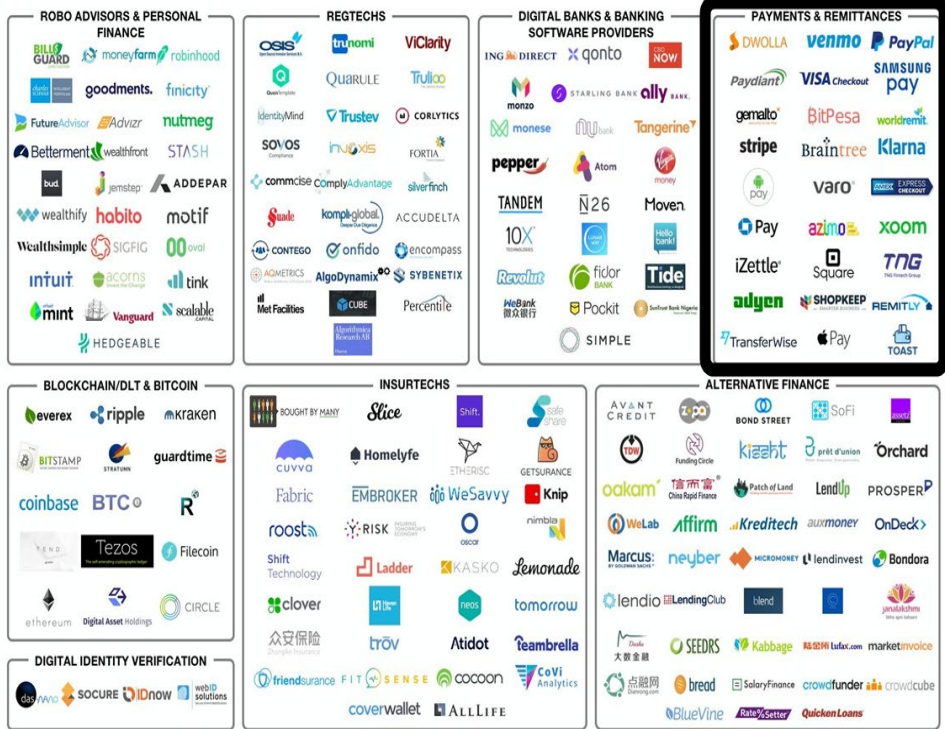


What is FINTECH?

Manole Capital Management exclusively focuses on the emerging FINTECH sector. We define FINTECH as “anything utilizing technology to improve an established process.”



For us, the quintessential FINTECH business is the payment industry. As you can see in this FINTECH ecosystem slide, we bolded the Payments and Remittances space, as that is our preferred area to invest. Others can invest in FINTECH’s through Alternative Finance companies or digital banks or Insurtechs, but for us, we love the payment sector.

We are attracted to the predictable, sustainable, and recurring revenues of their businesses, where they essentially earn consistent revenue per swipe.

When most investors discuss FINTECH, they rarely (if ever) discuss the exchanges. Similar to these payment and transaction-based models, many of

the exchanges also earn revenue, free cash flow and profits per transaction or trade. When it comes to trading certain assets (interest rates, equities, commodities, foreign currency, etc), there tends to be high barriers to entry or an impregnable moat around certain franchises. While many of these businesses are not recession proof, they have proven to be recession resistant.

Our Goal:

This note will review digital currencies, explore Bitcoin and the opportunities in the exchange space. We will use our over two decades of experience following and owning exchanges to draw some parallels for this new asset class. For example, there are “big picture” matters concerning storage, access, theft, usage, documentation, identity, rights and dozens of other issues. Blockchain and technology advancements theoretically solve some of these problems, but unfortunately not all.

Some digital currency or technology experts might find this analysis rudimentary. Others are new to this asset class and want a primer on the industry. That’s our primary goal or target, is to provide an initial 30,000 foot view on digital currencies and then dive into the details of the largest (and soon to be public) exchange. On the last two pages of this research note, we have provided a number of definitions or terms applicable for better understanding this sector.

As always, we strive to present our work in a very readable format. If they had the patience to read our research, we attempt to write our notes so our 80-year father or 14-year old son could easily understand. We will try our best to review the requirements to be considered a currency, as well as volatility, pricing, digital wallets, NFT’s (non-fungible tokens), stable coins and some other pertinent digital currency issues.

