

Arcane Crypto

Bitcoin mining project has come on stream

Arcane Crypto has successfully launched its bitcoin (BTC) mining operations (powered by renewable energy) in October after the delivery of the first batch of mining equipment (the second batch is due to be shipped in January 2022). As a result, management expects the group will become cash-flow positive from Q122. The company has also launched the first iteration of its unified tech platform (aimed at becoming the 'one-stop-shop' for several products offered by the Arcane Crypto group). Meanwhile, its Q321 results reflect the more muted activity in digital asset markets during the quarter after the sell-off in May.

Q321 revenue down c 19% vs Q221 on lower volumes

Arcane Crypto's revenues were SEK81.2m in Q321 vs SEK100.3m in Q221, primarily affected by the c 23% decline to SEK75.3m in gross turnover of the crypto broker Kaupang (accompanied by a somewhat lower gross margin of Kaupang at 2.0% vs 2.5% in Q221). This was associated with lower trading volumes in the broader digital asset market. Consequently, Arcane Crypto's EBITDA loss was SEK6.1m (vs SEK8.3m in Q221 when adjusted for the reversal of accrual of social charges). It also recorded a loss from associates at SEK1.3m (including the financial result of Puremarkets, Alphaplate and LN Markets). BTC mining was launched after the reporting date so has not contributed to the company's results.

Making progress with its unified platform

In terms of major portfolio developments, Arcane Crypto has rolled out the first version of its Arcane platform to offer several of the group's products under one roof. It also started consolidating the retail crypto exchange Trijo from Q321. Kaupang continues to enhance its premium offering for large private and corporate clients and has rolled out a recurring buy feature. Arcane Assets continues to pursue the launch and listing of an exchange traded product based on its hedge fund (expected early next year). Arcane Research experiences good demand for its institutional-grade research. Arcane Crypto has also made several new hires, including a new CFO and CTO, and is in the process of appointing a new chairman of the board (with Michael Jackson replacing Jonatan Raknes).

Valuation: Price of recent issue set at SEK0.203

Due to Arcane Crypto's early development stage, we refrain from valuing the group. However, as a broad reference point, we note the subscription price in the directed issue completed in August 2021 was SEK0.203 per unit (consisting of one share plus one warrant).

Historical financials

Year end	Revenue (SEKm)	EBITDA (SEKm)	PBT (SEKm)	EPS (SEK)	DPS (SEK)	P/E (x)	Yield (%)
12/18	0.0	(1.9)	(3.0)	N/A	N/A	N/A	N/A
12/19	0.0	(7.8)	(7.3)	N/A	N/A	N/A	N/A
12/20	1.9	(17.8)	(16.9)	N/A	N/A	N/A	N/A

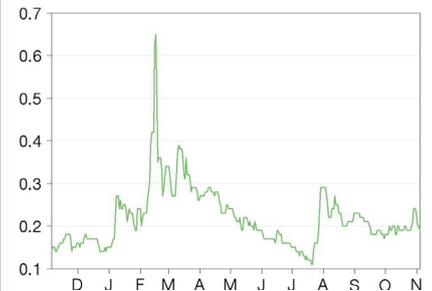
Source: Arcane Crypto

TMT

5 November 2021

Price **SEK0.195**
Market cap **SEK1,660m**

Share price graph



Share details

Code **ARCANE**
 Listing **Nasdaq First North**
 Shares in issue **8.51bn**
 Last reported gross cash at end-Q321 **SEK47.5m**

Business description

Arcane Crypto is an investment company acquiring and developing early-stage businesses in the blockchain-powered digital assets sector as part of a 'buy-and-build' strategy. It has several fully owned and minority-owned businesses across payments, trading, asset management, BTC mining, research and media. It has been listed on the Nasdaq First North alternative market since February 2021.

Bull

- Diversified exposure to the emerging digital assets theme.
- Several holdings approaching commercialisation stage.
- Continued high crypto trading volumes would likely benefit several of the company's holdings.

Bear

- Early-stage, loss-making businesses are inherently risky.
- Dependent on continued digital assets adoption.
- Several competing payment solutions to the Bitcoin Lightning Network.

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Q321 results reflect more muted digital asset markets

Arcane Crypto posted a SEK7.8m loss in Q321 compared to a SEK2.8m loss in Q320 and SEK7.1m loss in Q221, although the Q221 figure includes a positive SEK6.9m one-off item from the reversal of accrual of social charges related to warrants in Arcane Crypto. It generated a revenue of SEK81.2m in Q321, which primarily includes the gross turnover of Kaupang Krypto (SEK75.3m) and revenues from Arcane Assets (SEK3.5m vs SEK2.7m in Q221) and Arcane Research (SEK1.4m vs SEK0.7m in Q221). Moreover, Arcane Crypto's top line now includes the retail exchange Trijo, which became a 100% subsidiary from 2 July 2021 and generated c SEK0.5m in deposit and withdrawal fees in Q321 (no data available for Q221) as it has not yet started charging trading fees (see our [previous notes](#) for details).

