The Boatman Capital Research

Argo Blockchain: Who Benefits From Texas Deal?

Ticker: ARB.L
Date: 9 August 2021
Price: 131p
Market Capitalisation: £500m

We believe that Argo Blockchain purchased land in Texas seemingly for up to 100 times more than the acreage is worth, raising serious governance questions about why this deal was done and who benefited. We are particularly concerned that nine of the beneficiaries from this deal appear to be Argo shareholders.

We are also concerned that an apparently unreported multi-million dollar legal dispute between Argo and Celsius Network could threaten future bitcoin mining capacity and revenue. Argo leases about 40% of its mining fleet from Celsius.

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Executive Summary

Argo Blockchain, the London-listed bitcoin miner, recently bought a plot of land in Texas to build a mining facility. We believe that the purchase price may have been up to 100 times more than the land is worth, raising serious governance questions about why this deal was done and who benefited from it.

We are particularly concerned that nine of the beneficiaries appear to be Argo shareholders, based on SEC filings. The Board of Argo Blockchain needs to confirm who the beneficiaries of the Texas deal were so shareholders can have peace of mind that their company did not massively overpay for an empty plot of land, potentially to benefit a small group of influential investors.

We are also concerned that an apparently unreported legal dispute between Argo and Celsius Network, a large player in the crypto sector, could present a threat to bitcoin mining capacity (and therefore future revenue). Celsius has alleged “neglect” and “breach of good faith and fair dealing” by Argo, while Argo is seeking “millions of dollars” in damages for breach of contract. Argo leases about 40% of its mining fleet from Celsius. With such a large portion of Argo’s revenue tied to this souring relationship, we are surprised the company does not appear to have mentioned the litigation to investors or advised on its possible impact.

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In February 2021, Argo said it had reached agreement with DPN LLC to buy 320 acres of land in Texas for $5 million in shares initially, rising to $17.5 million. The company repeatedly told investors in RNS statements, the annual report and in comments by CEO Peter Wall that the asset acquired was 320 acres. In June, Argo admitted it was actually half that amount: 160 acres with, apparently, an option to buy a further 160 acres. It seems that for three months, Argo investors may have been misled over the scale of the Texas acquisition.

Argo also said that the DPN acquisition came with a “pre-negotiated” $100 million debt facility. This facility has failed to materialise and Argo has instead raised capital from shareholders and debt to pay for the Texas mining operation. Giving investors false information is considered market abuse by regulators and both the “320 acres” and “$100 million debt facility” may have been misleading. We also question whether Argo may have been padding out the benefits of the DPN transaction in order to justify the price.

According to a formal valuation by a certified real estate appraiser in Texas, the land acquired by Argo is worth $168,000 – not the $5 million rising to $17.5 million that Argo has agreed to pay. The $168,000 valuation is corroborated by local tax records and recent property sales in the area. Argo has disclosed no other asset or benefit it has gained from the DPN transaction, leading us to believe that the company is paying up to a 100x premium for the land.

According to company records, the seller, DPN LLC is registered in Delaware and its place of business is a virtual office service company in Austin, Texas. It has no website, no physical location and no obvious track record. Based on our interpretation of an SEC filing submitted by Argo in March 2021, it appears that nine of DPN's owners are also shareholders of Argo.

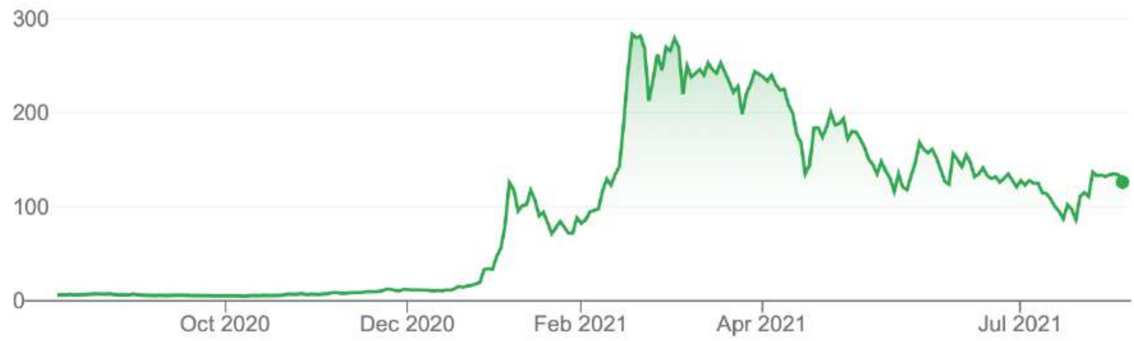
The fact that Argo shareholders profited from the DPN deal represents a potential conflict of interest and/or related-party transaction that a more transparent company might have wanted to disclose to investors at the time of the deal. And this transaction raises other, more troubling questions, such as:

