
Q&A with CoinFund's David Pakman – Blockchain and Web3: A Decentralized Future



The following article is based on an edited conversation between CoinFund Managing Partner David Pakman and Adams Street's Brijesh Jeevarathnam, Partner & Co-Head of Global Venture Fund Investments, Primary Investments, which took place at the Adams Street US Investor Conference in Chicago on June 7, 2022.

KEY TAKEAWAYS

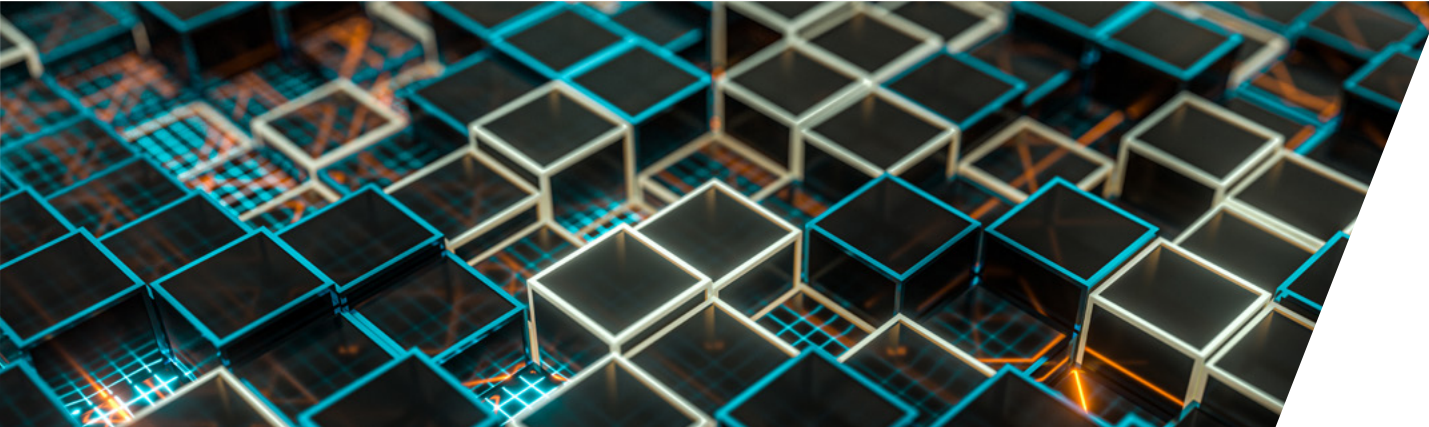
- Blockchain has the potential to transfer power from large, centralized Internet companies to a new generation of distributed, decentralized owners.
- More software developers are focusing on Web3 and blockchain technologies.
- The outlook for government regulation is increasingly positive, creating a potential benefit for the development of blockchain and crypto technologies and removing a barrier to investment.
- The market for NFT collectibles was \$15-\$22 billion in 2021, with average revenue per user of \$100-\$700, while peer-to-peer lending against digital assets, or DeFi, exceeds \$100 billion.
- The number of people with crypto wallets more than doubled in 2021 from the prior year to almost 100 million, while about 9 million people have purchased an NFT.

DAVID PAKMAN BIOGRAPHY

David started and ran the music group at Apple Inc., where he worked for seven years. After spending 15 years raising venture capital for three companies that he founded, he joined Venrock, where he spent 13 years mostly investing in early-stage consumer and enterprise companies. He led Venrock's investment in CoinFund in 2018, and in 2021 joined CoinFund, which has seed, venture and liquid funds that only invest in crypto-native businesses.

Brijesh Jeevarathnam: Thanks for joining us, David. So you're a classic technologist. Why did you leave that and join this crazy thing called blockchain?

David Pakman (DP): I've been in tech for about 30 years and the longer I have been in it, the more I appreciate that there are architectural innovation cycles that can last about 15 years. There was the birth of the personal computer in the mid-1980s; then about 10-12 years later came the commercial Internet with Web1; and then, around 2008, we had the migration to cloud, mobile and social.