Exhibit 1: Q321 results highlights

SEK000s	Q321	Q320	Q221	Q121	FY20*
Revenue	81,165	571	100,296	2,094	1,941
Other operating income	1	0	76	63	162
Total revenue	81,166	571	100,372	2,157	2,103
Cost of goods sold	(73,722)	0	(94,835)	N/A	N/A
Personnel costs	(7,730)	(2,197)	130	(8,846)	(8,992)
Other external expenses	(5,773)	(1,459)	(7,151)	(4,354)	(10,923)
EBITDA	(6,059)	(3,085)	(1,484)	(11,043)	(17,812)
Adjusted EBITDA**	(6,059)	(3,085)	(8,349)	(3,568)	N/A
D&A, including write-downs on intangibles	(2,046)	(48)	(1,063)	(36)	(66)
EBIT	(8,105)	(3,133)	(2,547)	(11,079)	(17,878)
Profit from participation in associated companies	(1,259)	448	(3,138)	447	37
Interest income and other financial income	2,260	8	(1,581)	1,606	1,193
Interest expenses and other financial costs	(662)	(156)	210	(127,024)***	(228)
Profit before tax	(7,766)	(2,833)	(7,056)	(136,050)	(16,876)
Income taxes	0	0	0	0	0
Net income	(7,766)	(2,833)	(7,056)	(136,050)	(16,876)
Adjusted net income****	N/A	N/A	N/A	(9,097)	N/A
EPS (diluted, SEK)	(0.001)	(0.005)	(0.001)	(0.016)	(0.031)

Source: Arcane Crypto, Edison Investment Research. Note: *Results of Arcane Crypto. **Adjusted for the accrual/reversal of accrual of social charges related to warrants in Arcane Crypto in Q121 and Q221. ***Includes SEK126.9m one-time accounting effect arising from the reverse takeover. ****Adjusted for the one-time accounting effect arising from the reverse takeover.

Kaupang's trading volumes down sequentially amid lower broader market activity

Kaupang posted a c 23% decline in gross turnover versus Q221 (SEK97.2m) amid more muted activity in the broader digital assets market (aggregate BTC volume in the market was down 41% during the quarter, according to the management). This is broadly in line with Safello, one of Kaupang's two major local listed competitors, which experienced a 28% revenue decline in Q321 vs Q221 (the other competitor, GooBit, has not reported its figures for the quarter ending October 2021 yet). Meanwhile, Trijo's gross trading volume was close to SEK40m, only slightly down from the c SEK40m in Q221, with a 150% increase in volumes experienced after the launch of the cooperation with the payment services provider Trustly on 30 July 2021.

Kaupang's gross profit was SEK1.5m versus SEK2.4m in Q221, translating into a gross profit margin of 2.0% versus 2.5% in Q221. While its two listed competitors generated a higher margin in recent quarters (suggesting higher average fees), we note Safello (which reported a 5.6% and 4.6% margin in Q321 and Q221, respectively) announced on 11 October it will lower its transaction fees, expecting a margin decline of c 50–75bp (all else being equal). Also, we note Safello charges a much lower 2% transaction fee to business and high net-worth clients (who are the main target group for Kaupang) versus 4–5% for retail clients. Overall, Arcane Crypto's gross profit (which includes revenue from Arcane Assets and Arcane Research) reached SEK7.5m in Q321 after

SEK5.5m in Q221 and management expects substantial growth over the coming quarters (which will be assisted by the recently launched mining operations, see below).

Associates remain in ramp-up stage

Arcane Crypto's EBITDA loss reached SEK6.1m in Q321 versus SEK3.1m in Q320 and SEK8.3m in Q221 (adjusted for the above-mentioned reversal of accrual of social charges). It has also booked a SEK1.3m loss from participation in associated companies (Puremarkets, Alphaplate and LN Markets). Alphaplate reported a loss of c £100k (or SEK1.2m) versus a SEK1.6m loss in Q221 and a SEK3.2m profit in Q121. We estimate that around SEK527k of the Q321 loss is attributable to Arcane Crypto given its 45% stake in the business. Alphaplate recently focused on the integration with Zodia Custody as a market maker (which is now complete) and continued to act as a market maker on the Trijo exchange. Puremarkets has completed a successful test trade on its Pure Digital platform via Zodia Custody. The next step involves further test trades between the investment banks who joined the consortium (which we understand is subject to further regulatory clarity). Meanwhile, LN Markets (operating a derivatives platform based on the Bitcoin Lightning Network) reported a trading volume of US\$53m (c SEK450m), down by 19% q-o-q from US\$65m (c SEK552m) in Q221, which in turn was down more than 25% vs the US\$88m in Q121. LN Markets has recently added a market data visualisation module for options and is now developing an options trading module (based on a broker model). Arcane Crypto recorded a positive financial result of c SEK1.6m in Q321 (vs a negative SEK1.4m in Q221), which we believe may at least partially reflect gains on Arcane Crypto's minor cryptocurrency holdings. The Q321 results also include some minor setup costs associated with its BTC mining operations.

