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A Quick Guide to Priced Equity, Convertible Notes, and SAFEs

Introduction:
Priced equity rounds, convertible notes, and Simple Agreements for Future Equity (SAFEs) are three common methods of raising capital in startup financing. Each of these investment instruments has distinct characteristics and implications for investors and founders. Here's how to differentiate between them:

Priced Equity Round:

Nature: In a priced equity round, investors purchase shares or ownership equity in the company at a predetermined price per share.

Valuation: The company's valuation is typically established before the round, and investors know the price they are paying for each share. This is often based on the company's perceived value at the time of the investment.

Ownership: Investors immediately become shareholders and have a specific ownership stake in the company, which may come with voting rights and a say in governance.

Rights: Investors in priced equity rounds typically receive standard shareholder rights and protections, including dividends, liquidation preferences, and anti-dilution provisions.

Exit Rights: In the event of an exit, such as an acquisition or IPO, equity investors have the opportunity to receive returns based on their ownership stake and the terms negotiated in the equity round.

Convertible Note:

Nature: A convertible note is a debt instrument that is structured as a loan to the startup, but with the option to convert the debt into equity at a later date.

Conversion Trigger: Conversion typically occurs upon a specific event, such as a future equity financing round (e.g., a qualified financing) or a maturity date specified in the note.

Interest: Convertible notes often accrue interest, but this interest is typically not paid in cash. Instead, it is added to the principal amount that converts into equity.

Valuation: Convertible notes do not set a fixed valuation for the company at the time of the investment. The conversion price is determined when the note converts, based on the terms of the financing round triggering the conversion.

Ownership: Investors in convertible notes are creditors of the company until conversion occurs. At the time of conversion, they become equity holders and receive shares in the company.

Rights: The rights of convertible note investors may vary but are typically outlined in the note's terms. They may have rights that prioritize their investment or provide certain protections in the event of a liquidation or subsequent financing round.

SAFE (Simple Agreement for Future Equity):

Nature: A SAFE is a simple and standardized investment instrument that allows investors to provide capital to a startup in exchange for the right to acquire equity in a future equity financing round.

No Debt: Unlike convertible notes, SAFEs do not represent debt; they are a form of equity-based instrument.

Valuation: Similar to convertible notes, SAFEs do not set a fixed valuation for the company at the time of investment. The valuation and terms are determined when the SAFE converts in a subsequent equity financing round.

Ownership: SAFE investors have a future right to acquire equity at a determined price in a future round, without being immediate shareholders of the company.

Rights: SAFEs can have different terms, but they typically provide investors with certain rights, such as a discount or valuation cap that provides a benefit when converting in a future round.

Summary

Priced equity rounds involve the immediate sale of shares at a fixed price, while convertible notes and SAFEs offer a way for investors to contribute capital with the expectation of future equity conversion. Convertible notes are structured as debt with conversion features, while SAFEs are not debt-based and are intended to be simpler and more founder-friendly investment instruments. The valuation of the company and the specific terms vary between these three options, making it important for both investors and founders to understand the implications of each choice.

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