Crypto winter 2022: the season for M&A opportunities

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Crypto winter, downturn or bear markets. Whatever you call it, 2022 has been a difficult year for cryptocurrencies.

What you need to know about crypto winter

- The current "crypto winter" is reflective of the fluctuations attached to all high-growth industries.
- However, the increased connectivity within the crypto industry relative to 2018 and the broader macro environment have created unique challenges relative to past crypto winters.
- Mergers and acquisitions (M&A) in the digital asset space continues to boom and our team has the first hand experience to assist from start to finish.

This current crypto winter in the broader economic context

Recent trends have once again demonstrated that cryptocurrencies are not immune to the vicissitudes of high growth sectors. The boom of 2021 has been replaced with depressed valuations, increased leverage, liquidity issues and heightened scrutiny. However, it is important to examine how we arrived at the current market to understand how this current crypto winter fits into the broader economic context and where the crypto industry goes from here.

2020 and 2021 were historic years for cryptocurrencies and other digital assets. Crypto assets reached a historic high in November 2021 as the price of Bitcoin, a benchmark for the broader crypto industry, rose to just under US$69,000. At that time, the total capitalization of the entire crypto industry was estimated to be around US$3.2 trillion, compared to a total capitalization of less than US$1.0 trillion in 2019.

This massive price increase (Bitcoin rose more than 300 per cent in 2020 and another 60 per cent in 2021) was undoubtedly tied to low interest rates and large stimulus packages that accompanied the depths of the COVID-19 pandemic. Although Bitcoin has been envisaged as an inflation hedge, investors – both institutional and retail – sought out Bitcoin and other cryptocurrencies as a preferred risk asset.

Accordingly, when inflation fears soared in early 2022 and monetary policy tightened around the world, it was not shocking to see cryptocurrencies suffered the same fate as other high growth industries. On Wednesday, March 16, 2022, the U.S. Federal Reserve approved a 0.25 percentage point interest rate increase, which is the first time the Federal funds rate increased in three years, and the first change since the start of the COVID-19 pandemic. What has followed has been a series of hawkish shifts in global monetary policy and a degradation of crypto prices across the board.

This crypto winter is both new and old. It is old in the sense that prolonged periods of price declines have previously occurred. There have been as many as eight crypto winters in the past, each with different characteristics. The idiosyncrasies of the current crypto winter do cause unique concerns. Beyond the aforementioned macro concerns around rising interest rates, the maturation of the crypto industry since previous crypto winters has also lead to new issues to confront.

In 2017, the use of leverage in purchasing crypto assets was primarily driven by retail investors via derivatives on cryptocurrency exchanges, but when crypto prices declined in 2018, such positions were automatically liquidated on exchanges once margin calls were unmet. In contrast, since 2020, there has been a considerable build out of yield-based decentralized finance, whereby leverage is provided by retail depositors to crypto funds and lending institutions. This has created greater interconnectivity amongst retail and institutional investors and compounded the effects of a crypto price decline. A notable example of this newfound interconnectivity was the fall of cryptocurrency lending company Celsius Network LLC in July 2022.

However, despite the unique challenges of the current market, there remains considerable optimism around cryptocurrencies reaching new highs in the medium-long term and for the massive potential of digital assets moving forward. Accordingly, many industry stakeholders are using this time to survey the market for new opportunities afforded by the current environment.

Opportunities for M&A and consolidation

In 2021, M&A involving at least one company in the crypto sector almost tripled, from the 59 moves in 2020 to 180 in 2021, according to data by *Architect Partners*. In the first half of 2022, the record-breaking pace of crypto M&A deals in 2021 was exceeded, as 92 crypto M&A deals completed by June 2022.

This most recent uptick is largely attributable to the crypto market's downturn as many smaller companies simply do not have the financial resources to survive the prolonged price decline. Companies who raised significant capital prior to the downturn, such as cryptocurrency exchange FTX, have actively sought acquisitions, recently evidenced by FTX's purchase of crypto lender BlockFi for a maximum price of US$240 million, in addition to providing a US$400 million revolving line of credit. We have seen similar activity on the Canadian front. Most recently, Coinsquare Ltd. announced that it will acquire Simply Digital Technologies Inc., a subsidiary of CoinSmart Financial Inc.

However, recent market conditions have also complicated the completion of previously announced acquisitions. On August 15, 2022, Galaxy Digital Holdings Ltd. (Galaxy Digital) announced the exercise of its right to terminate its US$1.2 billion acquisition of crypto custodian BitGo. The acquisition agreement was originally announced in May 2021 and extended on March 31, 2022. As part of the extension, BitGo received a promise of enhanced share consideration and a reverse termination fee of US$100 million should the transaction not be completed by December 31, 2022, subject to specific provisions. Galaxy Digital is claiming that no termination fee is payable in connection with the termination whilst BitGo claims the opposite. On September 13, 2022, BitGo filed a complaint in Delaware Chancery Court. The complaint was made available to the public on September 15, 2022. The lawsuit seeks more than US$100 million in damages from Galaxy Digital.

Although a legal determination has not yet been announced, the current economic backdrop interest and Galaxy Digital's pursuit of a NASDAQ listing are likely significant factors in the ultimate failure of this acquisition. As the crypto industry's first prospective US$1 billion acquisition, all digital asset stakeholders are monitoring how this litigation unfolds.

Moving forward we expect to see continued growth in M&A in the crypto space in remainder of 2022, with the possibility for strategic M&A from firms with limited crypto ties and acquisitions across the crypto food chain (exchanges, miners, *etc*.).

How we can help you

BLG's M&A Building Blocks tool is an insightful resource for all crypto industry stakeholders seeking to negotiate and complete an M&A deal. Further, BLG's Digital Assets Group continues to be actively involved in the digital asset space, with first hand experience assisting with mergers and acquisitions involving digital assets and distributed ledger technology.

In approaching any crypto-related M&A, our clients rely on our built-in knowledge and practical expertise when considering, structuring, and completing the transaction. We appreciate the nuanced representations, carve-outs, covenants, valuations, and termination provisions that accompany M&A in the digital asset space and are ready to assist your company in identifying and capitalizing on the opportunities presented by the current crypto winter.

By

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Expertise

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