Scaling Software with Web3 (Pt. 3)

Not relevant for US-based companies/founders/readers.

Escape Velocity

Rocket fuel for networks.

Key Considerations for Launching a Token Network

1. Structuring
2. Governance
3. Building the Book
4. Pricing
5. Investor Relations
6. Partners & Vendors

Structure: We Believe Aligning Interests Around a Single Asset – Tokens – Creates the Most Value.

Token-Only vs Dual-Class

- In **token-only** structures, (close to) 100% of cash flows are directed towards token buybacks. In dual-class, majority of cash goes to shareholders as dividends/retained earnings before tokenholders.
- Litmus test for dual-class structure risk: what happens if the company is acquired by hostile new management?
  - In token-only structures, acquirers are disincentivized to change agreements - otherwise tokenholders sell, impairing value of future token incentives and therefore future cash flow.
  - In dual-class structure, acquirers may find it profitable to change terms (rug-pull tokenholders) to maximize value of their equity.
- Dual-class structures make tokens "junk-equity" - tokenholders have a junior claim and therefore will be valued at lower multiples.

Notable Dual-Class Structure Outcomes

In Dual-Class Structures, Communities Often End Up with Only Half of Total Economics.

Shareholders earns 15% of cash flows (x) Insiders own 35% of token supply (=) Community only gets 55% of long-term economics

Communities with small economic interests are weaker & less valuable… users are more likely to churn/fork.

Dual-Class Structures are Unavoidable in Two Scenarios.

1 Web3 companies that need to play a central role in network operations (often for regulatory reasons).

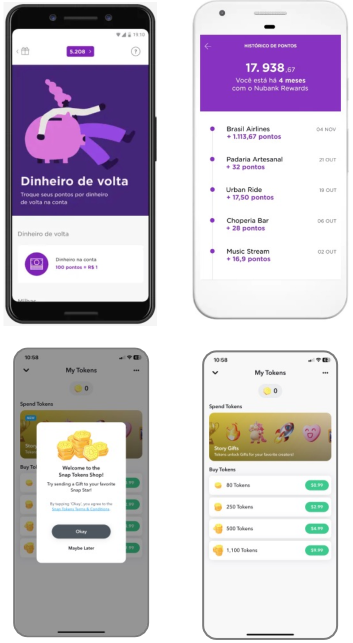
XNET — OpCo = mobile core administrator, interfaces with telco partners and FCC.

STORJ — OpCo = content moderator, helps censor illegal content.

rndr — OpCo = application developer, helps develop closed-source rendering software.

Will be valued at lower multiples than token-only networks with unambiguous value accrual.

2 Publicly-traded companies that want to provide tokenized experiences to users (but have fiduciary obligations to shareholders).



Nubank

- 60 million active users in latam with best-in-class user engagement/retention
- $24 billion market cap
- Points never expire, redeemable for R$1 or for in-app purchases/rewards

