

Case 23-2c

Nearly There

Nearly There (the “Company”), an SEC registrant, designs, develops, manufactures, and sells various navigation products and services. Because of significant research and development expenses and slumping sales results in recent periods, the Company is in need of additional capital to continue product development and to meet projected operating budgets for the coming year.

In November 20X2, the Company issued 5 million shares of Series B preferred stock at \$1.20 per share (the “Original Issue Price”) to new investors (the “Series B Preferred Stock”). Total proceeds, net of issuance costs, received by the Company from this issuance were approximately \$5.9 million. The significant terms of the Series B Preferred Stock are as follows:

- The par value of the Series B Preferred Stock is \$0.01 per share.
- *Dividends* — In each calendar year, the holders of the then-outstanding Series B Preferred Stock are entitled to receive, when, as, and if declared by the Company’s board of directors, cumulative dividends at the annual dividend rate of 8 percent of the Original Issue Price, as appropriately adjusted for any stock dividends, combinations, reclassifications, recapitalizations, or splits with respect to such shares.
- *Voting rights* — Holders of the Series B Preferred Stock have protective voting rights to vote together with the common stockholders on an as-converted basis on certain significant events (e.g., change in control, major asset sales, extraordinary distributions).
- *Conversion option* — At the holders’ option and at any time after the date of issuance, each share of the Series B Preferred Stock can be converted into the Company’s common stock. The initial conversion price is \$1.20, which is subject to certain adjustments including:
 - Stock dividends and combinations or subdivisions of common stock.
 - Reclassification and reorganization.
 - Adjustments for additional issuance of the Company’s equity securities.
- *Conversion price adjustment* — The conversion price will adjust downward if any equity security is issued by the Company for an amount per share that is less than the then-existing conversion price of the Series B Preferred Stock, thus providing “down-round protection” to the holders of the preferred stock.
- *Optional redemption feature* — After the third anniversary of the original issue date of the Series B Preferred Stock and upon the vote or written consent of at least a majority of the then-outstanding shares of Series B Preferred Stock, holders can

redeem the outstanding shares of the Series B Preferred Stock for cash. The redemption value is the Original Issue Price plus all declared but unpaid dividends.

- *Mandatory redemption feature* — After the sixth anniversary of the original date of the Series B Preferred Stock, the outstanding shares of the Series B Preferred Stock must be redeemed for cash. The redemption value is the Original Issue Price plus all declared but unpaid dividends.

Upon evaluation of the Series B Preferred Stock, the Company considered the economic payoff profile of the potential embedded features and concluded that the following separate units of account require further evaluation: (1) the conversion option and (2) the redemption option (includes both the optional redemption feature and mandatory redemption feature).

Additional facts:

- The conversion option was set at the money at issuance.
- The Company is well capitalized. The market capitalization of its common stock is \$100 million.
- The Company's common stock is publicly traded and the number of shares to be exchanged in the event that the Series B Preferred Stock is converted is small relative to the daily transaction volume of the Company's common stock.
- The Series B Preferred Stock is not remeasured at fair value. Accordingly, there are no changes to earnings related to Series B Preferred Stock after the issuance.
- The embedded features are deemed not to meet any scope exceptions in ASC 815-10-15.