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So, You Want to Buy a Blockchain Company:

Considerations for Corporate Transactions

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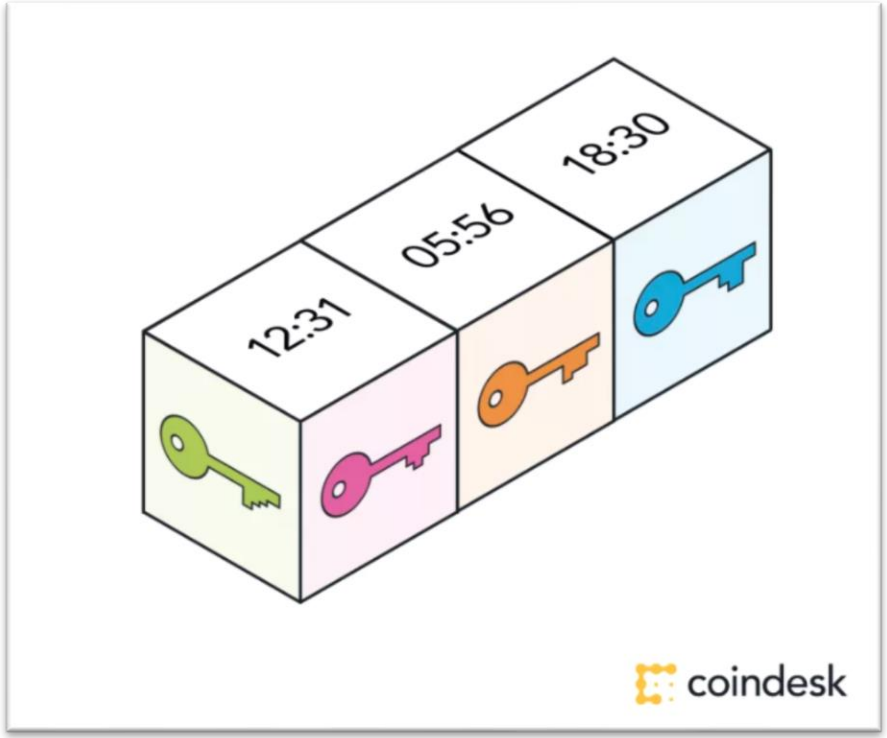
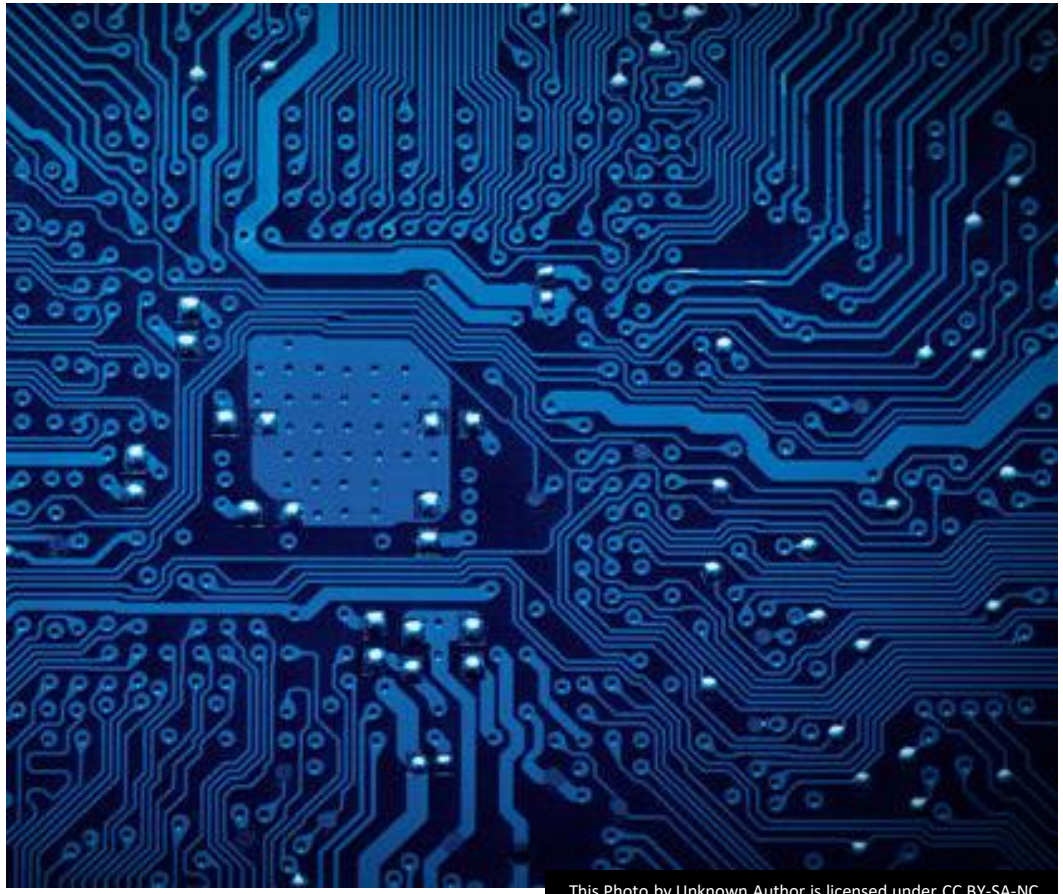
Refresher on Blockchain

