HILLSIDE ADVISORS LLC

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Hybrid Vigor℠

The Hillside Convertible Advisory Letter
Volume 4 Issue 6

Starting Over

Inside

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Nobody told me there'd be days like these. Strange days indeed.- John Lennon

The executives over at erstwhile convertible-issuance machines Sirius Satellite and XM Radio (now combined, of course) knew what they were doing when they started a Beatles station last month. The timing couldn't have been much better, as the music and philosophy of JPG and R provide a welcome respite for the craziness, the unpleasantly surreal nature, of today's world.

Anyway, welcome back to Hybrid Vigor. What do we have for you in this issue? Along with our usual statistical sections, which appear to contain a fairly strong warning about current market conditions quite apart from the geopolitical backdrop, we have writeups from Jeff Alton on small-cap shipper Costamare and Roman Terekhin on recent issuer RealPage.

We've been heartened to see the reasonably active new-issuance environment. If not now, when, we'd certainly ask. Sure, some companies might say they're waiting for clarity on tax reform, health-care changes, and so forth. Sometimes good things come to those who wait, but so do missed opportunities, and we can't help thinking companies sitting on the fence for raising capital will regret it if they don't act now.

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Tech Tech Tech

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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.

The action in tech stocks is reminiscent of the final months of the tech bubble of 2000 – and for the record we have no opinion on it. Clearly there is a lot of excitement about the future of Big Data and Machine Learning – excitement and extreme uncertainty – the same set of factors about the Internet which fueled the last tech bubble. And with all the tech excitement, one might think that the Ugly 20 would be littered with tech names – but no, it doesn't work that way. As close watchers of the Ugly 20 have come to learn, it takes a special set of circumstances to make it on the list – and a high-flying stock usually isn't one of them. In fact, over the course of the month the average HARP decreased from 8.42 to 8.32, while the average bond picked up 1½ points in price driving by an average 3% gain in stock price.

Over the past month Jack Dorsey's afternoon job paid off well for Square shareholders and bondholders with the stock up 16.43% and the bond up 11¾. And so why is Square 0.375% of 2022 on the Ugly 20? Not only on the list, but bigly so, having jumped all the way from 36th to 2nd. Not to mention, the bond's premium declined from 27.9% to 21.6%! The answer lies in its location, location, and location. A month ago, the bond was priced at 110¼, which put parity below par and so the 'at risk of loss' figure was measured as the distance from price to par. Today the price is 122 with parity at 100¼, which means that the 'at risk of loss' figure has increased by 9½ points over the course of the month. And that was with premium decreasing! Toss in a decrease in volatility from mid 40s to mid 30s, and the HARP calculation gives the bond less wiggle room for risk. All told, risk increased from 6.08 to 10.14 – an increase of 4.06, the largest single move in a period ever recorded by the Ugly 20. Can't win for losing, hey Jack? Even when you do well, there is criticism!

If location can get a bond into risk hot water, then it can also get a bond out of trouble. And so was the case for BioMarin 1.5% of 2020, which dropped from 3rd to 7th on the Ugly 20. With a 1.04 drop in HARP, it moved from 10.05 to 9.01 HARP. And in BMRN's case, it was the confluence of a stock price decline of 4.24% and the location on the price/risk curve. Previously the bond was priced at 124¼ with parity at par – sounds similar, no? Unfortunately, the stock decline brought parity down to 95¾, which means that if the bond also dropped in price then its point of reference for 'at risk of loss' figure will be measured from par and not parity – which is exactly what happened. The bond's decline of 5¼ points to 119 went straight to a reduction in risk. As a side note, this bond has about 6 months of call protection left and so holders should be getting rather uncomfortable with the stock's refusal to cooperate.

Another big mover this month was Clovis 2.5% of 2021, gaining 1.0 HARP points and moving up from 24th to 13th. In what is definitely a theme this month, Clovis too can attribute its risk enhancement to its change in location on the price/risk curve. Last month the bond was priced at 113¾, while this month it is at 124¼. This was obviously driven by an underlying stock price increase – a 20% gain this case. But more important is the location of parity. Last month parity was 81.4, and this month its 97¾, which means that much of that gain in bond price got added directly to risk since the 'at risk of loss' figure remains anchored on par. And it would have been a lot more of a risk increase if the 50-ish volatility figure wasn't dampening the HARP calculation as much as it is.

As a point of contrast with Clovis, let's look at ON 1% of 2020. Same sort of underlying story – parity remains below par, while bond is up substantially (five points in this case versus the Clovis move of 10½). The ON bond moved from 105½ to 110½ with the stock gaining 11.65%. Yet, HARP increased by 2.39 (versus Clovis of 1.0). Why? It's the same mechanics at work, right? Not quite. First off is the volatility – a mid 30s figure for ON versus 50-ish for Clovis – which take a substantial amount of risk off for Clovis. Second is actually location of parity for each of these bonds. Clovis has parity at 97¾ versus ON at 87. The difference in parity location is a big deal when parity is near par since the HARP calculation does not treat parity below/above par as a binary event, and instead the calculation eases into parity's impact on risk as parity closes in on par. Put another way, parity is on the verge of cutting HARP risk for Clovis, but not so much for ON.

