

# RIMÔN



## When You Can't Bootstrap Anymore - Early-Stage Venture Financing: SAFEs vs. Convertible Notes vs. Priced Equity

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# Disclaimer

Tell me you did not see this coming ...

- **Disclaimer**

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# Introduction

## Overview

- Understanding the key instruments in early-stage venture financing
- Importance of choosing the right financing method
- Focus on:
  - SAFEs (Simple Agreement for Future Equity)
  - Convertible Notes/Convertible Promissory Notes #something
  - Priced Equity

# Early Stage Fundraising Models

- Decision #1 –

Priced Equity v. Convertible Instrument

- Decision #2 –

SAFE v. Convertible Note



# Definitions

- Discount
- Valuation Cap
  - Pre-Money
  - Post-Money
- Goal – reward investors for added risk of being early



# Key Documents

- **SAFE**
  - SAFE Agreement (that's it)
  - [Side Letter]
- **Convertible Note**
  - Note
  - [Note Purchase Agreement]
  - [Side Letter]
- **Price Equity**
  - Stock Purchase Agreement
  - Certificate of Incorporation
  - Investor Rights Agreement
  - Voting Agreement
  - Co-Sale/Right of First Refusal Agreement

# SAFEs

- SAFE (Simple Agreement for Future Equity)
  - Documentation – SAFE Note
  - Terms
    - Discount
    - Conversion Cap
      - Pre-money
      - Post-money
    - Pro-Rata Rights
    - Most Favored Nations
- <https://www.ycombinator.com/documents>

# Convertible Notes

- Documentation – Note Purchase Agreement + Note OR Note
- Side Letters for Major Investors
- Terms
  - Discount
  - Interest Rate
  - Maturity Date
    - Conversion at maturity
    - Payout at maturity
  - Conversion Cap
    - Pre-money
    - Post-money
  - Pro-Rata Rights
  - Most Favored Nations
  - Cap on amounts raised



# How Does it Work

- Example:
  - Financing round of \$10M results in a per share price of \$1
  - Financing by SAFE or Convertible Note of \$500,000
- Conversion with no discount or cap – 500,000 shares
- Conversion of SAFE/Convertible Note with 20% discount - 625,000 shares (purchase price of .80)
- Conversion of SAFE/Convertible Note with Cap of \$5M – 1,000,000 shares (per share price of \$1/share at \$10,000,000 means share price of \$.50/share at a \$5,000,000 valuation)

# What Funding Structure Is Better?

- In theory, SAFEs are more founder-friendly than Convertible Notes
- In practice, assuming a Convertible Note does not remain outstanding for a significant period of time, it is more of a distinction without a difference.
- Big Difference is SAFE/Convertible Note v. Priced Equity
- Primary Advantages – quick and lower transaction costs
- Primary Disadvantages
  - Investors
    - Potentially inadequate reward for early financial risk
    - Minimal representations and warranties
    - No control
  - Founders
    - Full ratchet anti-dilution protection above the cap

# NVCA Venture Finance Deal Terms

## GENERAL INVESTOR PROTECTIONS

1. Maximum Raise in the Round Final Closing Date (SPA)
2. Company Representations (SPA)
3. Counsel Expenses (SPA)
4. Management/Information Rights (IRA)
5. Employee Non-Compete Requirement (IRA)
6. Board Matters (D&O Insurance, Expense Reimbursement) (IRA)
7. Employee Equity Vesting Requirements (IRA)

## VENTURE GENERAL PROTECTIONS

1. Pre-Money Valuation (SPA)
2. Automatic Conversions (Charter)
3. Pay-to-Play (Charter)
4. Investor Representations (SPA)
5. Lock-Up (IRA)
6. Drag-Along (Voting)

## INVESTOR CONTROL

1. Shareholder Voting Rights (Charter)
2. Board Composition (Voting)
3. Shareholder Protective Provisions (Charter)
4. Shareholder Board Designee Protective Provision (IRA)

## INVESTOR RETURN ENHANCEMENTS

1. Dividend (Charter)
2. Pro Rata Rights (IRA)
3. Right of First Refusal/Co-Sale (RoFR/Co-Sale)
4. Registration Rights (IRA)

## INVESTOR DOWNSIDE PROTECTION

1. Liquidation Preference (Charter)
2. Anti-Dilution Protection (Charter)
3. Redemption Rights (Charter)

# Finding the Documents

- SAFEs
  - <https://www.ycombinator.com/documents>
    - Original forms – pre-money
    - New forms – post-money
- Priced Equity
  - <https://nvca.org/model-legal-documents/>
- Convertible Note
  - No current standard, but ...

