HILLSIDE ADVISORS LLC

June 15, 2015

Hybrid Vigor℠

The Hillside Convertible Advisory Letter

Volume 2 Issue 24

Even When Bearing Gifts

Inside

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If there's one group of traders that doesn't fear the developments coming out of Greece, it's probably those who try to make money being long volatility. That's been a tough way to go for quite a few years now, but it would have been even tougher without the trading opportunities made available by this century's version of the ancient Greek dramatics.

In honor of this week's Greek anxieties, as well as my recent 30-year college reunion and the memories of the first freshman-year readings, I thought I'd imagine a world in which the ancient tragedians had not only power, jealousy and unbridled passion as themes but also the stuff that really makes the world go around—conversion premium.

Imagine Aeschylus' Agamemnon with a twist. Agamemnon is a hedge-fund manager who safely navigates his portfolio through a tumultuous market, providing solid positive returns while many of his peers are losing money. But after a successful visit to a client, he returns home to find that his wife, Clytemnestra, has moved all her assets to a competing manager who promises to outperform Agamemnon in the next cycle.

Or consider Sophocles' Oedipus Rex. On a long marketing trip, Oedipus encounters an old pension consultant who challenges Oedipus to prove that his alpha-generation system works in all markets. Oedipus takes offense and tells the consultant to go stick needles in his eyes, only to learn that the consultant had actually been responsible for Oedipus' initial seed capital. Not the right guy to mess with.

Finally, think about an update of Euripides' Bacchae. A leading convertible hedge-fund manager feels disrespected by an investor questioning his academic pedigree. He decides to liquidate his entire portfolio in a single day, throwing the entire market into chaos.

Who says convertibles are boring? Indeed, there are plenty of reasons to expect an eventful summer. We look forward to covering the excitement and sharing our HARP, HOCS and other opinions with you.

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June 15, 2015

Second Chance

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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.

When the heat comes on, you know the dog days of summer are here. And it sure seems like the Ugly 20 has complied. Another week of minuscule movement, though the decrease in the average HARP from 10.02 to 10.01 surely must portend to great things on the horizon. Price changes were muted with a 0.8% average stock decline and a corresponding ¼ point bond price decline. Even below the surface of the averages, the individual prices were muted with a 3¼ point move at the extreme while most moves were closer to the average. Rank-order changes were limited to a small number of one-tick up or down moves, with a single outlier generating a five rank move. Lots of words to simply state, "Paint dried and we watched it". But please bear with us. We just might turn a sow's ear into a silk purse.

Ugly 20 Average HARP

Weeks and weeks of complaining about RPM have now turned into complaining about the Illumina bonds. Another week in the pole position sits Illumina B 0.5% of 2021 with a blistering all-time personal best of 14.73 HARP. That's a 0.66 increase from the prior week, and frankly completely unneeded. The stock was up 2.41%, and the B bond punched in a full 2 points – about ¾ a point over delta neutral. And for HARP's sake, even delta-neutral would have been too much given that parity is at 85¾. While premium has been declining recently, until parity crosses par every mark up in the bond price makes the HARP worse. At a bond price of 124 that works out to 24 points minus the six years of half a point of coupon, to result in a

21-point loss if all doesn't go according to plan. A very steep price to pay.

If you missed the Illumina B bandwagon, there is always the Illumina A one not far behind. Illumina A 0% 0f 2019 moved from 5th to 4th on the Ugly 20 with a 0.56 HARP move to 11.93. Not quite as large a move as the B's, but still stinky with a half-point increase above dollar neutral. That puts the bond at 18 points over par with not even a single coupon to cushion the fall.

There are many ways to climb the Ugly 20, but one guaranteed way is for a bond to increase in price while its corresponding stock is decreasing in price. Array Biopharma 3% of 2020 put in one of those displays this past week. Stock down 1.31%, bond up 1¾ points. Parity is above par on this bond so HARP focuses on premium a lot more than absolute dollar price. With this inverted dollar neutral move, the bond jumped from 11th to 9th with a 0.44 HARP increase to 9.64. The bond's two years of call protection are closing fast as the large premium over parity of 24¼ points is shrunken to only 18¼ after coupons. 18¼ points of loss on the face of it would put any bond into the top five of the Ugly 20, but Array Biopharma escapes the rarified air due to the power of a mid 40's volatility. Anything can happen. Last year the stock was a 4-handle, this year a 7-handle. The volatility figure might be a bad approximation of a very punctuated extreme profile.

There were two new entrants on the Ugly 20 this week. Coming in a 20th, up from 26th, was Verint Systems 1.5% of 2021. With a HARP of 8.00 even and a price of 118¼, Verint is the typical bond attempting to pass through the premium burn zone from where parity is just below par until parity emerges above par and premium starts to ease up. At 18¼ points above par, retarded by six years of call protection and coupon collection, potential loss slides in at 12¼ points - not particularly bad given the competition. The problem is the low 20's volatility. But a lot of time remains, so we can't be particularly hard on Verint.
The second new entrant was our old friend ALJ – Alon USA Energy 3% of 2018 – coming in a 19th from 21st with a 0.05 HARP increase. Despite the reduction in HARP due to our refinement to handle dividend protection clauses better, ALJ cannot stay away. A price of 136 and an adjusted parity of 125¼ still hands out a sizable potential loss.