- Immutable electronic ledger
- Block = A group of records
- Blockchain = A string of blocks
- Basic Characteristics:
  - Permanent
  - Secure and tamper resistant
  - Public or private



Source: Coindesk, *What is Blockchain Technology?* (Mar. 9, 2017)

Recent Transactions



- Nuvei and Simplex ($250 million)
- Galaxy Digital and BitGo ($1.2 billion)
- Dapper Labs (multiple funding rounds)

Trends

- The Block: 314 deals in Q1; average deal size $12.7 million
- Financial Services
- NFTs/Gaming
- Enterprise Solutions, Data/Information Management, etc.

The Deal Process Overall

- Finding a Deal/Target Company
- Letter of Intent
- Due Diligence
- Purchase Agreement and other Ancillary Agreements
- Post-Closing Integration

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BEFORE THE DEAL: DUE DILIGENCE

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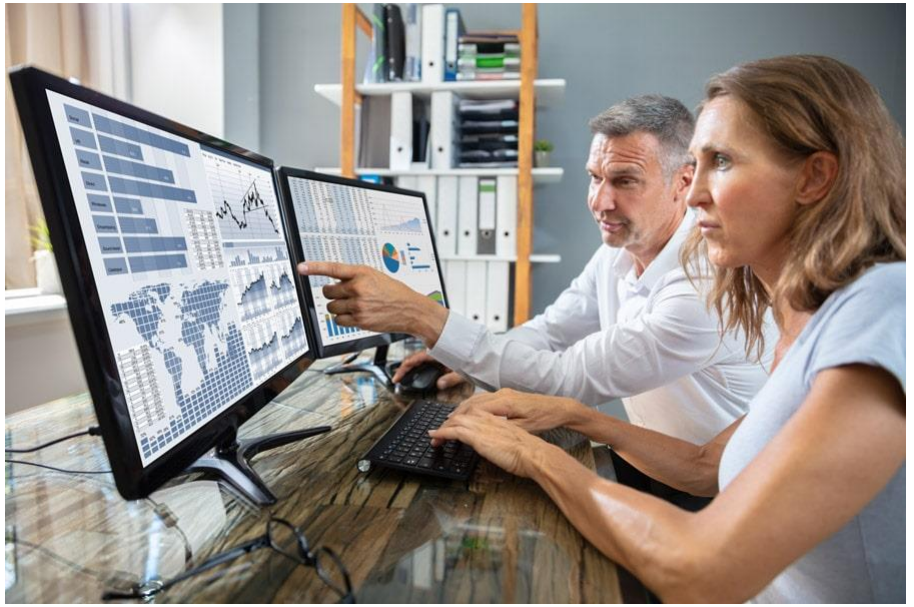
The Purpose of Due Diligence

Review of information relating to the Target company to:

- Gather information about the Target
- Check and verify the purchase price
- Check structure of the transaction (stock vs. asset)
- Identify potential liabilities
- Identify assets to be excluded
- Allocate risks in representations and warranties

Due Diligence Includes

- Areas of the Target reviewed during due diligence, among many, include:
  - Corporate documents
  - Contracts
  - Real and personal property
  - Financials and tax
  - Litigation
  - Employees and benefits
  - Compliance with Laws
  - IP



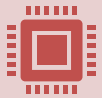
- Independent Due Diligence (UCC, Litigation, IP, Social Media)

Due Diligence Challenges

- Due diligence with start-ups is often more complex, with records potentially lacking and information not necessarily available
- Compliance with regulations/rules – what laws apply and in what jurisdictions
- Due diligence often takes longer for technology deals
- Status of technology
- Management and developers

Due Diligence Nuances: Defining Growth

Managing a regulatory framework that is in flux



Blockchain is seen as a nascent industry with many possible, yet currently unproven market sectors

Certain blockchain based technology is seen to have a short lifecycle or one that's hypersensitive to market factors (Dogecoin and NFTs?)