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Hillside Ugly 20 List (Prices as of June 9, 2017)

	Convertible	Price	Stock	Premium (%)	Premium (pts)	HARP
1	RPM 2.250% 2020-12-15	120.00	55.62	13.3%	14.05	10.18
2	SQUARE 0.375% 2022-03-01	122.00	23.03	21.6%	21.65	10.14
3	TERADYNE 1.250% 2023-12-15	123.00	34.04	15.0%	16.08	9.82
4	PRICELINE 0.900% 2021-09-15	113.25	1842.12	26.4%	23.63	9.62
5	PROOFPOINT 0.750% 2020-06-15	126.50	88.08	16.7%	18.07	9.20
6	AK 5.000% 2019-11-15	142.75	6.24	23.5%	27.19	9.03
7	BIOMARIN 1.500% 2020-10-15	119.00	90.23	24.2%	23.16	9.01
8	WEBMD 1.500% 2020-12-01	126.25	58.17	13.8%	15.32	8.81
9	RED 0.250% 2019-10-01	131.50	88.85	8.7%	10.47	8.45
10	CYPRESS 4.500% 2022-01-15	121.00	13.59	20.1%	20.25	8.35
11	INTERDIGITAL 1.500% 2020-03-01	126.25	82.85	10.3%	11.77	8.21
12	NXP 1.000% 2019-12-01	119.00	108.58	12.7%	13.42	7.87
13	CLOVIS 2.500% 2021-09-15	124.25	60.43	27.2%	26.59	7.80
14	INPHI 1.125% 2020-12-01	116.75	37.73	24.3%	22.81	7.40
15	CTRIP.COM 1.000% 2020-07-01	116.75	55.83	13.7%	14.09	7.33
16	VIAVI 0.625% 2033-08-15	113.00	11.15	14.4%	14.19	7.27
17	TRINITY 3.875% 2036-06-01	121.25	26.56	11.5%	12.54	7.07
18	DYCOM 0.750% 2021-09-15	114.50	87.24	27.2%	24.46	7.03
19	IRONWOOD 2.250% 2022-06-15	128.75	17.83	19.7%	21.20	6.91
20	ON 1.000% 2020-12-01	110.50	16.10	26.9%	23.46	6.87

Sources: Bloomberg, Kynex

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HOCS™ 20 Review

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They sure do know how to pick'em.

Last year, the dominant convertible exchange-traded fund, State Street's CWB, more or less doubled the convertible fund averages, coming in with a total return of better than 10% in a world that was making a lot closer to 5%. The secret sauce? Nvidia 1%, the fund's largest holding, which hit a triple (it even got partway down the third-base line). That accounted for essentially all the outperformance.

As we all know, you're only as good as your last trade, or as they ask in the rest of the world, what have you done for me lately? CWB's encore, and anchor, has been the Alibaba mandatory, known by the unforgettable ticker of MNXCZ, which now represents 8% of the fund. Word is that analysts at Alibaba's latest call were standing and applauding. Be that as it may, the convertible—if you dare call it that—is up about 50% on the year. So that's a big chunk, 4% or so, of the 10.32% CWB has returned so far in 2017. It's basically the difference between CWB and truer convertible funds, as we'll see in a minute.

We'll keep saying it—CWB is not a real convertible fund. Go to the videotape. Of the dozen or so new traditional domestic convertible-note issues since the beginning of May, the only one with a maturity greater than seven years was the 30-year Expedia contraption from the dealmakers at Liberty Media. The real lifeblood of the market is, of course, the shorter-dated paper that provides favorably asymmetric risk/reward payoffs. That isn't to say that it doesn't help pay the bills to get a landmark mandatory like the recent Becton Dickinson deal—of course it does—but it's kind of a sugar high.

But if the lifeblood of convertibles is short and medium-dated paper, CWB is anemic indeed. As you go down its current holdings list you need to go all the way to spots 15 and 16 to find traditional paper. Moreover, number 15 is Priceline 1% of 2018, trading at double par. Even number 16, Citrix 0.5%, is at 120 with less than two years to maturity and a coupon that won't even get you one of those 20 points back if the stock pulls back.

Let's put this in layman's terms. CWB has done a great job of riding an extended bull market. It's very poorly positioned to cushion a downturn.

Now to the videotape. Our flagship HOCS 100, powered somewhat by Tesla, has more than held its own this year. It's up 7.36% year-to-date, though that reflects a cool drop of 62 basis points on Friday as highfliers cooled significantly. (CWB, notably, dropped 1.09% Friday). Meanwhile, the convertible-based funds we track have returned 6.87% on the year.

On to the new HOCS 20 lists. In what may prove to be a warning, we have a rarity: the original version coming in with an average price above 100, at 101.13. Accordingly, the average HOCS score is a weak (for the top 20) 66.1, weighted more toward growth than we generally want to see. The top three names, though, still come in below par, led by Inphi 0.75%. Perhaps more interesting is what's missing—Tesla. It's been a mainstay of our HOCS 20 lists, and we still think investors seeking Tesla exposure should take the convertibles, especially the two issued in 2014, over the common. But at current absolute prices, the Tesla converts' safety scores are too low to get the deals into the original HOCS 20. They don't make China-free either, but the more liquid Over $300 Million version does have the Tesla 1.25% of 2021, the highest-ranking overall part of the Tesla pantheon with a 61 overall score.