- Were these shareholders in a position to influence decisions regarding the DPN purchase, such as the massively inflated price paid?
- Was the high price paid for DPN a means of funnelling shareholder funds to influential insiders and shareholders?

Introduction

Argo Blockchain mines bitcoin, which involves using computers to perform complex calculations that verify the blockchain. For performing this task, Argo earns bitcoin. This activity requires a large number of powerful computers and large amounts of electricity to power them. We have serious doubts about the viability of bitcoin mining as a business – but that's a story for another day.

Argo Blockchain joined the main board of the London Stock Exchange in 2018 and, for most of the period since, its stock price has bumped along at a few pence per share. When bitcoin prices took off earlier this year, so did the Argo share price. The company's stock hit 282p in February but has since dropped back to about 130p, valuing it at roughly £500 million. We think £500 million is an exceptionally high valuation for a company that has consistently made operating losses and has generated only £35.5 million of revenue so far this year.



When Argo was created, one of its early shareholders was Frank Timis, the infamous (real world) mining investor[1]. He was never a director of Argo. Timis was convicted twice for heroin possession in his youth and was later censured by regulators for misleading investors at Regal Petroleum. His African Minerals venture collapsed in 2015[2].

As of 23 February 2021, Timis's First Investments Holding was Argo's largest shareholder with 13.99%, according to the company's website. One month later, Argo no longer listed First Investments as a significant shareholder[3]. During that period Argo completed the Texas land deal outlined in this report and announced a £26.8 million capital raising – perhaps Timis saw something he didn't like?

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[1] https://www.ft.com/content/68beb09a-77f8-11e9-be7d-6d846537acab
[2] https://www.thisismoney.co.uk/money/markets/article-6943149/City-bad-boy-Frank-Timis-returns-stage-crypto-cash-coup.html
[3] https://argoblockchain.com/investors/#Reports_and_Shareholder_documents_section

Investors Misled Over Land Deal?

Argo Blockchain announced on 10 February 2021 that it had signed a letter of intent with "DPN LLC of New York" to acquire 320 acres of land in West Texas. The acquisition would allow Argo to build a new 200mW mining facility in Dickens County, where it could access "electricity at some of the lowest rates in the world".

The deal was concluded on 8 March 2021, with Argo acquiring DPN LLC via a US-based subsidiary. The price paid was $5 million in shares with a further $12.5 million in shares payable if certain contractual milestones were met.

A search of the Dickens County land registry[4] reveals that DPN owns plot 3394 (and presumably also 3395, which appears to be part of the larger square block.)

Source: Dickens County

Argo said that it bought this particular plot of land because there is an electricity substation on a neighbouring property, which would give the company access to up to 800mW of electrical power. The substation can be seen in Google satellite images of the land around plot 3394.

[4] https://maps.pandai.com/dickenscad/?find=3394

Source: Google Earth

As previously mentioned, Argo told its investors (repeatedly) that it had bought 320 acres in Dickens County. It made this claim in various RNS disclosures, in its annual report and in CEO interviews. For example:

> ARB), is pleased to announce it has entered into a non-binding Letter of Intent (LOI) with DPN LLC of New York, setting out the terms for Argo to acquire 320 acres of land in West Texas, USA, with access of up to 800-megawatts of
>
> Source: Argo RNS and Press Release, 10 February 2021

> Argo Blockchain, a global leader in cryptocurrency mining (LSE: ARB), is pleased to provide a further update to its previously announced non-binding Letter of Intent with DPN LLC of New York, which set out the terms for Argo to acquire 320 acres of land in West Texas, USA.
>
> Source: Argo RNS and Press Release, 8 March 2021