And here we are about 15 years later talking about blockchain. I think the data make it clear that we're in the midst of another architectural transition, away from giant, centralized data brokers such as Facebook and Google, to a decentralized Internet with ownership and blockchain at its root.

When I see those waves coming, I think the way to really look smart is by getting on the surfboard to ride them.

Q: So why should institutional investors look at allocating to blockchain?

DP: The single best-performing investible asset in the past 11 years is Bitcoin,¹ with a Compound Annual Growth Rate of about 200%.² So I don't think a professional investor is doing their capital a good service if they ignore that. That's my first observation.

My second observation is that it's a big innovation. Capitalism and governments are built on ledgers, a record-keeping system of contracts or equity. For example, our citizenship is canonically indicated in a database, our right to travel in our passport number.

But it's expensive to maintain because it requires humans to prove that the ledgers are accurate. The innovation is to take cryptographic protection and a novel mechanism for distributed consensus and merge it with a database, so that there is no longer a need for a human to make sure that what's written in the ledger is trustworthy and accurate.

That is maybe one of the biggest innovations anyone's ever seen, because it affects all governments around the world and the notion of companies and organizations.

Another reason people should pay attention is because many software developers are focusing on Web3, and the future of technology is always driven by what software developers are doing.

Why? Because Web3 is permissionless. Anyone can launch an app on a blockchain, and no centralized entity can tell that person to stop, no one can turn off the API. It's early, but I think people have to pay attention to that if they are a tech investor.

Q: Tell me about a real-world application, about a company that solved a pain point using blockchain.

DP: The best real world use case today is Non-Fungible Tokens, or NFTs – gaming and collectibles. Thirty to 40% of humans collect things, but everything we collect has been physical because, historically, digital assets were not scarce, anyone could create a copy.

But blockchains allow us to ensure that there's a limited number of a digital asset, so they can be scarce. Then we can prove in a ledger who owns them. And that's an NFT, a property right for a piece of digital creation.



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That unlocks digital collecting, which is really big. Sports NFT collectibles emerged last year and the total NFT market was \$15-22 billion,³ compared with \$50 billion⁴ for the global art market. Even for those that don't understand this trend yet, that is what is actually happening.

So I'm most excited about unlocking the potential for digital creativity to be sold directly to customers. I'm talking everything from fonts and software, to music, books, videos, images, computer-generated art, etc. And I don't have to sell that many to make a living if they sell for a couple hundred dollars.

A lot of other people are more excited about creating a more efficient mechanism for loaning against assets. Digital assets are worth about \$1 trillion⁵ today. When people have a valuable, liquid asset that they think is going to rise in value, they tend to borrow against it. But there's not a bank on the planet that will loan against someone's Ethereum, Bitcoin or NFTs. So the crypto world invented DeFi, where people lend peer-to-peer against those digital assets. That's an industry of over \$100 billion.⁶ So there's a lot of opportunity to streamline, enhance and grow the financial services business.



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Q: Why isn't this going to go away in three or six months? Why do you think this will be a sustainable trend?

DP: The ARPU [Average Revenue per User] of NFT collectors ranges between \$100 and \$700,⁷ which is one of the highest consumer product ARPUs in the mass market. And engagement is very high, so consumers really like this stuff, so I don't think it's going to go away.

It's not a fad, however, pricing will probably change.

CoinFund's seed and venture platforms invest in equity and tokens. We mostly invest in companies and get equity, just like a venture manager does, but we also get an option, or a warrant, or some right, for tokens in the future. Not all crypto companies issue tokens, but when they do, they can have nice asymmetric return profiles, so we think it's important to own both.