After that, if you want insight into how we traditionally invest in this space, please click on our fairly deep dive into Coinbase (ticker COIN). You can read their nearly 300-page S-1 filing with the [SEC \(click here\)](#) or you can let us serve as your “Cliff Notes” version. We will discuss their business model, how they generate revenue, their advantages, and disadvantages, as well as provide a framework for valuation and a price target.

We hope you find this latest research from Manole Capital topical and interesting. As always, feel free to follow us for additional FINTECH research.

Digital Currencies:

In our [1st quarter 2021 investor newsletter \(click here\)](#), we discussed COIN’s business and its opportunity. We wrote a couple pages on the subject, but felt it deserved a much larger and dedicated piece of research.

Before we dive into Coinbase, we wanted to provide our thoughts on Bitcoin and digital currencies. Over the last 5 years, we have done a significant amount of work on digital currencies, trying to understand their best usage, functionality, and their potential role in the future of payments. Are digital currencies a threat to the payment networks, processors, and merchant acquirers? In order to answer these questions, one has to understand how a typical payment transaction occurs. For example, who processes, clears, and settles a card transaction? We have written dozens of articles on this subject, which can easily be viewed on our website at www.manolecapital.com or by [clicking here](#).

The Requirements to Be a Currency:



In our opinion, there are two main requirements for something to be considered a viable currency. One is that it must be a **“store of value”** and the second is that it must be an **“medium of exchange”**.

A **“store of value”** is often defined as any asset that can smoothly maintain its economic value, rather than rapidly depreciating.

The other requirement is that the currency should be a **“medium of exchange”** or an instrument used to facilitate the sale, purchase, or trade of goods between parties.

In terms of speed and efficiency, Bitcoin’s decentralized platform cannot hold a candle to the centralized payment networks. Visa processes 1,700 transactions per second and it claims to have 40x the spare capacity, to handle 65,000 transactions per second. Paypal (PYPL) stated that during the 2020 holiday shopping season, it processed over 1,000 transactions per second. Using Bitcoin and its blockchain for global purchases and payments can process roughly 7 transactions per second.

As technology improves, one could argue Bitcoin processing will improve. However, if Bitcoin were to get used for payments, the conversion of crypto holdings into US dollars (using the blockchain) will actually *decrease* overall network transaction speeds.

In addition, there are significant acceptance advantages for the existing payment ecosystem. Visa and Mastercard are accepted in over 200 countries and at over 40 million global merchants. Their payment acceptance brands stand for trust and allows billions of purchase transactions to occur each year. The Visa and Mastercard logos are known around the

world, permitting the exchange of goods and services in seconds. While Bitcoin is slowly becoming more recognizable, it simply does not have the same acceptance. We believe the existing payment ecosystem handles the “medium of exchange” process well. The overall payment landscape is a well-oiled machine, that involves three to four parties, approving transactions in roughly 1 to 2 seconds.

We have discussed the long-term opportunity for a FINTECH company or two to create a “Super App Holy Grail”. This would be allowing customers to transact with their mobile phone, in whatever currency they wish, at all global merchants. Getting consumers to get rid of their leather wallets is easier said than done. Even though we consider ourselves to be fairly technologically savvy, we still have a wallet that looks a lot like George Costanza’s.

Several companies have recently announced their intentions to help spur Bitcoin acceptance. On March 30th, 2021, PYPL announced the launch of its “Checkout with Crypto” option. Participating merchants (initially ½ of PYPL’s 29 million) can offer their customers the ability to pay for purchases using Bitcoin, Litecoin, Ethereum or Bitcoin Cash. How will this work? Once a PYPL customer purchases or stores crypto holdings in their PYPL digital wallet, he/she will be permitted to use those funds at checkout. When a transaction occurs, PYPL users will see the option to apply their balance to complete a purchase. When customers choose this payment option, PYPL will exchange their crypto for US dollars through its clearinghouse partner, Paxos. The transaction will occur based upon a spot market rate, with a 50 basis point spread built in. PYPL will then remit payment (in US dollars) to the merchant, to satisfy the exchange of goods or services.

