

## QUICK START GUIDE

The biggest advantage of the post-money safe is that the amount of ownership sold is immediately transparent and calculable for both the founder and the investor. This Quick Start Guide will show how to take advantage of this new structure for the most common use cases. **For an in-depth discussion of the new structure and features of the safe generally, please review the rest of the Post-Money User Guide that follows. If you are an investor, we also recommend reviewing the “What if I’m an investor?” subsection in the Post-Money User Guide.**

*Note: in the examples below, if the valuation in the round in which the safe converts is less than the Post-Money Valuation Cap or too close to the Post-Money Valuation Cap, the safes may convert into more than the estimated ownership. Please see the Q&A section in the User Guide.*

### **1. Raising money with a Post-Money Valuation Cap and calculating ownership sold**

A founder is targeting a \$1 million raise and 15% ownership sold.

- Post-Money Valuation Cap is \$6.7 million (\$1 million / 15% = ~\$6.7 million).
- “I’m targeting \$1 million at \$6.7 million post / \$5.7 million pre. Post-money cap is \$6.7 million.”
- If the founder raises...
  - \$500k, then the ownership sold would be  $0.5/6.7 = \sim 7.5\%$
  - \$800k, then the ownership sold would be  $0.8/6.7 = \sim 12\%$
  - \$1 million, then the ownership sold would be  $1/6.7 = \sim 15\%$

### **2. Raising money with multiple Post-Money Valuation Caps and calculating ownership sold**

A founder is targeting a \$1 million raise and 15% ownership sold.

- Post-Money Valuation Cap #1 is \$5.5 million.
- Post-Money Valuation Cap #2 is \$8.3 million.
- If the founder raises \$500k on each cap, then she will have sold ~15%
  - $\$500k / \$5.5 \text{ million} = \sim 9\%$
  - $\$500k / \$8.3 \text{ million} = \sim 6\%$

### **3. Estimating the future dilutive impact of pro rata rights provided in the optional side letter**

The pro rata right entitles the safe holders to subscribe for a percentage of the total round equivalent to their as-converted ownership (e.g. 15% if they invested \$750k at a \$5 million Post-Money Valuation Cap). You can therefore backsolve dilution based on an assumption of how much the new investors in the Equity Financing will demand. That formula is just the following:

$$\text{Safe Pro Rata Allocation \%} = \frac{\text{Series A New Investors \%}}{(100\% - \text{Safes with Pro Rata \%})} - \text{Series A New Investors \%}$$

Example:

Safe fund raise

- Company sold 15% of the Company pre-Series A in safes by raising \$750k at a \$5 million Post-Money Valuation Cap
- Company gave every safe investor a pro rata side letter
- Company issues 8% of the Company pre-Series A in options to people hired between the safes and the Series A

Series A assumptions

- Lead investor and other new investors will own 25% post-Series A, not including the safe investors pro rata
- Option pool increase that creates a 10% unissued and available option pool post-Series A

Estimated dilutive impact post-Series A:

Safe Pro Rata Allocation %:	$25\% / (100\% - 15\%) - 25\% = \mathbf{4.41\%}$
Series A New Investors + Safes with pro rata:	$25\% + 4.41\% = \mathbf{29.41\%}$
Series A dilution:	$29.41\% \text{ investments} + 10\% \text{ option pool} = \mathbf{39.41\%}$
Adding it all up:	
Safe dilution:	$15\% * (100\% - 39.41\%) = \mathbf{9.09\%}$
Options dilution:	$8\% * (100\% - 10\%) * (100\% - 39.41\%) = \mathbf{4.36\%}$
Series A dilution:	$\mathbf{39.41\%}$
Total:	$\mathbf{52.86\%}$

Note #1: the 8% in options issued between the safes and the Series A are diluted by the safes and the Series A terms.

Note #2: the safe ownership is post-safes. It is not post-Series A. The safes are like their own round, which means they are diluted by the Series A (just like everyone else).

## **POST-MONEY SAFE USER GUIDE**

*In this User Guide, the new version of the safe is referred to as the “new safe,” “post-money safe,” “Standard Safe” or simply “safe.” The original version of the safe replaced by the new safe is referred to exclusively as the “original safe.”*

In late 2013, Y Combinator introduced the original safe, or the *Simple Agreement for Future Equity*. At the time of introduction, startups and investors were primarily using convertible notes for early stage fundraising. The original safe was intended to be a replacement for convertible notes, and it has generally been successful in doing so.

More than four years after introducing it, we decided it was time for the original safe to evolve. The most significant change in the new safe is that it is now a **post-money** convertible security, as explained in detail below. This change is a response to a shift we’ve observed in the way that early stage companies raise money from investors, which is to treat safe-based financings as independent seed rounds capable of providing multi-year runways, rather than shorter-term bridges to priced preferred stock rounds.

In the new safe, we have also removed the pro rata right that existed as a default option in the original safe. That pro rata right applied to the financing **after** the round in which the original safe converted (e.g. if the original safe converted in the Series A, the pro rata right applied to the Series B). Instead, we created a standard side letter with pro rata rights that apply to the round in which the safe converts (e.g. if the safe converts in the Series A, the pro rata right applies to the Series A), which can be used if and when the parties agree to it. Although our original goal was to create a universal standard for pro rata rights for all start-up companies, our experience has been that we can’t do this in a way that makes sense for all parties. For example, a company raising \$500,000 from 10 angels investing \$50,000 often has significantly different considerations than one raising \$2,000,000 from a single institutional investor. Also, the pro rata rights contained in the original safe were often misunderstood by both founders and investors as applying to the round in which the original safe converted (the Series A), rather than the round after the one in which the original safe converted (the Series B). So the standard pro rata side letter is an acknowledgment that this right is best handled case by case, and that the prior form of the right often wasn’t what founders and investors were expecting.

There are a few other changes that were incorporated into the new safe, and a complete listing of them can be found in Appendix III. Most importantly, the new safe is still a simple, standardized document, it retains the benefits of certainty and speed, and it continues to require little to zero in transaction costs for companies and investors.

Following the format of the original safe primer, this User Guide<sup>1</sup> describes why, when and how to use the new post-money safe.

***The information below applies specifically to a safe with a Post-Money Valuation Cap. Other versions of the safe are described in Appendix I.***

### **What do we mean by “post-money” safe**

There are two important aspects to what we mean by “post-money” in the new safe:

1. The valuation cap in the safe is stated in terms of a post-money valuation (in contrast, the valuation cap in the original safe was based on a pre-money valuation). A post-money valuation and a pre-money valuation are just two different ways of framing the same valuation of the company, but at different points in time. A pre-money valuation is the valuation of the company immediately **before** the company receives the investment in the financing in question. A post-money valuation is just the valuation immediately **after** the investment is made. For example, if a company is raising \$2 million at a \$10 million pre-money valuation, generally that’s the same as saying that it is raising \$2 million at a \$12 million post-money valuation.<sup>2</sup>

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<sup>1</sup> What happened to the word “primer?” We couldn’t agree on how to pronounce it!

<sup>2</sup> The exception is when there is a negotiated agreement, usually in a priced round context, that the pre-money valuation will not actually include safes or notes converting in the round, or portions of the option pool. For example, if the company is raising a \$10 million Series A at \$40 million pre-money, but the parties agree that \$1 million in outstanding safes converting

2. Safe conversion shares are calculated on a “post” money basis, specifically:
  - **The Post-Money Valuation Cap is “post” all of the safe money. It is NOT also “post” the Equity Financing (e.g. Series A) money.** As mentioned above, we believe the market has evolved to raising independent financing rounds using original (pre-money) safes. So it would be inconsistent for the post-money safes to have their post-money valuation calculated to include money raised in the Equity Financing round. Doing that, in some cases, would even result in the sum of the money raised on safes and in the Equity Financing exceeding the Post-Money Valuation Cap of the safes, which would be an absurd outcome (see the Q&A section for more on this topic). The result is that while the safes are not diluted by each other, the safes will be diluted by the new money raised in the Equity Financing.
  - **The Post-Money Valuation Cap is “post” the Options and option pool existing prior to the Equity Financing. It is NOT also “post” the new or increased option pool adopted as part of the Equity Financing (e.g. Series A).** Again, this is consistent with treating the safes as an independent fundraise from the Series A in which they convert (assuming the Series A is the Equity Financing converting the safes). The option pool that is created or increased as part of the Series A is intended to provide equity for the people hired after the Series A, with the money raised in the Series A. This means that the safes are not diluted by the Options granted or the pool created following the safe fundraise but prior to the Series A, which makes sense because that’s the hiring pool enabled by the safe money. But the safes are diluted by the new or increased option pool adopted as part of the Series A, because otherwise, the safes would be forcing the founders to bear all of the dilution for two rounds of hiring rather than one, despite only providing enough capital for one round of hiring.

## Why

The reasons to use the safe for early stage fundraising haven’t changed. Founders can close with an investor as soon as both parties are ready to sign and the investor is ready to wire money, instead of trying to coordinate a single close with all investors simultaneously. And as a flexible, one-document security without numerous terms to negotiate, safes save startups and investors money in legal fees and reduce the time spent negotiating the terms of the investment. Founders and investors will usually only have to negotiate one item: the valuation cap. Because a safe has no expiration or maturity date, there will be no time or money spent dealing with extending maturity dates, revising interest rates or the like.

But the more important question for users of the original safe is, why use the new safe? Because the post-money safe is the best way for both companies and investors to understand ownership. The original safe was standardized on a pre-money basis and inclusive of the Series A option pool increase, which made it difficult for founders to calculate precisely how they were being diluted when raising money. The answer to “how much of the company are we selling” was dependent on a recursive loop of how much was raised on other original safes, plus a hypothetical assumption about the Series A option pool increase that would be negotiated years later.

These unknowable elements meant that founders had a hard time planning out their fundraise so that they could sell an intended and expected portion of their company. Founders might *intend* to sell around x% of their company. But they didn’t have the best tools to accomplish this goal, which meant that they often ended up selling a lot more than they really wanted to, *when they didn’t have to*. The post-money safe should now help founders better align their intentions with outcomes, because calculating dilution and ownership requires little more than simple addition and division, and this simple calculation will make planning around those factors easier as well.

## When

Now as ever, most startups need to raise money soon after formation in order to fund their day-to-day operations, and the safe is a vehicle for investors to fund companies at that very early stage. Unlike the sale of equity in traditional priced rounds of financing, a startup can issue a safe quickly and efficiently, without multiple documents that require significant

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at a \$10 million Post-Money Valuation Cap will *not* be in the pre-money, then the Series A new money is not getting 20% ownership ( $10/(10+40) = 20\%$ ), it will be getting a little bit less because it will be diluted by the \$1 million in safes. Thus in this footnote example, the effective post-money valuation will be greater than \$50 million.

legal time. Like the original safe, the new safe is still a one-document security, although we have a new, standardized pro rata side letter that serves as an optional companion to the new safe, described in further detail in the Q&A section.