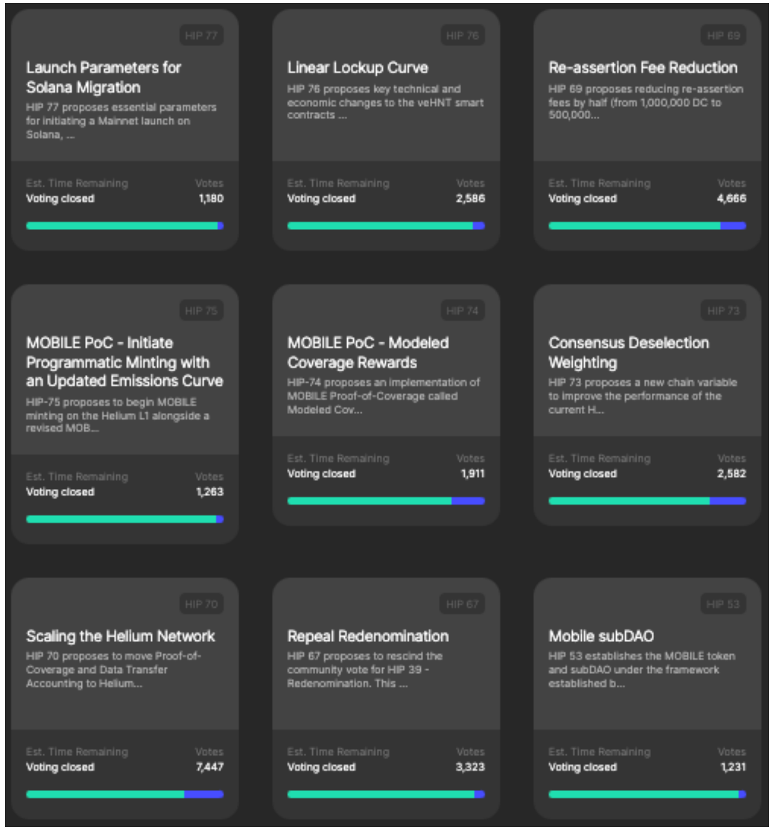
Snapchat

- 350 million active users globally, mostly younger cohorts
- $14 billion market cap
- Points never expire, but non-redeemable into cash (only in-app purchases)

Long-term network value likely capped at 1-5% of equity market cap.

Governance: Decentralizing Governance Too Quickly Brings More Headaches than Benefits.

Most governance votes are not heavily contested, with <1% tokenholder participation…



…But overpromising on governance & decentralization can publicly erode community trust.

CoinDesk

Arbitrum Governance Fracas Reopens the Question: Why DAOs?

A messy governance dispute over a major Ethereum scaling system has some complaining about "decentralization theater."

4 weeks ago

Cointelegraph

Arbitrum poses new governance proposals after community furor

The Arbitrum Foundation has unveiled two governance proposals after it backtracked on its first following community backlash.

3 weeks ago

Blockchain News

Arbitrum's Governance Token Return Proposal Rejected

A proposal to return 700 million ARB governance tokens to Arbitrum's DAO Treasury was rejected by 84% of the total votes received.

2 weeks ago

What Markets Really Care About are *Inviolable Economic Rights*, & a Long-Term Path Towards Decentralized Governance.

Inviolable Economic Rights

- The company will **never** unilaterally change the terms of its agreement with the network.
- Tokenholders expect to be treated as **first-class citizens** in all future value accrual.
- Investors crave **clarity on future dilution.** In the absence of clear guidance, markets will default to a worst-case (fully-diluted) worldview.

Long-term path to Governance

- Crypto infrastructure is still too clunky for everyday users to participate in on-chain governance.
- 99% of tokenholders have no interest in helping to govern the network, anyway.
- The other 1% are willing to wait years/decades for true on-chain governance, so long as there is a genuine desire and credible roadmap for getting there.

Building the Book: Understand that Prices are Not Magic.

Price = where *incremental buyers* meet *incremental sellers*

Buyers

29,171.87	$29,171.87	More
29171.86	2.22027	64,769.40560
29171.85	2.83931	82,827.92542
29171.84	0.07388	2,155.21554
29171.82	0.00439	128.06429
29171.81	1.15713	33,755.57651
29171.75	0.59204	17,270.84287
29171.74	0.00069	20.12850
29171.73	0.00064	18.66991
29171.64	0.00082	23.92074
29171.60	0.01570	457.99412
29171.58	0.01207	352.10097
29171.54	0.01657	483.37242
29171.50	0.00065	18.96148
29171.49	0.00780	227.53762
29171.38	0.00064	18.66968
29171.32	0.00684	199.53183
29171.24	0.00685	199.82299

Sellers

Price(USDT)	Amount(BTC)	Total
29173.37	0.25554	7,454.96297
29173.26	0.00065	18.96262
29173.13	0.00064	18.67080
29172.93	0.00684	199.54284
29172.87	0.00499	145.57262
29172.84	0.00069	20.12926
29172.78	0.00064	18.67058
29172.59	0.00499	145.57122
29172.53	0.00499	145.57092
29172.52	0.00678	197.78969
29172.43	0.00064	18.67036
29172.42	0.10000	2,917.24200
29172.30	0.00641	186.99444
29172.20	0.26596	7,758.63831
29172.00	0.02725	794.93700
29171.89	0.01715	500.29791
29171.87	8.33260	243,077.52396

Three Factors Drive Changes in Token Prices.