While this sounds easy, there are significant hurdles. Certain details are still emerging, but customers using this service must buy their crypto within their PYPL digital wallet. This will satisfy PYPL’s adherence to Know Your Customer (KYC) guidelines, but it doesn’t solve all potential hiccups. The four cryptocurrencies PYPL said customers can use, are likely to cause problems. The SEC and IRS have not deemed these to be currencies, but instead, consider them capital assets. If they were to be used for payment, the underlying client will potentially have capital gain taxes, if their PYPL digital wallet has paper gains. If you are making a \$20 purchase at Walgreen’s, we don’t believe customers are wanting to consider the tax ramifications of using their Bitcoin balance in their digital wallet. That potential \$20 purchase could potentially cost you a tax liability of 100%.

Even if we ignore the large tax issues, there are additional worries. So, if the cryptocurrency in your digital wallet is going to be used to fund purchases, who is going to pay for it? Merchants will have to pay for the cost of converting cryptocurrencies into US dollars, whatever that cost might be. There will be the traditional merchant discount rates applied, but this will ultimately be another cost for merchants to bear. Do you envision merchants are looking forward to additional processing costs, to help their customers transact in Bitcoin, especially when cards are so ubiquitous?

So, Tesla has decided it will accept Bitcoin as a form of payment. What does this really mean? If a consumer has a sizeable gain in Bitcoin and wishes to use it to purchase a “free” Tesla, there are serious tax consequences. Just like selling an appreciated stock, where a consumer has to pay capital gains taxes, Bitcoin would be under the same burden. Until the IRS classifies Bitcoin as a currency, and not property, this tax problem will remain.

The second problem comes if the Tesla buyer decides to return his/her new vehicle. Tesla reserves the right to pay the consumer back in cash, worth the original purchase price, not in Bitcoin. If Bitcoin jumps in value since the original transaction date, the consumer would be negatively impacted. If Bitcoin falls in price, Tesla could return a depreciated Bitcoin to the car buyer. Are there hundreds of thousands of consumers yearning to purchase a Tesla with Bitcoin? We doubt there’s too many, especially if they are aware of the tax issues.

Last week, Visa announced it would use various FINTECH API’s (application programming interface) offered by cryptocurrency custodian and privately-held Anchorage. Visa plans to settle transactions using US dollar stablecoin,

powered by the Ethereum blockchain. Once again, this is exciting news, but will likely encounter problems and take a while to come to fruition.

Before one uses Bitcoin to transact at the POS (point of sale), be actually believe it can become an excellent opportunity for money transfer. Western Union is about to turn 170 years old and can be considered the original FINTECH company. However, moving paper currency around the world is not terribly technologically advanced. Visa has launched an expanded version of its *Direct* platform, which will allow for cross border disbursements. Visa's platform supports real-time domestic and cross-border person-to-person, business-to-small business and business-to-consumer use cases, so the options are endless. Bill Sheley is the global head of Visa Direct, and he stated, "Visa is innovating to give financial institutions, governments, individuals and businesses new ways to pay and get paid beyond the card."

On the "store of value" front, the total addressable market for assets is enormous. For example, art and collectibles are a \$20 trillion market, gold is \$10 trillion, real estate is \$200 trillion, bonds are \$100 trillion and equities are another \$30 trillion. 50% of gold is used in jewelry and another 1/3 is used in electronics. While gold used to be used to back fiat currencies, Britain dropped the gold standard in 1931. The US followed suit in 1933 and totally abandoned the gold standard in 1973.

We agree that digital currencies are becoming a feasible "store of value", but in our opinion, digital currencies have significant challenges to becoming a "medium of exchange". With that caveat, the opportunity for the crypto-economy and digital currencies to thrive is still open ended and vast.

Inflation:

The world is always looking for additional asset classes and stores of value, especially as governments keep the currency printing presses running 24 hours a day, 7 days a week.

Last year, the Federal Reserve printed an unprecedented amount of dollars, roughly 1/5th of all US dollars ever printed. On a daily basis, the Bureau of Engraving and Printing produces over \$500 million over 38 million notes.