## How

The process hasn't changed: an investor and the company still agree on the amount to be invested and the valuation cap, they mutually date and sign a safe, and the investor sends the company the purchase amount. What happens next? Technically nothing, until the occurrence of one of the specific events described in the safe (priced round, sale of the company or dissolution). However, we strongly recommend that companies keep an accurate cap table to record and track how the safes will convert into stock, which should be much easier with the new safe.

## What if I'm an investor?

An investor generally only has to think about his/her own investment, rather than the structure of the entire round, and there are three questions that are most common:

### 1. What ownership am I getting for my investment?

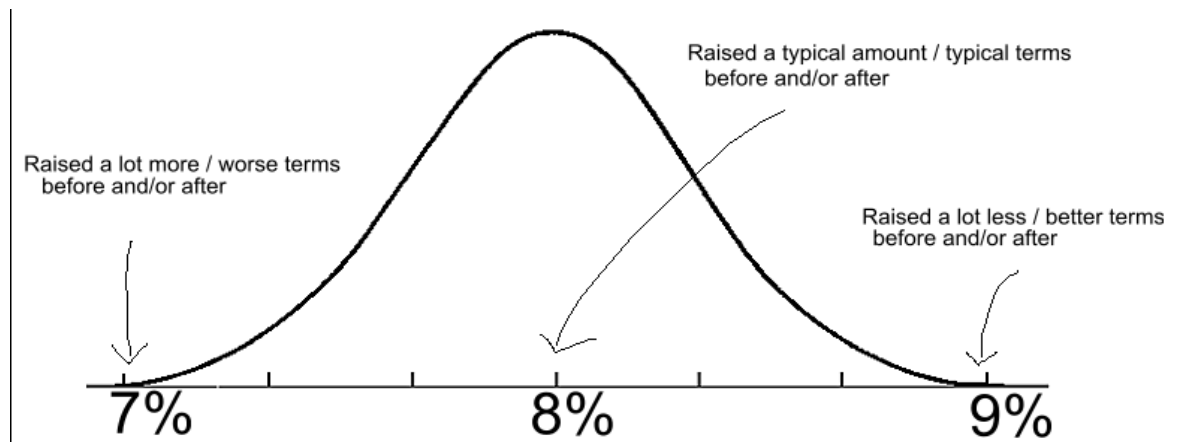
This wasn't actually a question that an investor could answer under the original, pre-money cap safes because:

- The company could raise as little or as much as it wanted on top of the pre-money valuation.
- The investor didn't necessarily know how much had been raised on other safes, and their corresponding valuation caps, *before* the investment.
- The investor didn't necessarily know how much was raised on safes, and their corresponding valuation caps, *after* the investment.
- The ownership calculation included an unknowable variable, which was the Series A option pool increase.
- The safes all diluted each other.

For example, if an investor gave a company a \$500k investment at a \$4.5 million pre-money valuation cap, the implied ownership was not necessarily  $500 / (4,500+500) = 10\%$ . Any of the following could have been the result:

- The company had already raised \$250k on a pre-money valuation cap of \$2.75 million, which meant that the \$500k in safes on the \$4.5 million pre-money valuation cap represented less than 10% because they would be diluted by the \$250k in safes at the lower valuation cap, and vice versa, even though the \$500k came later.
- The company raised \$1.5 million more on the same terms, after the \$500k, so the total implied ownership for the \$500k million was closer to  $500/(4,500+2,000)$ , plus the dilution from the \$250k prior safes = ~7%.
- Each of the figures above would also undergo some future adjustment based on the size of the option pool and option pool increase in connection with the Series A.

The end result is that under the original safe, an investment of \$500k at a \$4.5 million pre-money valuation cap only produced a *distribution* of ownership outcomes, rather than a *definite* ownership outcome. In other words, an investment on those terms might result in a median ownership of something like 8% post-conversion, but could also result in materially more or less ownership, like so (see next page):



So if the investor was investing under the original safe with these distributions, then with the new safe, the investor could invest that \$500k at a Post-Money Valuation Cap that implies a slightly higher pre-money valuation, i.e. ***the post-money safe allows the investor to exchange lower starting prices for more certainty on ending ownership.*** For example, the investor could opt to invest \$500k on a post-money safe with a Post-Money Valuation Cap of \$5.5 million (which implies a slightly higher pre-money of \$5 million instead of \$4.5 million), which locks in ~9% ownership until the safes convert and are diluted by the Series A round, rather than rolling the dice on a \$500k investment at a \$4.5 million pre-money valuation cap, which could result in a range of outcomes (some better and some worse).

Now investors can directly negotiate with the company on the amount of ownership they are looking for in relation to the amount they are investing. The valuation cap becomes a transparent product of that negotiation over ownership, and vice versa. A new investor can now say "I'd like X% for \$Y" and be a lot more certain that this is what he/she will actually get.

## 2. Would it be better to just do a priced round?

We think investors appreciate the speed, cost and simplicity advantages of the safe, but over the years, we've heard some investors express a preference for priced rounds.

One of the primary reasons certain investors prefer priced rounds has been the ownership uncertainty issue discussed above. With that solved, the question of priced round versus safe can be reduced to what other rights an investor is looking for -- e.g. board seats, investor veto rights, info rights, etc. that often come attached to a priced round -- and whether those rights are important or appropriate for the fundraising being proposed.

## 3. How should I think about pro rata rights?

The first question is whether an investor's strategy and resources make follow-on investments important and feasible to begin with, since low or no follow-on activity makes the pro rata side letter an unnecessary negotiation point.

Another question is whether it would be preferable to maximize starting ownership instead, by investing a larger amount at current prices, or negotiating for a lower Post-Money Valuation Cap in lieu of follow-on pro rata rights.

Assuming the answers to these questions lead an investor to conclude that a pro rata right to participate in the Equity Financing (e.g. Series A) is important, there isn't much else to this other than asking the company for the pro rata side letter as part of the safe investment and negotiating that ask if necessary. Please see Section E.1 (page 14) in the Q&A for additional guidance about pro rata rights.

## **The Usual Disclaimer**

The information in this User Guide (which includes the Quick Start section) is provided only as general information for educational purposes, and to provide some insight into our thinking and the process by which we arrived at the new safe. This User Guide is not being provided in the course of an attorney-client relationship and is not intended to be legal advice. This User Guide should not be used as a substitute for competent legal advice from a licensed attorney in your state.

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## Q & A

*Capitalized terms used but not defined in this section are defined in the safe.*

- A. Basic Mechanics
- B. Safe Conversion in Equity Financings
- C. Safe Conversion in Liquidity Events
- D. Calculating and Managing Dilution
- E. Pro Rata Rights
- F. Practical Tips for Using the Safe

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### **A. BASIC MECHANICS**

#### **1. Does a safe convert at a round of equity financing?**

Yes, when the company decides to sell shares of preferred stock in a priced round (an “Equity Financing”), the outstanding safes will convert into shares of preferred stock. There is no threshold amount of money in the post-money safe that the company must raise to trigger the conversion (there is, however, a suggested \$250,000 threshold in a safe with an MFN provision -- see Appendix I below).

#### **2. Does a safe holder have a choice about converting a safe in an Equity Financing?**

No, the conversion of a safe in an Equity Financing is automatic and the safe then terminates. A safe is intended to turn safe holders into stockholders.

#### **3. What happens to a safe if a company is acquired or merges with another company?**

A merger or acquisition is a “Change of Control,” which is a Liquidity Event in the safe. In a Liquidity Event, a safe holder is entitled to receive a portion of the proceeds equal to the greater of (1) a return of its Purchase Amount and (2) the as-converted proceeds it is entitled to in connection with a Liquidity Event (i.e., the proceeds it would be entitled to had its Purchase Amount been converted into common stock at the Post-Money Valuation Cap). In a Liquidity Event, the safe is junior to creditors and outstanding indebtedness (including outstanding convertible notes) and has the same priority as standard non-participating Preferred Stock. Please see Examples 3 and 4 in both Scenarios in Appendix II.

#### **4. What happens to a safe if the company goes public?**

An Initial Public Offering is also a Liquidity Event under the safe, so the treatment of the safe in an Initial Public Offering is the same as in a Change of Control.

#### **5. What happens to a safe if the company shuts down and goes out of business?**

If the company shuts down and goes out of business (a “Dissolution Event”), the safe holder is entitled to receive its Purchase Amount back. In a Dissolution Event, the safe is junior to creditors and outstanding indebtedness (including outstanding convertible notes) and has the same priority as standard non-participating Preferred Stock.

#### **6. What is the priority of the safe with respect to the company’s other securities in a Liquidity Event or Dissolution Event?**

The safe functions like standard non-participating preferred stock in a Liquidity Event or Dissolution Event. That means that it ranks junior to payment of outstanding indebtedness (including outstanding convertible notes), on par with payments to other safe holders and preferred stockholders, and senior to payments to common stockholders.



## 7. Does a safe ever expire?

A safe has no maturity date. A safe is designed to expire and terminate only when a safe holder has received stock, cash or other proceeds, in an Equity Financing, Liquidity Event or Dissolution Event – whichever occurs first. In theory, a safe could remain outstanding for a long time without the need to “extend” any dates or time periods.

## B. SAFE CONVERSION IN EQUITY FINANCINGS

### 1. What is the difference between Safe Preferred Stock and Standard Preferred Stock?

Standard Preferred Stock is the same preferred stock issued to new money investors in the Equity Financing. Safe Preferred Stock is issued in the Equity Financing as a separate series of preferred stock. Safe Preferred Stock has the same rights, privileges, preferences and obligations as the Standard Preferred Stock, but the liquidation preference, conversion price, and dividend rate are calculated based on the price per share of the Safe Preferred Stock (which is determined by dividing the Post-Money Valuation Cap by the “Company Capitalization” (described below)). For example, if the company issues Series A Preferred Stock in the financing, a safe holder would be issued Series A-1 Preferred Stock, the only difference being the name and the share price, liquidation preference, conversion price and dividend right attributable to that series. Safe Preferred Stock is also sometimes referred to as “shadow preferred stock” or a “sub-series” of preferred stock. See Example 1, Question 2 in Appendix II.

### 2. What if the pre-money valuation of the company in the Equity Financing is higher than the safe’s Post-Money Valuation Cap?