China-free looks very similar to the original-recipe version, with an overall score of 65.9. The profiles too are almost identical, both yielding a shade under 1% and requiring a premium over 50%. Not the kind of pictures you want to use when recommending the asset class, but that's where we are this week. The Over $300 Million rendition has a similar profile, but the overall HOCS score is a couple of points lighter at 63.5.

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Hillside HOCS 20 List

	Description	Convert	Stock	HOCS Overall	HOCS Growth	HOCS Safety	Yield	Premium
1	INPHI 0.750% 2021-09-01	98.75	37.73	72.9	74.1	70.5	1.05%	47.4%
2	AMAG 3.250% 2022-06-01	94.25	17.45	72.1	82.3	51.6	4.56%	47.8%
3	SUCAMPO 3.250% 2021-12-15	95.75	10.15	71.2	80.2	53.2	4.30%	56.5%
4	IONIS 1.000% 2021-11-15	105.00	49.88	70.7	71.4	69.3	-0.13%	40.6%
5	DEPOMED 2.500% 2021-09-01	86.00	9.94	70.2	78.0	54.8	6.33%	66.4%
6	VIPSHOP 1.500% 2019-03-15	100.50	12.61	69.9	60.8	88.1	1.21%	60.4%
7	ENVESTNET 1.750% 2019-12-15	97.00	37.40	67.8	60.4	82.7	3.00%	63.1%
8	DEXCOM 0.750% 2022-05-15	99.25	68.99	66.8	75.4	49.6	0.91%	42.6%
9	INTERCEPT 3.250% 2023-07-01	94.75	116.67	66.8	81.8	36.8	4.24%	61.3%
10	SILVER 2.875% 2033-02-01	97.25	9.52	66.6	64.1	71.5	3.98%	104.3%
11	RH 0.00% 2019-06-15	88.50	50.74	65.6	56.5	84.0	6.18%	102.5%
12	WEB.COM 1.000% 2018-08-15	99.25	24.10	65.2	55.6	84.4	1.65%	44.1%
13	RESTORATION 0% 2020-07-15	82.75	50.74	63.2	59.3	71.2	6.22%	92.6%
14	ILLUMINA 0.000% 2019-06-15	101.25	174.08	62.9	50.4	87.9	-0.62%	47.9%
15	PRICELINE 0.350% 2020-06-15	144.50	1842.12	62.0	74.5	37.0	-11.59%	3.2%
16	MEDIDATA 1.000% 2018-08-01	133.50	75.37	61.9	71.4	42.9	-23.06%	2.8%
17	HORIZON 2.750% 2022-07-01	95.75	15.29	61.8	73.5	38.3	3.68%	56.4%
18	INSULET 1.250% 2021-09-15	98.25	41.41	61.7	68.7	47.7	1.68%	38.5%
19	GOGO 3.750% 2020-03-01	90.50	11.61	61.7	62.7	59.5	7.68%	85.9%
20	LUMENTUM 0.250% 2024-03-15	119.75	60.50	61.4	74.3	35.7	-2.42%	20.0%

Sources: Bloomberg, Kynex

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Hillside HOCS 20 List ex China

	Description	Convert	Stock	HOCS Overall	HOCS Growth	HOCS Safety	Yield	Premium
1	INPHI 0.750% 2021-09-01	98.75	37.73	72.9	74.1	70.5	1.05%	47.4%
2	AMAG 3.250% 2022-06-01	94.25	17.45	72.1	82.3	51.6	4.56%	47.8%
3	SUCAMPO 3.250% 2021-12-15	95.75	10.15	71.2	80.2	53.2	4.30%	56.5%
4	IONIS 1.000% 2021-11-15	105.00	49.88	70.7	71.4	69.3	-0.13%	40.6%
5	DEPOMED 2.500% 2021-09-01	86.00	9.94	70.2	78.0	54.8	6.33%	66.4%
6	ENVESTNET 1.750% 2019-12-15	97.00	37.40	67.8	60.4	82.7	3.00%	63.1%
7	DEXCOM 0.750% 2022-05-15	99.25	68.99	66.8	75.4	49.6	0.91%	42.6%
8	INTERCEPT 3.250% 2023-07-01	94.75	116.67	66.8	81.8	36.8	4.24%	61.3%
9	SILVER 2.875% 2033-02-01	97.25	9.52	66.6	64.1	71.5	3.98%	104.3%
10	RH 0.00% 2019-06-15	88.50	50.74	65.6	56.5	84.0	6.18%	102.5%
11	WEB.COM 1.000% 2018-08-15	99.25	24.10	65.2	55.6	84.4	1.65%	44.1%
12	RESTORATION 0% 2020-07-15	82.75	50.74	63.2	59.3	71.2	6.22%	92.6%
13	ILLUMINA 0.000% 2019-06-15	101.25	174.08	62.9	50.4	87.9	-0.62%	47.9%
14	PRICELINE 0.350% 2020-06-15	144.50	1842.12	62.0	74.5	37.0	-11.59%	3.2%
15	MEDIDATA 1.000% 2018-08-01	133.50	75.37	61.9	71.4	42.9	-23.06%	2.8%
16	HORIZON 2.750% 2022-07-01	95.75	15.29	61.8	73.5	38.3	3.68%	56.4%
17	INSULET 1.250% 2021-09-15	98.25	41.41	61.7	68.7	47.7	1.68%	38.5%
18	GOGO 3.750% 2020-03-01	90.50	11.61	61.7	62.7	59.5	7.68%	85.9%
19	LUMENTUM 0.250% 2024-03-15	119.75	60.50	61.4	74.3	35.7	-2.42%	20.0%
20	HUBSPOT 0.250% 2022-06-01	99.75	71.10	61.2	72.6	38.4	0.30%	33.0%