Hillside Ugly 20 List (Prices as of June 12, 2015)

	Convertible	Price	Stock	Premium (%)	Premium (pts)	HARP
1	Illumina Tranche B 0.5% 2021-06-15	124.00	215.27	44.8	38.36	14.73
2	RPM International 2.25% 2020-12-15	117.75	49.66	24.1	22.87	13.17
3	Red Hat 0.25% 2019-10-01	126.50	78.19	18.3	19.57	12.52
4	Illumina Tranche A 0% 2019-06-15	118.00	215.27	37.8	32.37	11.93
5	Lam Research Tranche B 1.25% 2018-05-15	145.00	81.46	9.7	12.82	11.39
6	Emergent BioSolutions 2.875% 2021-01-15	123.50	31.84	23.6	23.58	11.23
7	Jazz Pharmaceuticals 1.875% 2021-08-15	118.50	178.59	32.0	28.73	9.97
8	Priceline.com 0.35% 2020-06-15	113.50	1174.17	26.4	23.71	9.65
9	Array Biopharma 3% 2020-06-01	134.00	7.56	22.1	24.25	9.64
10	NVIDIA 1% 2018-12-01	120.25	21.11	11.7	12.60	9.43
11	Salesforce.com 0.25% 2018-04-01	124.75	71.77	14.5	15.80	9.37
12	Medidata Solutions 1% 2018-08-01	119.00	54.42	25.7	24.33	9.02
13	BioMarin Pharma 0.75% 2018-10-15	144.50	122.03	10.7	13.97	8.85
14	SanDisk 1.5% 2017-08-15	142.00	66.10	8.6	11.24	8.76
15	ServiceNow 0% 2018-11-01	121.25	77.94	15.2	16.00	8.72
16	US Steel 2.75% 2019-04-01	121.25	24.56	26.3	25.25	8.71
17	Workday Tranche 2 1.5% 2020-07-15	121.00	79.63	23.5	23.02	8.61
18	Workday Tranche 1 0.75% 2018-07-15	116.75	79.63	21.3	20.50	8.43
19	Alon USA Energy 3% 2018-09-15	136.00	17.79	9.4	11.69	8.14
20	Verint Systems 1.5% 2021-06-01	118.25	63.78	19.5	19.30	8.00

Sources: Bloomberg, Kynex

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June 15, 2015

HOCS℠ 20

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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.

In a week which saw a lot of sound and fury signifying very little (unless you traded it well or badly) for the broad equity averages, but some encouraging activity in the convertible new-issuance market, the older paper did give rise to some worthwhile observations. As usual, we use our HOCS benchmarks and the highly successful, highly liquid, and questionably convertible CWB exchange-traded fund as our prisms.

First, HOCS 20 put in another good week, returning 79 basis points. Top-heavy with QIHU paper, the HOCS 20 benefited from another good week for the Chinese Internet security stalwart, as well as from strong Chinese performance in general. The middle QIHU bond, the 0.50% of 2020, has reclaimed the top spot on HOCS 20 from attractive but difficult-to-hedge Invensense 1.75%. For whatever it's worth, the borrow on INVN stock seems to be getting easier on one convertible commentator's online trading system. Perhaps the bond is worth another look. As we write this, the stock appears to be bucking a weak tape.

As we said above, Chinese names generally did well. E-House returned nearly 5% on the back of a possible management buyout, while 51job and Soufun also outperformed significantly. The HOCS 20, less the benefit of the Chinese names, was essentially flat for the week. Meanwhile, the experimental China-free HOCS 20 lost 45 basis points, thanks largely to a dive in borderline member Orexigen.

HOCS 100, obviously a much broader measure of convertible performance, had a modestly down week, dropping 27 basis points to bring the year-to-date measure to 5.40%. Still, this was meaningfully better than CWB, which lost 78 basis points to bring its year-to-date performance to 4.28%, or over a full percentage point behind HOCS 100. In general, we expect HOCS 100 to outperform CWB except in strongly upward-trending markets.

One interesting new name on this week's HOCS 20 is Accuray 3.75% of August 2016. This one won't be a long-term tenant, because we kick out bonds with less than a year to maturity. That said, the bond could be attractive to gamma addicts, especially if last week's (apparently) presentation-related pop follows through.

The overall HOCS 20 this week comes in with an average price just below 98, a yield of 2.83% and a premium of 52.3%, maintaining the reasonably defensive posture for which we have designed HOCS while allowing for decent upside participation should we return to a risk-on environment.

Restoration Hardware's zeroes dropped off the HOCS 20 thanks to last week's gains. Ever opportunistic, the company is bringing a new deal to market today—we examine the two bonds through our HOCS-tinted classes elsewhere in this issue.

