Understanding SAFE Funding

Simple Agreement for Future Equity (SAFE) and the Cozad New Venture Challenge

Students shouldn't feel concerned about receiving SAFE funding through the University of Illinois for their startup if they win big in the Cozad New Venture Challenge. **SAFEs are set up in such a way to be enormously beneficial to student founders.** *Let's break it down!*

Did you know?

- **Y Combinator pioneered the SAFE** in 2013 as a way for early-stage startups without valuations to get needed funding.
- **Industry-wide**, SAFEs are considered a good thing for startups. They're not unique to the University of Illinois, or the Cozad New Venture Challenge.
- **SAFEs are unrelated to Intellectual Property (IP).** The University does not receive the right to own your IP when you sign a SAFE.
- By entering into a SAFE, you help support future students like yourself. Any money the University makes from future equity in your startup is **reinvested into future SAFE recipients**.
- **A SAFE helps validate your startup to other investors.**

> **"Receiving our SAFE agreement was a great thing. When I went out to raise capital, having a SAFE made DeepWalk look favorable. Investors were willing to look at my company—it showed we were less of a risk."**
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> **BRANDON YATES**, founder of DeepWalk and 2019 Cozad Third Place winner, about the SAFE his team won through the Grainger Engineering Startup City Scholars program.

What exactly is SAFE funding?

- For the Cozad New Venture Challenge, SAFEs only apply to startups winning the top placement prizes—those receiving large monetary prizes.
- With a SAFE, the University of Illinois invests money in your company, but they don't receive *any* equity **until one of three events occur** (hence the term *future equity*).
- Below are the three events that can initiate a SAFE. The SAFE goes into effect and concludes when any one of these events occur. The University doesn't receive equity for each event—only the *first* one that applies to your company.

EVENT 1 Your Company Goes Through a Priced Round, or Series A

This is when your company has a valuation and you receive funding from an investor other than the University. **This is a good thing!** You've received more funding! This is when the University will receive equity, but it's usually a small amount. See the next page for an example. Also, angel rounds or seed rounds don't typically initiate the SAFE.

EVENT 2 You Sell Your Company

Also good news! This is called a *liquidity event*. It just means that you're selling your company. If this happens before your company goes through a priced funding round (see Event 1), this is when the University would receive equity from the SAFE, but it's **usually a small amount** compared to the amount you receive from the buyer. See the next page for an example. Also, **if your startup has insufficient funds to pay the University, then the entire amount would be forgiven, or the startup would be responsible for a partial payment** depending upon the situation.

EVENT 3 You Close Your Company

Not great news, but it happens sometimes. If your company's operations end and you never went through a priced funding round (see Event 1) or sold your company (see Event 2), then this is when the SAFE would be initiated. Since your company is closing, the University never becomes an equity partner. Instead, the SAFE investment is treated as a no-interest loan and has to be returned to the University. This is the same as with ANY investor—you are required to pay out your company's assets to your investors when ending operations. **There is a big IF, though**—this only applies **IF** your company still has assets. **If you don't have any assets, then the SAFE which is now a no-interest loan, is completely forgiven.** You don't owe the University any money. See the next page for an example.

Event 1 Example

EVENT 1 Your Company Goes Through a Priced Round, or Series A - ***Great News!***

The amount the University receives as equity depends on the startup's valuation with their priced round of funding.

- Startup A wins the Grand Prize in Cozad, and receives a **$25,000** award through a SAFE investment with the University of Illinois.
- One year later, Startup A raises **$500,000** from a VC firm in exchange for 500,000 shares of standard preferred stock, at a pre-money valuation of **$2,000,000** with a fully diluted capitalization of 2,000,000 shares of common stock.
- The price per share would be $1, and the post-money valuation would be **$2,525,000** ($2,000,000 + $500,000 from VC firm + $25,000 from UIUC SAFE).
- **The VC firm now owns approximately 20% of the startup** (500,000 ÷ 2,531,250 shares. The number of shares are 2,500,000 + 31,250 due to the calculations below).
- The University's $25,000 SAFE investment now converts to 25,000 of preferred stock at a discounted $0.80 per share (80% of $1 per share) as per the SAFE terms, or 31,250 shares (25,000 ÷ $0.80). **The University now owns approximately 1.2% of the company.**

Event 2 Example

EVENT 2 You Sell Your Company - ***Great News!***

- Startup B wins the Grand Prize in Cozad, and receives a **$25,000** award through a SAFE investment with the University of Illinois.
- Startup B later sells 1,000,000 of its 2,000,000 shares of common stock to a competitor for $2M at $2 per share of common stock. This results in a Change of Control, meaning that the competitor now owns the company.
- The University now receives either the **Cash Out Amount** or the **Conversion Amount**, *whichever is greater*.
- The Cash Out Amount would be the same as the SAFE investment: **$25,000**.
- The Conversion Amount in this case would be 25,000 shares at a discounted $1.60 per share (80% of $2 per share) as per SAFE terms, or 15,625 shares of common stock (25,000 ÷ $1.60). The Conversion Amount would then be **$31,250** (15,625 shares x $2 per share).
- Since the Conversion Amount, **$31,250**, is greater, the University would receive the Conversion Amount.

Event 3 Example

EVENT 3 **You Close Your Company**

EXAMPLE A

- Startup C wins the Grand Prize in Cozad, and receives a **$25,000** award through a SAFE investment with the University of Illinois.
- One year later, Startup C's operations come to an end. Startup C has **$0** in assets.
- The $25,000 SAFE investment is treated as a no-interest loan which is forgiven. **The University receives $0**.

EXAMPLE B

- Startup C wins the Grand Prize in Cozad, and receives a **$25,000** award through a SAFE investment with the University of Illinois.
- One year later, Startup C's operations come to an end. Startup C has **$50,000** in assets.
- In this case, the University is treated like any other investor. The **$25,000** SAFE investment is treated as a no-interest loan that must be returned. **The University receives $25,000**. Startup C's holders of common stock would receive the $25,000 remainder of the assets.

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