If you are the United States and the dollar is considered the dominant global currency, your perception of Bitcoin (or any digital assets) should be of concern. The ability of countries to simply print money should inherently be inflationary, yet Federal Reserve Chairman Jerome Powell continues to seek to get the US at and above 2% annually.

A couple of weeks ago, the Biden administration announced an infrastructure bill, called the American Jobs Plan, with a \$2 trillion spending target. In March of 2021, US government passed a \$1.9 trillion stimulus package. This followed a December of 2020 stimulus package of \$900 billion, as well as a CARES Act in March 2020 bill of \$2.2 trillion. We are not making a statement about the merits of any of these packages and stimulus programs. We simply are trying to point out the massive amount of money that is getting printed.

Many cryptocurrency bulls will cite inflationary worries with fiat currencies for why their digital cryptocurrencies assets are undervalued. We understand this argument, but always come back to an initial framework. If you are the US or the European Union or Chinese government, would you be able to control your society if there wasn't a viable currency in place? Would economies function without government control of its fiat currency? If cryptocurrencies become widely accepted and are considered a better version of payment, would governments be able to function? If the US couldn't issue additional debt to fund its spending initiatives, would it even exist? We just don't believe government regulators will allow certain cryptocurrencies to thrive, especially if it threatens their sovereign currencies and the international financial structure that enables them.

We tend to look at this as a simple supply and demand equation. While Bitcoin has currently issued 18.7 million tokens, there is only a maximum of 21 million that can be created. That fixed supply is counter to some governments. For example, there are countries that have taken the printing of fiat currency too far. Zimbabwe is but one example of runaway inflation. Here's a picture of one of their 100 trillion bills. Yes, that's a 100 trillion. Do you want to be a trillionaire? Simply buy one on eBay for \$8.99, [by clicking here](#).

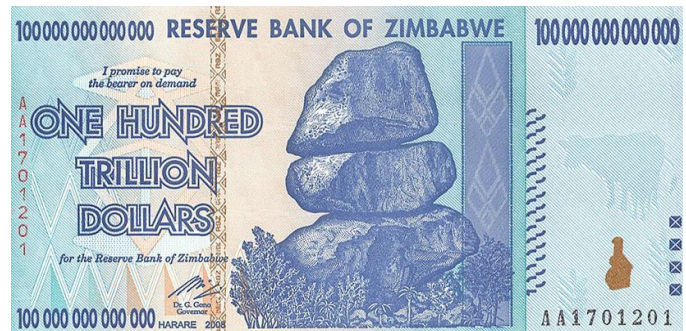
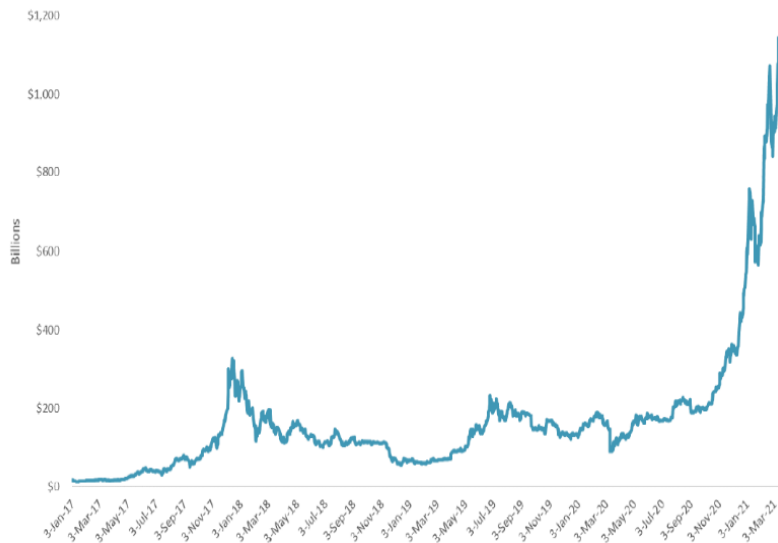


Exhibit 8 **Bitcoin Historical Market Capitalization (\$ billions)**



Source: Coin Metrics and Piper Sandler

As this Piper Sandler chart shows, Bitcoin now has a market capitalization of roughly \$1 trillion. If we look at the top 10 digital assets by market capitalization, the vast majority of market share falls to just 2 currencies, Bitcoin and Ethereum.