The safe holder’s ownership will be the greater of (1) what’s implied by the Post-Money Valuation Cap, or (2) what could be purchased for the Purchase Amount (i.e., the original amount invested under the safe) at the price per share paid by the new money investors in the priced round.

In most situations where the pre-money valuation of the company in the Equity Financing is higher than the Post-Money Valuation Cap, the Post-Money Valuation Cap will apply. In that case, the safe holder will be issued Safe Preferred Stock, which has a liquidation preference equal to the Purchase Amount. This feature means that the liquidation preference for safe holders does not exceed the original purchase amount of the safe (a 1x preference). See Question 2 in Examples 1 and 2 in Appendix II.

However, in certain situations where the Post-Money Valuation Cap and the pre-money valuation of the Equity Financing are close, the safe holder will actually receive more shares when using the price per share paid by the new money investors. In these situations, the safe holder will receive shares of the Standard Preferred Stock (described in further detail below) at the same price per share paid by the new money investors.

To be clear, the possibility that the safe holder will receive more equity if the Equity Financing valuation does not sufficiently exceed the safe’s valuation cap is not something that changed in the new safe. The original safe also operated this way. If the pre-money valuation of the Equity Financing was close to the sum of the pre-money valuation cap in the original safe and the amount raised under the original safe, investors under the original safe also received more equity. In either regime, valuation caps are just that -- caps, rather than final valuations.

### 3. What if the pre-money valuation of the company in the Equity Financing is lower than the safe’s Post-Money Valuation Cap?

As noted above, the safe provides that the safe holder will get the benefit of applying the Post-Money Valuation Cap or receive shares of Standard Preferred Stock at the same price per share paid by the new money investors, whichever results in a greater number of shares. When the pre-money valuation of the company in the Equity Financing is lower than the Post-Money Valuation Cap, the safe holder will always receive a greater number of

shares by using the price per share paid by the new money investors, and the Post-Money Valuation Cap will not apply. See Question 5 in Examples 1 and 2 in Appendix II.

**4. In an Equity Financing, how does the calculation of an investor’s shares under the post-money safe differ from the calculation of an investor’s shares under the original safe?**

Assuming the valuation cap applies when converting the safe (i.e., converting at the Safe Price is more advantageous to the investor than converting at the price per share of the Standard Preferred Stock), in both the original safe and the post-money safe, the number of shares issuable to the investor is equal to the (applicable pre- or post-money) valuation cap of the safe divided by the “Company Capitalization.”

The difference between the pre- and post-money safe share calculation lies in which securities are included in the “Company Capitalization:”

	<b>Original Safe</b>	<b>Post-Money Safe</b>
Outstanding shares of Capital Stock	Included	Included
Outstanding Options	Included	Included
Promised Options	Included*	Included
Unissued Option Pool	Included	Included
<b>Option Pool Increase</b>	<b>Included</b>	<b>Excluded</b>
<b>Safes, convertible notes and other similar convertibles</b>	<b>Excluded</b>	<b>Included</b>

\* Since the original safe covered the existing pool and its increase, it implicitly included Promised Options since those could only be issued out of the post-increase option pool.

**5. What is the Unissued Option Pool and why is it included in the Company Capitalization?**

First, some background. As mentioned above, the original safe evolved to become a complete replacement for a priced seed round, and the new safe was designed to incorporate changes to better match that reality. In priced seed rounds, an option pool of some size is adopted that does not dilute the seed investors. For example, a priced seed round might have these terms:

- \$5 million post-money valuation
- \$500k invested
- 10% available option pool

This means that the seed investors will own 10% ( $0.5/5 = 10\%$ ), and company employees who are issued Options will not dilute the seed investors’ 10% ownership until the company exhausts its 10% option pool. Once the pool is exhausted, the general expectation is that the pool will be expanded further and the resulting dilution will be shared by the company and the seed investors. The underlying logic is that up to a certain point, equity for company employees should not dilute the seed investors, since otherwise the seed investors would be funding their own dilution. Another way to characterize it is that the seed investors are valuing the company based on forward-looking expectations, which generally requires new employees to be hired. Regardless of the philosophical rationale, inclusion of some option pool is the conventional approach in priced rounds.

The safe approximates that option pool inclusion by including, in the Company Capitalization, a combination of the following:

- Outstanding Options -- Options that are actually issued and outstanding before the Equity Financing. Including these options ensures that safe holders get similar treatment as they would in a

priced seed round, i.e., they are not diluted by new hires made in between the safe round and the Equity Financing.

- Promised Options -- Options that are promised but not yet granted (see below for more details). Including these options ensures that safe holders are treated fairly in cases where the company delays the issuance of options to employees made in between the safe round and the Equity Financing, that otherwise would have or should have been issued and become Outstanding Options.
- Unissued Option Pool -- the unissued and available portion of the option pool that exists before the Equity Financing. Including this pool means the safe holders are treated similarly to how they would have been had the company done a priced round and not fully exhausted option pool increase that was reserved in connection with that round prior to the next priced round.

The above explanation of the option pool issue is also notable for what it does *not* include, which is the increase to the option pool that is typically required in the subsequent financing round (e.g. the Series A financing, if that is the first priced round following the safe fundraise). The reason for that exclusion has already been explained above. But it's clear that this exclusion is consistent with the framework of viewing the safes as an independent financing round. Including the Series A option pool increase in the Company Capitalization would effectively require the founders to bear all of the dilution by themselves for two rounds of hiring (the hires made with the safe money and the hires made with the Series A money), rather than one.

Most importantly, all of the above is consistent with the main goal of the new safe, which is making ownership easier to understand. When founders and investors look at the cap table prior to the Equity Financing, the existing option pool can just be used without any adjustments in order to determine who owns what. For example, if the pre-Equity Financing cap table looks like this:

Founders	90%
Option Pool	
Outstanding Options	8%
Unissued Option Pool	2%
Total	100%

And the company has sold \$500k in safes with a Post-Money Valuation Cap of \$5 million, then the cap table with the implied as-converted ownership of the safes is just that 10% ownership ( $0.5/5 = 10\%$ ) applied across the cap table, diluting each row by 10%:

Founders	81%
Option Pool	
Outstanding Options	7.2%
Unissued Option Pool	1.8%
Safes	10%
Total	100%

This example assumes that the Equity Financing has a pre-money valuation sufficiently greater than the Post-Money Valuation Caps of the safes. As noted earlier, if this is not the case, then the safes would end up with greater ownership.

## 6. What are “Promised Options” under the safe and why are they included in the Company Capitalization?

“Promised Options” are promised but ungranted options, restricted stock awards or purchases, RSUs, SARs, warrants or other like securities equal to the greater of those (a) promised pursuant to agreements made prior to the execution of the term sheet for the Equity Financing (or the initial closing of the Equity Financing, if there is no term sheet), or (b) treated as outstanding in the calculation of the Standard Preferred Stock’s price per share.

Practically speaking, the inclusion of Promised Options in the Company Capitalization means that the safe holders are not diluted by them, which we explain above. Mechanically this is done by including the Promised Options in the Company Capitalization, which reduces the price per share of the Safe Preferred Stock.

Fixing the number of Promised Options at the greater of (a) or (b) above does a few things.

- Clause (a) ensures there’s a default cut-off date (signing of the term sheet) from which to calculate the Promised Options figure. Promised Options most frequently arise when a company has hired employees but hasn’t had a chance yet to issue them the options promised to them. A clear cut-off date helps the company avoid a forced choice between (1) continuously updating the pro forma cap table for the Equity Financing to account for updates to the Promised Options figure all the way until the closing, or (2) freezing hiring until the Equity Financing closes.
- Clause (b) ensures that if the company and the investors in the Equity Financing agree to a different treatment for Promised Options that is more advantageous than the default treatment in clause (a), the safe holders get the same treatment. It also ensures that there’s consistency for all parties, since having two different ways of treating Promised Options would only create confusion.

An important and related note: when a company signs a term sheet for a priced round, most 409A valuation firms take the position that the then-current 409A price can no longer be used for option grants, because they view the term sheet as a material event that implies a change in the company’s valuation. This event can negatively impact employees who started work but haven’t received their options yet, since they joined the company in the riskier pre-term sheet period but will not receive the benefit of the lower pre-round 409A price. Thus, the practical advice that we and many others give to companies in this position is to make sure to take care of any “promised option” backlog prior to signing a term sheet for a priced equity round. If companies are handling promised options in this ideal manner, the number of “Promised Options” really should be zero anyway.

## C. SAFE CONVERSION IN LIQUIDITY EVENTS

### 1. What is the difference between Company Capitalization and Liquidity Capitalization?

The “Company Capitalization” is the denominator used in calculating the Safe Price, which is the price used to calculate the number of shares of Safe Preferred Stock issuable to the safe holder in an Equity Financing (i.e., the Safe Price equals the Post-Money Valuation Cap divided by the Company Capitalization). The Company Capitalization:

- Includes all shares of Capital Stock issued and outstanding;
- Includes all Converting Securities;
- Includes all (a) issued and outstanding Options and (b) Promised Options;
- Includes the Unissued Option Pool; and
- **Excludes** any increases to the Unissued Option Pool (except to the extent necessary to cover Promised Options that exceed the Unissued Option Pool) in connection with the Equity Financing.

The “Liquidity Capitalization” is the denominator used in calculating the Liquidity Price, which is the price used to calculate the Conversion Amount payable to the investor in a Liquidity Event (i.e., the Liquidity Price equals the Post-Money Valuation Cap divided by the Liquidity Capitalization). The Liquidity Capitalization:

- Includes all shares of Capital Stock issued and outstanding;

- Includes all (a) issued and outstanding Options and (b) to the extent receiving Proceeds, Promised Options;
- Includes all Converting Securities, **other than** any Safes and other convertible securities (including without limitation shares of Preferred Stock) where the holders of such securities are receiving Cash-Out Amounts or similar liquidation preference payments in lieu of Conversion Amounts or similar “as-converted” payments; and
- **Excludes** the Unissued Option Pool.

The primary difference between the Company Capitalization and the Liquidity Capitalization is that the Liquidity Capitalization excludes the Unissued Option Pool, because the acquirer in a Liquidity Event only buys the company’s outstanding equity, and equity that isn’t actually issued and outstanding, like the Unissued Option Pool, is simply not part of the equation. The company will also have no need to issue options from the Unissued Option Pool after the Liquidity Event.

The Liquidity Capitalization also excludes Converting Securities that will be cashed out based on their Purchase Amounts (and thus no longer treated as outstanding securities in the Liquidity Event) and Promised Options that will not be receiving any proceeds from the transaction.

