

## BLACKTECHSTARTUP EDUCATION

# Financing Overhang Before the Next Round: SAFEs, Notes, Debt, Preferences, Anti-Dilution & Pro-Forma Ownership

Model how old financing decisions convert, dilute, rank, constrain and change control before negotiating the next round.

Financing overhang is the accumulated economic and control effect of prior SAFEs, notes, debt, preferred stock, option pools, warrants and side letters. A clean-looking current cap table can change dramatically at the next financing. NVCA model documents illustrate the interaction of preferred economics and control rights; YC's SAFE materials emphasize understanding ownership sold. The founder needs a pro-forma financing model before setting terms.

## Know what weak and strong look like

| READINESS AREA       | WEAK / DILIGENCE RISK                                | STRONG / INVESTOR-READY                                                                 |
|----------------------|------------------------------------------------------|-----------------------------------------------------------------------------------------|
| <b>Convertibles</b>  | Principal listed, conversion ignored.                | Every SAFE/note conversion modeled at proposed round valuations.                        |
| <b>Debt</b>          | Monthly payment modeled; covenants/security ignored. | Maturity, liens, covenants, conversion, default and change-of-control terms abstracted. |
| <b>Preferences</b>   | Preferred shares treated as same as common.          | Liquidation preference, participation and seniority modeled in exit waterfalls.         |
| <b>Anti-dilution</b> | Term-sheet phrase not quantified.                    | Trigger and share-adjustment mechanics understood/modelled with counsel.                |
| <b>Control</b>       | Ownership percentage used as proxy for authority.    | Board seats, protective provisions, consent rights and voting agreements mapped.        |

## Build the instrument stack

Create one schedule for all common/preferred stock, SAFEs, notes, warrants, options and debt. Include economic terms, maturity, security/lien, conversion, preference, pro rata and consent/change-of-control rights.

## Model the priced round at several valuations

Show pre-financing fully diluted ownership, conversion shares, new-money shares, option-pool increase and post-financing ownership. Use actual instrument formulas; do not approximate all SAFEs as “cap amount ÷ valuation” when terms differ.

## Model liquidation economics

At several exit values show what each preferred class receives before/common alongside founders. Headline ownership can overstate founder economics when stacked preferences or participation are material.

## Map required consents

Identify which existing holders must approve new securities, debt, charter changes, sale, board changes or other reserved matters. An investor who owns a minority percentage may still possess blocking rights.

## Negotiate the cleanup, not just the new term sheet

Sometimes the financing requires note extensions, debt payoff/subordination, preference restructuring, option-pool changes or investor waivers. Identify those negotiations early so the round is not held hostage at closing.

## Run the diligence stress test before investors do

Do not rehearse an answer. Rehearse the evidence. Give yourself a short diligence window and try to produce the underlying records without rebuilding the story from memory. A clean result is reproducible, tied to a source system or signed document, and consistent with the numbers elsewhere in the company.

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→ **Convertibles:** Put the underlying records on screen and prove this standard: Every SAFE/note conversion modeled at proposed round valuations. If the evidence still looks like this weak

state—Principal listed, conversion ignored.—record the gap, name an owner and give it a due date instead of explaining it away.

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→ **Debt:** Put the underlying records on screen and prove this standard: Maturity, liens, covenants, conversion, default and change-of-control terms abstracted. If the evidence still looks like this weak state—Monthly payment modeled; covenants/security ignored.—record the gap, name an owner and give it a due date instead of explaining it away.

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→ **Preferences:** Put the underlying records on screen and prove this standard: Liquidation preference, participation and seniority modeled in exit waterfalls. If the evidence still looks like this weak state—Preferred shares treated as same as common.—record the gap, name an owner and give it a due date instead of explaining it away.

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→ **Anti-dilution:** Put the underlying records on screen and prove this standard: Trigger and share-adjustment mechanics understood/modelled with counsel. If the evidence still looks like this weak state—Term-sheet phrase not quantified.—record the gap, name an owner and give it a due date instead of explaining it away.

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→ **Control:** Put the underlying records on screen and prove this standard: Board seats, protective provisions, consent rights and voting agreements mapped. If the evidence still looks like this weak state—Ownership percentage used as proxy for authority.—record the gap, name an owner and give it a due date instead of explaining it away.

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## Do the math investors will do

Pro-forma discipline: run at least three valuation cases plus an exit waterfall. Example questions: At \$20M pre-money with \$5M new money, what percentage goes to converted SAFEs/notes before new money? What does a pre-money option-pool top-up do to founders? At a \$30M exit, how do 1x preferences change founder proceeds versus simple ownership percentages?

## Build the evidence investors can verify

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✓ Master financing-instrument schedule

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✓ Conversion model across three valuation cases

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✓ Post-financing fully diluted cap table

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✓ Option-pool top-up scenarios

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- ✓ Debt/lien/covenant abstract
- ✓ Liquidation waterfall at multiple exit values
- ✓ Consent/protective-provision matrix

## Questions an investor may ask

- ? What has to convert or be amended to close this round?
- ? Who absorbs the option-pool increase?
- ? Which holders can block the financing?
- ? How much founder ownership/economic value remains after conversion?
- ? What exit value is required before common participates materially?

## 30-day repair sprint

- 1 Days 1–5: inventory every financing instrument and side letter.
- 2 Days 6–10: abstract economic/control terms.
- 3 Days 11–15: model conversions and pool scenarios.
- 4 Days 16–20: model exit waterfalls and debt interactions.
- 5 Days 21–25: identify waivers/amendments/subordination needed.
- 6 Days 26–30: review with qualified counsel and lock the financing model used for negotiations.

## Research behind this guide

Use the primary and authoritative sources below to verify current rules, market conditions and technical guidance. Terms and regulations can change.

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NVCA — Model Legal Documents



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Y Combinator — SAFE Financing Documents



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SEC — Ready to Raise CAPITAL



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Carta — What Is a SAFE?



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**Important:** This guide is educational information, not individualized legal, tax, investment, employment, security or compliance advice. For decisions with material legal or financial consequences, use a qualified professional who can review your facts.

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