1 Structural Demand

Fiat-based revenues drive
price-insensitive buy pressure.

Cheapest sell-side liquidity (asks) are
taken off the market, regardless of price.

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Lowest bids picked off.

2 Staking Rate

Staked tokens are locked for a period of time
and cannot be sold on impulse.

Higher staking rate ⇒ less sell-side liquidity ⇒
faster upswings & slower declines in price.

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29173.37	0.25554	7,454.96297
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Sell-side becomes thinner.

3 Speculative Demand

Speculators add new demand
at various prices.

More buy-side liquidity (bids) added to
order books boosts price.

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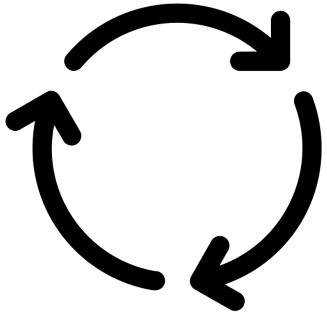
Buy-side becomes thicker.

The fourth factor – structural/forced sellers – is more difficult to predict & impact.

Success Requires Both Institutional (Price-Driven) & Retail (Product-Driven) Demand.

Retail Demand

- **Retail *buyers* have a limited impact on token price.** The $ inflows are too small to make a dent.
- **Retail *holders* can have a massive impact on price.** On day one, most tokens are owned by retail at zero cost basis – who are likely to sell at any price.
- **Key Driver: Staking Rate.** Apps with high staking rates reduce impulsive sellers, which drives more reflexive prices when new buyers enter.