Don't forget that many targets likely operate across international borders!

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Due Diligence: Intellectual Property

- Can the seller articulate what their Intellectual Property is?
  - Any patents? Trademarks?
  - Is it based in copyright?
  - Is there enabling technology and know-how (trade secrets)
- Is all of the Intellectual Property owned by the entity?
- Is it properly registered or protected (if a trade secret)?

Workforce and Employees: Acqui-Hiring

- Software development and engineering roles are in high demand with one of the most in-demand skill sets being "blockchain"
- Rather than hiring to fill key positions, many companies seek a specialized team through an acquisition
  - Example: Facebook acquired Chainspace and Servicefriend in 2019, speeding Libra and Calibra (Novi)
- Due diligence in assessing the competency of the talent is more important than ever and whether any restrictive covenants exist and could be assigned to a buyer

Valuation

- Are there enough comparisons that experts could determine a reasonable valuation?
- What history does the company have with respect to other methods of valuation?
- Assessing the reasonability of financial projections
  - Discounted Cash Flow: so many uncertainties
  - Comparable Companies: equity comp is difficult in a pandemic for technology (12 months of EBITDA)
  - Comparable Transactions: few transactions to declare a high confidence and many are private

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THE DEAL AND ITS TERMS

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The Deal/Purchase Agreement

- Structure (Stock vs. Asset)
- Valuation/Purchase Price
  - Closing Payment, Deferred Payment, Earnouts
- Representations and Warranties
  - An assertion of fact and promise that assertion of fact is true
  - Myriad of issues to be addressed
  - Specific intellectual property concerns (more to come)
  - Used to allocate risk
- Required consents/approvals

The Deal/Purchase Agreement

- Covenants – promise to do or not to do something
  - Confidentiality, indemnification, insurance requirements, non-compete, non-solicitation
- Holdbacks/Escrows for Claims, proof of technology
- Indemnification for possible breaches, pre-Closing actions
- Ancillary Agreements
- Others (conditions, termination rights, etc.)

The Deal/Purchase Agreement (cont.)

- Dispute Resolution
- Disclaimers
- Tech agreement negotiation can often take longer, in part due to the complexity of mitigating risk and indemnification

Workforce and Employees

- With the move towards acqui-hiring, you want to retain as many employees as you can but…
- Depending on whether it's a stock or asset purchase, you may lose restrictive covenants binding key employees.
- Consider a provision requiring the seller to have key employees (found in due diligence) sign new restrictive covenants but…
- Employees are at will. They may have the will to leave!

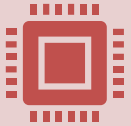
Representations and Warranties

- Financials
- Intellectual Property
  - Infringement risks
  - Licensure of underlying technology or coding (open source, copyleft)
  - Encumbrances
- Seller's Liabilities

Other "Known-Unknowns"

- The risk of antitrust
- Regulatory flux of U.S. and international laws
  - Financial Regs (think digital assets)
  - Sector Specific Regs (automotive, healthcare, consumer products, etc.)
  - Data Protection Laws
  - CFIUS and "Critical Technology" laws

Post-Transaction Integration



Integration is a significant part of the long-term success of a transaction

Balance of autonomy and integration

Importance of due diligence

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Technological Integration

- 70% of technology integration fail in the beginning of integration, not at the end
- The purchaser's experience and approach often play a role:
  - Does the purchaser understand the unique history of blockchain?
  - Is the acquiring culture sufficiently agile?
- Defining success may differ in a "full" integration vs. a "bolt-on" or "tuck-in" acquisition

Technological Integration

- It starts with ***people***
  - Identify and leverage your key technology resources
  - Be honest about skill sets and readiness
- Integrating your technical ***processes***
  - Mapping processes in your before and after landscape can assist in integrating the new technology
  - Look for interdependencies and whether they should be kept, enhanced or replaced
- But don't forget ***cost-management*** to avoid cost-proliferation in integrating technology

Cultural Integration

- Compensation, management, benefits, overlapping positions
- Tech vs. non-tech (rapid change, risk to drive innovation, structure of management and roles)
- Demand for skilled employees – what do employees want? What don't they want?
- Keeping morale and productivity
- Evaluate pre-Closing

Legal Integration/Compliance

- Begins with due diligence
- Continued compliance with applicable laws (new permits, regulations)
- Privacy and other obligations from pre-closing continue post-closing
- Privacy laws regarding sharing of information
- Software licenses, other limits of use

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Questions?

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