#### D. CALCULATING AND MANAGING DILUTION

##### 1. Do I need to think about the amount of money I’m going to raise before I issue safes?

Yes. And generally, founders should have some sense of a target range for their fundraise, such as \$500K - \$1 million. Investors will often want to know the answer to the question “what business or technical progress is this round intended to finance, over what period of time, and how much capital will that require?” before they invest, so founders are encouraged to think about a target amount to raise in advance.

##### 2. Is there a maximum amount of money that can be raised on a post-money safe?

Yes. Raising more than the Post-Money Valuation Cap would result in negative ownership for founders! We obviously recommend raising much less than that number.

An example: assume the founders own 100% of the company before using the post-money safe. The founders decide to raise money using a safe with a Post-Money Valuation Cap of \$5 million. Below are the resulting implied ownership levels for the founders at various amounts raised on the safe with these terms:

Amount Raised	Safe Ownership	Founder Ownership
\$500k	\$500k / \$5 million = <b>10%</b>	100% - 10% = <b>90%</b>
\$2.5 million	\$2.5 million / \$5 million = <b>50%</b>	100% - 50% = <b>50%</b>
\$5 million	\$5 million / \$5 million = <b>100%</b>	100% - 100% = <b>0%</b>

##### 3. Will the safe ever result in more dilution than is estimated?

Yes. If the Equity Financing valuation does not sufficiently exceed the safe’s Post-Money Valuation Cap, then the safe holder will receive shares of Standard Preferred Stock at the lower price per share paid by the new money investors. As a result, the safe holder will receive a greater number of shares than was originally estimated using the Post-Money Valuation Cap. As discussed above, the original safe also operated this way.

## E. PRO RATA RIGHTS

### 1. Do safe holders get pro rata rights?

The new post-money safe does not carry over the prior version of pro rata rights. As described earlier, that right generally wasn't the one that parties were expecting anyway. The right that the parties were looking for is the pro rata right to participate in the Equity Financing (i.e., the Series A, if the Series A is the round in which the safes convert). We considered putting that pro rata right to participate in the Equity Financing directly in the new safe. But after much thought and discussion with a number of frequent users of the original safe, we concluded that it's impossible to create a universal standard for pro rata rights, since what's appropriate for one company raising \$1 million may not be for another company raising \$100,000.

Instead, we've created a standard side letter with a pro rata right to participate in the Equity Financing that can be used at a company's discretion. This allows each company to decide what is in its best interest.

**Note to founders: Please consider this pro rata right carefully.** When putting together the Equity Financing round, you will have to make room for your new investors, your existing investors with pro rata rights, and perhaps your existing investors who don't have formal pro rata rights but whom you decide you want in the round. If you haven't carefully considered the pro rata right, you may end up taking more dilution than you anticipated in order to include all of these investors in the round. Therefore, we strongly recommend that you spend at least a little time thinking about how pro rata allocations might play out in an Equity Financing before you agree to grant them during your safe fundraising.

**Note to investors: If you ask for and receive this right, please be responsive and commit or pass quickly when a company tells you it is raising its Equity Financing and asks if you would like to participate.** In our conversations with founders, one of the biggest issues with pro rata rights is that investors who hold such rights are frequently slow to respond. Sometimes this is intentional, with the investor waiting until it looks like there is no closing risk and the round is absolutely certain. Other times, the investor doesn't respond until after the round has closed, and then asks for a pro rata allocation, which is infeasible at that point. These considerations can delay the finalization of allocations and the pro forma cap table for the round, and thus hold up the closing.

### 2. Can the pro rata side letter be used with the other forms of the safe listed in Appendix I?

In general, no. The pro rata side letter can only be used with forms of the safe that have a Post-Money Valuation Cap (either the standard safe with a valuation cap only, or a safe with a valuation cap and discount), since the investor pro rata ownership is calculated using the Post-Money Valuation Cap.

### 3. What are some principled ways in which a company can give out pro rata side letters?

- **Require a Minimum Investment Amount** -- An investor must invest at least some minimum amount in order to qualify for pro rata rights. This is a common approach in priced rounds. For example, if the company is raising \$1 million, and three investors have invested \$250k each, and the last \$250k consists of 25 people investing \$10k each, the company could give pro rata rights only to the investors who invested \$250k. In addition to being a straightforward method of allocating pro rata rights, it also streamlines the closing process for the Series A since there are fewer pro rata rights holders to wrangle before closing the round. Requiring a minimum investment amount can also function as an incentive for investors to increase the size of their initial safe check.
- **Give to All Safe Holders** -- This is the most expedient approach since it minimizes negotiation. The problem is that the company might not actually be avoiding negotiation, but instead may be deferring it until the Series A round. Because the amount of pro rata allocation may represent, combined with the Series A new money and associated option pool increase, more dilution than the founders want or are willing to accept, this approach is a trade-off.

- **Target a Projected Amount of Series A Pro Rata Allocation** -- Estimate how much extra ownership the company would have to sell in its Series A financing due to the pro rata rights held by safe holders and manage the allocation of pro rata rights accordingly. Founders can backsolve this by rearranging the formula covered in the Quick Start section.

$$\text{Safes \% with Pro Rata} = 100\% - \frac{\text{Series A New Investors \%}}{\text{Series A Total Round \%}}$$

If a company is: (a) raising 20% on safes, (b) estimates the Series A new investors will want 25%, and (c) wants the aggregate Series A dollars to represent no more than 28% (remember this doesn't include the option pool that has to be added as well), then the limit on the amount of pro rata rights would be  $100\% - (25\%/28\%) = 10.7\%$ . In other words, this works out to about half of the safes, i.e. safes representing ~10% ownership.

## F. PRACTICAL TIPS FOR USING THE SAFE

### 1. What corporate formalities need to be observed when issuing safes?

The company's board of directors must formally consent to the issuance of the safes at a meeting or in a written consent before the company issues any safes.

If there are existing shares of preferred stock outstanding, the company will also need to either (1) amend the company's certificate of incorporation to clarify that the safes are on par with the existing preferred stock in terms of liquidation priority or (2) enter into a separate agreement with all of its existing preferred stockholders acknowledging the same. Without an amendment to the company's certificate of incorporation or an explicit agreement with all preferred stockholders, the liquidation priority provisions of the safe may not work as intended.

### 2. Can a safe have a discount, or a "Most Favored Nation" (MFN) provision?

Yes. This User Guide describes a safe with a Post-Money Valuation Cap. Other versions of the safe are described in Appendix I.

### 3. The template safe contains a statement that it's on one of the forms available at <http://ycombinator.com/documents> and that each party represents and warrants it has not modified such form except to fill in blanks and bracketed terms. What is the purpose of this statement?

The safe is, and always has been, "open sourced" for founders and investors to use as they see fit. As expected, some users modified the online templates to change, delete or add various provisions, sometimes without notifying the counterparty of such modifications. This practice forced companies and investors alike to waste hours of time and effort doing line-by-line comparisons of the modified safes against the online template in order to identify the changes (or to confirm that no changes were made). We think it's important for parties to be very sure about what they are signing. The statement was added to the standard template to ensure there are no surprises. Users are welcome to remove the statement, with the idea that its absence alerts an unsuspecting party that one or more of the standard provisions has been modified.

### 4. My company has outstanding original safes. Can I switch to using the new safes?

Possibly. There are several options to try:

- If the company has only issued a few original safes, then it may be possible to work with those safe holders to (with approval from the company's board of directors) amend and restate the outstanding original safes into post-money safes.

- It's possible to mix pre-money and post-money safes. However, having a combination of the two creates cap table uncertainty, and the company will have to commit to careful cap table modeling by running the conversion calculations for all of the outstanding safes.
- If the company has a lot of original safes outstanding, the simplest route is to just keep using the pre-money safe template. We've always advocated that founders minimize the time spent on administrative issues and fundraising so they can get back to the work of running a company.

**5. My company has outstanding convertible notes. Can I switch to fundraising on post-money safes?**

It's generally not advisable to issue both convertible notes and safes since they are treated differently in a Liquidation Event or Dissolution Event (outstanding convertible notes are treated as indebtedness and therefore have priority over any outstanding safes). If a company has already issued many convertible notes, founders should probably continue issuing convertible notes for simplicity. If a company has only issued a few convertible notes, then it may be possible to work with the existing investors (with approval from the company's board of directors) to convert the outstanding convertible notes into post-money safes.

**6. Can the safe be amended?**

Yes. The safe can be amended with the written consent of the company and the investor, or with the written consent of the company and a majority-in-interest of all then-outstanding safes with the same terms. The ability to amend the safe with the consent of a majority-in-interest allows the company and its investors to work together to sensibly amend the safe if the need arises. An investor's Purchase Amount can never be amended without that investor's separate consent.

**7. Is the safe subject to transfer restrictions?**

Yes, the safe is subject to a transfer restriction in Section 5(d), which provides that it may not be transferred without the company's consent, unless it is being transferred to an affiliate. In practical terms, this means the safe holder cannot resell the safe to a different investor without the company's approval.

**8. What is the characterization of the safe for tax purposes?**

We cannot give tax advice, so the only definitive thing we can say is that you should consult with your tax advisor if this question is material to your usage of the safe. But we've always intended and believed the safe (original safe or new safe) to be an equity security.



## **Appendix I**

### Alternative Versions of a Safe (“Standard” version of a safe is Post-Money Valuation Cap only)

#### **1. Valuation Cap and Discount**

- This is a safe with a negotiated Post-Money Valuation Cap and a Discount Rate. The “Discount Rate” applies to the price per share of the Standard Preferred Stock sold in the Equity Financing and is equal to 100 minus the discount percent (e.g., a 20% discount off the price per share of the Standard Preferred Stock equals a Discount Rate of 80%).
- Either the Post-Money Valuation Cap or the Discount Rate applies when converting this safe into shares of Safe Preferred Stock in an Equity Financing, depending on which calculation is most advantageous to the investor.
- The treatment of this safe in a Liquidity Event is the same as a Standard Safe.

#### **2. Discount, No Valuation Cap**

- This is a safe with a negotiated Discount Rate that applies when converting this safe into shares of Safe Preferred Stock in an Equity Financing.
- In a Liquidity Event, the investor is entitled to receive a portion of the proceeds equal to the greater of (1) a return of its Purchase Amount or (2) the as-converted proceeds it is entitled to in connection with a Liquidity Event (here, the proceeds it would be entitled to had its Purchase Amount been converted into common stock at a price per share equal to the fair market value of such stock multiplied by the Discount Rate).

