

REVERSE CONVERTIBLES

AN OVERVIEW

Reverse Convertibles are complex structured products that combine the characteristics of debt and options to provide a relatively high income stream to the investor. These securities are unsecured senior debt obligations of the issuer and have maturities that usually range from three months to one year. Depending on the performance of the underlying equity, at the maturity of the securities, investors may receive full return of principal or be delivered shares of the underlying equity. Many Reverse Convertibles have some limited downside protection, known as a “knock-in” level, on the underlying equity. As long as the equity does not close below the knock-in level, the investor will receive their full principal at maturity. If the equity closes below the knock-in level at any time prior to maturity, the investor may receive a predetermined number of shares which will be worth less than the original principal amount. Therefore, return of principal is not guaranteed and could be zero. It is important to note that the investor’s earning potential is limited to the security’s stated coupon. The investor will not participate in any upside from the underlying equity.

A BASIC EXAMPLE

Underlying Equity	ABC Corp.			
Term	Six months			
Annualized Coupon	15% per year (7.50% for the 6 month period), paid monthly			
Initial Equity Price	\$20 per share			
Knock-in Level	80%			
Knock-in Price	\$16 per share (80% of the Initial Equity Price)			
Principal Amount	\$10,000			
Number of Shares	500 shares			
Payment at Maturity	In addition to the monthly coupon, the investor will receive <i>either</i> : <table border="1" style="margin-left: 20px;"> <tr> <td> <p>A. Full Return of Principal <i>Stock performs well and has not closed below the knock-in price:</i></p> <p>If the stock has not closed below the knock-in price of \$16 at any point over the term of the security, the investor will receive full return of principal, or \$10,000.</p> </td> </tr> <tr> <td style="text-align: center;"><i>OR</i></td> </tr> <tr> <td> <p>B. Equity Shares Worth Less Than Original Principal Amount <i>Stock has closed below the knock-in price:</i></p> <p>If the stock has closed below the knock-in price of \$16 at any point over the term of the security, the investor will be delivered 500 shares of the underlying equity. The value of the shares will be less than the original principal amount of \$10,000.</p> </td> </tr> </table>	<p>A. Full Return of Principal <i>Stock performs well and has not closed below the knock-in price:</i></p> <p>If the stock has not closed below the knock-in price of \$16 at any point over the term of the security, the investor will receive full return of principal, or \$10,000.</p>	<i>OR</i>	<p>B. Equity Shares Worth Less Than Original Principal Amount <i>Stock has closed below the knock-in price:</i></p> <p>If the stock has closed below the knock-in price of \$16 at any point over the term of the security, the investor will be delivered 500 shares of the underlying equity. The value of the shares will be less than the original principal amount of \$10,000.</p>
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IMPORTANT INVESTMENT CONSIDERATIONS

Investor Profile

Reverse Convertibles may not be a suitable investment for all investors due to the potential for loss of principal. Reverse Convertibles are created using a debt instrument and a put option. With a Reverse Convertible, the investor sells the issuer the right to potentially deliver the underlying equity to the investor at some point in the future. At maturity, the investor could receive either cash or shares of the underlying equity.

Reverse Convertible investors should have the financial knowledge and experience needed to evaluate the risks of such a transaction, and be financially able to bear the risk of a loss of principal. These investments are most suitable for sophisticated investors who are familiar with option and equity investing. In addition, because there can be no assurance that a secondary market will develop or be maintained, Reverse Convertibles are suitable for investors who intend to hold them until maturity.

Principal Risk

Reverse Convertibles do not guarantee return of principal at maturity. The investor’s payment at maturity is based on the performance of the underlying equity and could be zero. If the underlying equity has closed below the knock-in price at any point over the term of the security,

the investor may receive a predetermined number of shares of stock whose value will be less than the original amount invested. However, an increase in the value of the underlying equity will not increase the return on the Reverse Convertible.

Credit Risk

The creditworthiness of the issuer is an important consideration when evaluating any debt instrument. A purchaser of a Reverse Convertible must rely upon the issuer's ability to meet its obligations to make payments of principal and interest. However, it should be noted that because Reverse Convertibles are not principal-protected, the credit quality of the issuer on its own is not a sufficient measure of the safety of the principal invested. The expected performance of the stock must also be taken into consideration.

Liquidity Risk

Investors may have limited opportunities to redeem Reverse Convertibles prior to maturity. A secondary market is not guaranteed and may not exist. The issuer of the Reverse Convertible security will attempt, but is not obligated, to provide a market in the security. Any secondary market price may be influenced by unpredictable factors including prevailing market conditions, and the security may be worth less or more than its original cost. Reverse Convertibles are intended to be held to maturity.

Tax Implications

Because Reverse Convertibles are structured using two components, a debt portion and an option portion, there are differences in tax treatment between Reverse Convertibles and traditional fixed income securities. It is generally accepted that the holder of a Reverse Convertible will be required to pay ordinary income tax on a portion of the income and treat another portion of the income as a short-term capital gain at maturity. For this reason, it is recommended that these securities be purchased in tax-advantaged accounts. Investors should read the relevant section of the prospectus or offering circular carefully and should consult their tax advisor prior to any purchase.

CONCLUSION

Reverse Convertibles may be attractive investments for investors who seek a higher income stream than can be found with conventional fixed income securities. However, the investor must be willing to accept a risk of principal loss, and potentially owning the underlying equity. Investors considering a purchase of Reverse Convertibles should also have knowledge of options due to the option component of a Reverse Convertible. Each Reverse Convertible is offered pursuant to a prospectus or offering circular and pricing supplement. Investors should read each document carefully and contact their Janney Financial Consultant for more information before making an investment decision.

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