HILLSIDE ADVISORS LLC

June 15, 2015

Hillside HOCS 20 List

	Description	Convert	Stock	HOCS Overall	HOCS Growth	HOCS Safety	Yield	Premium
1	QIHOO 0.50% 2020-08-15	92.75	67.75	81.3	76.7	90.4	4.04%	71.6%
2	INVENSENSE 1.75% 2018-11-01	95.75	15.02	80.4	79.9	81.5	3.09%	39.5%
3	QIHOO 2.50% 2018-09-15	99.50	67.75	79.0	73.8	89.3	2.91%	63.0%
4	QIHOO 1.75% 2021-08-15	89.25	67.75	77.7	80.3	72.6	4.62%	59.1%
5	CALAMP 1.625% 2020-05-15	99.75	19.36	73.8	78.9	63.7	1.68%	42.2%
6	SOUFUN 2.00% 2018-12-15	97.00	9.95	73.3	63.4	93.1	4.09%	91.3%
7	E-HOUSE 2.75% 2018-12-15	96.50	7.10	72.8	64.3	89.9	5.22%	104.8%
8	WEB.COM 1.00% 2018-08-15	97.75	22.67	72.5	76.2	65.2	1.74%	50.9%
9	ENVESTNET 1.75% 2019-12-15	100.25	43.23	72.0	69.6	76.8	1.69%	45.8%
10	IGI 3.50% 2019-12-15	93.00	6.56	71.5	79.5	55.5	5.27%	60.1%
11	HERBALIFE 2.00% 2019-08-15	88.50	52.50	69.9	70.8	67.9	5.10%	45.4%
12	TESLA 1.25% 2021-03-01	94.50	250.69	69.2	75.1	57.2	2.28%	35.7%
13	ANI 3.00% 2019-12-01	108.50	55.70	68.8	80.1	46.3	1.04%	35.4%
14	LINKEDIN 0.50% 2019-11-01	102.75	215.72	68.7	65.0	76.1	-0.13%	40.3%
15	TESLA 0.25% 2019-03-01	96.25	250.69	67.9	71.3	61.1	1.29%	38.2%
16	ACCURAY 3.75% 2016-08-01	102.00	7.07	67.0	72.3	56.4	1.93%	36.7%
17	JINKOSOLAR HOLDING CO LT 4.00% 2019-02-01	99.00	30.46	66.9	72.5	55.8	4.65%	48.9%
18	FIREEYE 1.625% 2035-06-01	111.00	51.80	66.3	82.6	33.8	0.04%	30.2%
19	HELIX 3.25% 2032-03-15	101.00	15.30	66.3	58.6	81.7	2.87%	65.1%
20	SOLARCITY 1.625% 2019-11-01	93.50	55.18	66.2	78.5	41.6	3.23%	41.5%

Sources: Bloomberg, Kynex

HILLSIDE ADVISORS LLC

June 15, 2015

Euro Gang of 20

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Our note today is going to be very brief. Not for the lack of excitement in the European convert land but rather due to the abundance of it. With the Greek bailout negotiations collapsing over the weekend, the markets are declining across the globe. This whole Greek situation is indeed quite unpleasant and in all likelihood will continue to be such for some time.

We did our European HARP calculations as of Friday's close and thus they are a bit stale given today's price moves. Still, we see further confirmation that the HARP methodology works. Despite last week's mixed performance, overall, there was evidence of cheapening with the average HARP score declining 0.1, which is more than it sounds given the HARP scale. Several securities moved down on deltas significantly higher than what a model would suggest (e.g. Adidas AG 0.25% of 2019). A couple of others saw their prices decline with underlying stock prices moving in the opposite direction (e.g. ACS Actividades Fin 2 1.625% of 2019).

As we mentioned on several occasions previously, the experience of the US convertible market from last fall when high HARP names cheapened significantly on the back of equity market declines pretty much validated our methodology. This should serve as a cautionary tale for all convertible investors everywhere. It appears that this week promises to be an interesting one. We hope that should the equity markets' decline continue the convertible asset class will exhibit its defensive characteristics, high HARP names notwithstanding.

HILLSIDE ADVISORS LLC

June 15, 2015

Euro HARP 20 (Prices as of June 12, 2015)

	Convertible	Price	Stock	Premium (%)	Premium (pts)	HARP
1	Drillisch AG 0.75% 2018	196.56	40.82	5.8	10.81	18.23
2	Cap Gemini Sogeti 0% 2019	89.39	78.14	14.4	11.25	13.40
3	Fresenius Se & Co KGAA 0% 2019	126.32	55.66	12.7	14.23	12.94
4	Suez Environnement 0% 2020	21.71	17.17	26.5	4.54	12.84
5	Fresenius Medical Care A 1.125% 2020	120.99	74.86	19.0	19.32	12.52
6	Rag-Stiftung 0% 2021	114.33	33.66	25.1	22.95	12.35
7	Deutsche Post AG 0.6% 2019	133.82	26.36	4.8	6.09	11.36
8	SAF-Holland Group 1% 2020	123.37	13.25	14.8	15.90	10.86
9	ACS Actividades Finance 2.625% 2018	120.37	6.14	11.7	12.62	10.79
10	Nexity SA 0.625% 2020	48.60	35.80	28.9	10.91	10.75
11	Rag-Stiftung 0% 2018	112.46	33.66	26.1	23.27	10.71
12	Adidas AG 0.25% 2019	114.36	70.20	34.4	29.27	10.48
13	ACS Actividades Fin 2 1.625% 2019	112.38	6.14	17.6	16.80	10.32
14	Buzzi Unicem SPA 1.375% 2019	114.08	12.95	40.8	33.08	9.66
15	Parpublica 5.25% 2017	112.98	11.00	55.1	40.13	9.63
16	Acciona S.A. 3% 2019	121.73	66.88	14.7	15.61	9.37
17	NH Hotel Group SA 4% 2018	123.89	5.12	19.1	19.90	9.14
18	Prysmian SPA 1.25% 2018	112.31	19.90	25.9	23.13	8.65
19	Astaldi SPA 4.5% 2019	124.40	8.15	12.9	14.26	8.26
20	Abengoa SA 6.25% 2019	125.67	2.99	23.4	23.84	8.08