It is estimated that Bitcoin is over 55% of all cryptocurrency market capitalization and Ethereum is roughly 11%. Cryptocurrencies like Tether, Binance Coin, Stellar, Cardano, Litecoin have a modest following and just 1% to 2% market share (all under \$50 million in market cap).

Digital currencies should be considered assets, as they can be represented digitally, dynamically transmitted, and stored safely in the cloud. However, digital assets and

cryptocurrencies have a long way to go to become used in our globally interconnected economies.

Rules & Regulations:

In a perfect world, we think all assets should trade 365 days a year and 24 hours a day. In this hypothetical environment, assets should immediately process and settle with modest transaction fees. Why does the NYSE only officially operate from 9:30 am to 4:00 pm EST Monday through Friday (and not on holidays)? There are trades that occur pre-market and post-market hours, but liquidity and volumes are sparse. The simple answer is that this is the way it has always occurred and why should we change something that isn't broken.

The traditional exchanges have always had a set period of time where they are "open for business", but this is changing. For example, the technology backbone of the CME Group (ticker CME) is called Globex. It essentially permits 24/7 trading to occur on its electronic platform for equities, interest rates, commodities, foreign exchange and other assets. After years of investing in international growth, roughly 1/5th of all volumes come from outside of the US.

In order to have access to Globex, there are rules one needs to adhere to, as exchanges are heavily regulated entities. Just like banks need to conduct AML (anti-money laundering) and KYC (know your customer) due diligence on its customer base, the exchanges need to follow strict guidelines enforced by their regulators.

As of today, we believe there are over 50 distinct blockchain protocols which support more than 7,500 various digital assets. Unfortunately, the financial systems are not known as entities that are quick to adopt change and technology. The world has embraced the internet, as a revolutionary and transformational platform. However, financial systems are not comfortable seamlessly exchanging data, information and assets. There are numerous activities like cross border payments or peer-to-peer payments that are ideally suited for technological advancements, but rules and regulations exist to stymie growth.

The goal of an open and transparent financial system is honorable, but not terribly realistic. In terms of managing one's assets, especially money, the process can be cumbersome.

Volatility:

If we accept cryptocurrency as a digital asset, we then want to better understand how value is determined, where it can be stored and how best to process and handle its exchange. With decentralized assets, the network allows participants to transact without intermediaries. Who sets the value and determines price?

The most notable cryptocurrency is Bitcoin, and it has a CAGR (compound annual growth rate) of over 150%, from 2013 to 2020. In 2017, it rose 1,318%, but then fell by (72.6%) in 2018. In 2020, it rose over 302% and it currently is up well over 50% this year. Since January of 2017, there have been 5 corrections of 50% or more in Bitcoin, so it can be wildly volatile.

We are slowly getting comfortable with digital assets and cryptocurrencies as a "store of value" and believe they will become a viable asset in one's diversified portfolio. Each individual or entity needs to determine their own risk and reward framework, so cryptocurrency might be 10 basis points or 10% of one's portfolio.

Opinions on Bitcoin are changing every day. Back in 2018, the CEO of Blackrock (Larry Fink) called Bitcoin a currency "for money launderers." A year earlier, JP Morgan CEO, Jaime Dimon called Bitcoin a "fraud" and threatened to fire any bank employee who dealt with the currency. Fast forward to today: Blackrock (in January 2021) enabled two of its mutual funds to purchase Bitcoin, and a JP Morgan analyst recently published that he thinks Bitcoin could rise to \$146,000.

Recently, large institutional interest has boosted the price of certain digital assets. High profile investors like John Tudor Jones (May 2020) and Stanley Druckenmiller (November 2020) have made sizeable purchases of various digital currencies. Other companies like Microstrategy (August 2020) and Tesla (Feb 2021) have made sizeable transactions for their firm's balance sheet.

Stable Coins:

A stable coin is simply a digital asset that attempts to lower volatility by pegging itself to an actual fiat currency or physical asset (ex: gold). For example, Tether has a market capitalization of over \$40 billion, is backed by US dollars and it's the largest cryptocurrency stable coin. One of the risks associated with stable coins is ensuring that the proper amount of fiat currency is held in reserve to match the amount of stable coins in circulation.

