# Investing with SAFEs

Useful tips, handy tricks and avoiding traps

ARCHANGEL

# Archangel Ventures

- Early stage venture capital fund investing in Australian startups
- Invest in pre-seed and seed stage companies in a wide range of industries
- Mentors in multiple startup ecosystems, including Startmate and Antler
- Extensive experience as VCs, angels, founders and operators

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# Investing with SAFEs

- Australian founders have started to use SAFEs as their default funding mechanism for first rounds, so all angel investors need to be aware of what they are and how they work.
- Quick recap of what a SAFE is, what role it plays in early stage funding and how it actually helps startups get started
- Highlight some of the issues with the current Australian SAFE (including the AIC template) and share some war stories from our experience using SAFEs
- Go through the conversion process, some SAFE maths and point out some common conversion traps that you might run into

# Recap on SAFEs

- Simple Agreement for Future Equity was created in 2013 by Y Combinator accelerator in the US to make it easier to raise capital without going through a priced equity round
- In 2015 AVCAL (now AIC) released an Australian version of the SAFE to better represent the way things were done in Australia, including changing some of the language
- SAFEs are similar to convertible notes but don't have an interested component. The key parts of a SAFE are the valuation cap and discount (only parts that really get negotiated)
- In 2018 YC updated the US SAFE to make it a post money valuation cap as that part had caused a lot of confusion. The AIC template is still a pre money valuation cap
- Despite some confusion around pre money vs post money and document fragmentation that's occurred in Australia, it remains the dominant early fundraising mechanism for startups

# Not so SAFE

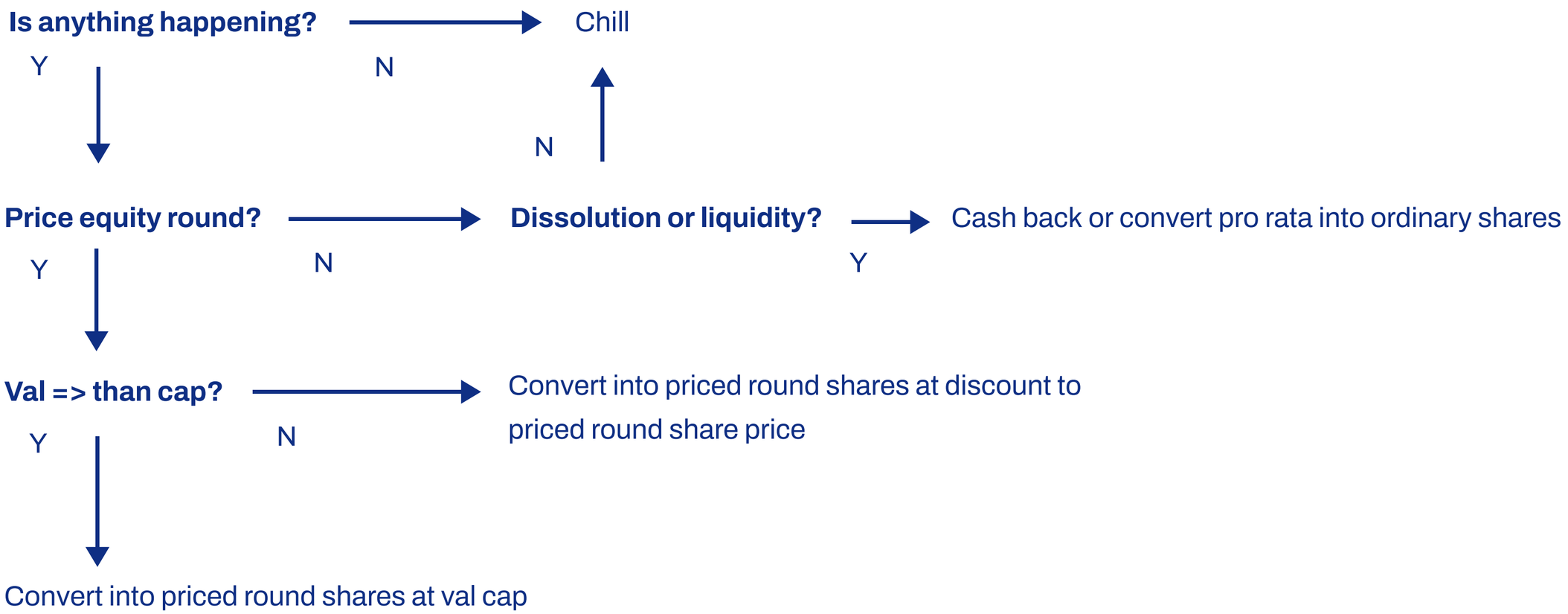
- AIC SAFE template based on an old version of the Y Combinator pre-money SAFE (pre 2018). The pre-money fully diluted calculation is problematic and less certain (see war stories)
- Doesn't address governance issues just the future issue of shares in the company. You don't get many of the standard terms or rights you'd expect in a Shareholders' Deed
- Given that AIC hasn't released a new version of the SAFE, there is a lot of document fragmentation with people amending it for pre vs post plus other things (FrankenSAFEs)
- SAFEs are not eligible for the Early Stage Innovation Company tax concessions and you may be issued share after the company no longer falls within the criteria
- The conversion of SAFEs can become very complex. A lot of lawyers are not good at maths and it's common for the SAFE conversion at a priced round to be miscalculated

