



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 certain size
 - 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