diffusetap
Virtual Event Series

# Investing in Crypto Startups 2023

*Guest Speaker:*

Peter Wokwicz
CEO
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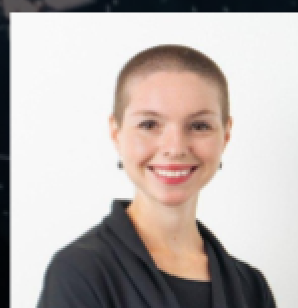
*Hosts:*

Kenny Estes
CEO & Founder
Diffuse



Ayla Kremb
COO & Co-Founder
Diffuse

# DiffuseTap: Investing in Crypto Startups 2023

Last time on DiffuseTap, Peter Wokwicz, CEO of Positron Capital Management, talked to us about why it's so hard to start a blockchain company in the U.S. compared to the rest of the world, why institutional investors need to invest in equity first, token later, and how the lack of regulatory clarity is turning off investors from investing in US crypto startups.

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## DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)… straight from your armchair like a boss.

## Meet the Speaker

PETER WOKWICZ has more than three decades of experience in tech and finance. He has led teams in upgrading legacy systems, launching new applications, and leveraging existing systems more effectively in a number of companies. Peter is currently the CEO of Positron Capital Management, a family office that manages a portfolio of cryptocurrency and digital asset investments.

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## About Diffuse®

We are an alternative fund platform offering differentiated investment products. From digital assets to VC funds and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information, visit www.diffusefunds.com.

KENNY ESTES: Mr. Peter Wokwicz, would you mind telling the good folks a little bit about your background and what you're up to over at Positron Capital Management?

PETER WOKWICZ: Sure. Thanks, Kenny. This is a great group. Every week, I'm just surprised you don't run out of topics. This is a great group of great people, and I'm happy to be part of it. I'm a technology and finance guy. I run a family office. I would say that recently, about 40% of what we do involves crypto in some direct or indirect way. And about 30% is some type of alternative type investments.

Our rule is that we try to have fun. If we make money that's great, but fun is the word we use all the time. That's what we try to do, and a lot of that involves crypto. Nowadays, if you want to have fun, you have to be involved in crypto. On a personal level, I invest in software, satellites, and robotics. That's my realm of expertise, as well as technology in general. That's a little background on me.

AYLA KREMB: I'll pop the first question in. What has changed in the last 12 months or so in the crypto startup investing space? Are there more or less companies, and more or less money around? Are there different structures that we should keep in mind? What has changed in the investment space in crypto?

PETER: I think up until this past weekend, we had the BRC 20 and the meme craze behind that. I think that in general, crypto is getting back to business. People are looking at business models a lot more, and looking at what actually works, what doesn't, and what the goals are. There are a lot of good ideas out there and a lot of crypto coming online that have the goal of disrupting asset management and financial banking models. We're seeing more and more of that. I think the whole trend is getting back to business, which is a good thing for crypto.

I'm very anti meme coins, even though you can make money off them. I'm very much against these types of coins. Even though this weekend we had another incident around meme coins, they were starting to die there for a while. But generally speaking, in the crypto startup world, we're still seeing some of the best minds and people. This group right here is a perfect example.

Most of us either have investments in crypto startups or are involved in the crypto world in some way. The best minds from finance, the best minds from math, and the best minds from business are all doing something in crypto today, which is great. That involves startups, and it's great to see. I think blockchains are starting to become very commonplace in what we do.

In fact, I challenged myself a couple weeks ago. From the time I woke up to the time I went to sleep, I counted how many blockchains I interacted with. I counted around seven, but the average person would not have recognized six of those. So I think we're starting to see more and more crypto startups and applications that actually use crypto or blockchains that we don't realize they are using.

For example, there's one supply chain startup we invested in that I would guarantee none of their customers realize that the entire application runs on a blockchain. They don't even see that the blockchain is there. I think that's a good thing, and I think more of that is forthcoming. It's so commonplace now that even though people here on this call will recognize when there is a crypto play or a blockchain play involved, the average consumer probably wouldn't recognize it. I think that's been a significant change in the last 12 months.

KENNY: I like it. I have a little blurb on that. I like to see businesses where the business model starts the slide deck, and then blockchain is down on slide eight, if at all. Because it doesn't really matter. At the end of the day, it's just a technical implementation.