#### **3. MFN [Most Favored Nation], No Valuation Cap, No Discount**

- This is a safe with no Post-Money Valuation Cap and no Discount Rate. If the company subsequently issues safes with provisions that are advantageous to the investors holding this safe (such as a Valuation Cap and/or a Discount Rate), the investor may choose to amend its safe to reflect the terms of the later-issued safes. The amendment term is the so-called “MFN Provision.” Note that, unless the later safes also include an MFN, the MFN of the safe is amended away once the safe holder decides the MFN is triggered. In other words, the MFN provision typically provides only one opportunity to amend the safe, not multiple opportunities as the company continues to issue additional safes. Moreover, it is important to be aware that the MFN provision does not permit the “cherry-picking” of terms. If a safe holder elects to convert its MFN safe to reflect the terms of subsequently-issued safes, the amended safe will be *identical* to the later safe (other than the Purchase Amount).
- If there is an Equity Financing before this safe is amended pursuant to the MFN Provision, the investor receives the same shares of preferred stock as the new money investors in the Equity Financing, at the same price. However, this safe does not automatically convert into shares of preferred stock unless the amount of new money raised in the Equity Financing is at least \$250,000.<sup>3</sup> This threshold amount provides the investor with some protection against an insignificant equity round raised at an artificially high valuation.
- If there is a Liquidity Event before this safe is amended by the MFN Provision, the investor is entitled to receive a portion of the proceeds equal to the greater of (1) a return of its Purchase Amount or (2) the as-converted proceeds it is entitled to in connection with a Liquidity Event (here, the proceeds it would be entitled to had its Purchase Amount been converted into common stock at a price per share equal to the fair market value of the common stock).

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<sup>3</sup> \$250,000 is a suggested threshold, but can be changed if the parties desire.

## Appendix II

### EXAMPLE 1 – post-money safes only

ABC, Inc. (the “Company”) raised \$1,000,000 from two investors. Investor A purchased a \$200,000 safe at a \$4m post-money valuation cap safe and Investor B purchased an \$800,000 safe at an \$8m post-money valuation cap.

#### 1) What is the estimated dilution from these two safes?

At this point, the Company has sold a minimum of 15% to investors.

Investor A = \$200,000 / \$4,000,000 = 5%  
 Investor B = \$800,000 / \$8,000,000 = 10%

The Company issued a pro rata side letter to Investor B, giving this investor the right to purchase 10% of the new money being raised in the next *Equity Financing*. For example, if the Company raises a \$5m Series A, Investor B would have a contractual right to invest up to \$500k.

#### 2) What is the impact of an Equity Financing on the Company’s cap table?

The Company signed a Series A term sheet to raise \$5m at a pre-money valuation of \$15m (which pre-money valuation includes (i) an ungranted and unallocated employee option pool representing 10% of the fully-diluted post-closing capitalization and (ii) all shares of Company capital stock issued in respect of outstanding safes and/or convertible promissory notes), resulting in a post-money valuation of \$20m. Investor C, the lead investor, will be investing \$4m for 20% post-closing fully diluted ownership.

Pre-money valuation:	\$15,000,000	Target available option pool:	10%
Total raise (new cash):	\$5,000,000	Option pool increase:	1,695,000 shares
Post-money valuation:	\$20,000,000	Series A price per share:	\$1.1144

Immediately prior to the financing and safe conversion, the cap table looks as follows:

	Common Stock	Preferred Stock	Stock Plan	Total Securities	Outstanding Ownership	Fully Diluted Ownership
Founders	9,250,000			9,250,000	93.43%	92.50%
Options outstanding			300,000	300,000	3.03%	3.00%
Promised options			350,000	350,000	3.54%	3.50%
<b>Total outstanding</b>	<b>9,250,000</b>	<b>0</b>	<b>650,000</b>	<b>9,900,000</b>	<b>100.00%</b>	<b>99.00%</b>
Options available			100,000	100,000		1.00%
<b>Total fully diluted</b>	<b>9,250,000</b>	<b>0</b>	<b>750,000</b>	<b>10,000,000</b>		<b>100.00%</b>

#### Safe Conversion

As explained in example #1 above, the Company’s outstanding post-money safes will convert into at least 15% of the *Company Capitalization*, which includes, without double counting, all safe and note conversion shares, the existing option pool, and all promised options, but excludes the new money shares as well as the option pool increase associated with the *Equity Financing*. In this example, the safes convert into exactly 15% because the post-money valuation of the *Equity Financing* is sufficiently high that all safes convert into *Safe Preferred Stock* at a price per share based on their respective valuation caps rather than *Standard Preferred Stock* at the Series A price per share (see Section B, question 2 in the Q&A).

Company Capitalization = Capital Stock Issued and Outstanding + Issued, Outstanding, and Promised Options + Unissued Options Pool + Converting Securities  
 = 9,250,000 + 650,000 + 100,000 + (Company Capitalization \* 15%)  
 = 10,000,000 / (100% - 15%)  
 = 11,764,705

Investor A's shares = 11,764,705 \* 5% = 588,235 shares of Series A-1 Preferred Stock  
Investor B's shares = 11,764,705 \* 10% = 1,176,470 shares of Series A-2 Preferred Stock

Immediately after the safe conversions, the Company's cap table looks as follows:

	Common Stock	Preferred Stock	Stock Plan	Total Securities	Outstanding Ownership	Fully Diluted Ownership
Founders	9,250,000			9,250,000	79.30%	78.62%
Investor A		588,235		588,235	5.04%	5.00%
Investor B		1,176,470		1,176,470	10.09%	10.00%
Options outstanding			300,000	300,000	2.57%	2.55%
Promised options			350,000	350,000	3.00%	2.98%
<b>Total outstanding</b>	<b>9,250,000</b>	<b>1,764,705</b>	<b>650,000</b>	<b>11,664,705</b>	<b>100.00%</b>	<b>99.15%</b>
Options available			100,000	100,000		0.85%
<b>Total fully diluted</b>	<b>9,250,000</b>	<b>1,764,705</b>	<b>750,000</b>	<b>11,764,705</b>		<b>100.00%</b>

#### New Money

The Company is raising \$5m at a pre-money valuation of \$15m. The Series A price per share is calculated as follows.

$$\begin{aligned} \text{Series A Price per Share} &= \text{pre-money valuation} / (\text{total fully diluted shares post safe conversion} + \\ &\text{option pool increase}) \\ &= \$15,000,000 / (11,764,705 + 1,695,000) \\ &= \$1.1144 \end{aligned}$$

The Company will sell 4,486,719 shares of Series A Preferred Stock (\$5,000,000 divided by the Series A price per share of \$1.1144). Investor C, the lead investor, will purchase 3,589,375 shares (\$4,000,000 divided by \$1.1144) and Investor B will exercise its pro rata right.

$$\begin{aligned} \text{Investor B's pro rata} &= \text{Total Series A Shares} * \text{pro rata ownership percentage} \\ &= 4,486,719 * 10\% \\ &= 448,671 \text{ shares of Series A Preferred Stock for } \$499,998.97 \end{aligned}$$

After the Series A financing round, the Company's cap table looks as follows:

	Common Stock	Preferred Stock	Stock Plan	Total Securities	Outstanding Ownership	Fully Diluted Ownership
Founders	9,250,000			9,250,000	57.27%	51.54%
Investor A		588,235		588,235	3.64%	3.28%
Investor B		1,625,141		1,625,141	10.06%	9.06%
Investor C		3,589,375		3,589,375	22.22%	20.00%
Other new investors		448,673		448,673	2.78%	2.50%
Options outstanding			300,000	300,000	1.86%	1.67%
Promised options			350,000	350,000	2.17%	1.95%
<b>Total outstanding</b>	<b>9,250,000</b>	<b>6,251,424</b>	<b>650,000</b>	<b>16,151,424</b>	<b>100.00%</b>	<b>90.00%</b>
Options available			1,795,000	1,795,000		10.00%
<b>Total fully diluted</b>	<b>9,250,000</b>	<b>6,251,424</b>	<b>2,445,000</b>	<b>17,946,424</b>		<b>100.00%</b>

Investor B maintained its 10% ownership by purchasing 10% of the shares of Series A Preferred Stock issued in this round. However, its post-closing fully diluted ownership is 9.06% instead of 10% because its safe conversion shares are diluted by the option pool increase. Investor A's post-closing fully diluted ownership is 3.28% because it was diluted by

both the total Series A Preferred Stock issued in this financing (since the Company did not grant it a pro rata side letter) as well as the option pool increase.

In the safe, the Series A Preferred Stock is referred to as *Standard Preferred Stock* and the Series A-1 and Series A-2 Preferred Stock is referred to as *Safe Preferred Stock*. The table below sets forth a comparison between the Standard Preferred and the Safe Preferred as each would be described in the Company’s certificate of incorporation.

	<b>Series A (Standard Preferred)</b>	<b>Series A-1 (Safe Preferred)</b>	<b>Series A-2 (Safe Preferred)</b>
Liquidation Preference on a per share basis	\$1.1144	\$0.3400	\$0.6800
Aggregate payout in a Change of Control transaction (each series pari passu with the others)	\$5,000,000	\$200,000	\$800,000
Conversion price and original issuance price at the time of the Series A financing	\$1.1144 Initially converts into 4,486,719 shares of common stock	\$0.3400 Initially converts into 588,235 shares of common stock	\$0.6800 Initially converts into 1,176,470 shares of common stock
Dividend rate per share (based on an 8% dividend)	\$0.0892	\$0.0272	\$0.0544

**3) What happens to the safes if the Company is acquired for \$10m prior to an Equity Financing?**

The Company receives a proposal to be acquired for \$10m in cash. Immediately prior to the acquisition, the Company’s cap table looks as follows:

	<b>Common Stock</b>	<b>Preferred Stock</b>	<b>Stock Plan</b>	<b>Total Securities</b>	<b>Outstanding Ownership</b>	<b>Fully Diluted Ownership</b>
Founders	9,250,000			9,250,000	96.86%	92.50%
Options outstanding			300,000	300,000	3.14%	3.00%
Promised options <sup>4</sup>			0	0	0.00%	0.00%
<b>Total outstanding</b>	<b>9,250,000</b>	<b>0</b>	<b>300,000</b>	<b>9,550,000</b>	<b>100.00%</b>	<b>95.50%</b>
Options available			450,000	450,000		4.50%
<b>Total fully diluted</b>	<b>9,250,000</b>	<b>0</b>	<b>750,000</b>	<b>10,000,000</b>		<b>100.00%</b>

In this *Liquidity Event*, the individual safe holders will automatically receive the greater of their *Purchase Amount* (the “*Cash-Out Amount*”) or the amount payable on their *Conversion Amount*, the number of shares of Common Stock equal to the *Purchase Amount* divided by the *Liquidity Price*.

$$\begin{aligned}
 \text{Investor A's Conversion Amount} &= \text{Purchase Amount} / \text{Liquidity Price} \\
 &= \$200,00 / (\text{Post-Money Valuation Cap} / \text{Liquidity Capitalization}) \\
 &= \$200,000 / (\$4,000,000 / (9,550,000 / 85\%)) \\
 &= 561,764
 \end{aligned}$$

<sup>4</sup> Because treatment of promised options is deal-specific, we have removed them here to simplify the example.

$$\begin{aligned}
\text{Investor B's Conversion Amount} &= \text{Purchase Amount} / \text{Liquidity Price} \\
&= \$800,000 / (\text{Post-Money Valuation Cap} / \text{Liquidity Capitalization}) \\
&= \$800,000 / (\$8,000,000 / (9,550,000 / 85\%)) \\
&= 1,123,529
\end{aligned}$$

The per share cash consideration for all stockholders, if the safes convert, is \$0.8901 (\$10,000,000 divided by the *Liquidity Capitalization* of 11,235,293). In this scenario, both safes would automatically convert into common stock because Investor A and Investor B's pro rata share of the cash consideration exceeds their respective *Purchase Amount* (see calculation below).

$$\begin{aligned}
\text{Investor A's share of cash consideration} &= 561,764 * \$0.8901 = \$500,026 \\
\text{Investor B's share of cash consideration} &= 1,123,529 * \$0.8901 = \$1,000,053
\end{aligned}$$

**4) What happens to the safes if the Company is acquired for \$3m prior to an Equity Financing?**

The Company receives a proposal to be acquired for \$3m in cash.