# Coming June 1 ...

## **Introducing... The ACA Form of Convertible Note and Convertible Note Term Sheet**



ANGEL CAPITAL ASSOCIATION



# What's In the New Convertible Note

- Expanded Representations and Warranties
- Participation Rights in Future Financings
- Select Information Rights
- Most Favored Nations Provision (optional)
- Observer/Board Seat (optional)
- Protective Provisions that require the approval of a majority of the noteholders with respect to select corporate acts
- Compliance with the Corporate Transparency Act

# The Data

- Source:

Carta - State of Pre-Seed: Q1 2024

<https://carta.com/blog/state-of-pre-seed-q1-2024/>

# Pre-Seed Funding Down 40%+ From Peak

## Pre-priced round investment effectively flat from Q4 to Q1

Total dollars raised by quarter, US pre-priced rounds on SAFEs and Convertible Notes | Q1 2020–Q1 2024



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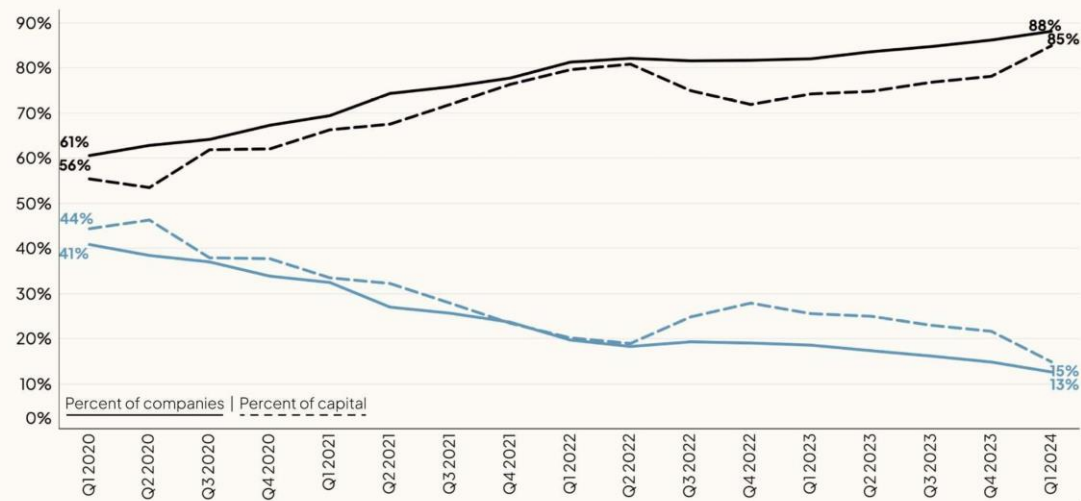
# When Is Graduation Time to Priced Equity?



# Safes Own Pre-Seed

## SAFEs dominate in pre-priced round startup investing

Percent of US pre-priced rounds by instrument | **SAFEs** vs **Convertible Notes** | Q1 2020–Q1 2024



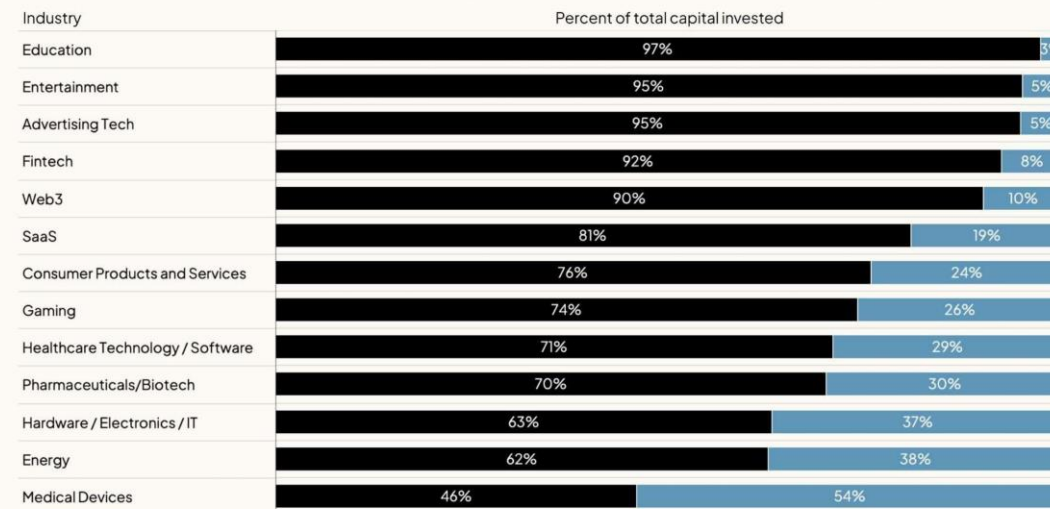
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# But Not in Every Sector

