

The background is a solid purple color with a faint, semi-transparent image of several stacks of coins and individual coins scattered around. The text is overlaid on this background.

LEO TOKEN CASE STUDY: DISTRESSED INVESTING IN DIGITAL ASSETS

ARCA DIGITAL ASSETS FUND

The Arca Digital Assets Fund is a long-only, opportunistic, event-driven fund focused on the most liquid cryptocurrencies. Each position in the fund is categorized into one of four strategies:

Long-Term Fundamental: 12- 36 month time horizon

Catalyst/Event-Driven: 1-3 month defined timeline

Asymmetric: Off-the-run / microcap tokens with high probability-weighted returns

Beta: Capturing overall market growth

The following case study focuses on our “Event-Driven” strategy.

BACKGROUND

On April 24, 2019, the New York State Attorney General (NYSAG) sued Bitfinex, one of the largest and oldest cryptocurrency exchanges, and its affiliated firm Tether, the company behind the stablecoin of the same name (Ticker: USDT). In short, \$850mm was misappropriated between their Exchange user accounts (Bitfinex) and the collateral of their stabletoken (Tether), and was ultimately seized. Tether was revealed to be only 74% backed by US dollars (instead of 100%), and Bitfinex now had a major capital shortfall. To plug this capital hole, Bitfinex announced that they would attempt to issue \$1 billion of new tokens (LEO) in exchange for \$1 billion of Tether tokens (USDT), whereby Bitfinex will effectively retire the incoming USDT to make up for the capital shortfall.

STRATEGIC IMPORTANCE OF TETHER

Tether is one of the few systemically significant companies in the entire crypto ecosystem. Each USDT is stated to be backed 1:1 by a dollar or cash equivalent and is designed to maintain a consistent price peg with the U.S. dollar. This allows USDT to be a stable alternative to other volatile cryptocurrencies and mimic the core properties of money, namely being a stable store of value, unit of account, and medium of exchange.

USDT has a market capitalization of \$2.8 billion, and it is a key source of liquidity for exchanges and traders around the world. 80% of all bitcoin trading is done in USDT.

FRAMING THE SITUATION

While many crypto market participants (with no capital markets experience or historical context) called this \$1 billion attempted raise “a bailout”, it differed from the bailouts seen during the Great Recession. Bear Stearns and Merrill Lynch are categorized as bailouts, because taxpayers had no choice as bank suitors were forced to purchase. And the TARP program was a bailout as the government chose to keep bad business models alive.

On the flipside, Jefferies and Knight Capital were not bailed out - they were saved by real investors who believed in the future prospects of the company once the capital hole was plugged. Bitfinex’s existing shareholders, and new investors, had the power to resuscitate this company.

OPPORTUNITY

Using a token to plug a capital shortfall, and programming the token with very favorable terms for investors, showcased the unique and flexible characteristics of issuing tokens instead of equity or debt. Upon learning about the transaction, we immediately went to work with an internal deal team consisting of: Jeff Dorman, CFA (Arca Chief Investment Officer and former capital markets banker and distressed trader), Phil Liu (Arca Chief Legal Officer and regulatory expert), and Hassan Bassiri (Arca Portfolio Manager and former M&A banker, who carries both a JD and CFA designation). Upon reviewing the legality of the deal, and the terms, we were able to construct one of the best risk/reward investments that Arca has seen to date.

LEO TOKEN TERMS



The LEO token offered favorable terms with equity-like features (“dividends” based on revenue growth), debt-like features (auto-paydowns with FCF and recovered assets) and utility features (reduced trading fees on a widely utilized platform) - all of which led to high upside, and more importantly, very low downside.

TERMS & DETAILS

- 27% of gross revenues from the Bitfinex trading platform will be used to buy back the tokens on a 3 hour basis into Perpetuity
- Buybacks are made at the market rate and LEO tokens used to pay fees may also be burned.
- Additionally, 95% of any of the \$850mm misappropriated funds recovered from Crypto Capital and 80% of the recovered net funds from the Bitfinex hack will be used to buy back tokens.
- Reduction of trading, lending, fiat and crypto deposit/withdrawal fees and derivatives fees, and access to future service offerings (IEOs, STOs, and a betting platform among others)
- After a series of missteps, and the NYAG watching them closely, Bitfinex could not afford to issue a security that traded down. It was very widely believed that they would be transparent about their cash flows, and would do everything in their power to ensure that this new token traded well.