But how does one value the token? One answer is, more than 18,000⁸ different tokens trade on liquid markets today, so we observe market trading and do some fundamental analysis. And there are things like using DCF [Discounted Cash Flow] because some networks generate fees and we can see the fee base. They don't all trade on a multiple of their fee base yet, but it is possible to start ascribing value that way. Some tokens don't have that fee base or liquid trading markets, which makes the job of valuing them harder.

This is why we [at CoinFund] think it's nice to have a hedge fund under the same umbrella. We have a liquid fund that only trades liquid tokens, and that trading helps inform us about how the market values tokens. There's rationality – not just sentiment – behind our views and our process.

Q: Let's stay on the risk side and talk about regulation. How do you see regulation? Friend or foe, and how should we think about it?

DP: In 2017 and 2018 it felt like governments may try to shut all crypto down. I think we're well past that now. In fact, I might argue that the pendulum has swung so that, in this country, we're seeing evidence of bipartisan support, as both Democrats and Republicans seem to be interested in the innovation behind crypto.

A lot of money is probably waiting for some regulatory clarity about: (i) what is a security and what's not; (ii) who can issue stablecoins and who can't; (iii) who is a reputable custodian; and (iv) are there insurance products? I think we're on the cusp of it.

I don't think retail investors need the protection that a lot of people think they need. Most of the big transitions we've seen in industry in the last 30 years were consumer led, not industry led, and I think crypto has largely been a consumer-led innovation.

So there should be rules – people shouldn't be able to prey on others – but I don't think we need to say an investor is required to have \$1 million or \$5 million of assets before they're allowed to buy crypto.



Q: You're very bullish on the space, but what about your views could be wrong?

DP: I think about this a lot. I think it's highly likely that we are directionally correct in the long term. We're evidence-based investors, and the evidence shows both significant developer adoption of these technologies and significant consumer adoption, even if numbers are still small on a relative basis versus adoption of the Internet. There are 5 billion people on the Internet,⁹ compared to approximately 100 million people with crypto wallets,¹⁰ while approximately 9 million people have bought an NFT. But that's up more than 100% since last year,¹¹ so I think we're heading towards a more blockchain-based, crypto-denominated world.

But what is the timing of that transition? That I don't know. So to the extent we're wrong, I think we could be betting too early and things could take a lot longer to grow.

If we're right that the future of the Internet is decentralized, it's possible that it is a \$30 or \$40 trillion market. I certainly wouldn't want to miss that.

Q: Some people aren't fully convinced yet as investors, but they almost see it as irresponsible not to have some allocation in the space. What do you think about some investors approaching this as I need to have some modest allocation to blockchain in case things work out, even though I'm skeptical?

DP: Most of us are wrong about the future. We're just bad at predicting the future, so we hedge against being wrong by putting some probabilities on the future and then allocating on a weighted-probability basis.

So people should think about the chance that the future of the Internet is going to be decentralized. Is there a 1% chance? Well, crypto's already a \$1 trillion industry.¹² It's been as high as \$3 trillion, and that's with very limited adoption. So, if we're right that the future of the Internet is decentralized, it's possible that it is a \$30 or \$40 trillion market. I certainly wouldn't want to miss that.

So people shouldn't put 50% of their alternatives or venture allocation to it, but other than Coinbase, Bitcoin and Ethereum, everything in crypto is less than five years old, so it's all venture risk right now. Venture's usually pretty good about trying to spread their investments across a landscape of different sectors by trying to pick the best entrepreneurs who are really onto something.