## Convertible Notes retain substantial share in certain sectors

Percent of US pre-priced round dollars invested by instrument | **SAFEs** vs **Convertible Notes** | April 2023–March 2024



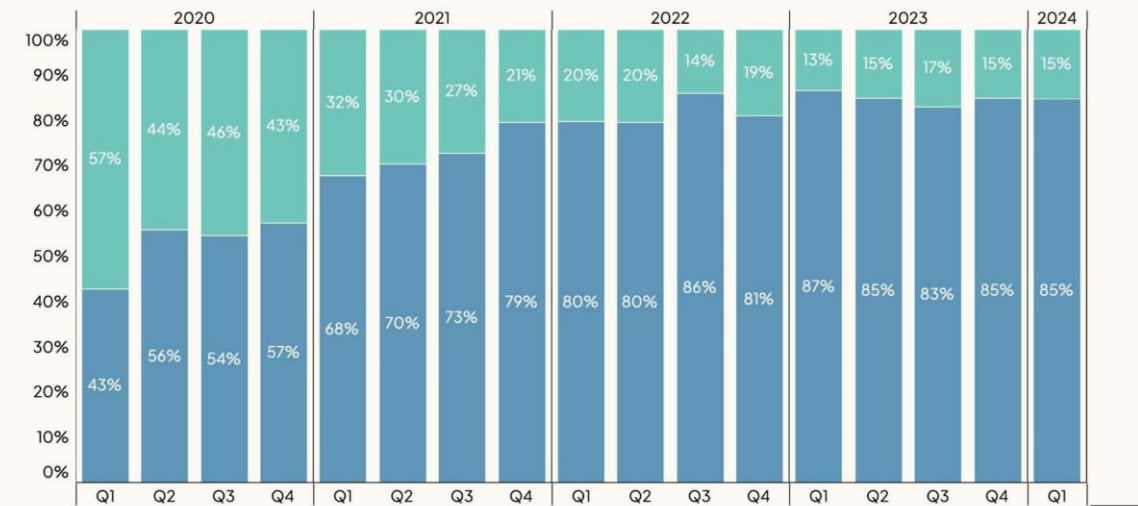
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# SAFEs Are Overwhelmingly Post-Money

## The post-money SAFE is now the default type

Percent of pre-priced round SAFEs by type | [Post-money](#) | [Pre-money](#) | Q1 2020–Q1 2024



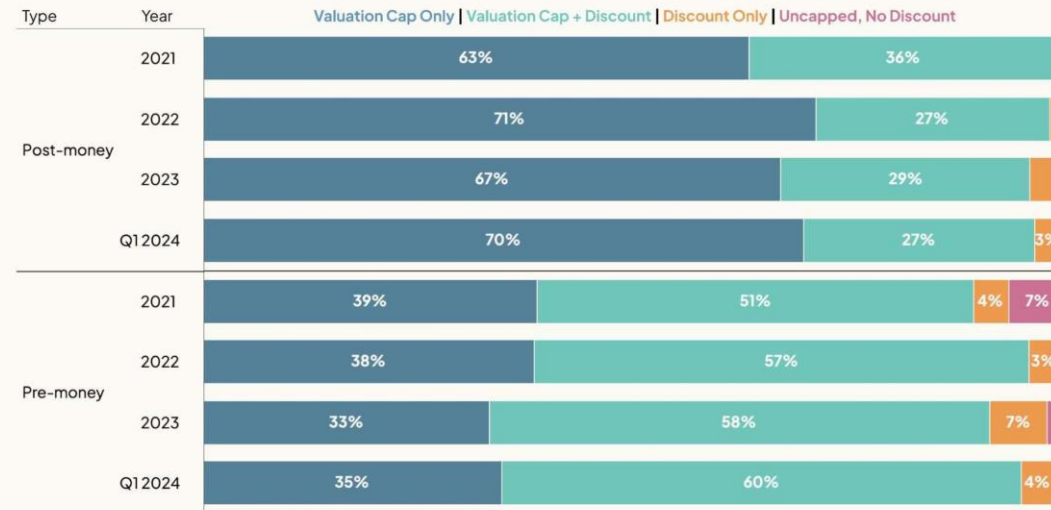
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# You're Probably Going to Need a Cap