> In March 2021 Argo acquired a hosting facility project with 320 acres of land in West Texas with access to 800MW of low cost clean energy power for a total consideration of US$17.5m. The Group intends on building out a 200MW
>
> Source: 2020 Report and Accounts, 29 April 2021

> Peter Wall, CEO: *"We got a piece of land there, 320 acres. We acquired a company that has been planning out a facility there for the last few years."*
>
> Source: Proactive Interview[5]

[5] https://www.youtube.com/watch?v=v_aiVf8H7aw

But Argo had actually bought 160 acres of land, as is clear from the Dickens County land registry. Argo did not give the correct acreage until the AGM presentation on 24 June 2021 – more than three months after the deal was completed.

> and our hosted facilities in Canada and the United States represent a combined 36 MW of power. In addition, we recently acquired 160 acres of land in western Texas with access to up to 800 MW of power where we are

Source: Argo AGM statement, 24 June 2021

At a post-AGM investor presentation on YouTube, the chief executive Peter Wall was asked about the difference. He said:

"Yeah, um, so there's some confusion about that. The initial RNS remarks stated 320 acres. There is 320 acres of land there. We have 160 acres with an option for another 160. So that's the differentiation there. So the legal folks have said we should say 160 because that's what we have purchased and can't include the option."

We understand that the option Wall mentions may cover block 3393 to the south of Argo's land, although we have not seen any evidence of the option or of an intention to sell by the owners. Either way, Argo stated numerous times in its communications with shareholders that it had bought twice as much land as it in fact had. For at least three months, it appears that Argo's investors may have been misled about the scale of the DPN acquisition.

Investors Misled Over Financing?

In the original announcement of the Texas land deal, Argo said that through its purchase of DPN LLC it would "gain access to a pre-negotiated $100 million credit facility"[6]. This debt facility would be used to build the Texas mining operation and expand Argo's mining fleet. The language in the announcement is clear and certainly gives the impression that the "pre-negotiated" facility was a done deal.

In early March, Argo raised £26.8 million via a capital raising and CEO Peter Wall[7] said that some of the funds would be used to develop the operations in Texas. There was no sign of the DPN "pre-negotiated" financing and Wall made it clear that this option was uncertain:

"We spoke in the past about a debt facility, we are still working that through. As everyone knows these things take time and that kind of money does not appear overnight. So in the meantime we need working capital to start building out Texas."

On 29 June 2021, Argo announced that it had secured a £14 million ($20 million) loan from Galaxy Digital underwritten with the company's bitcoins. The loan would be used, in conjunction with the capital raised previously, to build the Texas mining operation. The $100 million debt facility that had been part of the DPN deal was nowhere to be seen and has not been mentioned since.

The original announcement of the Texas deal appears, therefore, to have included misleading statements about the amount of land being purchased (320 acres vs 160 acres) and also access to a pre-negotiated $100 million credit facility. Perhaps these were honest mistakes, although that does not absolve Argo from its duty to avoid publishing accurate statements for investors – a form of market abuse[8]. Or investors may feel that the benefits of the DPN transaction were overstated to justify the price.

[6] Argo RNS 10 February 2021: https://polaris.brighterir.com/public/argo_blockchain/news/rns/story/xzm04lw
[7] https://www.youtube.com/watch?v=Gs_fUGmbSmY
[8] https://uk.practicallaw.thomsonreuters.com/6-101-7488?transitionType=Default&contextData=(sc.Default)&firstPage=true

Argo Pays What!

Argo Blockchain has paid $5 million (rising to $17.5 million) to acquire 160 acres of land in Dicken County where it is building a new bitcoin mining operation. As the image below shows, there isn't much on the land that Argo now owns. It is described as "native pasture" but "empty scrub" might be a better definition.