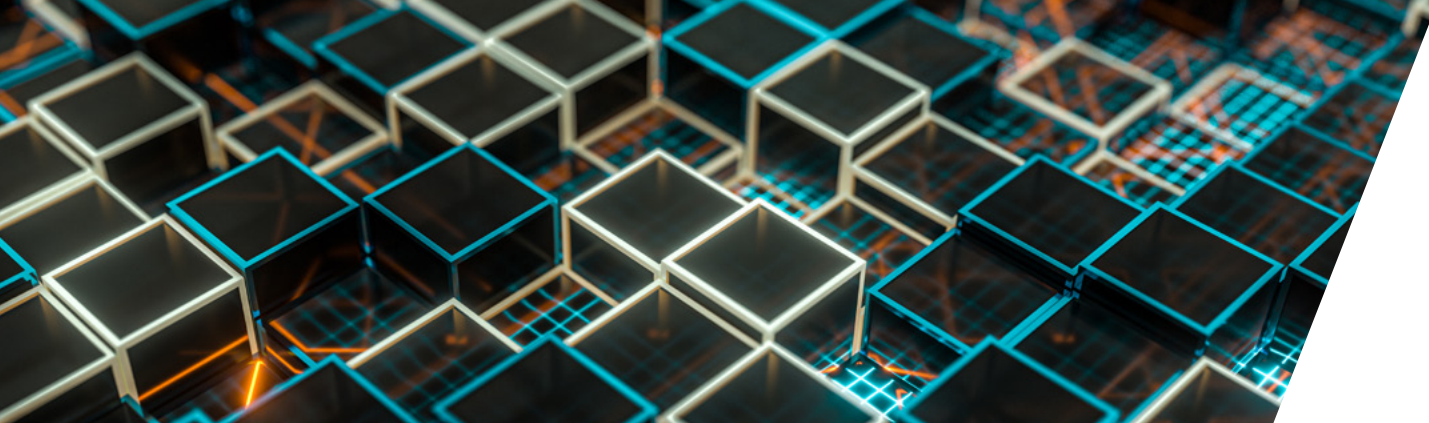
So I think there's a credible point of view that institutional investors should consider having at least some money allocated to this sector. The question is how to play it.

Q: Well, let's go from the why to the how. There are the big public tokens, or investing in early venture capital in the blockchain space. Which way do you go?

DP: I think it's "and" not "or." I think everyone should own some Ethereum and Bitcoin. Ethereum might be the Amazon Web Services of the next 20 years. Ethereum already generates more than \$10 billion in fees a year¹³ and is about a \$200 billion market cap,¹⁴ which is small compared to AWS. So if Ethereum becomes the next AWS, it could be a multi-trillion dollar asset. So I believe many investors should own some Ethereum and some Bitcoin, but then everything else – as we talked about – is venture risk.

So investors have to assess how to pick managers and where along the venture curve to invest. We like seed-stage investments because it's a large number of bets across a small amount of dollars per bet, so we can bet on 40 or 50 companies per fund with \$500,000 to \$1 million check sizes and we may not lose a lot when it goes wrong, but when we get it right, we have the potential to generate significant returns.

We also invest in Series A, early-stage venture, where opportunities can be right before the knee in the S-curve. There's some evidence of product market fit, and right after the investment, there is potential to have the steepest part of the value creation curve. ■



1. Source: [Bitcoin: The Best Performing Asset of the Decade?](#)
2. Source: [Bitcoin's compound annual growth is 'an unheard-of' 200% CAGR](#)
3. Sources: [Grand View Research, Non-Fungible Token Market Size](#); [Market Decipher: NFT Market Size Statistics and Forecast Report, 2022-2031](#)
4. Source: [The Art Basel and UBS Global Art Market Report](#)
5. Source: [CoinMarketCap.com as of June 7, 2022](#)
6. Source: [Consensys, DeFi Market Commentary, February 2022](#)
7. Source: [Cryptoslam NFT Global Sales Volume Index](#)
8. Source: [SoFi, Understanding the Different Types of Cryptocurrency](#)
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11. Source: [Security.org, NFT Awareness and Adoption Report](#)
12. Source: [CoinMarketCap.com as of June 7, 2022](#)
13. Source: [Tokenterminal.com as of June 7, 2022](#)
14. Source: [Tokenterminal.com as of June 7, 2022](#)



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