mentioned SunEdison's 2016 guidance which implied $1 per share in earnings and EBIT of $550 million in the core development business.

Mr. Einhorn also saw value in SunEdison's Yieldco, TerraForm Power (TERP). SunEdison sells its completed projects to TERP after completion. Because completed projects with PPA's in place offer steady cash flows to investors, TERP funding lowers the cost of capital for SunEdison, boosting acquisition prices paid by TERP. Investors can analyze the completed projects with predictable PPAs and cash flow inside TERP away from SunEdison's more complicated development business. SunEdison also is slated to receive incentive payments as TERP's dividend grows.

Unbridled Acquisitions

However, subsequent to that presentation, SunEdison went on an acquisition spree in 2015 which at first seemed to leverage the model further, but finally overwhelmed the markets, causing investors to question the viability of the company.

In fact, the deals have made SunEdison a much larger and different company than it was just one short year ago. A quick summary of the transactions:

- In early, 2015, SunEdison closed on its $2.4 billion acquisition of First Wind, expanding the company beyond solar to wind energy. SunEdison is still likely on the hook for an additional $566 million in milestone payments related to the transaction, $499 million of which is due this year.

- As mentioned, SunEdison announced plans to acquire residential solar installer Vivint Solar for $1.6 billion. The transaction is now likely to close at the beginning of 2016.

- This summer, SunEdison took 16% ownership in Brazil's Renova for $250 million, and committed to an additional $4 billion in projects to be acquired from 2017 to 2020 related to the transaction.

- Also during the summer, SunEdison launched an IPO for a new Yieldco to house international projects. Called TerraForm Global, Inc. (GLBL), the Company has traded below its IPO price since it came public on July 31. SUNE originally planned to sell 56.6 million shares for $19 - $21 per share, but settled for 45 million shares at $15. That stock closed at $6.90 on Friday.

The disappointing Yieldco IPO was damaging in several respects. Raising less equity means a lower capacity to do projects overseas in the future, reducing growth expectations. It also marked the beginning of investors questioning the Yieldco model as a tool to reduce funding costs and boost project yields.

To compensate, SunEdison has set up a number of financial "warehouses" to hold projects until they are dropped into a Yieldco or sold to a third party. These include:

- The 5-year, $500 million equity and $1 billion debt First Reserve Warehouse led by Bank of America for solar and wind projects.

- The 7-year, $240 million equity and $280 million debt TerraForm Private Warehouse sponsored by John Hancock and Macquarie Bank for wind projects.

- The 5-year, $300 million in equity and $700 million debt West Street Infrastructure Partners facility led by Goldman Sachs for solar and wind projects.

- The $650 million equity JP Morgan Asset Management Strategic Equity Partnership for solar and wind facilities.

Given the disintermediation in the Yieldco funding market, the warehouses will be put to use. SunEdison is currently guiding to a 50% increase in deliveries to 3,300 to 3,700 MW in 2016. The problem for SunEdison, however, is the lower margins associated with the warehouses and third party project sales and the corresponding impact on cash flow.

Market Backlash

While each piece of the puzzle seems to make sense on its own, taken together, all the moving parts and debt have significantly increased company risk beyond the original model of building solar plants backed by creditworthy PPAs.

For example, SunEdison violated a debt to equity covenant in a margin loan used to finance the First Wind acquisition and backed by TERP common stock, forcing SunEdison to put up an extra $152 million in cash to cure the violation. Needless to say, that spooked investors further. Combine that with yet another earnings miss this past quarter (-$0.91 per share vs estimates of -$0.70 per share) and that was enough to drive SunEdison's common shares below $5 per share.

Next steps? Like almost any business, it comes down to cash flow. That makes the name of the game operating margin as SunEdison tries to achieve its recent guidance of becoming cash flow positive in 2016. The increase in cash flow must be realized despite SunEdison being forced to replace its 25% margins in transactions with its Yieldco with lower margin transactions to its warehouses and third party sales. Even so, the company is currently guiding to 15% margin in its systems business, up from 13% last year. The company is also targeting $0.35 per watt in gross margin and $0.17 per watt in operating expense. Achieving those milestones would result in positive cash flow in 2016.

SunEdison has been proactive in seeking third party sales. In its joint venture with Dominion Resources, the company agreed to sell its interest in utility-scale solar projects for $820 million. The sale helped boost SunEdison's third party sales margin, and having such a large partner lends credence to SunEdison's third party sales goals.

Conclusions

With the prices of SunEdison common stock and convertible debt falling so far, so fast, the natural temptation is to look, at a minimum, for a dead cat bounce. However, the drop in stock price has been one-way as confusion mounts in the investor community over the numerous moving parts within SunEdison and the continuing stream of bad news. That includes the aforesaid Vivant acquisition, which continues to hang over the company as a question mark regarding management's decision making ability. That fear was heightened when SolarCity announced it was slowing growth to focus on cash generation. While unwinding the deal would most likely give a boost to the stock, that course of action seems to be falling on deaf ears at SunEdison as CEO Ahmad Chatila reaffirmed SunEdison's commitment to the deal in the company's last quarterly conference call.