SCENARIO ANALYSIS

First, we conducted a scenario and probability analysis:

Scenario 1: Bitfinex successfully raises the capital, and investors in these new LEO tokens would be rewarded in the same way Jefferies and Knight investors were, as the terms of these new LEO tokens were incredibly favorable to investors. With the capital hole filled, Bitfinex and Tether will likely continue to operate with a well deserved reputational blackeye. But, the tokens would begin to trade on relative value versus Binance Coin (BNB), and the cash flow sweeps combined with new use cases for the token would put a very high floor on the tokens.

Scenario 2: If the Bitfinex token issue fails, then the market will have sealed Bitfinex's fate, indicating that the terms of the sweetheart deal were not sweet enough, or indicating that deceitful actions such as fund misappropriation cannot simply be undone with fresh capital. Similarly, USDT would likely fall 25% (or further), to the level where their cash fully covers the tokens.

VALUATION MODEL

To understand the value or utility provided by an exchange token we used the TVEV ratio, a simple metric which is akin to P/E in equities. TVEV calculates the price of an exchange token (ET) for each dollar of average daily trading volume on the exchange - i.e., how much are you paying for the utility the token provides relative the network the token supports (the exchange).

- TV = Total Market Cap of the Exchange Token (ET)
- EV = Daily Exchange Volume in USD (30 day average)

Generally the lower the TVEV the more value/utility you're getting from the token; however, the TVEV has limitations just like all other metrics, so looking at the metric alone is not sufficient.

VALUATION

LEO is compared to BNB, the most successful token to-date issued by a crypto exchange (Binance).

BNB and LEO are both part security (holders are entitled to pay downs from finance revenue) and part utility (holders get reduced trading fees on their platform).

TOKEN VALUE TO 24-HOUR EXCHANGE VOLUME RATIO= TVEV								
Exchange	Token	Issue (\$)	Current (\$)	ROI	Total Supply (in millions)	MC (in millions)	ADV (in millions)	TVEV
Binance	BNB	\$0.10	\$30.00	29000%	183.35	\$5,500.34	1,083.29	5.08
Okex*	OKB	\$1.58	\$1.61	2%	300.00	\$483.00	1,186.27	0.41
Huobi*	HT	\$1.00	\$2.30	130%	50.00	\$115.00	669.64	0.17
Kucoin*	KCS	\$0.25	\$1.07	328%	179.66	\$192.24	25.10	7.66
Bitfinex*	LEO	\$1.00	\$1.80	80%	1,000.00	\$1,800.00	247.10	7.28

*Not part of the Bitwise Top 10 Exchanges which report "real" BTC Volume and thus excluded for analysis purposes

SUMMARY: LEO v. BNB	
Leo Premium	43%
Implied Volume	354.54
Relative LEO Price	\$1.25
Price Target	\$3.70

BUYBACK VALUE (AMOUNTS IN MILLIONS)								
Year		2018	2019	2020	2021	2022	2023	2024
Revenue	10%	418	460	506	556	612	673	741
Net Margin	90%	376	414	455	501	551	606	666
Buyback (\$)	27%		\$112	\$123	\$135	\$149	\$164	\$180
Beginning LEOs			1000.00	925.51	843.58	753.45	654.30	545.25
LEOs Bought Back		\$1.50	74.49	81.49	90.13	99.14	109.06	119.96
LEOs Outstanding			925.51	843.58	753.45	654.30	545.25	425.28

VALUATION- DISCOUNTED CASH FLOW

The LEO Token derives much of its value from the Buyback and Burn mechanism.