## About 95% of SAFEs had a valuation cap in Q1 2024

Percent of pre-priced round SAFEs by conversion terms | Q1 2021–Q1 2024



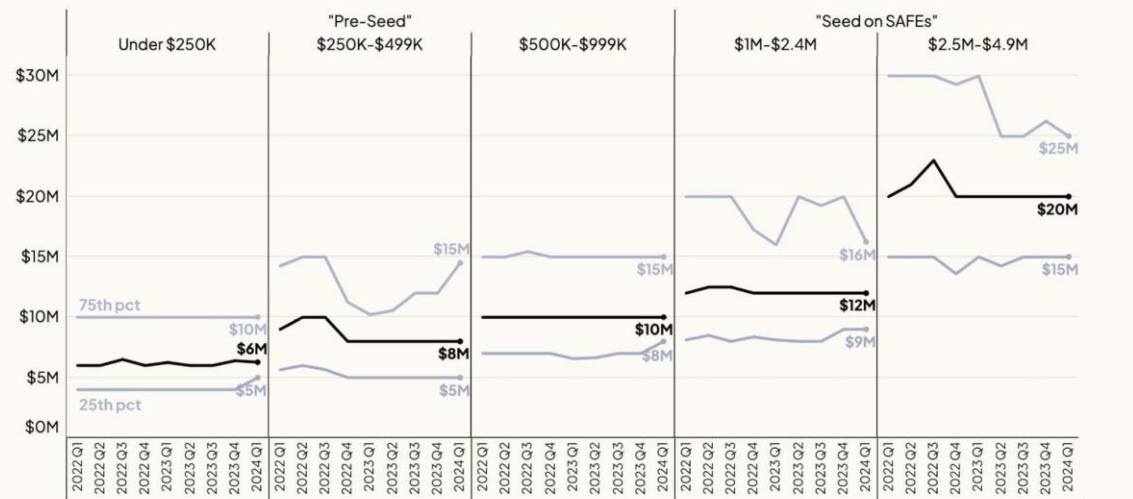
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# What Will Your Cap Look Like?

## Valuation caps steadily rise as round size increases

Valuation cap benchmarks by post-money SAFE round size | 25th percentile | Median | 75th percentile | Q1 2022–Q1 2024



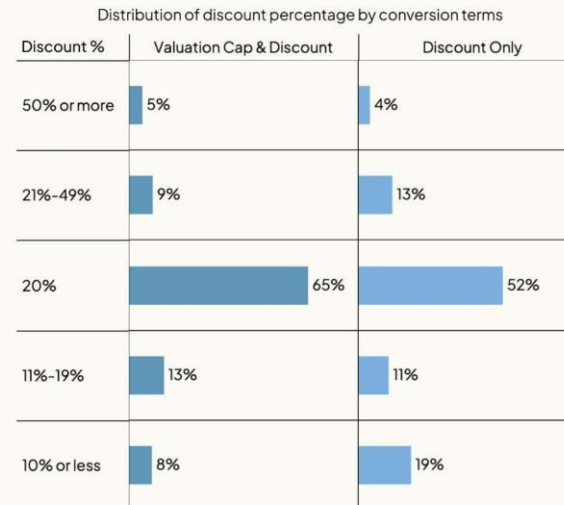
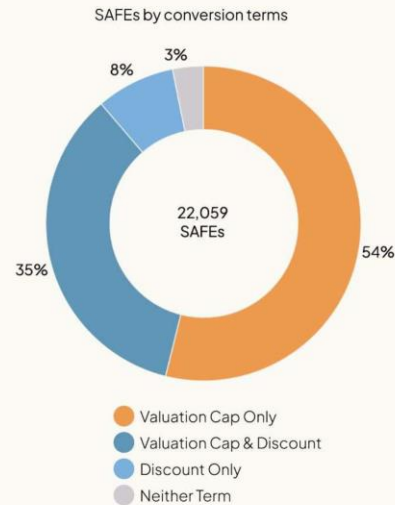
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# Your Discount is Likely to be 20%

