

Crypto's broadband moment is now!

Amsterdam-based Theta Capital is the largest investor in so-called crypto-native VCs in the Netherlands and possibly the world. According to Ruud Smets, Managing Partner and CIO of Theta Capital Management, investing in blockchain is especially interesting these days because the technology is shaping up to connect hundreds of millions of additional users in the near future and current investment sentiment for the asset class is low.

Door Harry Geels

What is your company's background?

'Theta Capital Management was founded in 2001. We have been investing in specialized alternative fund managers who show long-term structural outperformance after fees. Our client base consists mainly of family offices for whom we build bespoke portfolios. We also manage the Theta Distressed Credit Opportunities Pool, which capitalizes on the growing opportunities in distressed debt, and now the Theta Blockchain Ventures Funds.'

Why is blockchain technology interesting for investors?

'In 2017, as someone with an IT background, I delved into blockchain technology. Two key realizations quickly became apparent. Firstly, with this new technological architecture we now have internet protocols that natively transfer value and are investable. Imagine you could invest in the current internet protocols and earn a fee every time someone sends an email or streams a video. This is quite literally what happens with blockchain protocols. Secondly, the investment landscape is dominated by a completely new cohort of specialized investment firms that we call crypto-native VCs. We started talking to and researching these fund managers back in 2017.'

'The infrastructure of this new backbone for our financial system is currently being built.'



In the early blockchain years, traditional investment money had a very limited understanding of these new types of business models. They were not set up to invest in them and this is still largely the case. Hence, more than 90% of all promising blockchain technology projects are funded by a new generation of investors. At Theta, we were able to claim our place there thanks to the combination of our knowledge and experience with blockchain technology, our selection of fund managers, and the fact that we were there from the very beginning. We have since invested over \$600 million in more than 40 crypto-native VCs, with a global spread, covering the full blockchain ecosystem.'

How to invest in blockchain technology?

'First, it is important to note that I use the terms 'crypto' and 'blockchain' interchangeably. They both refer to this new generation of internet protocols, where decentralized, neutral, frictionless, 24/7, and secure 'value capture and transfer' is possible. I call them 'Protocol Businesses', as they combine elements of a traditional business model with public internet infrastructure. Ethereum, for example, generates fees from users of the protocol for transferring value over the protocol or using applications built on top. Those fees accrue to its 'owners', the ETH token holders who are active participants who validate transactions on the network. Because it is on public internet infrastructure, anyone can use Ethereum and anyone

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can become an Ethereum validator, earning the Ethereum fees. As neutral, public infrastructure, these new protocol businesses are seemingly infinitely scalable. Over \$16 billion in fees have already been generated by Ethereum from its users, almost all in the last 3 years. In 2022 alone, users transferred \$ 7.8 trillion worth of 'stable coins', or 'dollars on the blockchain rails' over the Ethereum protocol, according to Tokenterminal. This technology can do much more. For example, UniSwap is a decentralized exchange built on top of Ethereum. It is pure code and executes trades autonomously. Yet, it has had months of higher trading volumes than Coinbase, a traditional business with thousands of employees. To transfer value or use applications like Uniswap, users pay so-called 'gas fees' to the Ethereum protocol. Today, this adds up to about 6% return per year for the owners/validators of the network, according to Ultrasound.money. Finally, it is interesting that if you use Ethereum, part of your fee is 'burned.' This is a process similar to stock buyback and gives the tokens a long-term natural updraft.'

What about risk versus reward for investments in this field?

'Let's first look at how important blockchain will become. As Larry Fink of BlackRock recently said, 'the next generation for securities, will be tokenization of securities.' Currently, it is mainly 'native assets' such as Ethereum's 'ETH' that are available on blockchain rails, and this is an important reason why investors are quick to dismiss the technology. But imagine if all our existing assets moved onto these rails, such as equities, bonds and carbon credits. Once the regulatory framework for this is in place, things may move quickly. It is a matter of when, not if, and stable coins are an early indicator of this. The infrastructure for this new backbone of our financial system is currently being built and we are in the front seat, partnering with the top crypto-native VCs. I am very excited about the future. Back to the risk-reward question, we very

much value high quality returns, meaning that we prefer having many unrelated investments contributing to the performance, rather than one or two big bets. What is unique about the opportunity in blockchain VC, is that we are not only seeing unusual upsides, but also an unusually high quality of returns. Of our 2018-2019 vintage of underlying projects, only 13% are valued below cost (on average at 0.46 times the investment), 9% are still at cost, but 78% are valued above cost and show average gains of 14.45x our investment. And this was measured during a crypto bear market. But do note: past performance is no indication of future returns.

While I'm sure that these numbers aren't sustainable going forward, I do believe the risk-reward remains uniquely attractive as long as traditional investors remain on the sidelines. Most of our family office investors have come around to this and are now allocating a single digit percentage of their assets to crypto VC.'

Why invest in blockchain technology now?

'Fundamentally, there is enormous progress at the technology level. Blockchain technology is ready to onboard hundreds of millions of users. That is why we recently organized a conference on this subject called Crypto's Broadband Moment¹. At the same time, sentiment towards crypto technology is at a low due to factors that are unrelated to the technology itself, such as the FTX and Celsius frauds. It is telling that none of the 40+ VCs we work with had exposure to these companies. This mismatch between fundamentals and perception is the perfect backdrop for long-term investors. In addition, you have two massive tailwinds: institutional investors being underexposed to the asset class and existing assets moving onto this new infrastructure. So yes, we expect the next cycle is going to be significant and this is the time to position yourself. ■

About Theta Capital Management

Theta Capital Management is a leading global investor in crypto-native VC funds, having deployed more than \$ 600 million in the strategy since 2018. The Theta Blockchain Ventures program offers investors broad exposure to the most promising blockchain technology companies and protocols from their earliest-stage, private rounds. Theta Capital Management was founded in 2001 and has over \$ 1.1 billion invested in alternative investment funds.



Ruud Smets

Managing Partner and CIO,
Theta Capital Management

SUMMARY

The next version of the internet is made up of blockchain protocols which natively transfer value. They allow for internet native 'protocol businesses' that are investable.

These protocol businesses resemble traditional business models with fee-paying users, but at the same time are public internet infrastructure, allowing them to achieve much larger scale.

Investing in early-stage protocol businesses is completely dominated by crypto-native VCs, a new cohort of venture capital firms.

Amsterdam based Theta Capital has partnered with leading crypto VCs to invest over \$ 600mln into protocol businesses.

While the technology is ready to onboard hundreds of millions of users, sentiment is at a low due to external factors such as FTX, keeping traditional investors sidelined and offering great opportunities for specialized, long term investors.