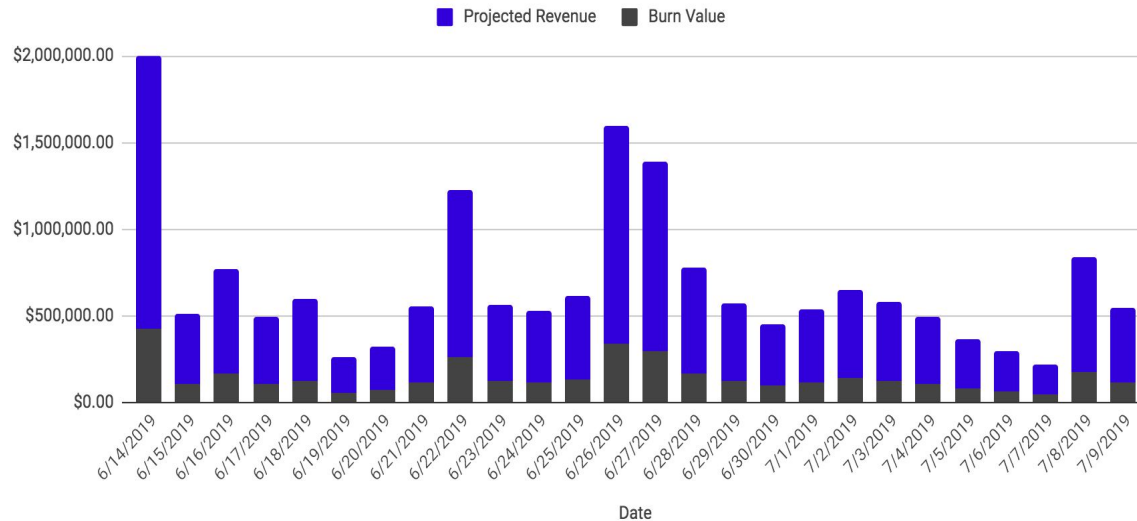
- 27% of Bitfinex Revenues Trading Platform will be used to buy back the tokens on a 3-hour basis
- These Buybacks take place on the open market providing constant buying pressure to the token
- Bitfinex continues to be transparent about these burns: <https://leo.bitfinex.com/>

[\(See Appendix for Full Valuation Model\)](#)

LEO BURNS

- So Far Bitfinex has burnt 2.07m LEO Tokens
- Based on Burns we can project yearly revenues of \$ 392,520,556.37

Dollar Value and Projected Revenue



VALUATION SUMMARY TODAY	
Utility Value	\$4.05
Current Price	\$1.58
Upside/Downside	156.04%

GROWTH EXPECTATIONS

At first glance based on the TVEV ratio, it seems LEO is overvalued compared to BNB as it's priced at a 43% premium based on total market cap. Our perspective is that the market is pricing in LEO's growth prospects and future utility based on the additional services that Bitfinex plans to offer using the \$1B raise and that as a major fiat on/off ramp for traders it commands a premium. LEO holders are entitled to reduced fees for trading, lending, deposits/withdrawals, and Bitfinex's expansion plans further include:

- A derivative platform with up to 100X leverage (the Bitmex playbook)
- EOSFinex - exchange project built on the EOS.IO software
- IEO Platform (beginning June 2019)
- Licensed STO Platform
- Sports Betting Platform (BetFinex)

ACTION

We constructed a trade where we could short (or avoid) USDT in case the new issue failed, but put in an order to buy the new issue as long as LEO priced the deal. By doing so, we avoided risk if the deal failed, but were in a position to capitalize if it succeeded.

Our channel checks indicated that this deal was going to get done easily, as Bitfinex was still a highly profitable company with strong equity backers, particularly in Asia. While we do not condone Bitfinex's actions which caused the capital shortfall, we do appreciate the value this opportunity created. It's simply a reality that people move on from scandals, and companies who remain solvent and profitable get to continue operating.

RESULTS

Arca was given a large allocation of the new issue at \$1.00/LEO token on May 20, 2019. As of May 31, the token was trading at \$1.49 (a 49% gain in under 2 weeks), and as of June 30, 2019, LEO traded at \$1.74. We continue to believe LEO is undervalued, and it remains one of our top positions.



ONGOING MONITORING

In an effort to be as transparent as possible, the LEO Transparency Dashboard was released to provide token holders with unique, verifiable insights into the token buyback process. Real-time token and exchange performance statistics include:

- **Live LEO Acquisition** shows the quantity LEO purchased by iFinex from the open market over the course of the current hour.
- **Pending LEO Burn** shows the total quantity of LEO to be burned in the upcoming buyback on-chain transaction. Tokens are burned on-chain every 3 hours.
- **Collected LEO (24h)** shows the quantity of LEO purchased by iFinex over the course of the previous 24 hours.
- **Daily LEO Burns (7 day Period)** provides a visual representation of the daily LEO burns across the previous 7-day period.
- **LEO Burn Transactions** displays the on-chain burn transactions for LEO, updated every 3 hours.

ABOUT **ARCA**

Arca is a full-service investment management firm building and managing institutional-caliber digital assets products. Their vision is to become the “BlackRock for Digital Assets/Blockchain” where they will eventually have a product portfolio so that any type of investor can find the right product(s) to gain exposure to digital assets. All of Arca's products meet the highest regulatory standards globally (set by the SEC) and have institutional-caliber operations (strict risk management, comprehensive compliance procedures, top service providers, and diligent reporting).