## When a discount is present, it is typically 20%

Total SAFEs by SAFE terms and percent of SAFEs by discount percentage | April 2023–March 2024



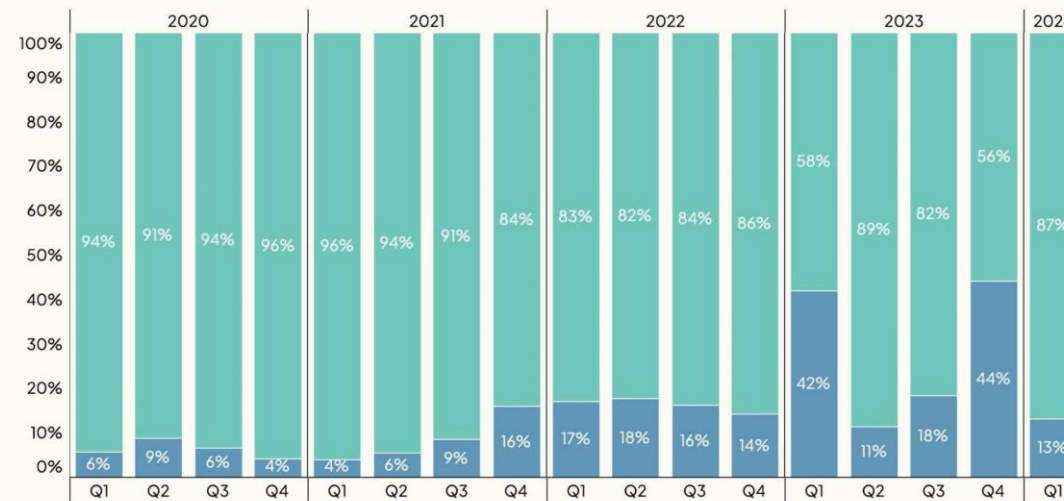
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# Convertible Notes More Likely to Be Pre-Money

## The pre-money Convertible Note is much more common

Percent of pre-priced round Convertible Notes by type | [Post-money](#) | [Pre-money](#) | Q1 2020–Q1 2024