# Some SAFE war stories

- Accelerator program excluded the ESOP from the fully diluted calculation impacting founders by a few % each time
- Company used its own SAFE (based on AIC template) to do 4 SAFE rounds up to a $60M valuation. The investors didn't realise they'd all been diluting themselves due the fully diluted calculation
- Conversion of 3 SAFEs at a priced round where all 3 investors came up with a different calculation for each of the SAFEs
- Large US VC miscalculated the conversion of the SAFEs at a priced round but wouldn't change it even when presented with the correct conversion numbers
- Lots of time and arguments with founders and lawyers over Excel spreadsheets to get to the correct conversion of SAFEs

# Conversion process

SAFEs cover multiple scenarios which can be complex to understand. Below is a simplified example of what happens with a new priced equity round where a val cap and discount SAFE converts to shares:



# SAFE conversion maths

Depends on the wording of the SAFE (pre vs post money, AIC vs YC) and the circumstances of the conversion (priced round, dissolution, liquidity event). Below is a comparison of the conversion maths for the AIC and YC SAFEs using a valuation cap:

**YC post money SAFE**

# of shares = Purchase Amount / SAFE Price

SAFE Price = Valuation Cap / Company Capitalization

Company Capitalization = all shares, converting securities, options and unissued option pool

**AIC pre-money SAFE**

# of shares = Purchase Amount / SAFE Price

SAFE Price = Valuation Cap / Fully Diluted share capital

Fully diluted = all ordinary shares assuming all securities were exercised or converted **excluding** SAFEs and convertible notes

# Conversion traps

- You must read every SAFE. As the Australian SAFE is not a standard template, there are many good and bad versions
- You need to be clear on whether the valuation cap is pre-money or post money. This has a material impact on the number of shares that you will be issued at the priced round
- Pre-money SAFE on pre-money SAFE means that everyone gets diluted each time and your final ownership is uncertain until the final conversion event
- Post money SAFE on post money SAFE will gives everyone clear ownership as there is no additional dilution each time. More consistent with the original philosophy for SAFEs
- Need to include the ESOP in the fully diluted calculation, but not the new ESOP (or top up) that may be done as part of the priced round

# Useful resources and tools

**YC SAFE documents**

https://www.ycombinator.com/documents

They invented the SAFE so it's useful to look at their intention and what happens in other markets

**SAFE user guide**

https://www.ycombinator.com/assets/ycdc/Primer%20for%20post-money%20safe%20v1.1-2af8129e12effd9638eeab383b7309142c8f415e5cdb0bc210d573f779177a1c.pdf

Useful for looking through the examples and for understanding the philosophy underpinning the SAFE

**SAFE Genie**

https://notegenie.io/

Good for doing calculations, running through some scenarios and testing your understanding of SAFE conversions

**AIC SAFE template**

https://www.aic.co/AIC/aic/Investment/Guidelines-Templates-21.aspx

Beware! As we discussed earlier, there are problems with the template, so maybe just use it for a comparison

# Q & A

# Appendix

# YC SAFE clauses

The "**Post-Money Valuation Cap**" is $[_____]. See **Section 2** for certain additional defined terms.

**1.** ***Events***

(a) **Equity Financing**. If there is an Equity Financing before the termination of this Safe, on the initial closing of such Equity Financing, this Safe will automatically convert into the greater of: (1) the number of shares of Standard Preferred Stock equal to the Purchase Amount divided by the lowest price per share of the Standard Preferred Stock; or (2) the number of shares of Safe Preferred Stock equal to the Purchase Amount divided by the Safe Price.

"**Company Capitalization**" is calculated as of immediately prior to the Equity Financing and (without double-counting, in each case calculated on an as-converted to Common Stock basis):

- Includes all shares of Capital Stock issued and outstanding;
- Includes all Converting Securities;
- Includes all (i) issued and outstanding Options and (ii) Promised Options; and
- Includes the Unissued Option Pool, except that any increase to the Unissued Option Pool in connection with the Equity Financing shall only be included to the extent that the number of Promised Options exceeds the Unissued Option Pool prior to such increase.

"**Converting Securities**" includes this Safe and other convertible securities issued by the Company, including but not limited to: (i) other Safes; (ii) convertible promissory notes and other convertible debt instruments; and (iii) convertible securities that have the right to convert into shares of Capital Stock.

"**Safe Price**" means the price per share equal to the Post-Money Valuation Cap divided by the Company Capitalization.

"**Standard Preferred Stock**" means the shares of the series of Preferred Stock issued to the investors investing new money in the Company in connection with the initial closing of the Equity Financing.

"**Unissued Option Pool**" means all shares of Capital Stock that are reserved, available for future grant and not subject to any outstanding Options or Promised Options (but in the case of a Liquidity Event, only to the extent Proceeds are payable on such Promised Options) under any equity incentive or similar Company plan.

# AIC SAFE clauses

## 3. Qualifying Financing

(a) If there is a Qualifying Financing before the Termination Date, the Company will automatically issue to the Investor that number of QF Shares equal to the higher of:[5]

(i) the Purchase Amount divided by the Discount Price; or

(ii) the Purchase Amount divided by the Safe Price

rounded to the nearest whole number.

**Safe Price** means the price per share equal to the Valuation Cap divided by the Fully Diluted share capital of the Company;

**Fully Diluted** means the total aggregate number of Ordinary Shares in the capital of the Company which would be on issue assuming all securities issued by the Company were exercised or converted in accordance with their terms, but excluding:

(a) this instrument;

(a) any other Safe financing instrument; or

(b) any convertible notes;



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