ABOUT **ARCA HEDGE FUNDS**

Arca's private funds provide the most appropriate way for institutional investors to gain exposure to crypto as an asset class. Their flagship offering is the Arca Digital Assets Fund, which is a long-only, opportunistic, event-driven fund focused on the most liquid cryptocurrencies. They analyze global economic events and asset classes in combination with crypto-specific events, and use a bottom-up thesis-driven approach to token selection, which includes a thorough technical vetting process that evaluates the strength of a protocol and underlying infrastructure.

APPENDIX: DISCOUNTED CASH FLOW

We took these LEO Burns and Projected Revenues to build out a DCF Valuation Model

Economic Activity												
Average Total Daily Volume	\$93,560,315.03	\$114,611,385.91	\$133,952,057.28	\$150,905,364.53	\$165,229,584.68	\$176,992,511.17	\$186,442,770.49	\$193,908,902.19	\$199,732,737.82	\$204,231,798.81	\$207,682,101.93	\$210,313,546.48
Transaction Fee Rate (maker + taker)	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%
LEO Discount	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%
Transaction Fee Saved (daily)	\$70,170.24	\$85,958.54	\$100,464.04	\$113,179.02	\$123,922.19	\$132,744.38	\$139,832.08	\$145,431.68	\$149,799.55	\$153,173.85	\$155,761.58	\$157,735.16
Transaction Fee Saved (annual)	\$25,612,136.24	\$31,374,866.89	\$36,669,375.68	\$41,310,343.54	\$45,231,598.81	\$48,451,699.93	\$51,038,708.42	\$53,082,561.97	\$54,676,836.98	\$55,908,454.92	\$56,852,975.40	\$57,573,333.35
Discounted TX Fee Saved (Annual)	\$25,612,136.24	\$21,637,839.24	\$17,440,844.56	\$13,550,483.76	\$10,232,221.44	\$7,559,081.15	\$5,491,508.53	\$3,938,908.20	\$2,798,075.09	\$1,973,174.39	\$1,383,799.52	\$966,436.56
LEO Volume Daily	\$8,985,284.12	\$11,006,973.05	\$12,864,399.75	\$14,492,550.34	\$15,868,210.39	\$16,997,890.61	\$17,905,468.41	\$18,622,495.86	\$19,181,801.57	\$19,613,879.43	\$19,945,237.38	\$20,197,954.32
LEO Volume Annual	\$3,279,628,703.80	\$4,017,545,162.16	\$4,695,505,908.27	\$5,289,780,874.78	\$5,791,896,793.76	\$6,204,230,071.36	\$6,535,495,968.97	\$6,797,210,990.04	\$7,001,357,571.95	\$7,159,065,992.99	\$7,280,011,643.42	\$7,372,253,328.04
Total Economic Value Derived from LEO	\$3,305,240,840.04	\$4,048,920,029.05	\$4,732,175,283.95	\$5,331,091,218.32	\$5,837,128,392.56	\$6,252,681,771.29	\$6,586,534,677.39	\$6,850,293,552.01	\$7,056,034,408.92	\$7,214,974,447.92	\$7,336,864,618.83	\$7,429,826,661.39
LEO GDP from Discounts	0.77%	0.77%	0.77%	0.77%	0.77%	0.77%	0.77%	0.77%	0.77%	0.77%	0.77%	0.77%
LEO GDP from Tx Volume	99.23%	99.23%	99.23%	99.23%	99.23%	99.23%	99.23%	99.23%	99.23%	99.23%	99.23%	99.23%
Growth Rate												
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Growth Rate in Bitfinex Volume	30%	22.50%	16.88%	12.66%	9.49%	7.12%	5.34%	4.00%	3.00%	2.25%	1.69%	1.27%
Utility Value												
Monetary Base Required for BNB GDP	\$472,177,262.86	\$578,417,147.01	\$676,025,040.56	\$761,584,459.76	\$833,875,484.65	\$893,240,253.04	\$940,933,525.34	\$978,613,364.57	\$1,008,004,915.56	\$1,030,710,635.42	\$1,048,123,516.98	\$1,061,403,808.77
Current Utility Value from BNB Float	\$0.59	\$0.79	\$1.02	\$1.27	\$1.57	\$1.93	\$2.37	\$2.97	\$3.84	\$5.28	\$8.19	\$17.42
Present Value of BNB Utility	\$0.59	\$0.55	\$0.48	\$0.42	\$0.36	\$0.30	\$0.26	\$0.22	\$0.20	\$0.19	\$0.20	\$0.29

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