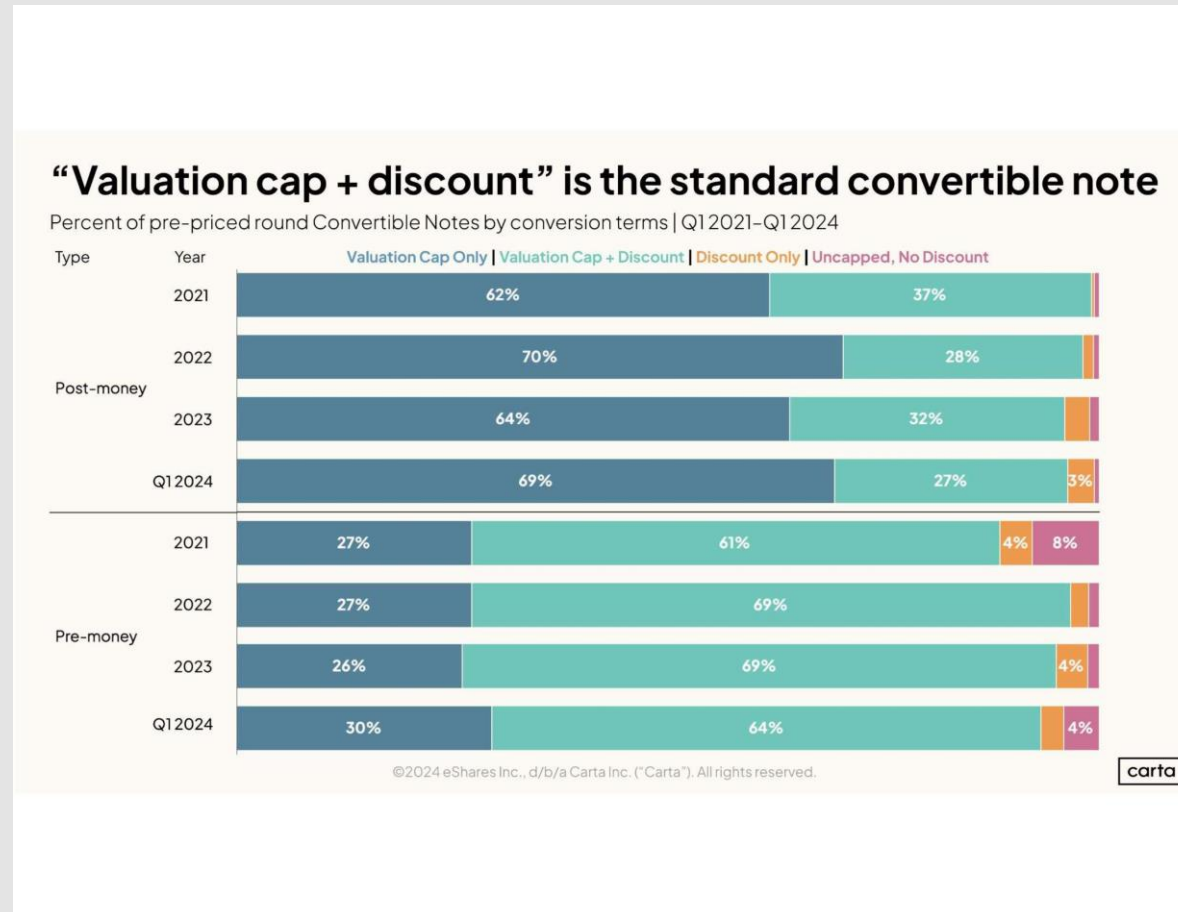


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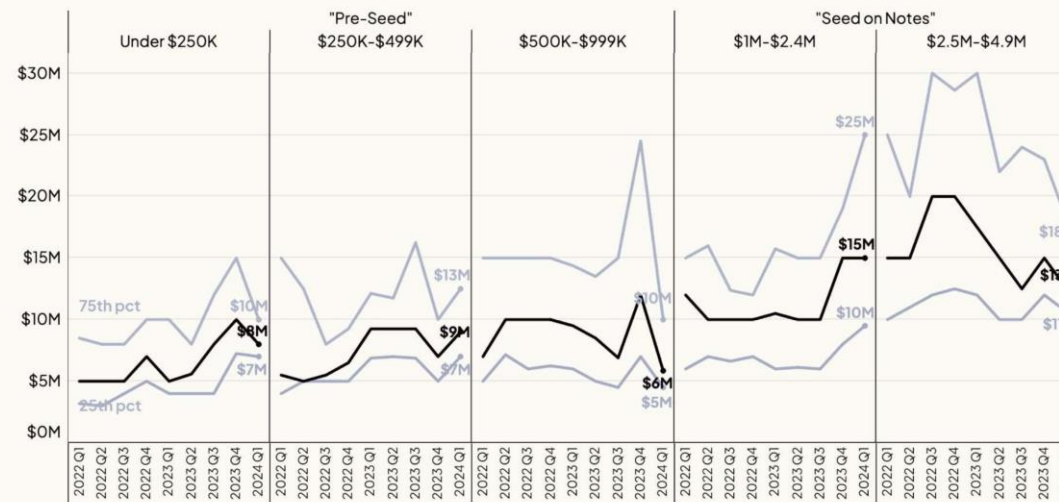
# In Convertible Notes Cap+Discount Wins



# What Will Your Cap Look Like?

## Valuations caps for convertible note rounds fell in Q1

Valuation cap by pre-money Convertible Note round size | 25th percentile | Median | 75th percentile | Q1 2022–Q1 2024



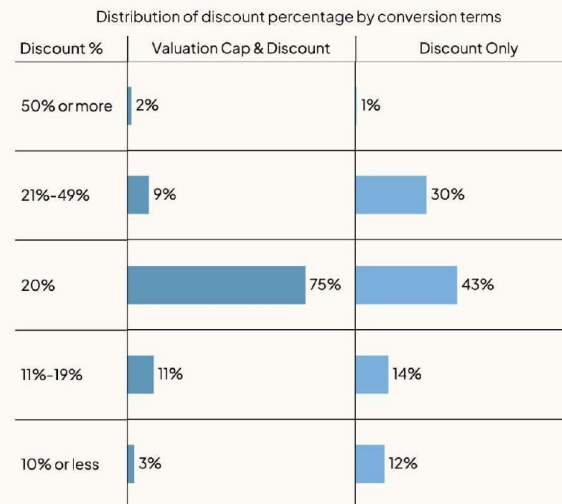
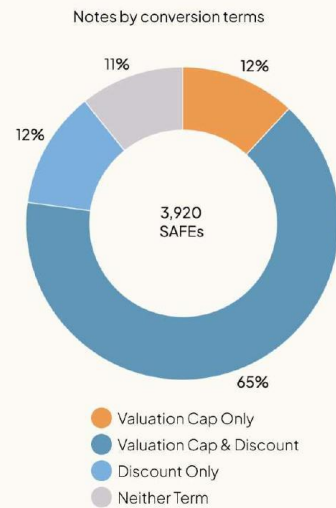
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# Your Discount is Likely to be 20%