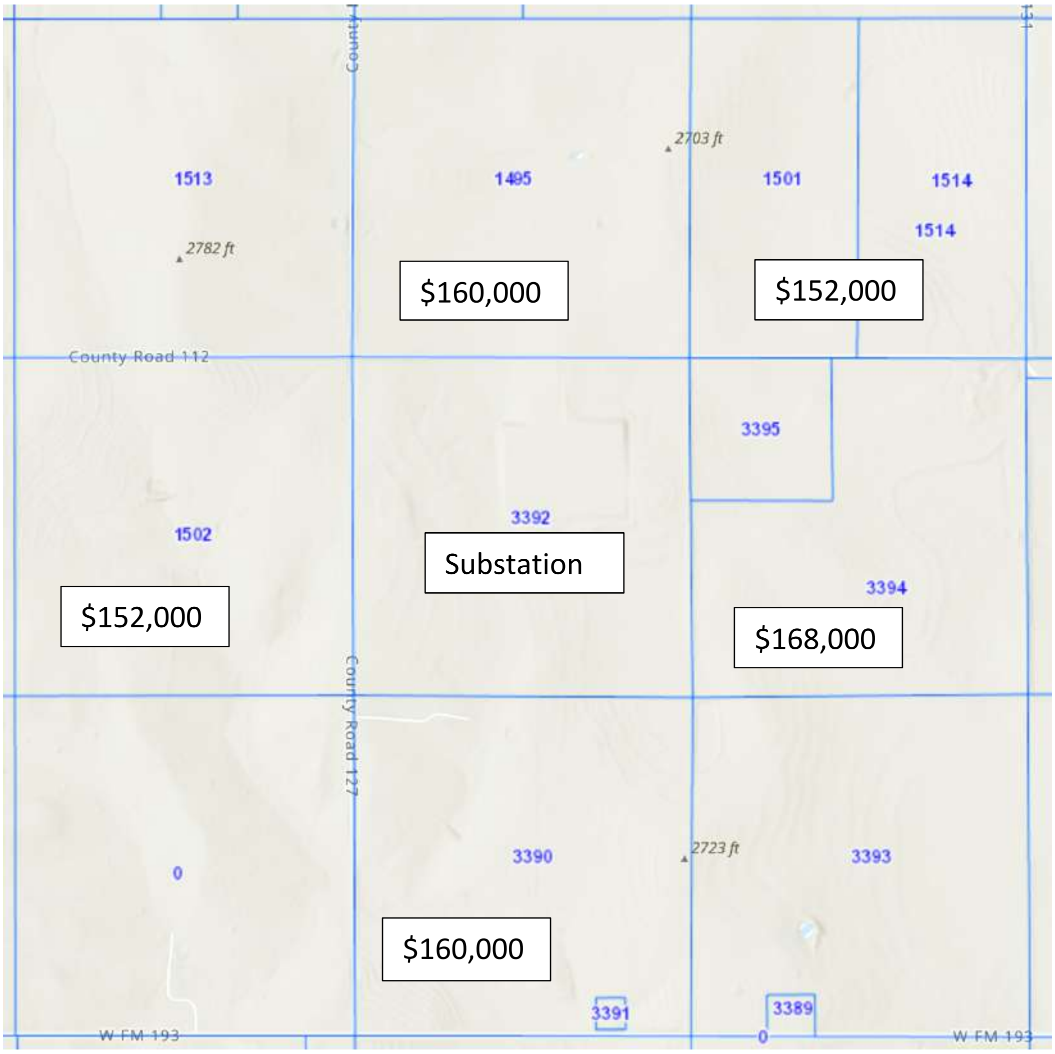
Block 3394, Dickens County

So, is $17.5 million for scrub land in West Texas a reasonable price to pay? In order to determine what the land might be worth the services of a Lubbock-based real estate broker were engaged to give a formal appraisal of Argo's block 3394 and other land parcels nearby. [The appraiser was certified by the Texas Appraiser Licensing and Certification Board. Each property appraisal was approximately 40 pages long and included detailed analysis of land use, land condition and local price comparisons.]

The formal appraisal for Argo's land gives a valuation of **$168,000**. That is just 1% of the total amount that Argo has agreed to pay and 3% of the initial $5 million. Or put another way, Argo has paid a premium of 30x to 100x for some dirt in Texas.

We asked the experts whether access to the substation might increase the value of the land and were told that it would have little to no impact on the price. According to the appraisals, there are also no land use restrictions so no need to pay a premium for permits. And the land does not even come with subsurface rights so there's no chance of striking oil in the future if bitcoin mining doesn't pay off.

