

STATEMENT OF POLICY REGARDING PREFERRED STOCK

Amended April 27, 1997

- I. INTRODUCTION. The North American Securities Administrators Association, Inc. ("NASAA") has determined that the following guideline relating to preferred stock is consistent with public investor protection and is in the public interest. Nothing shall prevent the Securities Administrator ("Administrator") from applying different standards than those contained in this Statement of Policy.
- II. DEFINITIONS. The terms used in this Statement of Policy are defined pursuant to the NASAA Statement of Policy Regarding Corporate Securities Definitions.
- III. A public offering of preferred stock may be disallowed by the Administrator if the Issuer's ADJUSTED NET EARNINGS for the last fiscal year or its average ADJUSTED NET EARNINGS for the last three (3) fiscal years prior to the public offering were insufficient to pay its fixed charges and preferred stock dividends, whether or not accrued, and to meet the redemption requirements, if applicable, of the preferred stock being offered.
- IV. As an alternative to III. above, the Administrator may choose to apply a CASH ANALYSIS. The Administrator may consider the Statement of Cash Flows if the statement demonstrates that the issuer has had positive "Net Cash Provided by Operating Activities" for its last fiscal year. The Administrator may request that the issuer submit a financial statement demonstrating an average positive "Net Cash Provided by Operating Activities" for the last three (3) fiscal years prior to the public offering. In either instance there must be sufficient cash to cover the preferred stock dividend whether or not declared.
- V. Section III. and IV above shall not apply to public offerings of convertible preferred stock that are superior in right to payment of dividends, interest and liquidation proceeds to any convertible debt and preferred stock that are or may be legally or beneficially, directly or indirectly, owned by PROMOTERS. The risks of failure to declare or pay dividends and the equity characteristics of the convertible preferred stock must be disclosed in the offering prospectus. An offering of such securities may be reviewed using guidelines for equity offerings.
- VI. If the Issuer's NET EARNINGS are subject to cyclical fluctuations or if the Administrator deems it necessary for investor protection, the Administrator may require that the Issuer establish redemption requirements.
- VII. A public offering of EQUITY SECURITIES may be disallowed by the Administrator if the Issuer's articles of incorporation authorize its board of directors to issue preferred stock in the future without a vote of the common shareholders unless:

- A. The issuer represents in its prospectus or offering document that it will not offer preferred stock to PROMOTERS except on the same terms as it is offered to all other existing shareholders or to new shareholders; or
- B. The issuance of preferred stock is approved by a majority of the Issuer's INDEPENDENT DIRECTORS who do not have an interest in the transaction and who have access, at the issuer's expense, to issuer 5 or independent legal counsel.

ANALYST NOTES

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PURPOSE

The purpose of this policy is to determine whether an offering of preferred stock is consistent with public investor protection and is in the public interest. (Do the preferred shareholders have superior rights to the promoters or other insiders or, are earnings (or cash flow) adequate to pay dividends on the preferred shares?)

POLICY SUMMARY

Adjusted New Earnings are the issuer's net earnings after charges for interest and dividends, adjusted on a pro forma basis to reflect:

- The elimination of any required charges for debt, debt securities, or preferred stock that are to be redeemed or retired out of the offering proceeds;
- The effect of any acquisitions or capital expenditures that were made by the issuer after its last fiscal year, or which are proposed or required to be made during the current fiscal year, which materially affect the issuer's net earnings;
- The effect of charges or dividends on debt, debt securities, or preferred stock issued after the issuer's last fiscal year;
- The effect of any charges or dividends on debt, debt securities, or preferred stock that were issued during the issuer's last fiscal year, but were outstanding for only a portion of such fiscal year, as if charges or dividends, such debt, debt securities, or preferred stock had been outstanding for the entire fiscal year; and
- The effect of any other material changes to the Issuer's future net earnings.

A public offering of preferred stock may be disallowed if the Issuer's adjusted net earnings (in the alternative, a cash analysis) for the last fiscal year, or its average adjusted net earnings for the last three fiscal years, were insufficient to pay its fixed charges and preferred stock dividends and to meet the redemption requirements, if applicable.

A cash analysis may be used as an alternative to the adjusted net earnings computation. The Lead Examiner may request a Statement of Cash Flows from

counsel or from the issuer. New Cash Provided by Operating Activities will be reflected on the Statement of Cash Flows in conformity with generally accepted accounting principles. This formula will add back certain noncash charges such as depreciation, depletion, and amortization. If debt securities are to be redeemed or retired from the proceeds of the public offering, a pro forma adjustment for the elimination of the related interest charges, net of applicable income taxes, must be made. The issuer must demonstrate that it had positive Net Cash Provided by Operating Activities for its last fiscal year. The Lead Examiner may wish to request that the issuer submit a financial statement demonstrating an average Net Cash Provided by Operating Activities for the last three fiscal years.

The Lead Examiner shall not apply the foregoing policy to public offerings of convertible preferred stock, and such offering may be reviewed using guidelines for equity offerings (corporate securities) if:

- The convertible preferred stock is superior in right to payments of dividends, interest, and liquidation proceeds to any convertible debt and preferred stock that are or may be legally or beneficially owned by promoters.
- The risks of failure to declare or pay dividends and the equity characteristics of the convertible preferred stock are disclosed in the prospectus.

A public offering of Equity Securities (corporate securities) may be disallowed if the issuer's articles of incorporation authorized its board of directors to issue preferred stock in the future without a vote of the common shareholders unless:

- The issuer represents in the prospectus that it will not offer preferred stock to Promoters except on the same terms as it is offered to all other existing shareholders or to new shareholders

Or

- The issuance of preferred stock is approved by a majority of the issuer's Independent Directors who do not have an interest in the transaction and who have access, at the Issuer's expense, to issuer or independent legal counsel.

WHERE TO LOOK

In "Description of Securities" "Selected Financial Data", and in the Financial Statements.

REVIEW ISSUES AND POTENTIAL SOLUTIONS

It may be difficult to determine whether a public offering of preferred stock may be disallowed. The difficulty is in determining whether the Issuer's adjusted net earnings are sufficient to pay its fixed charges and preferred stock dividends and to meet the redemption requirements of the preferred stock being offered. If a cash analysis is applied it may be difficult to determine the total amount of non-cash charges that should be included in calculating the ratio.

The pro forma ratio of adjusted net earnings to fixed charges must be at least 1 to 1. (This should be determined by the Lead Examiner. It may be incorrectly determined in the prospectus.)