Sources: Bloomberg

HILLSIDE ADVISORS LLC

June 15, 2015

New Issue: Restoration Hardware (RH) Convertible Senior Notes due 2020

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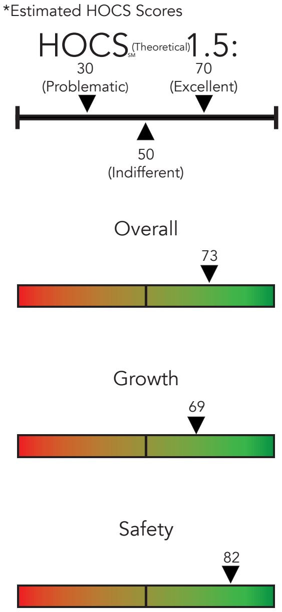
Theoretical Bond Pricing
RH

0.125% 2020/06/15
Price (Bond) = 100.00
Stock = $96.22
Premium = 27.5%
HOCS-Overall = 73
HOCS-Growth = 69
HOCS-Safety = 82

Stock Price as of June 12, 2015
*Estimated HOCS Scores



This morning, Restoration Hardware announced a new $250 million five-year convertible note issue. We believe the midpoint of the price talk to be 0.125% up 27.5%. While this issue has a great deal in common with the existing zero-coupon note, our HOCS methodology, which focuses on bonds at the new-issue sweet spot, still gives us some insights.

We noted in our HOCS 20 writeup that last week's earnings-related rally pushed the existing zero-coupon notes off the HOCS 20 list and into honorable-mention territory. Well, this morning's move may reverse things. As we write, the existing convertible is quoted around 101 ½ with the stock at 93 ½, forcing it to look more and more like the new issue. This is good for a HOCS slash line of 68/64/78. The new issue's provisional HOCS line is 73/69/82, notably better despite the similarity between the bonds. This comes largely because HOCS is designed to capture relatively small pricing differences around par because of the above-versus-below-par dichotomy major outright investors have traditionally exhibited.

That said, the new bond's HOCS advantage would essentially disappear if the old bond were to come down another point. So while we think an old-into-new swap is reasonable at current levels, we would not recommend selling the old bond much lower than its current price. Put another way, the market, given two similar bonds, has behaved efficiently this morning.

The net proceeds of the issue are aimed at RH's build-out of its next generation large format gallery stores. These stores, at about 45,000 sq. ft., are big enough to hold a majority of RH's complete merchandise line. Reports from the initial next generation Atlanta store are favorable and RH expects to have design galleries open in four additional cities by the end of 2015. These new stores are part of Restoration Hardware's strategy to offer product through tightly integrated sales channels including online, bricks-and-mortar stores and its famous catalogue.

Last week, Restoration Hardware announced quarterly results that beat consensus estimates on the top and bottom line, reporting revenues of $422 million versus consensus estimates of $419 million and adjusted EPS of $0.25 versus consensus estimates of $0.18. Free cash flow for the quarter was ($43.7) million on the back of $29 million in capital expenditures as it invests in its new, larger format stores. Importantly during the next generation store build-out, GAAP operating margins increased to 4.0% in Q1 2015 form 1.3% in the same period last year. The company also slightly increased 2016 full year revenue guidance and upped 2016 EPS guidance by about $0.06/share. We have been bullish on RH as it upgrades its bricks and mortar stores and continues to execute on its integrated store/internet/catalogue strategy.

Financial Summary
(LTM Pro Forma $MM)

Revenues:	$1,923
EBITDA:	214
FCF:	(6.5)
Cash & Equivalents:	419
Total Debt:	660
Leverage:	3.6

Source: SEC Filings & Hillside Advisors

HILLSIDE ADVISORS LLC

June 15, 2015

SouFun (SFUN): The Transformation Process Continues

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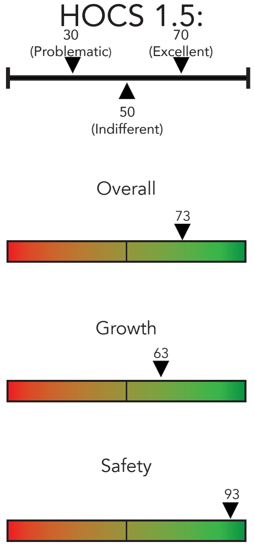
SFUN

2% 2018/12/15
Price (Bond) = 97.00
Stock = $9.95
YTP = 4.09%
Premium = 91.3%
HOCS-Overall= 73
HOCS-Growth = 63
HOCS-Safety =93

As of June 12, 2015

HOCS 1.5:



Like the transformative high school years for kids, real-estate Internet platform SouFun (SFUN) is growing up. The transition is never easy. You see the potential in a teenager, but behavior can be erratic and there are some disappointments along the way. As it turns out, SouFun is turning 16 this week and it is attempting to complete the transformation from an Internet-based real-estate listings company into an "adult" full service Chinese real-estate company.