Sources: Bloomberg, Kynex

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Hillside Advisors HOCS 20 List (Issue Size > $300 Million)

	Description	Convert	Stock	HOCS Overall	HOCS Growth	HOCS Safety	Yield	Premium
1	AMAG 3.250% 2022-06-01	94.25	17.45	72.1	82.3	51.6	4.56%	47.8%
2	SUCAMPO 3.250% 2021-12-15	95.75	10.15	71.2	80.2	53.2	4.30%	56.5%
3	IONIS 1.000% 2021-11-15	105.00	49.88	70.7	71.4	69.3	-0.13%	40.6%
4	DEPOMED 2.500% 2021-09-01	86.00	9.94	70.2	78.0	54.8	6.33%	66.4%
5	DEXCOM 0.750% 2022-05-15	99.25	68.99	66.8	75.4	49.6	0.91%	42.6%
6	INTERCEPT 3.250% 2023-07-01	94.75	116.67	66.8	81.8	36.8	4.24%	61.3%
7	RH 0.00% 2019-06-15	88.50	50.74	65.6	56.5	84.0	6.18%	102.5%
8	RESTORATION 0% 2020-07-15	82.75	50.74	63.2	59.3	71.2	6.22%	92.6%
9	ILLUMINA 0.000% 2019-06-15	101.25	174.08	62.9	50.4	87.9	-0.62%	47.9%
10	PRICELINE 0.350% 2020-06-15	144.50	1842.12	62.0	74.5	37.0	-11.59%	3.2%
11	INSULET 1.250% 2021-09-15	98.25	41.41	61.7	68.7	47.7	1.68%	38.5%
12	GOGO 3.750% 2020-03-01	90.50	11.61	61.7	62.7	59.5	7.68%	85.9%
13	LUMENTUM 0.250% 2024-03-15	119.75	60.50	61.4	74.3	35.7	-2.42%	20.0%
14	HUBSPOT 0.250% 2022-06-01	99.75	71.10	61.2	72.6	38.4	0.30%	33.0%
15	SCORPIO 2.375% 2019-07-01	89.00	3.82	60.9	65.7	51.3	8.31%	137.4%
16	TESLA 1.250% 2021-03-01	113.75	357.32	60.6	66.8	48.2	-2.27%	14.6%
17	MOLINA 1.625% 2044-08-15	127.00	68.22	58.5	62.6	50.5	-17.79%	8.1%
18	HERBALIFE 2.000% 2019-08-15	102.25	68.88	58.0	48.7	76.5	0.95%	28.1%
19	FINISAR 0.500% 2036-12-15	97.25	25.04	57.8	51.2	71.1	1.13%	71.6%
20	AKAMAI 0.000% 2019-02-15	98.00	48.13	56.8	39.7	91.1	1.21%	82.4%

Sources: Bloomberg, Kynex

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The Month That Was: May 2017

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After a bit of a lull in new issuance last month, which was expected during earnings season, we saw a pickup again in May. Over the course of the month eight issues priced for total proceeds of $2.675 billion. Kicking off the month was **Hubspot** (HUBS) on May 3. The company announced a $300 million senior convertible note offering that was upsized to $350 million. The deal was priced at 0.25% up 35% with a five-year maturity giving it an initial HOCS slash line of 61 Overall / 71 Growth / 41 Safety – an okay score but not stellar for a new issue. HUBS is a leading inbound marketing and sales platform. Proceeds from the deal will be used for a hedge transaction and for general corporate purposes. The bonds are now trading at 99.75 versus $71.10 giving it a current HOCS slash line of 61 / 73 / 38.

On May 5, **AMAG Pharmaceuticals** (AMAG), a repeat offender, announced a $250 million senior convertible deal that was upsized to $300 million. The five-year bond was priced at 3.25% up 37.5% giving it an initial HOCS slash line of 73 Overall / 83 Growth / 52 Safety, a very good score for a new issue. The company plans to use the proceeds and cash on hand to repay the $320.8 million outstanding balance on its credit facility and terminate the facility. AMAG has also entered into an agreement to repurchase $158.9 million face of its 2.5% of 2019 convertible bonds for $171.3 million with cash on hand. AMAG is a biopharmaceutical focused on women's health, anemia management, and cancer support care. With the bonds now trading at 94.25 versus $17.45 the HOCS is now 72 / 82 / 52.

Up next, on May 8, was **Kaman Corporation** (KAMN), another repeat offender. The company priced $175 million of convertible bonds at 3.25% up 25% with a seven-year maturity. The bonds received an initial HOCS slash line of 42 Overall / 38 Growth / 51 Safety, a most unattractive score for a new issue. KAMN is a provider of parts for the aerospace and industrial distribution markets. The company plans to use the proceeds from the deal for a capped call transaction and to repay existing indebtedness including $163.5 million to repurchase $103.5 million face of the company's 2017 convertible notes. As of Friday's close the bonds were trading at 102.5 versus $52.17 giving them a HOCS slash line of 42 / 40 / 46.