Immediately prior to the acquisition, the Company's cap table looks the same as in question #3 above in which it was acquired for \$10m. The calculation of each safe holder's *Conversion Amount* is therefore the same. Investor A and Investor B would receive 561,764 and 1,123,529 shares respectively.

The per share cash consideration, if the safes convert, is \$0.2670 (\$3,000,000 divided by the *Liquidity Capitalization* of 11,235,293). In this scenario, neither safe would convert since the safe holders' pro rata share of the cash consideration is less than their *Purchase Amount* (see calculation below). After the safe holders are paid back, the remaining cash consideration of \$2m is shared pro rata among all other stockholders.

$$\begin{aligned}
\text{Investor A's share of cash consideration} &= 561,764 * \$0.2670 = \$149,991 \\
\text{Investor B's share of cash consideration} &= 1,123,529 * \$0.2670 = \$299,982
\end{aligned}$$

If in the example above, the Company had outstanding promissory notes, then those would have been paid back prior to the safes since the safe holders' right to receive their *Cash-Out Amount* is junior to payment of outstanding indebtedness and credit claims.

**5) What is the impact on the Company's cap table of an Equity Financing with a post-money valuation of \$11m?**

The Company signed a Series Seed term sheet to raise \$2.2m at a pre-money valuation of \$8.8m (which pre-money valuation includes (i) an ungranted and unallocated employee option pool representing 10% of the fully-diluted post-closing capitalization and (ii) all shares of Company capital stock issued in respect of outstanding safes and/or convertible promissory notes), resulting in a post-money valuation of \$11m. Investor C, the lead investor, will be investing \$1.65m for 15% post-closing fully diluted ownership.

Pre-money valuation:	\$8,800,000	Target available option pool:	10%
Total raise (new cash):	\$2,200,000	Option pool increase:	1,573,000 shares
Post-money valuation:	\$11,000,000	Series Seed price per share:	\$0.6577

Immediately prior to the financing and safe conversion, the cap table looks the same as in example #2 above. The Company's outstanding post-money safes will convert into a minimum of 15% of the Company's Capitalization. However, if the Series Seed price per share is less than the *Safe Price*, then the safe conversion shares are calculated based on the *Purchase Amount* divided by the Series Seed price per share.

For purposes of this comparison, the *Company Capitalization* is calculated as follows.

$$\begin{aligned}
\text{Company Capitalization} &= \text{Capital Stock Issued and Outstanding} + \text{Issued, Outstanding, and Promised Options} + \\
&\text{Unissued Options Pool} + \text{Converting Securities} \\
&= 9,250,000 + 650,000 + 100,000 + (\text{Company Capitalization} * 15\%) \\
&= 10,000,000 / (100\% - 15\%) \\
&= 11,764,705
\end{aligned}$$

	Investor A	Investor B
(1) <i>Purchase Amount</i> divided by Series Seed price per share	304,090 shares	1,216,360 shares
(2) <i>Purchase Amount</i> divided by <i>Safe Price</i>	588,235 shares (11,764,705 * 5%)	1,176,470 shares (11,764,705 * 10%)
Method that results in the greater number of shares	(2) Safe Price	(1) Series Seed price per share

For purposes of calculating the number of shares Investor A receives, the *Company Capitalization* is calculated as follows.

$$\begin{aligned}
 \text{Company Capitalization} &= \text{Capital Stock Issued and Outstanding} + \text{Issued, Outstanding, and Promised Options} + \\
 &\text{Unissued Options Pool} + \text{Converting Securities} \\
 &= 9,250,000 + 650,000 + 100,000 + (\text{Investor B shares} + (\text{Company Capitalization} * 5\%)) \\
 &= (10,000,000 + 1,216,360) / (100\% - 5\%) \\
 &= 11,806,694
 \end{aligned}$$

$$\text{Investor A's shares} = 11,806,694 * 5\% = 590,334 \text{ shares of Series Seed-1 Preferred Stock}$$

Immediately after the safe conversions, the Company's cap table looks as follows:

	Common Stock	Preferred Stock	Stock Plan	Total Securities	Outstanding Ownership	Fully Diluted Ownership
Founders	9,250,000			9,250,000	79.02%	78.35%
Investor A		590,334		590,334	5.04%	5.00%
Investor B		1,216,360		1,216,360	10.39%	10.30%
Options outstanding			300,000	300,000	2.56%	2.54%
Promised options			350,000	350,000	2.99%	2.96%
<b>Total outstanding</b>	<b>9,250,000</b>	<b>1,806,694</b>	<b>650,000</b>	<b>11,706,694</b>	<b>100.00%</b>	<b>99.15%</b>
Options available			100,000	100,000		0.85%
<b>Total fully diluted</b>	<b>9,250,000</b>	<b>1,806,694</b>	<b>750,000</b>	<b>11,806,694</b>		<b>100.00%</b>

In this scenario, Investor B's safe converted into 10.3% ownership versus the 10% implied by its \$8m post-money valuation cap because the Series Seed price per share is less than this safe's Safe Price. Because Investor B has a pro rata right, it will also be calculated based on this 10.3% ownership.

#### New Money

The Company is raising \$2.2m at a pre-money valuation of \$8.8m. The Series Seed price per share is calculated as follows.

$$\begin{aligned}
 \text{Series Seed Price per Share} &= \text{pre-money valuation} / (\text{total fully diluted shares post safe conversion} + \\
 &\text{option pool increase}) \\
 &= \$8,800,000 / (11,806,694 + 1,573,000) \\
 &= \$0.6577
 \end{aligned}$$

The Company will sell 3,344,990 shares of Series Seed Preferred Stock (\$2,200,000 divided by the Series Seed price per share of \$0.6577). Investor C, the lead investor, will purchase 2,508,742 shares (\$1,650,000 divided by \$0.6577) and Investor B will exercise its pro rata right.

Investor B's pro rata = Total Series Seed Shares \* pro rata ownership percentage  
 = 3,344,990 \* 10.3%  
 = 344,533 shares of Series Seed Preferred Stock for \$226,599.36

After the Series Seed financing round, the Company's cap table looks as follows:

	Common Stock	Preferred Stock	Stock Plan	Total Securities	Outstanding Ownership	Fully Diluted Ownership
Founders	9,250,000			9,250,000	61.45%	55.32%
Investor A		590,334		590,334	3.92%	3.53%
Investor B		1,560,893		1,560,893	10.37%	9.33%
Investor C		2,508,742		2,508,742	16.67%	15.00%
Other new investors		491,715		491,715	3.27%	2.94%
Options outstanding			300,000	300,000	1.99%	1.79%
Promised options			350,000	350,000	2.33%	2.09%
<b>Total outstanding</b>	<b>9,250,000</b>	<b>5,151,684</b>	<b>650,000</b>	<b>15,051,684</b>	<b>100.00%</b>	<b>90.00%</b>
Options available			1,673,000	1,673,000		10.00%
<b>Total fully diluted</b>	<b>9,250,000</b>	<b>5,151,684</b>	<b>2,323,000</b>	<b>16,724,684</b>		<b>100.00%</b>

**EXAMPLE 2** – combination of pre-money and post-money safes

ABC, Inc. (the "Company") raised \$1,000,000 from two investors. Investor A purchased a \$200,000 safe at a \$3.8m pre-money valuation cap safe and Investor B purchased an \$800,000 safe at an \$8m post-money valuation cap.

**1) What is the estimated dilution from these two safes?**

At this point, the Company has sold at least 15% to investors. However, in this scenario there is more uncertainty since the dilution from the pre-money valuation cap safe is more difficult to estimate because it depends on both (i) the option pool increase associated with the *Equity Financing* in which the safe will convert as well as (ii) how much in total the Company raises on convertible securities.

Investor A = \$200,000 / (\$200,000 + \$3,800,000) = 5%

Investor B = \$800,000 / \$8,000,000 = 10%

The Company issued a pro rata side letter to Investor B, giving this investor the right to purchase 10% of the new money being raised in the next *Equity Financing*. For example, if the Company raises a \$5m Series A, Investor B would have a contractual right to invest up to \$500k.

**2) What is the impact of an Equity Financing on the Company's cap table?**

The Company signed a Series A term sheet to raise \$5m at a pre-money valuation of \$15m (which pre-money valuation includes (i) an ungranted and unallocated employee option pool representing 10% of the fully-diluted post-closing capitalization and (ii) all shares of Company capital stock issued in respect of outstanding safes and/or convertible promissory notes), resulting in a post-money valuation of \$20m. Investor C, the lead investor, will be investing \$4m for 20% post-closing fully diluted ownership.

Pre-money valuation:	\$15,000,000	Target available option pool:	10%
Total raise (new cash):	\$5,000,000	Option pool increase:	1,700,000 shares
Post-money valuation:	\$20,000,000	Series A price per share:	\$1.1115

Immediately prior to the financing and safe conversion, the cap table looks as follows:

	Common Stock	Preferred Stock	Stock Plan	Total Securities	Outstanding Ownership	Fully Diluted Ownership
Founders	9,250,000			9,250,000	93.43%	92.50%
Options outstanding			300,000	300,000	3.03%	3.00%
Promised options			350,000	350,000	3.54%	3.50%
<b>Total outstanding</b>	<b>9,250,000</b>	<b>0</b>	<b>650,000</b>	<b>9,900,000</b>	<b>100.00%</b>	<b>99.00%</b>
Options available			100,000	100,000		1.00%
<b>Total fully diluted</b>	<b>9,250,000</b>	<b>0</b>	<b>750,000</b>	<b>10,000,000</b>		<b>100.00%</b>

#### Safe Conversion

As explained in question #1 above, the Company's outstanding safes will convert into at least 15% ownership. However, unlike in the post-money safes only scenario, there is less certainty on how dilutive the safes will be since Investor A invested using a pre-money safe.