For SouFun, that means expanding from a website with China real-estate listings to a transaction-based, "360 degree" approach that also includes interacting with developers, agents, buyers and renters in both the primary and secondary Chinese real-estate markets.

The new strategy has required a heavy investment in personnel and advertising. Unfortunately for SouFun, that investment coincided with the recent downturn in the Chinese real-estate market, crimping margins and causing SouFun to miss quarterly estimates. Now, however, the Chinese real-estate market appears to be turning and SouFun's new businesses are gaining traction. With a HOCS score of 73 overall/ 63 growth/ 93 safety against a convertible bond price of 97 and a stock price of $9.95/share, SouFun is poised to bounce back.

Company Description

The centerpiece of SouFun's business has always been its real-estate Internet portal, fang.com (fang means home), which includes real-estate listings from 350 cities across China, as well as Hong Kong, Taiwan, Singapore and Vancouver, Canada. The portal had 53.2 million unique visitors and 32.8 million reregistered members as of the fourth quarter of 2014. SouFun traditionally monetized the website by offering marketing and listing services to developers and brokers through the portal. Marketing services include selling banner and links to developers and agents. Listing services include on-line stores for developers and agents. SouFun lets individuals list their properties free of charge on the site in order to deepen the listing base of the site in order to draw additional visitors.

With the burgeoning China real-estate market as a tailwind, SouFun enjoyed strong growth with this original business model, increasing sales from $39 million in 2006 to $224 million in 2010, for a 55% compound annual growth rate. Gross margins were strong at 72% and operating margins were 35% in 2010. The vast majority of fees were derived from primary real-estate market developers as the secondary market was much slower to grow in China.

SouFun has since added several new businesses over the years as follows:

Service	Segment	Year Established
Listings	Listing	Legacy Business
Marketing & Promotion	Marketing	Legacy Business
Home Furnishing Web Site	E-Commerce	2011
Real Estate Membership	E-Commerce	2011
Direct Sales Service	E-Commerce	2014
Real Estate Brokerage	E-Commerce	2014
Financial Products	Other	2015

Source: Company filings & Bloomberg

Each segment has continued to grow with marketing services beginning to mature.

($ million)	2010	2011	2012	2013	2014
Marketing services	167,711	246,634	249,861	278,322	294,484
E-commerce services	—	24,170	102,162	188,107	244,344
Listing services	40,355	67,125	72,874	161,547	145,654
Other value-added services	3,001	5,897	5,361	9,403	18,400
Other value-added products	13,423	—	—	—	—
Total revenues	224,490	343,826	430,258	637,379	702,882

Source: Company filings

In 2011, SouFun launched jiatax.com, an Internet platform for third party sellers of home furnishings. It was SouFun's first foray into the transaction business, with SouFun taking a 5% to 15% transaction fee on products sold through the site. SouFun refers to its transaction business as its E-commerce services.

SouFun then added a real-estate-based transaction service for developers and their retail clients. The product includes a membership service in which members would pay between RMB 5,000 and 20,000 to join and then receive discounts on property purchases from developers. In 2014, SouFun added a twist on the membership business, which they refer to as direct sales services. In the direct sales service product, membership to receive discounts is free for individuals and SouFun takes a fee from the developer when a sale is made.

The E-Commerce segment has grown rapidly, essentially starting from scratch in 2011 and reaching revenues of $244 million in 2014.

In 2015, SouFun launched the company's online brokerage services which is aimed at establishing SouFun's presence in every part of the transaction in the Chinese secondary real-estate market. SouFun serves as an online intermediary between buyers and sellers, offering services including property listings, advisory services, transaction negotiation and documentation. SouFun is also leveraging the system to enter the rental market. The company has launched the service in five major urban centers including Beijing and Shanghai.

To expand its services more efficiently, SouFun has invested in and partnered with a number of bricks- and-mortar real-estate agencies, but friction has developed in some of those partnerships because SouFun and the partners are essentially competing for the same customer. SouFun is presenting such partnerships as a frenemy relationship. SouFun offers the offline brokers the use of the SouFun platform to make the brokers more efficient allowing them to close more transactions, but at a lower profit as they share fees with SouFun.

Not everyone is buying that approach, however. For example, SouFun and Century 21 China originally announced an expanded relationship, with SouFun investing in Century 21 China, but the parties could not come to terms.

SouFun is also developing its own national network of boots on the ground representatives under the SouFun franchise umbrella, mainly in secondary cities. At the end of the first quarter 2015, there were 2,143 franchise partners. For a fee, the franchisees receive training and the use of the SouFun name to promote the SouFun primary, secondary, rental and home furnishings business.

Finally, SouFun launched a financial-services product platform to assist buyers in obtaining financing to purchase real estate. Home buyers will have access to traditional commercial banks to obtain mortgages and SouFun is also attempting to set up a P2P (peer-to-peer) system whereby after SouFun makes a loan to a client, the company will seek to sell it to other investors through its website.

While the early e-commerce businesses were added with little expense, the direct sales and financial businesses have demanded a much higher investment. SouFun has hired 11,000 new employees in order to offer the new brokerage and financial services and SouFun has also stepped up its advertising through other online vehicles such as Baidu, Sina and Tencent. These investments and the slow China real-estate market weighed on first quarter results.