The map below shows the valuation from our appraisals of the blocks of land around Argo's proposed facility:



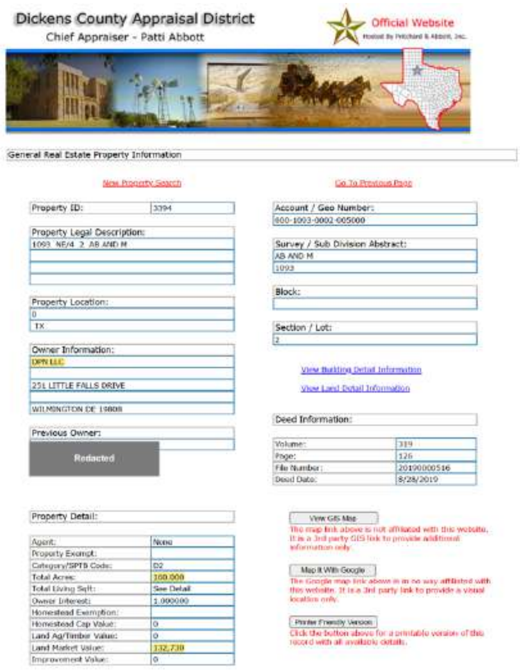
The appraisals for land blocks around the substation range from $152,000 to $168,000. Or $950 to $1050 per acre. These valuations are comparable to the sale prices of other properties that have exchanged in the neighbourhood recently:

Sale	Size	$/Acre
2	79.1	$1,275
6	80.0	$1,000
7	80.0	$1,000
1	108.1	$1,470
8	160.0	$700
9	160.0	$1,200
10	160.0	$1,050
Subject	160.0	-----
3	166.2	$1,250
5	168.7	$1,100
4	334.9	$1,050

Source: Appraiser's Report[9]

[9] The land with higher per acre prices typically come with residential properties on them. Argo's land has no property.

Our appraisal of Argo's land is also comparable to the Dickens County tax assessment, which gives the land a value of $132,730. (Tax appraisals are typically lower than actual land value but this is useful corroboration that the taxman does not think Argo's land is worth $5 million - 17.5 million.)



Source: Dicken County

So why has Argo paid $5 million, rising to $17.5 million, for property valued at roughly $168,000? There is nothing significantly special about the land itself – there is almost nothing there. Other substations exist in Texas and even other parcels of land around the Dicken County substation that could have been bought instead of block 3394 for a fraction of the price. Given the other errors relating to this deal, we question whether investors were misled about the true value of this land. If so, this raises troubling questions about why they were misled and who could be benefiting from the seemingly wildly overvalued purchase of this land.

Who is DPN?

According to the Dicken County land registry, plot 3394 was sold to DPN LLC on 28 August 2019 for an undisclosed sum. We tried to establish what DPN paid for the land but the elderly couple who sold the plot have apparently signed an NDA forbidding them from discussing the deal, which seems unusually secretive for a patch of land with nothing on it.

We initially looked for DPN in New York because Argo repeatedly referred to its new partner as "DPN LLC of New York" but the company has no registered footprint there. Rather, DPN is registered in Delaware and was established on 8 July 2019 – less than two months before the purchase of the Texas land.

Delaware corporate documents show a merger agreement between Argo Innovation Facilities (US) Inc. and DPN LLC dated 4 March 2021. The place of business for DPN is given as 2028 East Ben White Blvd. Suite 240, Austin, Texas. This is the location of Scan Mailboxes, a virtual office service company.

State of Delaware
Secretary of State
Division of Corporations
Delivered 10:28 AM 03/05/2021
FILED 10:28 AM 03/05/2021
SR 20210809617 - File Number 5265322

State of Delaware
Certificate of Merger of
Domestic Limited Liability Company into
Domestic Corporation

Pursuant to Title 8, Section 264 of the Delaware General Corporation Law (the "DGCL") and Title 6, Section 18-209 of the Delaware Limited Liability Company Act ("LLC Act"), the undersigned corporation executed the following Certificate of Merger.

FIRST: The name of the surviving corporation is Argo Innovation Facilities (US), Inc. ("Surviving Corporation") and the name of the limited liability company being merged into this surviving corporation is DPN LLC ("Merging LLC").