In prior official commentary, the Governor of the Central Bank of Russia - Elvira Nabiullina - stated that Russia was against any form of private currency, as it threatened financial sovereignty. Russia's Ministry of Internal Affairs also was considering seizing all digital currencies and claiming cryptocurrencies criminal activity. Now, in January 2021, the Bank of Russia began to test a ruble-based stable coin. While starting cautiously, the Russian Central Bank is exploring the possibility of issuing its own digital currency. There are numerous countries that are investigating the process of issuing CBDC's or Central Bank Digital Currencies.

The People's Bank of China has studied the process of issuing a digital yuan, the European Central Bank is looking into a digital Euro.

Other governments and regulators have highlighted the risks of digital currencies. The UK's Financial Conduct Authority called crypto assets "high risk, speculative investments" where investors "should be prepared to lose all their money." US Treasury Secretary (and former Federal Reserve Chairwoman) Janet Yellen has warned on investing in digital currencies too. Just a week ago, India's Reserve Bank took a fairly bearish tone on digital currencies. Rumors are that India is looking to pass a law outlawing cryptocurrencies and making anyone trading or holding them punishable with sizeable fines. India's Finance minister is Nirmala Sitharaman and she said India's Cabinet will shortly issue a final ruling on the matter and that the government's ruling is "under preparation and nearing completion".

Will additional countries look to make cryptocurrencies illegal? These type of comments act as a governor to adoption and change. Politicians and governments are worried about losing control of their economies. Statements like this are further evidence that governments will remain a headwind. We aren't going to put this in the realm of a new "space race", but the country that embraces this technology first might have an early advantage versus those that are afraid of change.

Digital Currency Conclusion:

This quick digital currency discussion was created to set the framework for an analysis of Coinbase (ticker COIN). Will digital currencies replace traditional payment systems? We do not believe it will, but continued adoption and traction in digital currencies is noticeable.

Is Bitcoin poised to climb higher, or will it crash? We simply don't know. What we do know is that we prefer to own the medium where these "assets" trade. We would compare this to the Gold Rush of the mid-1800's. Back in 1849, Levi Strauss made a fortune selling picks, pans and shovels to '49ers looking for gold. Back then, some would say, "There's gold in those mountains."

Nowadays, there's a huge opportunity in the collection of data and information. We truly have no idea what the price of Bitcoin will do, except we know that it will be very volatile. As we know, volatility leads to trading, which should equate to profits for the exchanges.

Coinbase (ticker COIN):

Speaking of exchanges, let's now discuss another exchange and FINTECH company, Coinbase (ticker COIN). This 13-page stock specific research note on Coinbase discusses their business model and outlook.

The stated goal of COIN is "to create an open financial system for the world." While this is altruistic, it seems to be fairly broad based goal. It is noble to strive to create a financial system that is transparent for all mankind. It might be more prudent to strive to provide an end-to-end infrastructure and technology platform for all types of cryptocurrencies.

Terminology / Definitions / Glossary:

