1. 1 SAFE (SIMPLE AGREEMENT FOR FUTURE EQUITY)

Brief Description

The Simple Agreement for Future Equity ("SAFE") is a financing instrument used in early-stage funding and seed funding, and resembles the dynamics of a convertible note without having the intricacies that a convertible debt instrument would entail. Via a SAFE the investor receives the right to purchase the shares of a company in a future round of equity, subject to pre-defined conditions set ex-ante in the agreement.

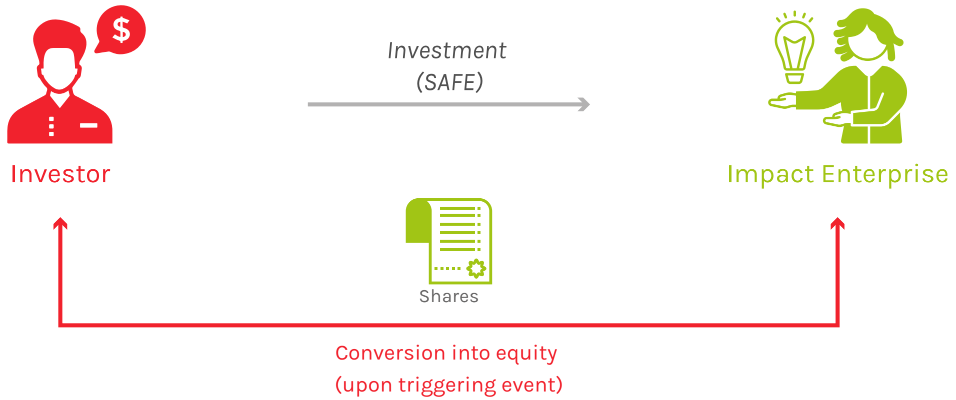

Figure 1.2 - "SAFE", source: Roots of Impact.

Purpose/Fit	Flexible, quick and simple source of funding in unpriced[9] seed rounds
Can replace	Debt – convertible notes
Risk/Return Profile	High Risk/High Return
Enterprise Lifecyle	Seed stage
Maturity	n/a – it is linked to the equity funding round (or dissolution event, or another triggering event)

9 Unpriced in this context means that there is no company valuation that would allow to calculate the company share investors would get for a certain amount of investment.

Emergency-Proof: This instrument is particularly relevant in difficult historical moments such as the Covid-19 crisis when flexibility and quick access to funding are critical to overcoming the severe social, financial, and economic challenges faced by enterprises.

Defining Criteria

- **Liquidity event or triggering event:** A specific event triggering conversion into equity. The most common event is an equity funding round (it is usually a series A financing, i.e. when the company provides equity shares to the investors for the first time). Another triggering event could be a trade sale, which is the sale of the overall business, or a part of it, to another company.

- **Dissolution event:** In the case of the company going out of business, the SAFE investor is entitled to receive its purchase amount or any other agreed amount back.

- **Discount rate:** It allows the SAFE investor to convert to equity at a discounted price in the course of a subsequent round of financing. Discount rates typically range between 10% and 25%, and the discount factor is calculated as follows: [100 – discount rate]%.

- **Valuation Cap:** Upon raising funds above a certain threshold, it allows the SAFE investor to convert at the cap share price. The valuation cap works as a ceiling on the valuation that will be used to calculate the conversion price for the SAFE investors, which are entitled to convert at the lower of the valuation cap or the price, in the subsequent financing.

- **Pro-rata rights or participation rights:** They entitle the SAFE investors, during subsequent rounds of funding, to invest additional funds in order to maintain their ownership percentage and avoid dilution.

Interesting Variants and Options

- The triggering event can also be linked to a change of control, an M&A, or other predefined circumstances.
- The valuation cap can be applied to pre [10] or post [11] money valuation.
- Most favoured nation provision ("MFN"): in case of multiple issues of SAFE, the company has to inform all the SAFE investors about each new additional issuance and enable them to check whether the terms are preferable. For instance, if a valuation cap or discount is introduced in the new round of SAFE, then the previous holders are entitled to amend their SAFE to reflect the new terms.
- Linking financial rewards to the achievement of impact, for example reducing the discount rate or increasing the valuation - see "Examples of relevant terms" below.