Weak Quarterly Results

First Quarter 2015 results missed EPS estimates:

Revenue in $ millions

	Actual 3-31-15	Consensus Estimate 3-31-15	Percent Difference Act. V. Est.	Previous Year Actual 3-31-14	Percent Change Y-O-Y
Revenue	*$123.4*	*$117.7*	*4.8%*	*$121.2*	*1.8%*
Adjusted EPS	*$0.02*	*$0.04*	*(50.0%)*	*$0.11*	*(81.8%)*

Company Filings and Bloomberg

The slim revenue gain was a result of the Chinese real-estate market slowdown. The decrease in EPS was a result of the new hiring and advertising expenses. Gross margins dropped to 65% in Q1 2015 from 79% in Q1 2014. Operating margins dropped to 6% in Q1 2015 from 38% in Q1 2014.

However, the new direct-sales businesses seem to be gaining traction. SouFun closed $2 billion in gross market value (GMV) of new homes and $1.1 billion of GMV in secondary homes from January to April 2015. Most importantly, closings increased every month, albeit off a very low base. The direct sales business was the main contributor to the 75% increase in e-commerce revenue, totaling $51.5 million for the quarter. That's compared to a 13.5% decrease in marketing revenue and a 44% decrease in listing revenue. All of SouFun's businesses should perk up as the real-estate market bounces back.

Equity & Convertible Bond Thoughts

Despite the disappointing first quarter, SouFun bumped up its 2015 revenue guidance from $773 million to $808 million after it issued its first quarter results. EPS should rebound even more rapidly as the company leverages its fixed investment in human resources.

Soufun's stock has been beaten down as the company endured a slower Chinese real-estate market and the consequential margin squeeze. Falling from historical highs at just under $20/share in early 2014 to $5/share after releasing Q4 2014 earnings, the stock looks priced to appreciate further as the China real-estate rebound continues. With a higher fixed-cost base, SouFun needs to grow revenues. The new direct sales products are well positioned to capture a reasonable share of the expanding rental and secondary real-estate markets. As a testament to the SouFun strategy, operating cash flow has remained positive even while the company has pumped money into the business.

In addition to the stock, the 2.0% 2018 convertible bond seems like a good place for long-only convertible funds looking for yield as the bond sports a 4.09% yield to a 2016 put and a 2.91% yield-to-maturity. While the convertible bond still has a 91.3% premium, continued market penetration by SouFun and the ability to leverage its expanding network may even provide enough spark to launch the SouFun equity back to old highs, which would put the bond at the money.

Bond holders might even be able to enjoy a quick score if SouFun mimics competitor E-House management's bid to take the company private. Last week E-House management surprised the market by lobbing a bid to take the company private at a mere 15% premium to the recent stock trading range, no doubt thinking that an arbitrage trade was available in China's red-hot IPO market. Going private in the US and taking the company public in the red hot China market seems to make sense, or at least it is worth a try with a cheap bid. SouFun could see the wisdom of the move and try the same strategy.

Even if SouFun management continues to stick with its US listing, we prefer the company to E-House. SouFun is plowing money into businesses at the heart of the Chinese real-estate market which looks set to expand over the long term, regardless of any boom/bust cycles. That's the opposite of E-House, which seems to have wandered a bit off course with its foray into the tangential social media space. We like SouFun's strategy of sticking to businesses that it knows best.

HILLSIDE ADVISORS LLC

June 15, 2015

Financial Summary

SFUN (Dollars in Millions)	Fiscal Years Ended					LTM		Quarter Ended	
	31-Dec-10	31-Dec-11	31-Dec-12	31-Dec-13	31-Dec-14	31-Mar-14	31-Mar-15	31-Mar-14	31-Mar-15
Revenues	224	344	430	637	703	668	705	121	123
Y / Y Change	----	53.2%	25.1%	48.1%	10.3%	----	5.6%	----	1.8%
Gross Profit	162	277	349	535	557	560	541	96	80
Operating Profit	78	140	199	350	310	362	267	50	7
EBITDA	81	146	207	364	323	260	282	52	11
Interest Expense	0	4	12	15	17	16	16	5	4
Income Tax Expense	18	43	56	70	82	73	72	15	6
Capital Expenditures	(6)	(60)	(18)	(7)	(8)	N/A	N/A	N/A	N/A
% Revenues	-2.5%	-17.5%	-4.2%	-1.1%	-1.1%	N/A	N/A	N/A	N/A
Free Cash Flow	101	98	201	401	206	N/A	N/A	--	--
Total Debt	4	256	351	621	581	581	581	581	581
% Total Debt	2802.2%	38.2%	57.1%	64.7%	35.6%	N/A	N/A	N/A	N/A
Gross Margin	72.4%	80.6%	81.2%	83.9%	79.3%	83.9%	76.7%	79.5%	64.7%
Operating Margin	34.9%	40.8%	46.1%	55.0%	44.0%	54.3%	37.9%	40.9%	6.1%
EBITDA Margin	36.0%	42.4%	48.2%	57.0%	45.9%	39.0%	40.0%	43.2%	8.5%