On May 8, **DexCom** (DXCM) announced a $300 million five-year convertible bond offering. The deal priced at 0.75% up 35% giving it an initial HOCS slash line of 70 Overall / 80 Growth / 50 Safety, a very good score. DXCM is a medical device company focused on continuous glucose monitoring systems. The company plans to use $75 million of the proceeds to repay borrowing under the credit facility and the balance for general corporate purposes and capital expenditures, including the build-out of its manufacturing facility in Arizona. With the bonds now trading at 99.25 versus $68.99, the HOCS slash line is 67 / 75 / 50.

Dermira (DERM) announced a $250 million five-year convertible bond offering that priced at 3% up 30% on May 9. The deal received an initial HOCS slash line of 65 Overall / 83 Growth / 30 Safety, an okay score for a new issue, but nothing to get excited about and the safety score is a concern. DERM is a development-stage biopharmaceutical company focused on dermatologic diseases. The company plans to use the proceeds for working capital, capital expenditures, and general corporate purposes including possibly expanding the business by in-licensing or acquiring products or businesses. Based upon Friday's closing price of 107 versus $27.57 the bonds now have a HOCS slash line of 56 / 75 / 17.

On May 16, **Atlas Air Worldwide** (AAWW), another repeat offender, announced a $250 million seven-year deal that was upsized to $260 million. AAWW is a global provider of outsourced aircraft and aviation operating services. Atlas operates the largest fleet of 747 freighters. The deal priced at 1.875% up

32.5% giving it an initial HOCS slash line of 52 Overall / 57 Growth / 40 Safety, a very subpar score with a particularly worrisome safety score. The company plans to use the proceeds to repay a higher-cost a revolving credit facility, to enhance business and financial flexibility, to support growth, fund a convertible notes hedge, and for general corporate purposes. With the bonds now trading at 110.25 versus $53.50, the bonds have a HOCS slash line of 48 / 56 / 31.

Also on May 16, RealPage (RP) announced a five-year $300 million deal that priced at 1.5% up 27.5% for an initial HOCS slash line of 61 Overall / 56 Growth / 72 Safety. RP is a provider of software and data analytics for the real estate industry. The company plans to use the proceeds for a convertible note hedge transaction and general corporate purposes including future acquisitions. At Friday's close the bonds were trading at 105.25 versus $35 for a HOCS slash line of 48 / 53 / 39. Please also see Roman Terekhin's note on RP's credit in this issue.

And finally, on May 22, ServiceNow (NOW), yet another repeat offender, announced a $750 million deal that priced at 0% up 32.5% with a five-year maturity. NOW is a provider of enterprise cloud computing solutions for customer support, human resources, and security operations, among others. The deal received an initial HOCS slash line of 57 Overall / 61 Growth / 49 Safety. The company plans to use $575 million of the proceeds to repay the 0% of 2018 convertible notes, with the balance used for a convertible note hedge transaction and to repurchase $55 million of stock. At Friday's closing price of 101.5 versus $103.74 the HOCS slash line is now 55 / 60 / 47.

In other news, Air Lease (AL) amended its unsecured revolver by increasing it from $3.5 billion to $3.7 billion. The maturity for the majority of the commitments was extended by one year to May 5, 2021. The facility remains priced at L+105. In a separate announcement the company reported selling $600 million of 2.625% of 2022 senior notes at 99.553%. Proceeds from the deal will be used for general corporate purposes including the purchase of commercial aircraft and the repayment of existing indebtedness……… Blucora (BCOR) has closed on a new credit facility, which includes a $375 million senior secured term loan and a $50 million revolver which mature in 2024 and 2022 respectively. The term loan was priced at L+375, which is a reduction of 225 basis points compared to the previous term debt. Proceeds from the term loan are being used to repay the TaxAct-HD Vest 2015 credit facility, to redeem the just-matured convertibles, and to pay fees and expenses associated with the new facility……… Chesapeake Energy (CHK) sold $750 million of 8% senior notes due 2027. Proceeds from the offering will be used to finance a portion of the tender offer it has commenced for up to $750 million of certain outstanding notes……… DDR Corp (DDR) has sold $175 million of 6.375% Class A cumulative redeemable preferred shares. Proceeds will be used to repay debt, including its 4.75% notes due 2018 and for general corporate purposes. Earlier in the month DDR priced a $450 million offering of 4.7% senior notes due 2027. Proceeds will be used to repay borrowings under its revolver and for general corporate purposes……… EPR Properties (EPR) has issued $450 million of 4.5% of 2027 senior notes. Proceeds from the offering will be used to repay outstanding balances on the company's revolver and for general corporate purposes including funding the ongoing pipeline of acquisitions and build-to-suit projects……… Immunomedics (IMMU) terminated its previously announced global licensing agreement with Seattle Genetics, which returns the full rights of Sacituzumab Govitecan, a breast cancer treatment, to IMMU. With the termination of the deal, IMMU was in need of capital, which was remedied with a $125 million placement of series A-1 convertible preferred stock. The company also announced that Cynthia L. Sullivan has stepped down as President and CEO, with Michael R. Garone, the current CFO, filling the role on an interim basis. Activist investor Venbio was the driving force behind the announcements…….. Meritage Homes Corp (MTH) has sold $300 million of 5.125% of 2027 senior notes. Proceeds will be used to pay down borrowings on the company's unsecured revolver and for general corporate purposes including the redemption of its 1.875% convertible notes due 2032……… Micron Technology (MU) announced Sanjay Mehrotra, the co-founder of former CEO of SanDisk, as its new CEO……… Molina Healthcare (MOH) sold $330 million 4.875% of 2025 senior notes. Proceeds will be used to repay the 1.625% of 2044 convertible senior notes……… Pandora (P) entered into an agreement for a $150 million investment from KKR. As part of the deal, Richard Sarnoff, from KKR, will join Pandora's board. The investment will be in the form of Series A convertible preferred stock. The preferred stock will pay a 7.5% cash dividend or 8% if paid in kind, at its option……… **RH** (RH) has authorized a $700 million share repurchase program……… **Sprint** (S) has commenced tender offers for cash for up to $1 billion for its 9% guaranteed notes due 2018 and its 8.375% notes due 2017……… **Tyson Foods** (TSN) has sold $2.75 billion in senior notes across four different tranches. Proceeds from the deals will be used to fund a portion of the Advance Pierre Food acquisition.