SECOND: The Agreement and Plan of Merger has been approved, adopted, certified, executed, and acknowledged by the Surviving Corporation and the Merging Corporation.

THIRD: The name of the Surviving corporation is Argo Innovation Facilities (US), Inc. a Delaware corporation.

FOURTH: The Certificate of Incorporation of the Surviving Corporation, as in effect immediately prior to the merger, shall be the Certificate of Incorporation of the Surviving Corporation.

FIFTH: The merger is to become effective on March 4, 2021.

SIXTH: The Agreement and Plan of Merger is on file at 2028 East Ben White Boulevard, Suite 240, Austin, Texas 78741-9631, the place of business of the surviving corporation.

SEVENTH: A copy of the Agreement and Plan of Merger will be furnished by the Surviving Corporation on request, without cost, to any member of Merging LLC or any stockholder of Surviving Corporation.

IN WITNESS WHEREOF, the Surviving Corporation has caused this certificate to be signed by an authorized officer, the 4th day of March, 2021

ARGO INNOVATION FACILITIES (US), INC.

By:

Name: Peter Wall
Title: President

Given that DPN was established just a couple of months before the Texas land was purchased and that the company has no physical location, website or obvious track record, we assume it was a special purpose vehicle set up specifically for the land deal. As previously mentioned, Argo initially claimed that its purchase of DPN also brought with it $100 million in pre-negotiated financing but this has not materialised. We therefore assume that the only asset of value within DPN was the 160 acres of land.

Who Benefits?

About a week after Argo bought DPN, the company filed a form D with the SEC to confirm the issuance of $5 million in shares as part of a merger transaction. The transaction is described by Argo as a "forward triangular merger involving issuer's US subsidiary". While DPN is not mentioned in the filing, it seems reasonable to assume that the SEC document relates to the DPN deal given that the timing, sum of money involved and details of a merger all match what was publicly announced.

The SEC form[10] asks for the "total number of investors who already have invested in the offering". This is clarified in the SEC notes for form D to mean[11]: "specify the total number of investors who already have invested." According to the filing, nine DPN beneficiaries had already invested. It seems logical to conclude, therefore, that nine owners of DPN[12] were already shareholders in Argo when this deal was done. Of those, three are not considered accredited investors.

14. Investors

[X] Select if securities in the offering have been or may be sold to persons who do not qualify as accredited investors, and enter the number of such non-accredited investors who already have invested in the offering. 3

Regardless of whether securities in the offering have been or may be sold to persons who do not qualify as accredited investors, enter the total number of investors who already have invested in the offering: 9

Source: SEC Edgar

Five days later, on 17 March 2021, Argo filed another form D with the SEC[13]. This shows that Argo paid a further $1 million in shares to an individual who appears to already be an investor in the bitcoin miner. It is not clear from the form whether this transaction was related to the DPN acquisition but the timing suggests it might be.

Given that Argo Blockchain agreed to buy the Texas land seemingly for 100 times more than it is currently worth, we think it is reasonable to ask who benefited from this transaction? This question becomes particularly significant given that nine DPN beneficiaries appear to be Argo shareholders.

[10]https://www.sec.gov/Archives/edgar/data/0001841675/000184167521000002/xslFormDX01/primary_doc.xml
[11] https://www.sec.gov/about/forms/formd.pdf
[12] Details of DPN's shareholders are not publicly available.
[13]https://www.sec.gov/Archives/edgar/data/0001841675/000184167521000003/xslFormDX01/primary_doc.xml

The fact that Argo shareholders may have profited from the DPN deal represents a potential conflict of interest and/or related-party transaction that a more transparent company might have wanted to disclose to investors at the time of the deal. And this transaction raises other, more troubling questions, such as:

- Were these shareholders in a position to influence decisions regarding the DPN purchase, such as the massively inflated price paid?
- Was the high price paid for DPN a means of funnelling shareholder funds to influential insiders and shareholders?

We assume that the Board of Argo Blockchain knows who the beneficiaries of the DPN deal were. After all, a key part of any due diligence process is to ask about the owners of a business you are buying. The Board should, therefore, be able to confirm who the beneficiaries were so shareholders can have peace of mind that their company did not massively overpay for an empty plot of Texas land, potentially to benefit a small group of influential investors.

