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ADVISORY MEMORANDUM

Re: Seed Round Financing Instruments

Seed rounds typically involve one or more of the following instruments: convertible notes, simple agreements for future equity ("***SAFEs***"), convertible preferred stock, and common stock. Convertible notes are the most common instrument used for seed round fundraising, however, SAFEs are becoming more popular. Common stock is the simplest and easiest to use instrument for seed rounds.

Which instrument is used will depend on a number of factors. These include: (i) the sophistication of the investors (more sophisticated investors are generally more comfortable with SAFEs and convertible notes); (ii) preferences of the investors (larger investors may dictate which instrument is used); (iii) cost to prepare and use a certain instrument (more complex instruments such as SAFEs and convertible notes generally cost more to prepare); (iv) time (if companies need the money quicker, less complicated instruments such as common stock are often used); and (v) the market cycle.

I. Convertible Notes.

Convertible notes are debt securities. Some of the key terms include principal amounts, maturity date, fixed interest rate, and a claim on the company's assets that is senior to all equity holders. Convertible note holders usually seek to convert the notes into the same preferred security that the company issues to the first institutional investor in a Series A round. Therefore, the conversion terms usually are the most important and most negotiated. If a note is converted, the noteholder would become a stockholder of the company.

a. Conversion. Convertible notes convert into different types of equity upon the occurrence of trigger events. Common triggers include subsequent fundraising events, certain corporate transactions (for example, if the company is sold or acquire other businesses), and the maturity of the note.

b. Conversion Price. Noteholders receive equity based on the principal and interest balance of the note, upon the occurrence of the conversion events. The conversion price often depends on the discount rate and valuation cap. The conversion price will usually be at a lower valuation than the valuation at which new money is being raised.

II. Simple Agreements for Future Equity (SAFEs).

SAFEs are one of the newer instruments used in the seed round. SAFEs are commonly used as a substitute for convertible notes when the company is concerned that the maturity date of the notes may occur before the company is able to hold another round of fundraising. SAFEs are very similar to convertible notes except that SAFEs lack maturity dates and do not award interest. SAFEs have the same priority as convertible notes in liquidation and convert to equity using the same mechanisms.

III. Convertible Preferred Stock.

Convertible preferred stock is not as commonly used in seed rounds as they are used in later financing rounds, but they are still used from time to time. When used in a seed round, convertible preferred stock is referred to as “Series Seed preferred stock”. Series Seed preferred stock instruments generally are very similar to the convertible preferred stock instruments used in later rounds, but Series Seed preferred stock instruments are trimmed down as many seed round investors are not as sophisticated as institutional venture capital investors. The provisions cut out usually include registration rights, rights of first refusal, price-based anti-dilution, drag-along rights, and investor designees on the board of directors.

IV. Common Stock.

Common stock is the simplest instrument to use in a seed round. Investors who receive common stock will often receive the same security that the company’s founders hold. Common stock usually grants the following rights to shareholders: voting for the company’s board of directors; receive dividends; and receive a proportional share of company’s remaining assets if the company is liquidated. Common stock holders generally do not receive other rights and preferences granted to investors who use instruments such as convertible notes and SAFEs.