- **Address:** An alphanumeric reference to where crypto assets can be sent or stored.
- **Bitcoin:** The first system of global, decentralized, scarce, digital money as initially introduced in a white paper titled Bitcoin: A Peer-to-Peer Electronic Cash System by Satoshi Nakamoto.
- **Block:** Synonymous with digital pages in a ledger. Blocks are added to an existing blockchain as transactions occur on the network. Miners are rewarded for “mining” a new block.
- **Blockchain:** A cryptographically secure digital ledger that maintains a record of all transactions that occur on the network and follows a consensus protocol for confirming new blocks to be added to the blockchain.
- **Cold storage:** The storage of private keys in any fashion that is disconnected from the internet. Common cold storage examples include offline computers, USB drives, or paper records.
- **Crypto:** A broad term for any cryptography-based market, system, application, or decentralized network.
- **Crypto asset (or ‘token’):** Any digital asset built using blockchain technology, including cryptocurrencies, stablecoins, and security tokens.
- **Crypto Asset Volatility:** Represents our internal measure of crypto volatility in the market relative to prior periods. The volatility of crypto assets is measured on an hourly basis (using 10 minute price intervals within each hour) for each crypto asset supported for trading on Coinbase, averaged over the applicable time period (quarterly), then weighted by each crypto asset’s share of total trading volume during the same time period across a select set of trading platforms, in addition to the Coinbase platform, that operate in similar markets including itBit, Bitfinex, Bitstamp, bitFlyer, Binance.US, Binance, Kraken, Gemini, Bittrex, and Poloniex.
- **Cryptocurrency:** Bitcoin and alternative coins, or ‘altcoins’, launched after the success of Bitcoin. This category of crypto asset is designed to work as a medium of exchange, store of value, or to power applications and excludes security tokens.
- **Cryptoeconomy:** A new open financial system built upon crypto.
- **Customer:** A retail user, institution, or ecosystem partner on our platform.
- **DeFi:** Short for Decentralized Finance. Peer-to-peer software-based network of protocols that can be used to facilitate traditional financial services like borrowing, lending, trading derivatives, insurance, and more through smart contracts.
- **Ecosystem partners:** Developers, creators, merchants, asset issuers, organizations and financial institutions, and other groups building decentralized protocols, applications, products, or other services for the cryptoeconomy.
- **Ethereum:** A decentralized global computing platform that supports smart contract transactions and peer-to-peer applications, or “Ether,” the native crypto assets on the Ethereum network.
- **Fork:** A fundamental change to the software underlying a blockchain which results in two different blockchains, the original, and the new version. In some instances, the fork results in the creation of a new token.
- **Hodl:** A term used in the crypto community for holding a crypto asset through ups and downs, rather than selling it.
- **Hot wallet:** A wallet that is connected to the internet, enabling it to broadcast transactions.
- **Institutions:** Businesses that include hedge funds, small to large financial institutions, and corporations.
- **Miner:** Individuals or entities who operate a computer or group of computers that add new transactions to blocks, and verify blocks created by other miners. Miners collect transaction fees and are rewarded with new tokens for their services.
- **Mining:** The process by which new blocks are created, and thus new transactions are added to the blockchain.
- **Network:** The collection of all miners that use computing power to maintain the ledger and add new blocks to the blockchain. Most networks are decentralized, reducing the risk of a single point of failure.
- **Protocol:** A type of algorithm or software that governs how a blockchain operates.
- **Public key or private key:** Each public address has a corresponding public key and private key that are cryptographically generated. A private key allows the recipient to access any funds belonging to the address, similar to a bank account password. A public key helps validate transactions that are broadcasted to and from the address. Addresses are shortened versions of public keys, which are derived from private keys.

- **Retail users:** Individual users with an account on our platform.
- **Security token:** A crypto asset that is a security. This includes digital forms of traditional equity or fixed income securities, or may be assets deemed to be a security based on their characterization as an investment contract or note.
- **Smart contract:** Software that digitally facilitates or enforces a rules-based agreement or terms between transacting parties.
- **Stablecoin:** Crypto assets designed to minimize price volatility. A stablecoin is designed to track the price of an underlying asset such as fiat money or an exchange-traded commodity (such as precious metals or industrial metals). Stablecoins can be backed by fiat money or other crypto assets.
- **Staking:** An energy efficient equivalent of mining. Stakers use pools of tokens as collateral to validate transactions and create blocks. In exchange for this service, stakers earn a reward.
- **Supported crypto assets:** The crypto assets we support for trading and/or custody on our platform, which included over 90 crypto assets as of December 31, 2020.
- **USD Coin or USDC:** A stablecoin issued through the Centre Consortium (co-founded by Coinbase and Circle Internet Financial Limited, or Circle), backed by fully reserved assets, held by the issuer, and able to be purchased and sold on a 1:1 basis for U.S. dollars.
- **Wallet:** A place to store public and private keys for crypto assets. Wallets are typically software, hardware, or paper-based.
- **Wallet user:** A retail user who has established an account with a username on our non-custodial software-based product. Coinbase Wallet is an application that allows the user to connect to DeFi applications and self-custody crypto assets. While they operate separately from our main platform, wallet users are included in the following key business metrics: Verified Users and Monthly Transacting Users.

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