Investor A's Conversion Shares = Purchase Amount / Safe Price

$$\begin{aligned}
 \text{Safe Price} &= \text{Pre-Money Valuation Cap} / \text{Pre-Money Safe Company Capitalization} \\
 &= \$3,800,000 / (\text{Pre-Financing Fully Diluted Shares} + \text{Option Pool Increase}) \\
 &= \$3,800,000 / (10,000,000 + 1,700,000) \\
 &= \$0.3248
 \end{aligned}$$

$$\begin{aligned}
 &= \$200,000 / \$0.3248 \\
 &= 615,763 \text{ shares of Series A-1 Preferred Stock}
 \end{aligned}$$

Investor B's Conversion Shares = 10% \* Post-Money Safe Company Capitalization

$$\begin{aligned}
 \text{Post-Money Safe Company Capitalization} &= \text{Capital Stock Issued and Outstanding} + \text{Issued, Outstanding, and} \\
 &\text{Promised Options} + \text{Unissued Options Pool} + \text{Converting Securities} \\
 &= 10,000,000 + 615,763 + (\text{Post-Money Safe Company Capitalization} * 10\%) \\
 &= 10,615,763 / (100\% - 10\%) \\
 &= 11,795,292
 \end{aligned}$$

$$\begin{aligned}
 &= 11,795,292 * 10\% \\
 &= 1,179,529 \text{ shares of Series A-2 Preferred Stock}
 \end{aligned}$$

Immediately after the safe conversions, the Company's cap table looks as follows:

	Common Stock	Preferred Stock	Stock Plan	Total Securities	Outstanding Ownership	Fully Diluted Ownership
Founders	9,250,000			9,250,000	79.08%	78.42%
Investor A		615,763		615,763	5.27%	5.22%
Investor B		1,179,529		1,179,529	10.09%	10.00%
Options outstanding			300,000	300,000	2.57%	2.54%
Promised options			350,000	350,000	2.99%	2.97%
<b>Total outstanding</b>	<b>9,250,000</b>	<b>1,795,292</b>	<b>650,000</b>	<b>11,695,292</b>	<b>100.00%</b>	<b>99.15%</b>
Options available			100,000	100,000		0.85%
<b>Total fully diluted</b>	<b>9,250,000</b>	<b>1,795,292</b>	<b>750,000</b>	<b>11,795,292</b>		<b>100.00%</b>



### New Money

The Company is raising \$5m at a pre-money valuation of \$15m. The Series A price per share is calculated as follows.

$$\begin{aligned}\text{Series A Price per Share} &= \text{pre-money valuation} / (\text{total fully diluted shares post safe conversion} + \\ &\text{option pool increase}) \\ &= \$15,000,000 / (11,795,292 + 1,700,000) \\ &= \$1.1115\end{aligned}$$

The Company will sell 4,498,426 shares of Series A Preferred Stock (\$5,000,000 divided by the Series A price per share of \$1.1144). Investor C, the lead investor, will purchase 3,598,740 shares (\$4,000,000 divided by \$1.1115) and Investor B will exercise its pro rata right.

$$\begin{aligned}\text{Investor B's pro rata} &= \text{Total Series A Shares} * \text{pro rata ownership percentage} \\ &= 4,498,426 * 10\% \\ &= 449,842 \text{ shares of Series A Preferred Stock for } \$499,999.39\end{aligned}$$

After the Series A financing round, the Company's cap table looks as follows:

	Common Stock	Preferred Stock	Stock Plan	Total Securities	Outstanding Ownership	Fully Diluted Ownership
Founders	9,250,000			9,250,000	57.13%	51.40%
Investor A		615,763		615,763	3.80%	3.42%
Investor B		1,629,371		1,629,371	10.06%	9.06%
Investor C		3,598,740		3,598,740	22.22%	20.00%
Other new investors		449,844		449,844	2.78%	2.50%
Options outstanding			300,000	300,000	1.85%	1.67%
Promised options			350,000	350,000	2.16%	1.95%
<b>Total outstanding</b>	<b>9,250,000</b>	<b>6,293,718</b>	<b>650,000</b>	<b>16,193,718</b>	<b>100.00%</b>	<b>90.00%</b>
Options available			1,800,000	1,800,000		10.00%
<b>Total fully diluted</b>	<b>9,250,000</b>	<b>6,293,718</b>	<b>2,450,000</b>	<b>17,993,718</b>		<b>100.00%</b>

Investor B maintained its 10% ownership by purchasing 10% of the shares of Series A Preferred Stock issued in this round. However, its post-closing fully diluted ownership is 9.06% instead of 10% because its safe conversion shares are diluted by the option pool increase. Investor A's post-closing fully diluted ownership is 3.42% because it was diluted by the total Series A Preferred Stock issued in this financing (since the Company did not grant it a pro rata side letter).

### **3) What happens to the safes if the Company is acquired for \$10m cash prior to an Equity Financing?**

The Company receives a proposal to be acquired for \$10m in cash. Immediately prior to the acquisition, the Company's cap table looks as follows:

	Common Stock	Preferred Stock	Stock Plan	Total Securities	Outstanding Ownership	Fully Diluted Ownership
Founders	9,250,000			9,250,000	96.86%	92.50%
Options outstanding			300,000	300,000	3.14%	3.00%
Promised options <sup>5</sup>			0	0	0.00%	0.00%
<b>Total outstanding</b>	<b>9,250,000</b>	<b>0</b>	<b>300,000</b>	<b>9,550,000</b>	<b>100.00%</b>	<b>95.50%</b>
Options available			450,000	450,000		4.50%
<b>Total fully diluted</b>	<b>9,250,000</b>	<b>0</b>	<b>750,000</b>	<b>10,000,000</b>		<b>100.00%</b>

<sup>5</sup> Because treatment of promised options is deal-specific, we have removed them here to simplify the example.

In this *Liquidity Event*, Investor B will automatically receive the greater of its *Cash-Out Amount* or the amount payable on its *Conversion Amount*. Investor A has the option of either receiving its *Cash-Out Amount* or automatically receiving the amount payable on its *Conversion Amount* if it fails to select the cash option.

$$\begin{aligned} \text{Investor A's Conversion Amount} &= \text{Purchase Amount} / \text{Liquidity Price} \\ &= \$200,00 / (\text{Pre-Money Valuation Cap} / \text{Liquidity Capitalization}) \\ &= \$200,000 / (\$3,800,000 / 9,550,000) \\ &= 502,631 \end{aligned}$$

$$\begin{aligned} \text{Investor B's Conversion Amount} &= \text{Purchase Amount} / \text{Liquidity Price} \\ &= \$800,000 / (\text{Post-Money Valuation Cap} / \text{Liquidity Capitalization}) \\ &= \$800,000 / (\$8,000,000 / ((9,550,000 + 502,631) / 90\%)) \\ &= 1,116,959 \end{aligned}$$

The per share cash consideration for all stockholders, if the safes convert, is \$0.8953 (\$10,000,000 divided by the Liquidity Capitalization of 11,169,590). In this scenario, both safes would convert into common stock because Investor A and Investor B's pro rata share of the cash consideration exceeds their respective Purchase Amount (see calculation below).

$$\begin{aligned} \text{Investor A's share of cash consideration} &= 502,631 * \$0.8953 = \$450,006 \\ \text{Investor B's share of cash consideration} &= 1,116,959 * \$0.8953 = \$1,000,013 \end{aligned}$$

#### 4) What happens to the safes if the Company is acquired for \$3m prior to an Equity Financing?

The Company receives a proposal to be acquired for \$3m in cash. Immediately prior to the acquisition, the Company's cap table looks the same as in question #3 above in which it was acquired for \$10m. The calculation of each safe holder's *Conversion Amount* is therefore the same. Investor A and Investor B would receive 502,631 and 1,116,959 shares respectively.

The per share cash consideration, if the safes convert, is \$0.2686 (\$3,000,000 divided by the *Liquidity Capitalization* of 11,169,590). In this scenario, neither safe would convert since the safe holders' pro rata share of the cash consideration is less than their *Purchase Amount* (see calculation below). After the safe holders are paid back, the remaining cash consideration of \$2m is shared pro rata among all other stockholders.

$$\begin{aligned} \text{Investor A's share of cash consideration} &= 502,631 * \$0.2686 = \$135,007 \\ \text{Investor B's share of cash consideration} &= 1,116,959 * \$0.2686 = \$300,015 \end{aligned}$$

If in the example above, the Company had outstanding promissory notes, then those would have been paid back prior to the safes since the safe holders' right to receive their *Cash-Out Amount* is junior to payment of outstanding indebtedness and credit claims.

#### 5) What is the impact on the Company's cap table of an Equity Financing with a post-money valuation of \$11m?

The Company signed a Series Seed term sheet to raise \$2.2m at a pre-money valuation of \$8.8m (which pre-money valuation includes (i) an ungranted and unallocated employee option pool representing 10% of the fully-diluted post-closing capitalization and (ii) all shares of Company capital stock issued in respect of outstanding safes and/or convertible promissory notes), resulting in a post-money valuation of \$11m. Investor C, the lead investor, will be investing \$1.65m for 15% post-closing fully diluted ownership.

Pre-money valuation:	\$8,800,000	Target available option pool:	10%
Total raise (new cash):	\$2,200,000	Option pool increase:	1,575,000 shares
Post-money valuation:	\$11,000,000	Series Seed price per share:	\$0.6566

Immediately prior to the financing and safe conversion, the cap table looks the same as in example #2 above. The Company's outstanding safes will convert based on their calculated *Safe Price*. However, if the Series Seed price per share is less than the *Safe Price*, then the safe conversion shares are calculated based on the *Purchase Amount* divided by the Series Seed price per share.

