The Boatman Capital Research

Argo Blockchain: Why Investors Should Be Concerned

Ticker: ARB.L
Date: 6 December 2021
Price: 123p
Market Capitalisation: £575m

We think that investors wanting exposure to bitcoin can find better opportunities than Argo Blockchain elsewhere. Divesting from Argo into other assets would have the added benefit of avoiding a company that appears to have displayed serious governance failures and has significantly diluted investor shareholdings over the past year.

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Executive Summary

In August, the Boatman Capital published a report on Argo Blockchain (ARB/ARBK) that raised concerns over the company's purchase of a plot of land in Texas. The deal is worth up to $17.5 million – about 100x more than the value of the land. Since our first report, other issues have come to light that raise further questions about Argo's business strategy and its governance standards:

- Argo has diluted shareholders by 52% so far this year with further dilution likely given potential capex requirements of $1.5-2 billion for the Texas project.
- Argo issued a junk bond at eye-watering interest rates and still only managed to attract about two-thirds of the target amount, perhaps reflecting concern in the bond market over the company's viability. Argo also has a bitcoin-backed loan charging an interest rate of 11.5%.
- Argo has published inaccurate and misleading statements about its Texas acquisition. We believe this may constitute market abuse under Financial Conduct Authority rules.
- Argo is paying up to $17.5 million for land in Texas valued at approximately $168,000. The company claims the deal came with other benefits but the sale agreement shows none. We also understand that environmental and land use permits are not required, despite work on these areas being cited as benefits of the deal. We remain sceptical that the premium paid by Argo is justifiable. And we question whether Argo's management is prudently spending shareholders' money.
- On the subject of prudent use of money: Argo has parked $5 million of cash with a supplier while, at the same time, claiming it needs to raise money from shareholders and take on expensive debt obligations.
- Argo also wrote off a $1 million investment in GPUone Holdings after the Canadian company ceased trading earlier this year.
- Argo's management accidentally disclosed potentially inside information to a fund manager, who then shared it on Twitter. This would appear to be a negligent act by Argo's management.
- Argo has seen four of its five board directors quit this year, including the chairman and a director who managed only three months on the job. This brings total director turnover during the past 24 months to seven.
- Peter Wall is currently CEO and interim chairman, in breach of UK corporate governance guidelines.

Better Opportunities Elsewhere?

Some fans of Argo Blockchain (the "Argonauts") appear more interested in exposure to bitcoin than the company's governance issues. But investors hoping to hold Argo as a proxy for bitcoin may be disappointed.

Company	Bitcoin[1]	Bitcoin value US$[2]	Market Cap US$ 24/11/21	Bitcoin value/Market Cap
Microstrategy	114,042	647,0822,180	7,250,000,000	0.89
Marathon Digital	7,453	422,888,389	5,290,000,000	0.08
Hut 8	4,729	268,326,740	2,083,870,000	0.13
Galaxy Digital	16,400	930,547,575	3,360,000,000	0.28
Bitcoin Group	3,947	233,955,518	261,353,000	0.86
Riot Blockchain	3,995	266,679,071	4,180,000,000	0.05
Argo Blockchain	2,196[3]	120,585,285[4]	842,300,000	0.14

The table above shows ratios of estimated bitcoin treasuries to market capitalisation. The higher the ratio, the more the market value is correlated to bitcoin held by a company.

For the bitcoin miners, the correlation is weak. Just 14% of Argo's market value is attributed to its bitcoin holdings – or put another way, 86% of the company's value is based on its mining capability. We think the market is significantly over-valuing Argo's mining operations. These operations are likely to generate approximately £70 million of revenue this year on a market value of £650 million – a multiple in line with Netflix's. Argo Blockchain is no Netflix.

We think that investors wanting exposure to bitcoin can find better opportunities elsewhere – and divesting into other crypto assets would have the added benefit of avoiding a company that appears to have displayed serious governance failures and has significantly diluted investor shareholdings.

[1] https://www.buybitcoinworldwide.com/treasuries/
[2] https://www.buybitcoinworldwide.com/treasuries/
[3] Based on holding at end of Oct 2021.
[4] Based on bitcoin price on 24/11/21

Should Investors Be Concerned About Argo Blockchain?

1. **Dilution**

At the start of this year Argo had 307,905,000 shares in issue and the number now stands at 468,082,335. Argo shareholders have therefore been diluted by 52% so far this year – their share of the company has been halved, in other words.

Add roughly a further 7.7 million shares to cover the additional $12.5 million pledged for the DPN acquisition and dilution will be over 54%. Unlike bitcoin, there is apparently no fixed supply of Argo shares.

Thanks to the accidental release of potentially inside information by Argo executives (see below), we know that it could cost between $1.5 billion and $2 billion for the company's Texas mining facility to reach its stated ambition of 800MW[5]. It therefore seems inevitable that shareholders will face more dilution in the future as Argo's capex demands continue to outpace its ability to generate profits.