So, you're a bit of an anomaly in the sense that you're all about family office investing, but you're also doing a lot of direct on-chain interaction. You said you hit seven in one day, which is pretty impressive. Thinking about it from other family offices who are not that comfortable with blockchain, how do you get yourself comfortable with security, custody, and all of those pieces?

PETER: With blockchain, you own your own assets. That means you have to control your own assets. That's the key of crypto, and we've said this so many times. The hardware wallets, the institutional offerings now, even Metamask has an institutional offering and Coinbase Prime, we use them because they're safe. You have to use the big guys if you want that safety. But you also have to pay fees for that. That's one of the penalties.

And over time when we migrated to the institutional solutions,, we said, "Okay, tough luck," we have to pay the higher fees. We have to deal with some approval hassles. But we're run like a traditional financial organization that way, even in the crypto space. There's good options out there, but any big crypto platform has institutional offerings right now.

It's just good to go with their institutional side versus their individual side because the institutional side does have approvals and offerings that they don't offer on the consumer side. On the institutional side in the US, for example, a lot of these platforms can still offer staking yield, yield performance, and things like that. Whereas on the consumer side, they may not be able to anymore.

KENNY: I'm going to do a double-barreled question on that one. You're doing a lot on-chain. Coinbase Prime does not allow you to withdraw to seven different chains. I know that for a fact. So, is Metamask Institutional the only thing you could use here? What are the things that allow you to have this level of flexibility to go where the opportunity is, but also where a lot of the risk lives?

PETER: Yep. Yes, we do use Metamask Institutional as well as some other platforms. We still use hardware wallets too that we move around, which is a bit unique. It also helps to have a team that's not that geographically dispersed. But we also have moved hardware wallets through FedEx and things like that. And even though we don't have to, we have multiple hardware wallets in places that we can just apply a phrase to and have a control token. That's what we do.

And we also do things outside the US, and sometimes that gets a little bit harder. In those cases, questions like "what on and off ramps to use" gets a little bit more complex. But again, there are big guys out there that do this. There are private platforms who, nobody really even knows their name, but do a good job. There are ways of doing it.

AYLA: Beautiful. In terms of setting up a crypto fund, what has changed? Should that crypto fund now be domiciled in the US? Would you put it overseas? Or would you rather just invest in crypto today? What's the best structure?

PETER: I think you have to have an entity in the US just for reputation purposes. But the reality is for Positron Capital Management, we're in many different countries. We have an entity in Singapore, we have an entity in Luxembourg, and we're looking at a couple other places now. You really have to diversify.

The crypto startups we're investing in will usually have an entity in the US. That will usually be where the executives are and where the investment entity is. A lot of the product development is done overseas. Then there's more of an operating entity that is in a crypto friendly, tier-one business country. I won't list names, but they're all countries we're familiar with that are very crypto friendly, and also have a good business environment. You need that entity as well.

Typically on crypto startups, we usually see three layers of entities to support the business model. It's hard to get away from that right now. A lot of the crypto startups we invest in can't do their business model in the US. Even though their executives are in the US and the investment entities are in the US, they don't do their business model in the US yet. It's almost a metaphor for where you need to be as an investment entity. I think you just need to copy the startups you're investing in.

KENNY: Interesting. As I alluded to before, you're a lot more comfortable with getting your hands dirty in a typical family office. You can get your head around and get comfortable with that type of three-tier, onshore-offshore type setup. Are a lot of investors in that same headspace? Or is it just turning off a lot of US investors? And then, as a corollary, how does this play out long term? Where are we going if this is a difficulty?

PETER: It is turning off some investment from the US. And unfortunately, some businesses can't do their business models in the US, which is a big concern of mine. You get some regulatory concerns if you have hedge funds and things like that when you want to go offshore. But if you have an investment entity that you invest $5,000 in startup costs, you can get an entity overseas setup that is owned by the US entity. You can then invest overseas.

Now, there's some new regulations coming forth, where if it acts like and is run by a US entity, then it's under US jurisdiction. I doubt that will actually be put into practice, but we are starting to see that threat a little bit. That would shut down even some of the big guys out there, so I don't think that will actually go into process. But again, I think everyone should have a foreign entity right now.

