

The SWAN Network works to avoid investing in SAFE Notes

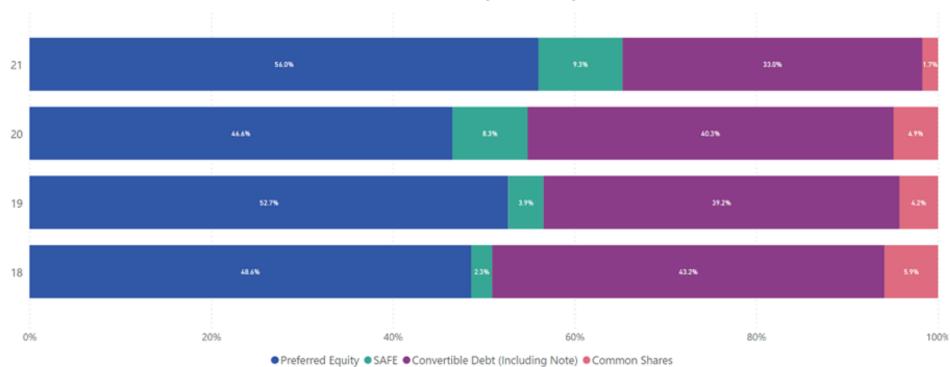
- SAFE Notes earn no interest
- SAFE Notes have fewer protections for investors

Angel Capital Association networks rarely invest via SAFE notes

Preferred Stock and Convertible Notes are predominant

FIGURE 4: % OF ANGEL DEALS BY DEAL STRUCTURE

% of Transactions by Security & Year



Source: Angel Funder's Report, 2022



"Standard" Safe Notes

- Are not a loan
- Conversion at any size of preferred stock financing
- Are basically a warrant
- Optional structures:
 - No valuation cap and no discount (Just say no)
 - A valuation cap, but no discount (Just say no)
 - A discount, but no valuation cap (Just say no)
 - A valuation cap and a discount (same as Conv. Note)

What a Convertible Note has that SAFE lacks

- Always a Cap and a Discount
- · Loan terms:
 - Interest earned (Yes!!!!!)
 - Maturity date (Yes)
- More conversion triggers (Yes)
 - Equity round of a <u>certain size</u>
 - Maturity date
 - Exit
- Other investor rights (Yes!!!!)
 - Possible Board of Directors participation
- Many other terms (next slides)

Convertible Debt – Key Terms



Valuation cap

- Impacts the number of shares issued at conversion
- Example:
 - If series A investors offer a pre-money of \$8M, then \$1M of their money buys 1/9th of the company
 - But if the Notes's Cap is \$4M, then \$0.5M (the angels' prior convertible note amount) also buys 1/9th of the company when series A occurs

- Discount on series A price (~15%)
- Interest rate (~ 3 to 8%)
- Conversion trigger
 - A series A of a certain \$ size (e.g., \$2M)
- Maturity date
 - Investors can ask for repayment at that date
 - Or sometimes, a forced conversion at that date using the valuation cap



More Convertible Debt Terms

- Use of Proceeds: Allowable uses. Includes: cannot be used to pay off prior debt
- Closings: Is there a minimum \$
 amount for 1st closing?
- Change of Control: Payout protections
- Most Favored Nation: If future Conv. Debt has better terms, then we get those also
- Pre-Payment: allowed only if investor agree

- Information Rights: Details are specified
- Protective Provisions: Actions by company that conv. debt investors must approve
- Board of Directors: Do we get a seat?
- Key Person Clause: E.g., CEO will continue full time for 5 years
- Conditions to Closing: List of required steps, e.g., conversion to C-Corp
- Fees and Expenses: Who pays legal transaction fees



Sometimes a SAFE note is required

NSF Phase 1 SBIR grants do not allow any debt (for example, a convertible note) on a company's balance sheet