Examples of SAFE structures

- SAFE with valuation cap but no discount (most common)
- SAFE with no valuation cap but with discount
- SAFE with both valuation cap and discount

Examples of relevant terms (as formulated in a contract):	
Discount Factor/Price	The Discount Factor is (80%). The Discount Price is the price per share of the Standard Preferred Stock sold in the Equity Financing multiplied by the Discount Factor.
Conversion Price	The Conversion Price means either (i) the SAFE Price or (ii) the Discount Price, whichever calculation results in a greater number of shares of SAFE Preferred Stock, where SAFE Preferred Stock means the shares of Preferred Stock issued to the SAFE investor in an Equity Financing, having identical rights, privileges, preferences and restrictions as the shares of Standard Preferred Stock, other than with respect to (i) the per share liquidation preference and the conversion price for purposes of price-based anti-dilution protection, which will be equal the Conversion Price; and (ii) the basis for any dividend rights, which will be based on the Conversion Price.
SAFE Price	SAFE price means the price per share equal to the Valuation Cap divided by the Company Capitalisation.
Valuation Cap	The (Post-Money) Valuation Cap is (USD 5,000,000)
MFN Amendment Provision	If the Company issues any Subsequent Convertible Securities prior to termination of this SAFE, the Company will promptly provide the Investor with written notice thereof. In the event the Investor determines that the terms of the Subsequent Convertible Securities are preferable to the terms of this instrument, the Investor will notify the Company in writing. Promptly after receipt of such written notice from the Investor, the Company agrees to amend and restate this instrument to be identical to the instrument(s) evidencing the Subsequent Convertible Securities.
Optional: Link to Impact Performance	• The pre-agreed discount rate of (20%) is reduced by (1%) for every (1,000 units of social outcomes) achieved by the Company up to a discount rate of (0%) • Alternatively: The pre-defined valuation cap of (USD 5,000,000) increases by (USD 10,000) for every (1,000 units of social outcomes) achieved by the company up to a valuation cap of (USD 8,000,000)

10 Pre-money refers to the value of a company prior the latest round of financing.

11 Post-money refers to the value of a company right after a financing round.

Main Advantages

- SAFE allows companies to raise investment along their natural company's value growth curve, without having to sell a high percentage of their company at a low valuation in the early stage of their lifecycle. Thus, SAFE allows companies to raise money at an appropriate time.

- The legal costs associated with the draft and implementation of the agreement are low and far from being comparable to other forms of financing.

- SAFE allows for greater flexibility as there is no maturity, and therefore no fixed deadline for conversion.

- Using a valuation cap, the investors can lock in their economics by exactly knowing which percentage of the company they will theoretically own as a result of their investment.

Main Challenges

- Similar to equity instruments, there is no recovery provided in the case of bankruptcy.

- Investors could prioritise owning preferred stocks, which would enable them to receive control rights, board seat, veto rights, and/or other economic rights.

- Investors are not remunerated [12] for the early-stage risk they are taking. In fact, they get paid only when the company raise additional funding.

- Unlike debt instrument, a SAFE does not accrue interest and it lacks a maturity date, which entails that there is no guarantee of equity ownership for the investor.

(Hypothetical) Example of SAFE

Company ImpactFly is a startup that aims to revolutionize the use of drones to measure access to electrification and clean drinking water in rural areas. The company is evenly owned by two founders (2 million shares each, 4 million in total) who decide to raise capital via a USD 500,000 SAFE offered by an investor. Once the agreement is signed, the two founders can use the money received to process the building of their venture. After 16 months the company is booming and the sales pipeline is skyrocketing, but the company is still not profitable and ImpactFly needs to raise additional funds (e.g. Series A round) in order to scale their business. The two founders approach a venture capital fund to raise an additional USD 1 million for 25% of the ownership, translating into a pre-money valuation of USD 4 million.

12 It could be argued that the discount rate compensates the investor for the additional risk borne.

Summary of information

- Pre-money valuation of USD 4 million
- Number of outstanding shares of 4 million
- SAFE Investment of USD 500,000
- Share price pre-money of USD 1

Let's look at the transaction under three different scenarios:

The SAFE is offered with a 15% discount

- The SAFE investor is entitled to a discount of 15%, therefore he or she will be able to convert at 85% of the price, providing the investor with 11% of the post-money (USD 5 million) ownership.

The SAFE is offered with a valuation cap of USD 3 million

- The SAFE investor is entitled to convert at 75% of the price as a result of a valuation cap of USD 3 million, providing the investor with 12% of the post-money (USD 5 million) ownership.

The SAFE is offered with a 15% discount and a valuation cap of USD 3 million

- The investor is entitled to convert at the minimum price between the discount price and the valuation cap price. In this case, the investor would apply the cap allowing him or her to obtain a 12% ownership instead of 11%.

Case studies and additional resources about SAFE can be found here.