That's all for now. We'll be back in July. Enjoy the start of summer!

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June 12, 2017

Costamare Inc. (CMRE): Ready to Set Sail?

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After a punishing crash in container-ship charter rates, the industry finally looks poised to snap back. We particularly like Costamare, with its headquarters in Greece and operating company based in Monaco. The company leases container ships to liner companies such as Maersk. The industry last saw an upturn in charter rates in 2015, but a glut of container-ship deliveries and moderating world trade sent charter rates in freefall, culminating in the bankruptcy of the Korean giant shipping company, Hanjin. Now the industry seems poised for a rebound and we believe that Costamare is ready to benefit.

Container Ship Charter Industry

The Hanjin bankruptcy seemed to mark the bottom of the recent cycle in charter rates. Since then, rates have begun to rebound and Maersk offered hope when it commented earlier in the year that the container industry may have seen a bottom.

A comparison of daily charter rates at the last peak in 2015 and what appears to have been the trough a few months ago:

Date	Harpex Index	TEU* 1100	TEU 1700	TEU 2500	TEU 2800	TEU 3500	TEU 4250	TEU 6500	TEU 8500
2-5-2015	619.72	$8100	$9750	$12000	$13250	$12500	$14250	$18000	$35000
1-28-2017	322.35	$5800	$6150	$5900	$6500	$6000	$4250	$6750	$8000
6-3-2017	458.92	$6000	$6400	$9500	$10000	$9250	$8500	$11000	$12000

* TEU: (twenty-foot-equivalent) is the unit that describes the capacity of container ships. TEU 1100 represents that the container ship can hold and transport roughly 1100 containers.

If world trade in goods holds firm, there are other reasons to be optimistic, including a tightening supply of container ships in the near term. News reports indicated that there were over 300 idle container ships globally at the end of 2016, partially due to the Hanjin bankruptcy. Since then, the number has reportedly been cut in half thanks to accelerated scrapping and a light order book.

In January 2017, 35 container vessels, equating to 119,500 TEUs, were scrapped. By comparison, there were just 9 scrapped, accounting for 27,000 TEUs, during the same time in 2016. Most of the scrapped vessels have been of the smaller, older, less useful variety. Smaller ships have become scrap candidates because the Panama Canal was widened to accommodate larger vessels and the oversupply of charter ships has made scrapping more economically appealing. For example, in late 2016, a 7-year-old 4,250 TEU vessel was valued just above scrap at $5.87 million, less than 10% of the original purchase price of $60 million.

The light order book for container ships over the next few years should also bolster charter rates. The shipping industry is always cyclical and orders dry up when charter prices drop. New orders declined from 250 in 2015 to 76 in 2016, a year-over-year decrease of 70%. Consensus estimates have the global container-ship fleet growing around 3.1% in 2017, slightly higher than 2016, but that represents that tail end of the latest round of orders from the good times in 2015.

This industry upcycle may also last longer than the previous cycle. While we are always reticent to declare that it is different this time, one should consider the substantial number of shipyard closures over the past few years. There are currently about 160 shipyards active today versus just over 300 in 2009. Many that remain open have cut capacity. Bottom line is that should the order book turn up, it will take longer to get ships built and delivered.

Costamare, Inc.

In this current environment, we recommend that investors look at Costamare, the container-ship leasing company managed by the founding Konstantakopoulos family, which still owns a majority of the company. While competitor Seaspan is struggling with cash-flow issues, Costamare has issued new shares twice in the last nine months to raise fresh capital to buy ships during the downturn. Costamare is run conservatively, with the company paying cash to buy a ship and then arranging longer-term financing. Another conservative hallmark of Costamare is that ship financing matches asset life with liabilities. In fact, Costamare's debt amortization payments are sometimes higher than depreciation expense. When charters are placed for longer terms, it makes owning a ship similar to project finance under these parameters. Revenue is locked in for extended periods of time and the more efficiently the ship is operated, the higher the profits.