Source: Bloomberg, SEC Filings

Credit Waterfall

SFUN (Dollars in Millions)	31-Mar-15	Total Debt (Cum. Bal.)	EBITDA Multiple	Net Debt (Cum. Bal.)	EBITDA Multiple
Current Share Price	$9.95				
Shares Out. (Millions)	414.0				
Latest Twelve Months:					
EBITDA	282				
Cash & Cash Equivalents	668				
Bank Loans					
Short-Term Bank Loans	81				
Long-term Bank Loans	100				
Senior Unsecured Debt					
2.00% Senior Cvt. Notes due 2018	400				
Total Debt	581	581	2.1x	(87)	NM
Equity Market Cap.	4,119	---	---	---	---
Enterprise Value	4,032	---	---	4,032	14.3x

Source: SEC Filings

HILLSIDE ADVISORS LLC

June 15, 2015

Insulet Corp (PODD): Priming the Pump

Kathy Schick
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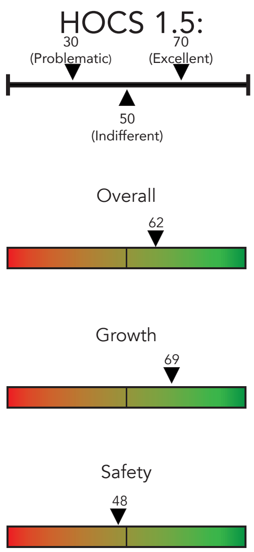
PODD

2% 2019/06/15
Price (Bond) = 96.75
Stock = $29.91
YTM = 2.87%
Premium = 50.4%
HOCS-Overall = 62
HOCS-Growth = 69
HOCS-Safety = 48

As of June 12, 2015



We first took a look at Insulet in early February (February 3, 2015 Hybrid Vigor) when the convert made it onto the HOCS 20 list as a result of the convertible bond following the stock down on disappointing fourth quarter sales guidance. Since then the stock has traded in a range of $26.23 to $35.62, with the price in the middle of the range currently. The convertible bond has traded as high as 104.875 during that period and was as low as 90.50. Like the stock, it is trading in the middle of that range. The premium has contracted a bit since our last look and is now at 50.4%. We still think the bond is attractive with good downside protection, a yield-to-maturity of 2.87%, and significant upside possible.

First Quarter 2015 Results

Since we already covered the company's history and detail on what it does in our last piece, we can jump right into what has happened since February. For those who want a refresher, though, we have included the company description at the end of this piece.

PODD announced first-quarter 2015 results on April 30. Adjusted EPS was in line with expectations but revenue fell short. Total revenue for the quarter was $61.2 million versus management's guidance of $67 to $69 million and a consensus estimate of $68 million. Management attributed the shortfall to: (1) $4 million reduction in international safety stock; (2) $2 million delayed shipments of drug delivery products; and (3) $1 million neighborhood business shipments impacted by harsh winter weather.

Table 1: Revenue Summary

Net Sales						
(in millions)	Q1 2015	Q1 2014	% Chg	FY 2014	FY 2013	% Chg
US OmniPod	$39.2	$40.8	-3.9%	$173.4	$150.7	15.1%
Int'l OmniPod	3.7	12.8	-71.1%	50.2	24.7	103.2%
Drug Delivery	4.7	1.2	291.7%	5.4	7.9	-31.6%
Neighborhood	13.6	14.4	-5.6%	59.7	63.8	-6.4%
Total Net Sales	$61.2	$69.2	-11.6%	$288.7	$247.1	16.8%

Sources: Company Filings

PODD's European distribution partner, Ypsomed, had previously been holding high levels of safety stock due to prior production issues that had led to delays in filling orders.

PODD added a fourth production line at Flextronics in late 2014, which has eliminated the prior production issues. Ypsomed reduced its safety stock levels in the first quarter now that the turnaround on shipments is much quicker. This resulted in a larger than expected reduction in international sales in the first quarter. Sales to Ypsomed are expected to return to normal levels in the second quarter. Inventory in the US was also reduced for the same reasons, but was in-line with expectations and did not contribute to the shortfall.

PODD is focused on finding new opportunities outside diabetes to use its drug-delivery technology. Amgen received FDA approval in January for an on-body delivery system for Neulasta, an injection that reduces the risk of infection during strong chemotherapy. PODD entered an agreement with Amgen in late 2013 to use its OmniPod technology for an on-body injector for Neulasta. The first shipments occurred in February. Timing issues in March led to a $2 million shortfall in revenue relative to guidance in the first quarter. The shortfall is expected to be recovered going forward and management expects this business to be a larger contributor to revenue.

Of the $7 million revenue shortfall during the quarter, management expects $6 million to be realized during the year. The company reaffirmed its full year 2015 sales guidance of $305 to $320 million with growth to resume in the second half of the year. For the second quarter revenue is expected to be in the range of $67 to $70 million.

The Way Forward

There are a number of reasons to be optimistic that sales growth will return in the near term. The OmniPod currently has 15% market share for pumpers and only about 4% of the overall Type 1 Diabetes market in the US. This gives the company significant room for growth just in the US market.

Management plans to spend an additional $15 million this year on US sales and marketing. An additional 15 sales reps will be added in the US bringing the total to 150. A new executive team has been brought on board to focus on execution. Historically the company has been primarily focused on patients. While it will continue to focus on the patient, it has come to realize that healthcare providers and payers are equally important to drive growth. Additional resource will also be devoted to getting Medicare reimbursement for the OmniPod.