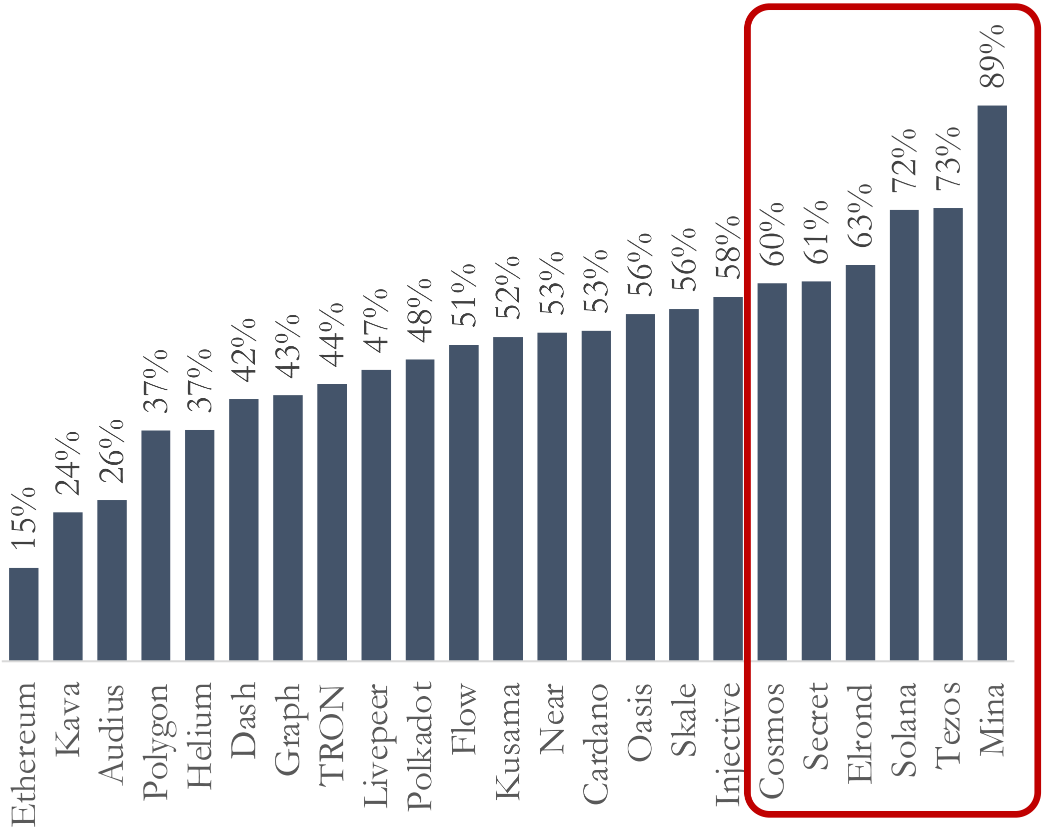


Institutional Demand

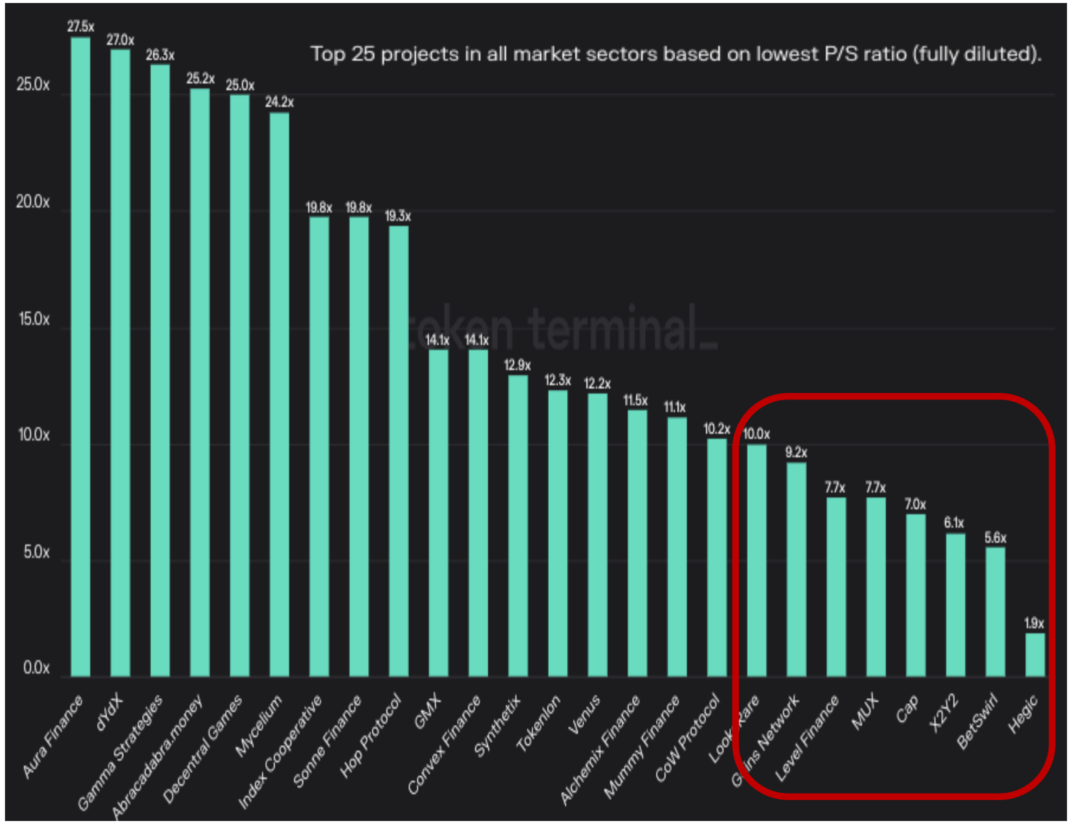
- **Institutional *buyers* can massively impact token price.** Even one medium-sized institution can outweigh all retail volume.
- **Institutional *sellers* should be managed with lockups.** Liquid token funds are generally willing to be collaborative on terms (while protecting their upside/downside).
- **Key Driver: Yield & Coverage.** Investors will price tokens based on yield & coverage ratios, relative to a network's perceived revenue quality & growth prospects.

Few Networks in Crypto Achieve 60%+ Staking Rates or Offer 10%+ Yields.

Staking Rate



FDV Multiple



Source: Staked.US and TokenTerminal, as of Apr'23

Pricing: Other Networks are Valued at 10x-1000x FDV Multiples, Despite Heavy Net Token Issuance (<10% Coverage).