For now, however, Costamare is executing shorter-term charters with clients until rates pick up. Costamare is also using its newly raised capital to purchase used boats at attractive prices. Costamare will consider any size boat segment if the company believes that it can earn a reasonable IRR on the ship.

Another reason for executing short-term leases: lower-sulfur marine fuel will be required after 2020. This could erode margins for charter companies with longer-term contacts in place if the price of fuel increases significantly. With its shorter-term leases, Costamare would be able to raise daily charter rates or scrap boats if they are no longer economically feasible due to an increase in fuel costs. Costamare management undoubtedly has this in mind as it invests the newly raised capital to buy used ships.

Costamare also has an agreement with York Capital Management under which Costamare can purchase 49% interest in a vessel, with York owning the balance. The agreement allows Costamare to expand more quickly and diversify its risks. Costamare still manages the ships and is compensated for it. So far Costamare and York have purchased $1.2 billion in vessels under the agreement, which runs through 2020.

Total debt stands at a moderate 4x adjusted EBITDA. Notably, Costamare remained profitable throughout the industry downturn. Now with the industry on the rebound, we believe that the stock could double over the next few years, in part because of historical enterprise value/ adjusted EBITDA ratios. The stock pays a $0.40 annualized dividend, providing a 6.07% yield based on Friday's close.

Disclaimer: An affiliate of Hillside Advisors has a position in CMRE.

Credit Waterfall

Costamare Inc. (CMRE) (Dollars in Millions)	3/31/2017	Total Debt (Cum. Bal.)	Adj. EBITDA Multiple	Net Debt (Cum. Bal.)	Adj. EBITDA Multiple
Current Share Price(1)	$6.83				
Shares Out. (Millions)	105.8				
Latest Twelve Months:					
EBITDA (Adj.)	302				
Free Cash Flow	220				
Cash & Cash Equivalents	141				
Credit Facility(2)					
Credit Facility	384				
	384	384	1.3x	243	0.8x
Term Loans(3)					
Mas Shipping Co.	18				
Montes Shipping Co. and Kelsen Shipping Co.	54				
Costamare Inc.	30				
Undine Shipping Co., Quentin Shipping Co. and Sander Shipping Co.	174				
Raymond Shipping Co. and Terance Shipping Co.	113				
Costamare Inc.	46				
Uriza Shipping S.A.	36				
Costis Maritime Corporation, Christos Maritime Corporation and Capetanissa Maritime Corporation	105				
Rena Maritime Corporation, Finch Shipping Co. and Joyner Carriers S.A.	30				
	607	991	3.3x	850	2.8x
Capital Lease(4)					
Capital Lease Obligations	357				
	357	1347	3.5x	1207	4.0x
Total Debt	1347	1347	4.5x	1207	4.0x
Equity Market Cap.	723	---	---	---	---
Enterprise Value	1930	---	---	---	6.4x

(1) Close stock price as of June 9, 2017

(2) Reflects principal amount of credit facility outstanding, unadjusted for unamortized debt discount. The Facility bears interest at the 3, 6, 9 or 12 months (at the Company's option) LIBOR plus margin.

(3) Reflects principal amount of term loans outstanding, unadjusted for unamortized debt discount. The interest rate of long-term debt as at March 31, 2017 was in the range of 2.20%-6.03%. The weighted average interest rate as at March 31, 2017 was 4.8%.

(4) Reflects principal amount of capital lease obligations outstanding, unadjusted for unamortized debt discount.

Sources: Bloomberg and Company Filings

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June 12, 2017

Financial Summary

Costamare Inc. (CMRE)	Fiscal Years Ended					LTM		Quarter Ended	
(Dollars in Millions)	31-Dec-12	31-Dec-13	31-Dec-14	31-Dec-15	31-Dec-16	31-Mar-16	31-Mar-17	31-Mar-16	31-Mar-17
Revenues	386	414	484	490	468	490	453	120	106
Y / Y Change	----	7.3%	16.8%	1.3%	-4.5%	----	-7.4%	----	-11.9%
Gross Profit	185	202	250	265	256	267	246	67	57
Operating Profit	155	169	215	218	166	221	150	56	40
EBITDA (Adj.)	253	282	334	350	317	349	302	85	70
Interest Expense	28	33	46	45	50	45	64	12	14
Income Tax Expense	0	0	0	0	0	0	0	0	0
Capital Expenditures	265	642	88	3	3	3	4	1	2
% Revenues	68.7%	155.0%	18.2%	0.6%	0.6%	0.6%	0.9%	0.5%	1.9%
Free Cash Flow	(97)	(456)	155	242	224	244	220	57	53
Total Debt	1,562	1,868	1,767	1,551	1,415	1,499	1,341	1,499	1,341
% Total Debt	-6.2%	-24.4%	8.8%	15.6%	15.8%	16.3%	16.4%	3.8%	4.0%
Gross Margin	47.9%	48.7%	51.7%	54.0%	54.7%	54.5%	54.3%	55.3%	53.4%
Operating Margin	40.1%	40.8%	44.4%	44.4%	35.5%	45.0%	33.1%	46.5%	37.8%
EBITDA (Adj.) Margin	65.5%	68.2%	69.0%	71.4%	67.8%	71.3%	66.7%	70.9%	66.4%
EBITDA (Adj.) / Interest	8.9x	8.6x	7.2x	7.8x	6.4x	7.7x	4.7x	7.3x	5.0x
EBITDA (Adj.) - Capex / Interest	-0.4x	-10.9x	5.3x	7.7x	6.3x	7.6x	4.6x	7.3x	4.9x

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June 12, 2017

RealPage (RP): Credit Snapshot

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On May 17th, RealPage priced $345 million senior convertible notes due 2022, a bullet structure with COCO and issuer cash/shares option on conversion.