Argo vs Celsius

Argo Blockchain has a policy of "HODL", which is crypto-speak for holding onto the bitcoin it mines. For true believers, this is the sensible thing to do as the price will inevitably rise in the future. However, this policy means that Argo's options for generating cash are limited so it has developed other options.

The company can raise debt using its bitcoin stash as collateral (as it did with Galaxy Digital) and it can raise money in the market by issuing new shares, although based on media commentary some shareholders are getting irritated at being repeatedly diluted[14].

Argo has also explored leasing, signing an agreement in November 2020 with Celsius Network to finance the purchase of 4,500 mining rigs[15]. The 24-month leasing deal with Celsius, one of the largest players in the crypto sector, allowed Argo to add 430 petahash of computation power to its fleet. Given that Argo currently has about 1075 petahash of total computational power, the Celsius deal represents approximately 40% of Argo's mining fleet[16].

At the same time the Celsius lease agreement was announced, Argo also said that it had agreed to manage an unnamed partner's fleet of 4,378 new bitcoin miners. As part of the servicing agreement Argo would receive a monthly fee for managing its partner's mining fleet, theoretically giving the company much-needed cash income.

Unfortunately, it appears that the deal has collapsed and lawsuits have been filed. As a result of the litigation, we know that Argo's partner was Celsius – the same company that is financing the lease on 40% of Argo's fleet. According to a lawsuit[17] filed by Argo Innovation Labs Inc. against Celsius on 20 April 2021, the company is seeking payment of an invoice for $85,132.17 as well as damages of "several million dollars".

Argo says it sent Celsius an invoice for February services on 11 March 2021 but its partner did not pay. Instead, Celsius "unilaterally instructed" the hosting company to move its rigs to another mining pool, making it "impossible for Argo to provide the services and to calculate the fees due".

Celsius's response to the Argo claim provides more detail. Celsius said it acquired new rigs and then leased about half to Argo while retaining the rest under a management contract with its partner. As the rigs began to arrive, Celsius alleges that Argo deployed all of the first 1,058 machines for its own benefit when at least 350 should have been mining for Celsius.

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[14] https://www.shareprophets.com/views/56057/explosive-argo-blockchain-why-did-it-hide-bad-news-allowing-director-share-dumping-and-27m-share-placing
[15] https://polaris.brighterir.com/public/argo_blockchain/news/rns/story/x2n4e7x
[16] https://www.businesswire.com/news/home/20210429005540/en/Argo-Blockchain-Plc-"Argo"-or-"the-Group"-2020-Full-Year-Results
[17] US District Court, District of New Jersey Case No 2:21-cv-09791

Celsius also alleges that when the Celsius rigs arrived in January 2021, it took until 27 February to complete the installation – a delay of one month. When further machines arrived in February these sat "idle" without being installed or activated for a week. Celsius claims that these delays cost it about $750,000. Celsius also claims that Argo moved the rigs from a mining pool that charged no fees into one that did – so Celsius moved them back.

The Celsius response states: "The conduct of Argo, and specifically the misappropriation of all mining rigs for Argo's benefit, constitutes a breach of the duty of good faith and fair dealing inherent in all contracts, as the result of which Celsius has been damaged." The company is seeking damages from Argo.

If Celsius's claims are true, it should be a concern to Argo shareholders as it implies their company may have been both incompetent and self-serving in the execution of this partnership. But regardless of the merits of the case, the breakdown in relations with Celsius after just two months does not reflect well on Argo's ability to act as a service provider for partners. Nor does it bode well for Argo's ability to generate cash from future service agreements and, if that cashflow opportunity is lost, the company may need to go back to raising cash from capital raisings – diluting existing shareholders further.

As previously mentioned, a large proportion of Argo's mining fleet is leased from Celsius. We are therefore concerned that the litigation and apparent breakdown in relations between Argo and Celsius could be a threat to current and future leasing agreements. With roughly 40% of Argo's revenue tied to this souring relationship, we are surprised the company does not appear to have mentioned the litigation to investors or advised on its possible impact.

--Ends--