	Ethereum	sweatcoin	livepeer	rndr	helium
Monthly Protocol Net Revenues	$180m	$1.5m	$40k	$85k	$25k
(%) Token Price	$1,800	$0.006	$4.50	$1.50	$1.50
Monthly Token Buyback	**100k**	**250m**	**9k**	**55k**	**17k**
	Source: TokenTerminal	*Source: Medium*	*Source: Messari*	*Source:: Medium*	*Source: Dune*
Annualized Yield Token Burn / Circ Supply	**1%** (vs 120m circulating)	**50%** (vs 5.9b circulating)	**0.4%** (vs 28m circulating)	**0.2%** (vs 365m circulating)	**0.01%** (vs 145m circulating)
Coverage Ratio Token Burn / Token Issuance	**100%** (vs 100k/mo issuance)	**17%** (vs 1,500m/mo issuance)	**5%** (vs 200k/mo issuance)	**2%** (vs 3m/mo issuance)	**0.7%** (vs 2.5m/mo issuance)
Yield-to-Worst Token Burn / Max Supply	**n/a**	**13%** (vs 22.5b max supply)	**0.4%** (vs 28m max supply)	**0.1%** (vs 521m max supply)	**0.01%** (vs 223m max supply)

We Suggest Launching at Conservative Multiples (10x FDV) & Issuance (75%), Then Targeting 10-20 Years of Runway.

Implied Years of Runway

Annualized Yield \ Coverage Ratio	90%	75%	50%	20%	10%	1%	0.1%
0.1%	25+	25+	25+	25+	25+	9	1
1%	25+	25+	25+	23	10	1	0.2
5%	25+	25+	18	5	2	0.3	0.1
10%	25+	$\boxed{25+}$	9	2	1	0.2	0.1
25%	25+	11	4	1	0.4	0.1	0.1
33%	25	8	3	0.8	0.3	0.1	0.1
50%	16	5	2	0.5	0.3	0.1	0.1

What multiple will the market support?

What is the right pace of net token issuance?

Investor Relations: Suggested Disclosures

What do investors want to see?

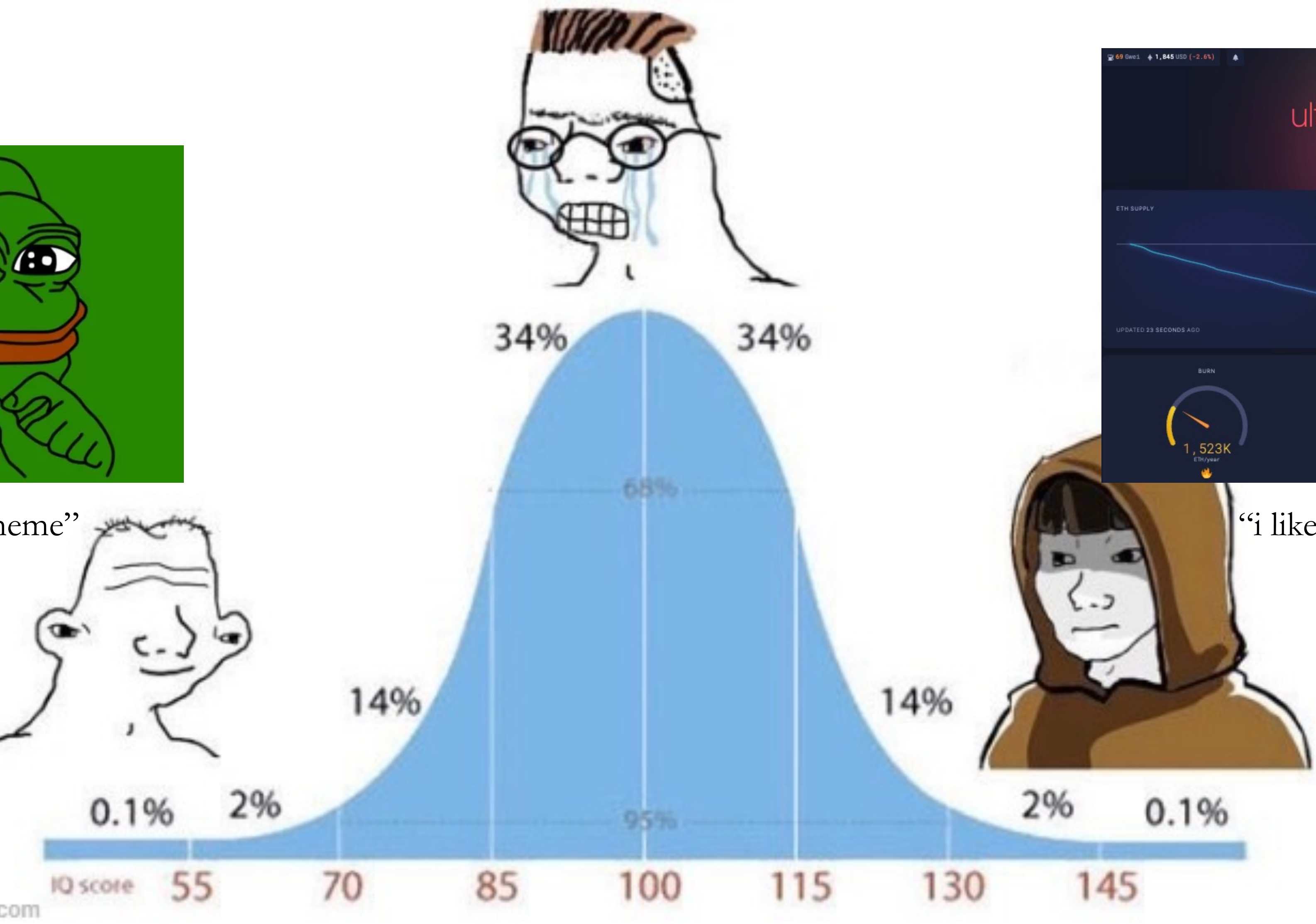
- Dashboards for on-chain data
- APIs for off-chain data
- Methodology for verifying token buybacks/burns
- Token unlock schedule (the more detailed the better)
- Team & treasury-owned wallets & transactions
- Product roadmap, growth plans, & community calls
- Historical network financials & projected budget
- Historical governance proposal results
- Key vendor, investor, & partner relationships