The drug-delivery business has significant potential growth. The company initiated shipments for Amgen's on-body Neulasta injector in the first quarter and is in talks with other companies relating to non-diabetes drugs that could use the OmniPod drug delivery system. Management has guided for drug delivery revenues of $15 to $20 million for full year 2015 up from $5 million in 2014.

PODD has a new personal diabetes manager (PDM) under development. The company expects to file for approval of the device with the FDA by the end of 2015. The new device will have added capabilities and integrated blue tooth technology. The company is also working on a Type 2 diabetes PDM through a collaboration with Eli Lilly.

Management expects the business to attain operating profit break even by late 2015. In the meantime liquidity is good with the cash on hand. Aside from $11 million of capital leases, the convertible bonds are the only debt and are not due for another four years.

The 2.0% Convert

The 2% senior convertible notes of 2019 receive a HOCS slash line of 62 Overall / 69 Growth / 48 Safety, a good score which places it just outside of the HOCS 20. We feel the score continues to reflect the company's prospects accurately with the potential for strong sales in the near term but with very modest

EBITDA and negative free cash flow still present. The convert profile remains attractive with the price below par, a premium just over 50%, and a yield-to-maturity of 2.87%.

Company Description

PODD is a medical-device company focused on diabetes. Its primary business is the OmniPod Insulin Management System, an insulin infusion system for people with insulin-dependent diabetes. It is the only tubeless pump on the market. The company began marketing the system in the US in 2005 and introduced an improved model in 2013. The system is also sold in Europe, through a partnership with Ypsomed, and in Canada, through a partnership with Glaxo. In June 2011 the company acquired Neighborhood Diabetes to expand its diabetes offerings to a full suite including blood glucose testing supplies, traditional insulin pumps, pump supplies and pharmaceuticals. Through the acquisition, PODD also obtained access to a larger number of insulin dependent patients. PODD has the capability to process claims as either durable medical equipment or through pharmacy benefits.

PODD is focused on insulin-dependent diabetes. There are two types of intensive insulin management therapies available today. Multiple daily injections (MDI) therapy involves using syringes or insulin pens. MDI therapy can require up to six shots per day. The other option is continuous subcutaneous insulin infusion (CSII) therapy. CSII therapy involves using an insulin pump. CSII is more expensive than MDI and currently accounts for about 27% of the market versus 73% for MDI. PODD accounts for about 15% of the CSII market. The up-front cost for the OmniPod system is lower than traditional insulin pumps, but the ongoing costs are higher. Management has chosen this pricing strategy because it makes CSII therapy more accessible to insulin-dependent patients and there is less risk for third-party payers due to the lower upfront expenditures. This strategy provides the company with a recurring revenue stream once it has a new customer signed up.

Credit Waterfall

Insulet Corp (PODD) (Dollars in Millions)	31-Mar-15	Total Debt (Cum. Bal.)	Adj. EBITDA Multiple	Net Debt (Cum. Bal.)	Adj. EBITDA Multiple
Current Share Price	$29.91				
Shares Out. (Millions)	56.8				
Latest Twelve Months:					
EBITDA (Adj.)	17				
Free Cash Flow	(7)				
Cash & Cash Equivalents	146				
Senior Secured Debt					
Cap Leases	11	11	0.6x		
Senior Unsecured Debt					
2.00% Senior Cvt. Notes due 2019 (1)	201	212	12.5x	67	3.9x
Total Debt	212	212	12.5x	67	3.9x
Equity Market Cap.	1,699	---	---	---	---
Enterprise Value	1,766	---	---	---	103.9x

(1) Reflects principal amount of convertible securities outstanding, unadjusted for unamortized debt discount.

Sources: Bloomberg, Company Fil

HILLSIDE ADVISORS LLC

June 15, 2015

Financial Summary

PODD (Dollars in Millions)	Fiscal Years Ended 31-Dec-12	31-Dec-13	31-Dec-14	LTM 31-Mar-15	Quarter Ended 31-Mar-14	31-Mar-15
Revenues	211	247	289	281	69	61
Y / Y Change	38.8%	16.9%	16.9%	8.5%	----	-11.5%
Gross Profit	92	112	143	143	33	33
Operating Profit	(36)	(29)	(12)	(19)	(2)	(9)
EBITDA (Adj.)	(15)	(3)	22	17	6	0
Interest Expense	16	17	15	13	4	3
Income Tax Expense	0	0	0	0	0	0
Capital Expenditures	(11)	(7)	(11)	(14)	(2)	(4)
% Revenues	-5.2%	-3.0%	-4.0%	-4.9%	-3.1%	-7.1%
Free Cash Flow	(40)	(4)	(3)	(7)	(3)	(8)
Total Debt (1)	118	122	175	181	124	181
% Total Debt	NM	NM	NM M	NM M	NM	NM
Gross Margin	43.7%	45.5%	49.6%	51.0%	47.4%	53.6%
Operating Margin	NM	NM	NM	NM	NM	NM
EBITDA (Adj.) Margin	NM	NM	0.0%	NM	NM	NM

(1) Reflects carrying amount of convertible securities outstanding, net of unamortized debt discount.

Sources: Bloomberg, Company Filings

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