The majority of us on this call are from the US, and so we have a huge US bias. But a lot of what's going on in the crypto startup world is outside the US right now. In a lot of the good plays, if you want to make money, you have to be outside the US right now. The perfect example is on the yield side.

There are some platforms in the US where you can make a yield on your money. You can make 8% from the US. But if you do it from a foreign entity, you can make 13 to 14% for the exact same type of yield play. That's because they don't want to deal with people from the US. As soon as a crypto platform brings on a customer in the US, they're under US jurisdiction. And that just creates a lot of headaches.

For example, Goldfinch Finance is a company that has the GFI token. They're based out of San Francisco and they do commercial lending. They have a great executive team, and they have a number of x-Coinbase people there. They also have big VCs invested in them, and their business model is doing very well overseas. But for two years they tried to get their business model properly into the US, and they couldn't.

That's a perfect example. In their model they have a three-tier entity. They even have a DAO involved. But even though it's a US entity or company, they're not doing their business model in the US yet. That is a concern that we have, and it's something that will hopefully get resolved soon.

AYLA: Personally, I think that the globalization of crypto is going to be bottlenecked for a little bit longer on our side in the US. It's not going to be an overnight fix here. In terms of the investment structure, do you take tokens, equity, or both?

PETER: Good question. I think one of the things people don't realize by being on the other side of the crypto startup world is that we actually invest in equity. First and foremost is the equity side. All the big VCs do the same thing. Token is secondary. A lot of times, there are some really good business models out there that have a token without utility.

Tokens will never appreciate if they don't have any utility. It's almost as if they are created not to appreciate. You may see a good business model out there and want to buy a token without realizing that it doesn't really reflect any utility.

We come in and we get equity first, and then we'll either get a grant on the token or we'll buy the token on the markets. That's typically the way we'll do it, especially if the token has voting rights or has governance, or will require some ownership of the token. But it's always equity first. Especially if it's one of those governance tokens that will not appreciate and are not meant to appreciate–that's a mistake a lot of people make. Go after equity first.

KENNY: Okay. Let's talk about when you invest. Are you typically pre-revenue or post-revenue? What do you see as the advantages and disadvantages to the concept of revenue? Some people would argue that that's an antiquated idea from before blockchain days. Where's your head around all that?

PETER: I think it's no different than the traditional startup world when you invest. I mean, we're starting up some ourselves. We have one right now that we just invested in that is a new mining company. They don't really have a name yet. They don't have a corp. It's just three executives that we committed capital to. That's very early. But it's never too early to start.

But one thing we did late last year is we actually went through a few thousand of what we call reputable tokens out there. We went through all the business models behind them and took about three months to get through. And out of that, we had about a half-dozen that are actually really good business models. They have great management, and they're not that well known yet. And they might not have any outside investments. We approached a few of those and two of them have already been successes. That was only last December.

I think there's two sides. One is the start-up angel investing side. But there's also the later stage of looking at great ideas and thinking that they may just need a little help, a little capital, and then they can take off. I think if anybody is willing to do their due diligence and review a lot of these businesses, there is a lot out there. You can find some diamonds in the rough for sure.

AYLA: What would you say are some tokens that have utility and are not just governance tokens, for example?

PETER: Any of the big tokens we talked about have utility. The top tokens out there all have utility, and are good investments. But when you get down to the small startups, there's just so many out there that you just have to do your due diligence on each one. We already mentioned GFI, for example. GFI originally didn't have any utility. But now with some governance changes, there is utility being added to the token. I expect that to appreciate over time. Actually, I expect that to go up now because it does have some utility to it.

But again, there are so many factors. Utility is tied to the business model and the cost of doing that model. We also do some tokenization of heavy assets, and that token has a lot of utility that's created by those assets. We sell off the future yield from rental income, that token is backed by an asset, and you get the depreciation expense. That's a token that has utility. Anything that has a dividend or yield attached to it has utility.

Now, unfortunately, this goes back to the international side. If you're in the US, you can't invest in that token. You have to invest by using apps from outside the US. But we're seeing a lot of tokenization of assets, where the token is backed by an asset, has tons of utility, and some of these even pay a dividend out. And again, that's where I think some of the best investments are right now, if you don't want to actually invest in a startup or equity. Look at some of the tokens out there that are generating yield that are backed by real world assets. Those will have utility.

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