Information accessibility is as important as availability.

Bad UI can cause the market to not "give credit" for publicly-disclosed information.

Don’t Overthink It: Memes Are The Best Investor Relations

“i like the meme”



“i like the meme”

It Can Take a Village to Launch a Network.

In life and especially in crypto, choose your partners *very* carefully.

	Products & Services	Typical Costs	Key Players
Market Makers	• Guarantee minimum daily trading volume to meet exchange listing requirements • Accelerate listing timeline (weeks vs months)	• 3-5% of tokens on loan to provide liquidity • 3-5% of tokens via SAFTs / warrants • Short time horizons (likely to sell unlocks)	DWF LABS, GSR, CUMBERLAND A DRW COMPANY, jump, WINTERMUTE
Exchanges	• Venue for retail & institutional liquidity • Co-marketing • Potential investment ($200k-$2m)	• $100-250k one-time listing fee for large exchanges • 30-50bps fees on future trades • 6-12+ month process at large CEXs	coinbase, Huobi, BINANCE, OKEX, BYBIT
Legal Counsel	• Legal & regulatory • Structuring • Tax	• $1-2k per hour • Typically 50-150 hours of up-front legal work • Some will accept partial payment in tokens	redacted
L1s and L0s	• Robust infrastructure • Co-marketing & dev resources • Potential grant/investment ($20k-$2m)	• Platform dependency • Critical features may still be in development • Security vulnerabilities	
Validators	• Run independent nodes • Strengthen network decentralization • Testnet/mainnet launch support	• 2-5% of tokens (across all validators) • Sometimes more depending on the type of network	CHORUS ONE, Validation Cloud, Figment, BLOCKDAEMON
Smart Contract Auditors	• Review contracts for common vulnerabilities • Combination of code + human review • “Audit” is a bit of a misnomer… many still get hacked	• $10-20k in cash • Most projects get multiple audits • New audits needed whenever contracts change	CERTIK, Quantstamp, SHERLOCK, SLOWMIST

Escape Velocity

Rocket fuel for networks.

Website: https://www.ev3.xyz/

Twitter: @DAnconia_Crypto and @MoneroMahesh

Telegram: @salgala and @moneromahesh