Also during the call, Mr. Chatila stated that SunEdison was now seeking to become a more "boring company," but the continued growth forecast speaks otherwise. As much a finance company as it is a renewable energy developer, SunEdison has lost investor faith. That alone limits its flexibility and increases risk. Clearly, the increasing likelihood that SunEdison will be unable to tap capital markets jeopardizes SunEdison's future.

With debt high and market credibility low, we would suggest paying heed to the low HOCS scores and sitting this one out until more visibility is available regarding SunEdison's operating margins and the ability of Yieldcos to return to the capital markets. This path may forego some upside in the short run should SunEdison work through the current difficult environment, but the growth in solar will play out over decades, offering investors plenty of opportunity over the long haul.

Financial Summary

SUNE	Fiscal Years Ended					LTM		Quarter Ended	
(Dollars in Millions)	31-Dec-10	31-Dec-11	31-Dec-12	31-Dec-13	31-Dec-14	30-Sep-14	30-Sep-15	30-Sep-14	30-Sep-15
Revenues	2,239	2,716	2,530	2,008	2,484	2,219	1,865	681	476
Y / Y Change	----	21.3%	-6.8%	-20.6%	23.7%	----	-16.0%	----	-30.1%
Gross Profit	337	295	336	145	222	118	329	68	111
Operating Profit	21	(1,301)	57	(314)	(537)	(545)	(800)	(190)	(250)
EBITDA (Adj.)	186	(1,073)	304	(45)	(179)	(208)	(373)	(83)	(125)
Interest Expense	29	77	135	189	410	334	654	111	214
Income Tax Expense	(53)	73	65	28	(36)	(40)	(268)	9	(35)
Capital Expenditures	632	453	486	598	1,741	1,446	1,860	463	816
% Revenues	28.2%	16.7%	19.2%	29.8%	70.1%	65.2%	99.7%	68.0%	171.4%
Free Cash Flow	(285)	(468)	(749)	(1,305)	(2,511)	(2,430)	(3,197)	(740)	(1,021)
Total Debt	683	1,927	2,368	3,576	7,199	6,345	11,672	6,345	11,672
% Total Debt	-41.7%	-24.3%	-31.6%	-36.5%	-34.9%	-38.3%	-27.4%	-11.7%	-8.7%
Gross Margin	15.1%	10.9%	13.3%	7.2%	8.9%	5.3%	17.6%	10.0%	23.3%
Operating Margin	0.9%	-47.9%	2.3%	-15.6%	-21.6%	-24.6%	-42.9%	-27.9%	-52.5%
EBITDA (Adj.) Margin	8.3%	-39.5%	12.0%	-2.3%	-7.2%	-9.4%	-20.0%	-12.1%	-26.3%
EBITDA (Adj.) / Interest	6.4x	-13.9x	2.2x	-0.2x	-0.4x	-0.6x	-0.6x	-0.7x	-0.6x
EBITDA (Adj.) - Capex / Interest	-15.4x	-19.8x	-1.3x	-3.4x	-4.7x	-5.0x	-3.4x	-4.9x	-4.4x

Source: Bloomberg, Company Filings and Hillside Advisors

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Credit Waterfall

SunEdison Inc (SUNE) (Dollars in Millions)	30-Sep-15	Total Debt (Cum. Bal.)	EBITDA Multiple	Net Debt (Cum. Bal.)	EBITDA Multiple
Current Share Price	$4.93				
Shares Out. (Millions)	316.7				
Latest Twelve Months:					
EBITDA	(125)				
Free Cash Flow	(1,021)				
Cash & Cash Equivalents	2,393				
Revolver & Credit Facilities					
Letter of Credit Facility	716				
Other Credit Facilities (Recourse to SUNE)	219				
Other Credit Facilities (Non-Recourse to SUNE)	282				
SMP Ltd Credit Facility	334				
	1,551	1,551	NM	-842	NM
Term Loans					
Term Loan due 2016	169				
First Reserve Warehouse Term Loan	465				
TERP Private Warehouse Term Loan	280				
Margin Loan due 2017	169				
Pre-,Construction, and Term Debt (Recourse to SUNE)	54				
Pre-,Construction, and Term Debt (Non-Recourse to SUNE)	2,012				
	3,149	4,700	NM	2,307	NM
Senior Notes					
Senior Notes due 2020 (1)	800				
Senior Notes due 2023 (1)(2)	946				
Senior Notes due 2025 (1)	300				
	2,046	6,746	NM	4,353	NM
Senior Subordinated Debt					
2.00% Senior Subordinated Cvt. Notes due 2018 (3)	300				
0.25% Senior Subordinated Cvt. Notes due 2020 (3)	600				
3.75% Guaranteed Exchangeable Senior Notes due 2020 (3)	336				
2.75% Senior Subordinated Cvt. Notes due 2021(3)	300				
2.38% Senior Subordinated Cvt. Notes due 2022 (3)	460				
2.63% Senior Subordinated Cvt. Notes due 2023 (3)	450				
3.38% Senior Subordinated Cvt. Notes due 2025 (3)	450				
	2,896	9,642	NM	7,249	NM
Other Obligations					
Financing Leaseback	1,468				
Permanent Financing (2)	831				
Construction Financing	332				
Financing Lease Obligations	137				
Project Debt	440				
	3,208	12,850	NM	10,457	NM
Total Debt	12,850	12,850	NM	10,457	NM
Equity Market Cap.	1,561	---	---	---	---
Enterprise Value	12,019	---	---	---	NM

(1)Non-recourse to SunEdison.

