SAFES AND CONVERTIBLE NOTES EXPLAINED

How early-stage investment turns into ownership later, and what the valuation cap and discount really mean.

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AT A GLANCE

- A **SAFE** (simple agreement for future equity) and a **convertible note** both let an investor put money in now and get **shares later**, usually when the company raises a priced round.
- The two key terms are the **valuation cap** (the most the investor's price can be based on) and the **discount** (a percentage off the next round's price).
- A convertible note is a **loan** with interest and a due date. A SAFE is **not a loan**.

WATCH OUT

These are legal agreements with real consequences for your ownership. Use standard forms where possible, and have a lawyer review them.

Why it matters

SAFEs and notes are the most common way startups raise early money, because they're faster and cheaper than setting a valuation. But many founders sign them without understanding how much ownership they'll give up when they convert.

SAFE vs. convertible note

	SAFE	Convertible note
Is it a loan?	No	Yes
Interest	None	Yes, usually added to the amount that converts
Due date	None	Yes (maturity date)
Converts when	A priced round, sale or other event	A priced round, or as the note says at maturity
Common terms	Valuation cap, discount, or both	Valuation cap, discount, interest rate, maturity

The two key terms

- **Valuation cap:** a ceiling on the company value used to set the investor's price. If the next round's value is higher, the investor still converts at the cap, so they get more shares.
- **Discount:** the investor gets a lower price than new investors, often 10% to 25% off.
- If both apply, the investor usually gets **whichever gives them the better price**.

Many SAFEs today are **post-money SAFEs**: the cap includes the SAFE money itself, so it's easier to see what share the investor will own.

Example: Sofia's SAFE

> EXAMPLE
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> Sofia's company has **10,000,000** shares, all owned by the founders. An angel invests **$100,000** on a **post-money SAFE** with a **$2 million cap** and a **20% discount**. A year later, investors buy shares in a priced round valuing the company at **$6 million** before their money, or **$0.60 per share**.

Way to convert	Price per share	Shares for $100,000
At the new round's price	$0.60	About 166,667
With the 20% discount	$0.48	About 208,333
With the $2 million post-money cap	Set so the SAFE owns 5%	About 526,316

The angel gets the best result: about **526,316 shares**, or 5% of the company just before the new round's money comes in. That's because $100,000 is 5% of the $2 million cap. The founders' share drops from 100% to about 95% before the new round dilutes everyone further.

> KEY POINT
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> Several SAFEs add up. Before signing, **model what everyone will own** after all your SAFEs convert and the next round closes. See **R-16 Ownership and Dilution: The Cap Table Explained**.

Step by step

1. **Use a standard form** your lawyer recommends.
2. **Choose a cap** that reflects your stage and progress. See **R-15 Valuation: What Your Business Is Worth to Investors**.
3. **Decide on a discount**, if any.
4. **Model your ownership** after conversion.
5. **Keep a record** of every SAFE and note in your cap table.
6. **Tell future investors** about every SAFE and note you've signed.

Common mistakes

- **Signing many SAFEs without tracking total dilution.**
- **Setting a cap far too low or too high.**
- **Forgetting that convertible notes are debt** with a due date.
- **Using unusual terms** that scare off future investors.

Your checklist

- ☐ Decide between a SAFE and a convertible note
- ☐ Set the cap and discount with advice
- ☐ Model ownership after conversion
- ☐ Have a lawyer review the documents
- ☐ Record it in your cap table

Key words, explained

Word	What it means
SAFE	Simple agreement for future equity.
Convertible note	A loan that converts into shares later.
Valuation cap	The maximum company value used to set the investor's price.
Discount	A lower price than new investors pay.
Priced round	Investors buy shares at a set price per share.

Where to go next

- **R-15 Valuation: What Your Business Is Worth to Investors**
- **R-16 Ownership and Dilution: The Cap Table Explained**
- **R-17 Reading a Term Sheet**

IMPORTANT
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