RealPage is a provider of software for the real estate industry. Although there are other business lines, on-demand software comprises 95% of the revenue ($593 million latest twelve months). All the revenues were generated in the US.

We generally like this credit. The company has been in business for a while, has a large and diversified customer base and a solid management team. It has been growing its top line and generating EBITDA ($92 million for the past twelve months) and, by our reckoning, was also close to break-even on a free-cash-flow basis. Not bad for a smallish (under $3 billion market cap) technology company operating in a highly competitive market segment. Call us old-fashioned, but we also like the fact that insiders own 31% of the stock (most of which is held by Stephen T. Winn, current CEO and Chairman).

RealPage has been growing both organically and through acquisitions and its credit statistics are somewhat of a moving target. As of March-end, the leverage was quite low – at 0.7x using LTM EBITDA. Adjusting the March-end numbers for the convertible issue and the pending acquisition of Lease Rent Options (LRO), we estimate that forward measure of leverage is 3.7x. We used Bloomberg consensus adjusted EBITDA estimate for this year which is $160 million. While under 4x leverage is arguably still acceptable for this company, this is a far cry from where things are now and increases credit risk substantially. When making pro-forma adjustments, we assumed that the $300 million all-cash price tag for LRO will be paid from cash on hand and by drawing on the delayed-draw term loan facility. Post these adjustments, we estimate that on a gross basis there will be $360 million of bank debt above the convertible. Since the company is quite acquisitive it is not unreasonable to assume that it may draw on its banking line further (around $370 million remains available) if it finds an attractive target. Still, we think that given the size of the LRO transaction, it should keep the management busy for a while and away from searching the market for more companies to buy, though the real estate-related software space does remain quite fragmented.

We have not considered the merits of the LRO acquisition in detail but we like the fact that RealPage expects advancements on two fronts: the real-time lease transaction data repository and data science. We also take comfort in the fact that management has done 35 acquisitions over the past fifteen years. Its accumulated experience should mitigate the integration risk.

Additionally, since the debt is rather cheap, the coverage ratios are very comforting on both historic and pro-forma bases.

The current implied spread on the convertible appears reasonable and we think that at least in the short term the bond floor should hold well. However, the progress of LRO integration (the transaction is yet to close) should be watched carefully as there is not much room for error given the significant increase in leverage.

RealPage (RP)

Credit Tear Sheet

June 11, 2017

RealPage is a leading global provider of software and data analytics to the real estate industry. Clients use its platform to improve operating performance and increase capital returns. Founded in 1998 and headquartered in Richardson, Texas, RealPage currently serves over 11,200 clients worldwide from offices in North America, Europe and Asia.

All numbers are in USD mm, except as indicated

Leverage (Nominal values)	*Pro-forma* Amount	Multiple of EBITDA LTM	Multiple of EBITDA Fwd
Unrestricted Cash	116.5		
Secured Debt	360.7	1.3x	2.3x
Unsecured Debt	345.0	1.3x	4.4x
Redeemable Preferred	-	1.3x	4.4x
Gross Long-Term Debt	705.7	1.3x	4.4x
Net Long-Term Debt	589.2	0.7x	3.7x
Equity Market Cap	2,891.8		
EV	3,481.0	32.1x	21.8x

Liquidity	*Pro-forma*
Unrestricted Cash	116.5
Total bank line availability	252.3
Total Liquidity	368.8

Debt Maturity Schedule	*Pro-forma*
2017	2.3
2018	5.5
2019	6.3
Thereafter	691.6

Coverage Ratios	2016A	2017E	2018E
EBITDA	91.0	160.0	195.0
Interest Coverage	32.1x	27.2x	33.1x
Fixed Charge Coverage	7.4x	10.1x	12.2x

Off-Balance Sheet Debt	
Capitalized op. leases	88.0
Other	-
Total	88.0

Pro-forma Capital Structure

	Status	Security Type	Coupon	Maturity	Curr	Ratings	Amt o/s	Mkt Px	Nominal
Debt	**Sec'd**	Delayed Term	**L+175**	2/27/2022	**USD**	NR	**150.0**	100.000	150.0
		Revolver	**L+175**	2/27/2022	**USD**	NR	**-**	100.000	-
		Term Loan	**L+175**	2/27/2022	**USD**	NR	**122.7**	100.000	122.7
	Sec'd Sum								**272.7**
	Unsec'd	Sr CB	**1.5%**	11/15/2022	**USD**	NR	**345.0**	106.000	345.0
	Unsec'd Sum								**345.0**
Debt Total									**617.7**
Equity	**Common**	Common Stock	**82.682**	mm shares	**USD**	@	**34.975**		2,891.8
	Common Sum								**2,891.8**
Equity Total									**2,891.8**
Grand Total									**3,509.5**

Sources: Bloomberg, company filings and documents, Hillside Advisors estimates

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June 12, 2017

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