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Series Seed Equity

Tech Coast Angels
October 1, 2021

Series Seed Preferred Stock

2008-2010



Why Series Seed

- **Simple Way to Buy Preferred Stock**
 - 2-3 documents (Term Sheet, COI, Investment Agreement)
 - Important protections are included
- **Commitment to Valuation**
 - Notes and SAFEs don't avoid valuation with valuation cap.
- **Cost – Investor Counsel**
 - Not significantly different from Notes versus value
- **Tax**
 - IRC 1202 QSBS Exclusion of Gain applies
 - IRC 1272 Original Issue Discount N/A

IRC 1202

- Provides federal tax exclusion from income of gain recognized on the sale of QSBS held more than 5 years up to \$10M
- IRC 1045: If held less than 5 years, you can rollover w/in 60 days
- From 2010 – 2015 its long-term viability was uncertain

➤ December 2015/2016 the benefit was made permanent

❖ While Notes and SAFEs had developed in the absence of this long-term benefit, with it, equity is now much more important.

📌 See John Harbison's email from 9.29.21 – write to your senators and congressional reps today.



	SAFEs	Convertible Notes	Series Seed
Up			
MFN	✗	✓	✓
Pro Rata	✗ Unless Side Letter	✗	✓
Ownership Clarity (“Shuffle”)	✓ Post-Money SAFE	✗	✓
Change in Control Min Return	✓	✓	✓ Veto Voting
Down			
Liquidation Pref or Priority	✗	✓	✓
What’s Going On			
Reps and Warranties	✗	✗	✓
Board Seat	✗	✗	✓
Information Rights	✗	✗	✓
Protective Provisions - Veto	✗	✗	✓
Tax			
IRC 1202 or LTCG	✗	✗	✓
Original Issue Discount Tax	N/A	✗	N/A



A Potential Outcome

Assumptions:

- Angel Round: \$1M on \$4M Pre or Cap; 20% Discount, 7% Interest
- Series A: 18 months post Angel; \$3M on \$12M Pre; Increase Option Pool
- Exit 5 ½ years post Angel; \$50M
- OID Effective tax rate of 14.1% and LTCG rate of 20%
- Note: this is federal tax only; state tax does not recognize IRC 1202

Convertible Notes	Post Money		Payout	OID Tax	LTCG Tax	Tax Paid	Take Home
	Shares	%					
Founders / Advisors / Options	11,000,000	63.94%	\$31,971,493.05				
Angel Investors - Notes	2,762,260	16.06%	\$8,028,506.95	\$14,791.48	\$1,605,701.39	\$1,620,492.87	\$6,408,014.08
Series A Investors	3,440,565	20.00%	\$10,000,000.00				
Total	17,202,825	100.00%	\$50,000,000.00				
Series Seed Preferred Stock	Post Money		Payout	OID Tax	LTCG Tax	Tax Paid	Take Home
	Shares	%					
Founders / Advisors / Options	11,000,000	65.19%	\$32,592,592.59				
Angel Investors - Seed	2,500,000	14.81%	\$7,407,407.41	\$0.00	\$0.00	\$0.00	\$7,407,407.41
Series A Investors	3,375,000	20.00%	\$10,000,000.00				
Total	16,875,000	100.00%	\$50,000,000.00				\$999,393.33



“Over time, equity rounds have become cheaper to consummate, and the legal fees argument doesn't carry much weight these days. In the end, the main force driving the use of convertible debt in early-stage companies is the parties' desire to avoid setting a valuation.”

- Brad Feld, Jason Mendelson; Venture Deals

“Do priced equity rounds instead of notes. As I wrote seven years ago, the cost of doing a simple seed equity deal has come way down.... Honestly, I wish the whole scourge of notes would go away and we could go back to the way things were done for the first twenty years I was in the venture capital business.”

- Fred Wilson, AVC, March 12, 2017



Talking Points

- **Saving a small amount on a \$1M+ investment doesn't carry much weight, especially when investors may save ~\$1M on taxes**
- **Simplified cap table – eliminate SAFEs and Notes each converting at different prices**
- **No avoiding valuation with Notes and SAFEs**
- **Founders do not have threat of Note default**
- **Investors receive important assurances**
 - More appropriate reps and warranties
 - Board seat
 - Information rights
 - Protective provisions/veto rights
 - MFN
 - Pro Rata

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