Investor A's Conversion Shares = Purchase Amount / Safe Price

$$\begin{aligned} \text{Safe Price} &= \text{Pre-Money Valuation Cap} / \text{Pre-Money Valuation Cap Safe Company Capitalization} \\ &= \$3,800,000 / (\text{Pre-Financing Fully Diluted Shares} + \text{Option Pool Increase}) \\ &= \$3,800,000 / (10,000,000 + 1,575,000) \\ &= \$0.3283 \end{aligned}$$

$$\begin{aligned} &= \$200,000 / \$0.3283 \\ &= 609,198 \text{ shares of Series A-1 Preferred Stock} \end{aligned}$$

Investor B's Conversion Shares = Company Capitalization \* Target Ownership

$$\begin{aligned} \text{Company Capitalization} &= \text{Capital Stock Issued and Outstanding} + \text{Issued, Outstanding, and Promised Options} + \\ &\text{Unissued Options Pool} + \text{Converting Securities} \\ &= 9,250,000 + 650,000 + 100,000 + (\text{Investor A's shares} + (\text{Company Capitalization} * 10\%)) \\ &= 10,609,198 / (100\% - 10\%) \\ &= 11,787,997 \end{aligned}$$

	Investor A	Investor B
(1) Purchase Amount divided by Series Seed price per share	304,599 shares	1,218,397 shares
(2) Purchase Amount divided by Safe Price	609,198 shares	1,178,799 shares (11,787,997 * 10%)
Method that results in the greater number of shares	(2) Safe Price	(1) Series Seed price per share

Immediately after the safe conversions, the Company's cap table looks as follows:

	Common Stock	Preferred Stock	Stock Plan	Total Securities	Outstanding Ownership	Fully Diluted Ownership
Founders	9,250,000			9,250,000	78.88%	78.20%
Investor A		609,198		609,198	5.19%	5.15%
Investor B		1,218,397		1,218,397	10.39%	10.30%
Options outstanding			300,000	300,000	2.56%	2.54%
Promised options			350,000	350,000	2.98%	2.96%
<b>Total outstanding</b>	<b>9,250,000</b>	<b>1,827,595</b>	<b>650,000</b>	<b>11,727,595</b>	<b>100.00%</b>	<b>99.15%</b>
Options available			100,000	100,000		0.85%
<b>Total fully diluted</b>	<b>9,250,000</b>	<b>1,827,595</b>	<b>750,000</b>	<b>11,827,595</b>		<b>100.00%</b>

In this scenario, Investor B's safe converted into 10.3% ownership versus the 10% implied by its \$8m post-money valuation cap because the Series Seed price per share is less than this safe's *Safe Price*. Because Investor B has a pro rata right, it will also be calculated using this 10.3% ownership.

### New Money

The Company is raising \$2.2m at a pre-money valuation of \$8.8m. The Series Seed price per share is calculated as follows.

$$\begin{aligned}\text{Series Seed Price per Share} &= \text{pre-money valuation} / (\text{total fully diluted shares post safe conversion} + \\ &\text{option pool increase}) \\ &= \$8,800,000 / (11,827,595 + 1,575,000) \\ &= \$0.6566\end{aligned}$$

The Company will sell 3,350,594 shares of Series Seed Preferred Stock (\$2,200,000 divided by the Series Seed price per share of \$0.6566). Investor C, the lead investor, will purchase 2,512,945 shares (\$1,650,000 divided by \$0.6566) and Investor B will exercise its pro rata right.

$$\begin{aligned}\text{Investor B's pro rata} &= \text{Total Series Seed Shares} * \text{pro rata ownership percentage} \\ &= 3,350,594 * 10.3\% \\ &= 345,111 \text{ shares of Series Seed Preferred Stock for } \$226,599.89\end{aligned}$$

After the Series Seed financing round, the Company's cap table looks as follows:

	<b>Common Stock</b>	<b>Preferred Stock</b>	<b>Stock Plan</b>	<b>Total Securities</b>	<b>Outstanding Ownership</b>	<b>Fully Diluted Ownership</b>
Founders	9,250,000			9,250,000	61.34%	55.21%
Investor A		609,198		609,198	4.04%	3.64%
Investor B		1,563,508		1,563,508	10.37%	9.33%
Investor C		2,512,945		2,512,945	16.67%	15.00%
Other new investors		492,538		492,538	3.27%	2.94%
Options outstanding			300,000	300,000	1.99%	1.79%
Promised options			350,000	350,000	2.32%	2.09%
<b>Total outstanding</b>	<b>9,250,000</b>	<b>5,178,189</b>	<b>650,000</b>	<b>15,078,189</b>	<b>100.00%</b>	<b>90.00%</b>
Options available			1,675,000	1,675,000		10.00%
<b>Total fully diluted</b>	<b>9,250,000</b>	<b>5,178,189</b>	<b>2,450,000</b>	<b>16,753,189</b>		<b>100.00%</b>

## **Appendix III**

### **Summary of Substantive Changes in the New Post-Money Safe**

This is only a summary of the substantive changes to the Standard Safe. In general, the other flavors of the new safe (valuation cap & discount, MFN-only, discount-only) only vary from the Standard Safe to the extent necessary to implement and be consistent with their distinctive features (i.e. adding the discount, adding the MFN, etc.). Version numbers are stamped on the upper right-hand corner of each form of new safe.

#### **Version 1.0 - Release Date 9/28/2018**

**Statement that neither party has changed the safe form except to fill in blanks and bracketed terms.**

Location: Second paragraph of the Preamble

Purpose: Covered in the Q&A section above.

**The safe is expressly copyrighted and made available under the Creative Commons Attribution-No Derivatives 4.0 License.**

Location: First page footer

Purpose: Similar purpose as above. People have periodically asked us if they could re-publish the safe documents in educational or reference materials, and our replies typically tracked the terms of the Creative Commons license mentioned, i.e. provide attribution and please do not change the form without asking us first. We also wanted to make sure that if other people publish the safe documents in other public-facing channels (e.g. other websites, circulars, etc.), they publish the actual safe documents, rather than modified versions that might confuse people into thinking that they are viewing or using the “standard” versions.

**Deletion of the post-conversion round pro rata right; addition of optional conversion round pro rata side letter.**

Location: Section 1(a); Pro Rata Side Letter

Purpose: Covered in the introduction and Q&A section above.

**Safe holder’s payout choices in a Liquidity Event are indifferent to the form of consideration.**

Location: Section 1(b)

Purpose: In a Liquidity Event, the original safe provided the holder with two options: (1) receiving up to 1x their investment back in cash (or a lesser pro rata amount of cash if the company did not have enough cash to repay all of the original safes selecting this option), or (2) receiving the number of shares of common stock equivalent to the original safe’s as-converted ownership in the company, based on the calculated Liquidity Price and Liquidity Capitalization. For example, if the original safe holder invested \$1 million at a \$9 million pre-money valuation cap, and there were no other original safes, the holder could choose between receiving up to \$1 million in cash (or a lesser amount, if not enough cash was available), or receiving approximately 10% of the company in the form of common stock ( $1 / (9 + 1) = 10\%$ ).

The new safe provides the holder with the option of receiving value that is the greater of (1) 1x their investment back in cash and/or other forms of consideration (e.g. acquirer stock), or (2) the amount payable on the as-converted ownership of the safe. This is done via the defined term “Proceeds” - which covers all proceeds payouts from the Liquidity Event, whether stock or cash - and specifying the safe holder receives the portion of Proceeds that is the greater of the Purchase Amount or what would be payable on the as-converted ownership of the safe.

Also, in acquisitions where the proceeds consist of a mix of cash and stock, sometimes proceeds recipients are given a choice between whether they want all cash, a mix of cash and stock, and/or all stock. The new safe stipulates that if other company securityholders are given that choice, the safe holders will be treated the same way and also given that choice (subject to legal restrictions and constraints, such as securities regulations). However, if the acquirer does not provide a choice and mandates a particular cash/stock split, then safe holders would be bound by such terms of the acquisition.

**The safe's priority in relation to other claims and securities in a Liquidity Event or Dissolution Event is confirmed to be on par with standard preferred stock.**

Location: Section 1(d)

Purpose: Covered in the Q&A section above. In our view, safes have always been properly classified as equity securities, so this language confirms the original intent.

**The definition of Company Capitalization was changed in the following ways: (1) the safe and other safes are included, (2) the Equity Financing option pool increase is no longer included and (3) the Unissued Option Pool and Promised Options are specifically included.**

Location: Definition of "Company Capitalization"

Purpose: Change #1 is what mechanically ensures that the valuation cap expressed in the safe operates as a post-money valuation cap.

Change #2 ensures that all unknowable or dynamic elements of the conversion calculation, at the time the safes are issued, are eliminated from the conversion calculation, since that is the only way to ensure a quick and easy way of calculating the dilution implied by the safes. This concept is covered in the introduction and in the Q&A section of this User Guide.

Change #3 ensures that there is some reasonable approximation to the result that the company and investors would have agreed on had they opted for a priced seed round instead. This is also covered in the Q&A.

**The definition of Liquidity Capitalization was changed in the following ways: (1) the safe and other safes are included, except for safes and other securities opting to take their Cash-Out Amounts or similar liquidation preference payments; and (2) Promised Options are included, but only to the extent they are receiving Proceeds.**

Location: Definition of "Liquidity Capitalization"

Purpose: Change #1 is what mechanically ensures that the valuation cap expressed in the safe operates as a post-money valuation cap. It also ensures that all securities taking liquidation preference payments are not included in the denominator - since those securities are not taking "as-converted" proceeds, they should not be part of the capitalization used to determine everyone's share of the remaining "as-converted" proceeds following the payout of liquidation preferences.

Change #2 ensures consistency if the terms of the acquisition include payouts to holders of Promised Options, which can happen from time to time.

**The Investor Representations now also include an explicit acknowledgment and agreement that if the safe holder is not an accredited investor at the time of the Equity Financing, the company can rescind the safe by returning the Purchase Amount.**

Location: Section 4(b), first sentence

Purpose: This language ensures that the company is not obligated to issue shares upon conversion if the safe holder is not accredited at the time of the Equity Financing, since otherwise it would make the Equity Financing ineligible for various Regulation D safe harbors and/or cause issues with compliance with federal and state securities regulations.

**The safe now includes a provision that allows a "majority-in-interest" to amend the safe.**

Location: Section 5(a)

Purpose: Covered in the Q&A.

**If the company pays a dividend on outstanding shares of common stock (besides dividends paid in the form of additional shares of common stock), the safe holder now has the right to receive dividends as well, based on the safe's as-converted ownership.**

Location: Section 5(c) and definition of "Dividend Amount"

Purpose: From time to time a company will mature into a sustainable, cash flow positive business that is nonetheless unlikely to ever make it to venture scale and a traditional venture exit (an outcome that is not limited to companies funded by safes). In that case, the dividend provision provides a way for safe holders to attain some liquidity by receiving payouts at the same time that stockholders (e.g., the founders) are dividending themselves profits from the business.