## 20% is the median Convertible Note discount

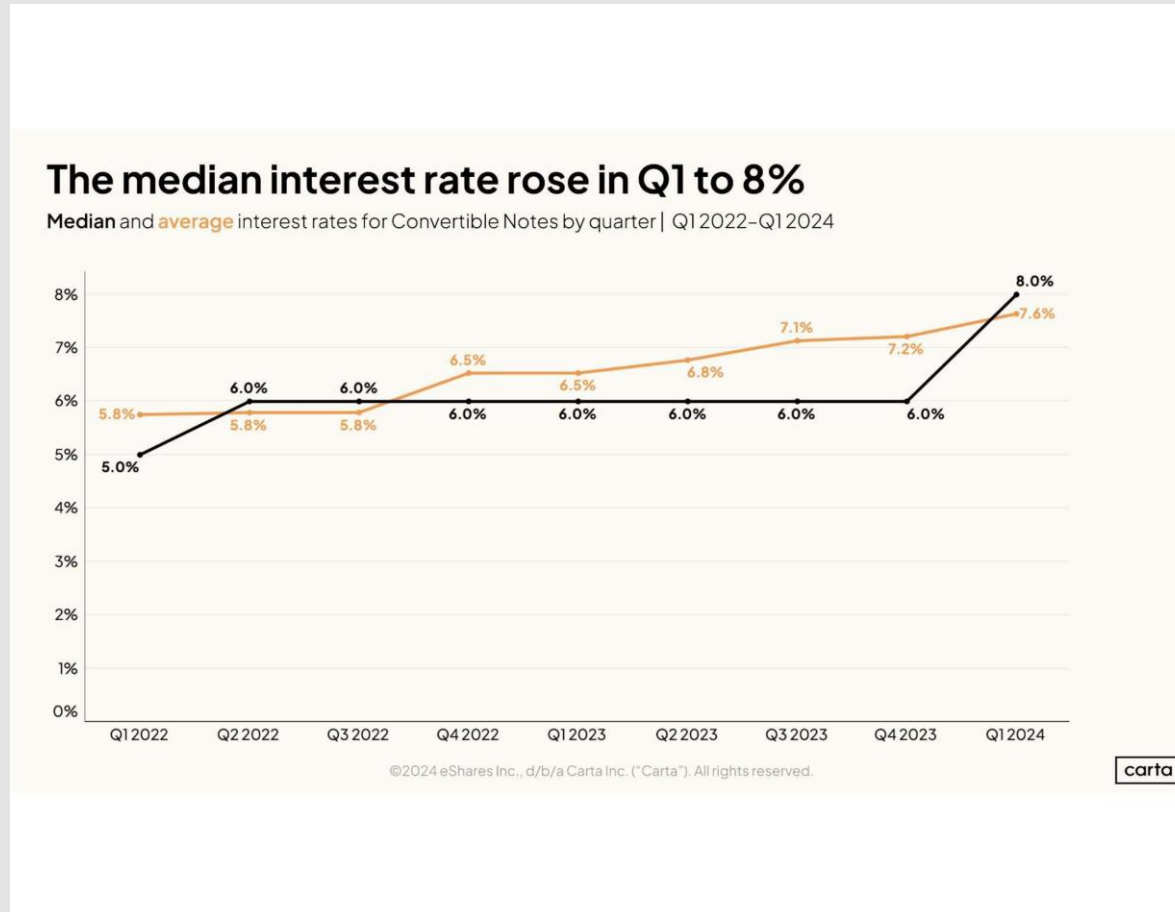
Total Convertible Notes by terms and percent of Notes by discount percentage | April 2023–March 2024



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# Interest Rates are Very Real





# Conclusion

## Choosing the Right Instrument

- Context Matters: The best choice depends on the company's stage, investor preferences, and specific circumstances.
- Balance: Weigh the trade-offs between simplicity, cost, valuation certainty, and control.
- Consultation: Engage with legal and financial advisors to make an informed decision.



# Thank you

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