Additional funding provided for the acquisition of mining equipment

The company's cash position at end-September 2021 was SEK47.5m (vs SEK33.5m at end-June 2021), assisted by the directed issue of 300.9m units, each consisting of one share and one warrant entitling the holder to subscribe to one newly issued share, completed on 30 August. The issue was carried out to 'a group of qualified investors with a proven interest in Arcane Crypto and the crypto currency sector', according to the company's press release. The issue price was SEK0.203 (in line with the closing price on the preceding trading day), while the subscription price of the warrants stands at SEK0.2436. The issue will (on full exercise of the warrants) result in a c 6.85% dilution, but has allowed Arcane Crypto to raise gross proceeds of SEK61.1m from the share issue (and potentially a further SEK73.3m on full exercise of the warrants). Part of the proceeds have been used to purchase the first batch of BTC mining equipment for c SEK36m, with the cost of the second batch ordered in October 2021 at SEK28m. The management expect the mining operations will allow Arcane Crypto to become cash flow positive starting from Q122.

BTC mining operations launched post Q321

A key recent highlight of Arcane Crypto's development is the ramp up of its BTC mining operations. Management confirmed mining started just after the end of Q321 based on the first batch of 352 application-specific integrated circuits (ASICs), which we estimate represents a total hashrate of 38,720Th/s. The second batch of 360 ASICs with a hashrate of 36,000Th/s is due to be delivered in January 2022. We estimate that on full deployment and based on the current network state (including a global hashrate of c 160 Exahash/s and BTC price at US\$61.5k), Arcane Crypto's mining operations would generate c US\$9.4m of annual revenue. The company entered into an agreement to sell its processing power to the mining pool Luxor Technologies to smoothen out the revenue from BTC block rewards and transaction fees.

Management has not disclosed details of the operating costs related to the mining operations but confirmed that even at the current high electricity prices in Norway, the operations are 'highly profitable'. Nevertheless, in the long run it may consider setting up further mining operations in other geographical locations to diversify the risk associated with changes in electricity prices in the respective local markets. Arcane Crypto does not intend to accumulate the mined BTC on its balance sheet but will rather sell it or use in the flow of its other businesses (eg to maintain liquidity in the Lightning channels). Having said that, it will also consider deploying derivative strategies to further enhance its profit on the mining operations (with the simplest being the sale of BTC futures contracts to collect the premium during a market contango). Management also flagged that at some stage the company may consider offering mining-as-a-service solutions to its client seeking exposure to BTC mining.

With respect to other major portfolio developments, Arcane Assets continues to work with Valour Structured Products on introducing an Exchange Traded Product based on the former's hedge fund. While it is a complex process from a regulatory perspective and the technical standpoint (eg assuring sufficient liquidity and intraday pricing for the hedge fund), management expects to launch the product early next year. The company is also exploring the opportunity of becoming depository-lite compliant to be able to market the fund to EU investors. Kaupang has launched an insured custody offering as part of its premium services to large private customers and corporate clients and has rolled out a recurring buy (ie dollar-cost averaging) feature for all users in Q321. The integration with Teslacoil has been put on hold pending further developments of the new unified Arcane platform (which will introduce a 'one-stop-shop' approach to Arcane Crypto's offering, see our previous [update note](#) for details). The first iteration of the platform has recently been launched. Arcane Research sees good demand for institutional-grade crypto research as illustrated by, among other things, a 25% sequential growth of the subscription base of the weekly market report in Q321; demand for Arcane's consulting services; weekly press coverage; and continued partnerships, eg with BlockFi. In response to this demand, the company has doubled its research team so far in 2021.

We also note a number of important additions to Arcane Crypto's team. Natalia Goldin Lundh joined the Arcane Assets team as head of investor relations and business development, Oisín Zimmerman has become Arcane Crypto's new CTO and head of product (he was previously senior vice president of product management at DNB), while Linus Jönsson joined as CFO. Moreover, on 28 October 2021, Arcane Crypto's nomination committee proposed that Michael Jackson was elected as chairman of the board and Simon Saneback was elected as a new member of the board. Jonatan Raknes will resign from his position as chairman and member of the board, while Anna Svahn, Kristian Kierkegaard and Viggo Leisner will remain members of the board.

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