(2) Net of unamortized discount / premium

(3) Reflects principal amount of convertible securities outstanding, unadjusted for unamortized debt discount.
Source: Bloomberg, Company Filings, Earnings Presentation and Hillside Advisors

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November 16, 2015

Clovis Oncology (CLVS) – Is All Lost?

Kathy Schick
kathy@hillsideadvisors.com

Clovis Oncology (CLVS) took the market by surprise this morning when the company put out a press release regarding its lead drug candidate Rociletinib, a treatment for non-small cell lung cancer containing the genetic marker T790M which makes tumors resistant to existing treatments. In a nutshell the FDA is asking for additional clinical data in its efficacy analysis for both the 500 mg and 625 mg dose patient groups. CLVS had filed the NDA (new drug application) for Rociletinib in July and had been given a PDUFA (Prescription Drug User Fee Act) date of 3/30/16. Clovis is a development stage biotechnology company with no drugs on the market. The news that its lead drug candidate, at the very least, will be delayed in gaining FDA approval, caused the stock to fall about 70% as we were writing.

As management explained the problem, the company was providing confirmed and unconfirmed interim data as they were becoming available during the clinical trials. As the efficacy data matured, the number of unconfirmed responses that converted to confirmed was lower than expected. For the 500 mg dose the confirmed response rate is now 28% and for the 625 mg it is 34%, roughly 20 points lower than the interim data, information the company has had since the end of October but just today released publicly. This alone is concerning, but adding to the problem is competition from AstraZeneca. Its competing drug, Tagrisso, received FDA approval on Friday. Tagrisso has a much higher response rate of 59%, which calls into question Rociletinib's commercial potential.

Clovis management will provide the updated data requested by the FDA by the end of day today, but that sheds little light on when or how this will be resolved. Management still feels confident Rociletinib will be approved. Patients using Rociletinib or Tagrisso are hard to treat and were typically diagnosed on average five years before trying these treatments following more traditional options. Most patients who did not receive positive results from Rociletinib during the clinical trials remained on treatment.

Clovis has two other drugs in the pipeline. Rucaparib, a treatment for ovarian cancer, is in Phase 2 and 3 trials. Lucitanib, a treatment for breast and lung cancers, is in Phase 2 trials. Clovis issued stock in July when the price was at $78 per share, once again showing that it's better to raise money when you can than when you have to. Biotechs are the only companies that seem to understand this, for good reason, and this helps understand why biotechs go bankrupt less often than you might expect. The net proceeds of nearly $300 million gives the company a cash cushion to weather this unexpected change of events. As of September 30 cash totaled $606 million. The $287.5 million of 2.5% of 2021 convertible bonds are the only debt. Cash burn for the last twelve months was $213 million, but that number has been growing quarterly. The annual run rate using the third quarter cash burn is $287 million. So the company has about 2.4 years of cash on hand, not great but not disastrous.

The 2.5% convertible notes due 2021 received a HOCS slash line of 48 Overall / 69 Growth / 6 Safety as of last Friday, before the news, with the converts at 179 versus $99.43 on the stock. This morning with the converts at 82 versus $30, the HOCS slash line is 53 / 61 / 37, an improved overall score and surely a better outright entry point, but nothing to get excited about on its own. We would take a wait and see attitude before considering jumping in.

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November 16, 2015

X 2.75% Put: A Steal in Steel

Bill Feingold
bill@hillsideadvisors.com

An alert subscriber pointed out that after Friday's close U.S. Steel filed an 8-K describing a purchase from two holders of $197.655 million face amount of the 2.75% convertibles due 2019. Steel bought the bonds at par plus accrued, and while the company characterized the purchase in the filing as a response to unsolicited offers, what really happened was two large holders exercising a put triggered by the bankruptcy of Steel's Canadian subsidiary.

Our reader pointed out that according to the "Events of Default" section of the prospectus, "failure by the Company or any of its subsidiaries to pay any indebtedness" constitutes an event of default, which in turn means that "either the trustee or the holders of not less than 25% in the principal amount of outstanding notes may declare the notes due and payable."

The put did not appear to have significant value when Steel Canada filed for bankruptcy in 2014, but it has become more relevant with the stock's protracted slide amidst the continuing decline in commodity prices. Interestingly, the bond started trading below par just under two months ago. Even more interestingly, the bonds traded at 98.29 this morning, even after the disclosure of the put exercise.

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