2. **Debt**

Perhaps realising that diluting shareholders by more than 50% in a year might be unpopular, Argo decided to raise debt via a 5-year bond in November. The B-rated bond carries an interest rate of 8.75%, placing it firmly in "junk" territory. But even with an interest rate substantially above normal corporate offerings, demand appears to have been muted and it raised $40 million versus the $57.5 million target, according to SEC filings[6]. The bond market has given its verdict on Argo Blockchain and it does not look good: even with a high interest rate as enticement, Argo could only raise two-thirds of its target amount.

Separately, Argo has raised debt in the form of a bitcoin-backed loan from Galaxy Digital. Argo initially borrowed $20 million from Galaxy and then extended the loan by $25 million (£18.05m) on 9 September 2021.[7] The loan period was just 50 days and was collateralised against 1,504 bitcoin, approximately 90% of Argo's entire holdings at the time[8].

The loan appears to have been a bridge to prevent Argo running out of cash before its Nasdaq listing at the end of September. $25 million of the loan has since been repaid from the IPO proceeds with the remaining $20 million rolled over until October 2022 with an interest rate

[5] https://polaris.brighterir.com/public/argo_blockchain/news/rns/story/xq7k3kw
[6] https://www.sec.gov/Archives/edgar/data/0001841675/000110465921135341/tm2130707-4_f1.htm#tPRSH
[7] https://polaris.brighterir.com/public/argo_blockchain/news/rns/story/wv144vw
[8] https://www.sec.gov/Archives/edgar/data/1841675/000110465921114734/tm2115473d14_ex10-10.htm

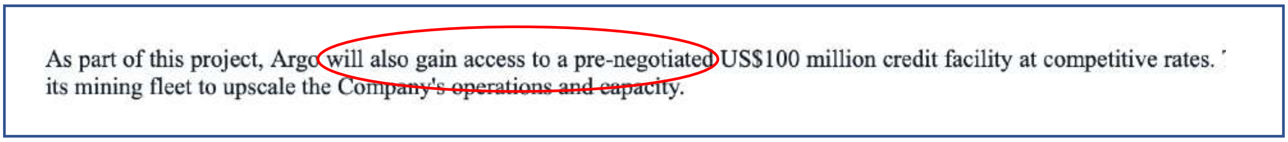
of 11.5%[9], which is more like a credit card rate than a corporate loan rate. Argo said that it could not confirm how much bitcoin was being used as collateral for this loan as the terms are confidential.

Debt interest of 11.5% for the bitcoin-backed loan and 8.75% for the bond means that borrowing is a very costly option for Argo. It seems inevitable, therefore, that future expenditures will need to be funded by shareholders, who will face yet more dilution.

3. Publishing Misleading Information

When Argo announced its plan to acquire a plot of land in Texas via an entity called DPN LLC, the company told investors that it was getting 320 acres. It had actually only acquired 160 acres plus an option to acquire a further 160 acres, a fact that was not reported until several months later.

Argo also told investors that the deal came with a "pre-negotiated US$100 credit facility", which would be used to fund construction of the Texas facility. However, the sales agreement between Argo and DPN[10] makes it clear that this facility had not been secured. In other words, there was no pre-negotiated credit facility and it never materialised.


As part of this project, Argo will also gain access to a pre-negotiated US$100 million credit facility at competitive rates. '
its mining fleet to upscale the Company's operations and capacity.

Argo has said that the debt was "always an optional part of the deal" and it felt there were better options available. This raises a question as to why the credit facility was presented as an agreed part of the deal when it was not. And what were Argo's better options given that it described the $100 million facility as being at "competitive rates". Later in the year, Argo raised debt via a bond at a rate of 8.75% and a loan at 11.5%, neither of which could be described as particularly competitive.

Both the reporting oversights detailed above may have given the impression that the DPN transaction was delivering more benefits than it actually did. Knowingly giving shareholders false information is considered market abuse by UK regulators[11].

4. Texas

As mentioned above, Argo acquired a company called DPN for up to $17.5 million in March. DPN owned a plot of land in Texas and that is now being used to build Argo's bitcoin mining

[9] https://www.sec.gov/Archives/edgar/data/0001841675/000110465921135341/tm2130707-4_f1.htm#tDOOI
[10] https://www.sec.gov/Archives/edgar/data/1841675/000110465921107653/tm2115473d12_ex10-5.htm
[11] https://www.handbook.fca.org.uk/handbook/MAR/1/8.html?date=2016-03-21

facility. In our first report, we pointed out that the Texas land was valued at just $168,000. We questioned why Argo's management was willing to pay a premium of nearly 100x for DPN and its land. Peter Wall addressed some of our concerns in a YouTube video[12]. He said:

"It wasn't just a land acquisition, it was a project acquisition… I'm going to lay out some of the legwork that was done by the DPN team. There was a load study that was done. There was early stage of an interconnection agreement. There was geotech and surveying work that was done. There was municipal and environmental planning that was done. There was substation and engineering design that was done and site and engineering that was also done. It was a shovel ready project that allowed us to skip 12-18 months of legwork."

Since our initial publication, the sale agreement between Argo and DPN[13] has become available. The sale document clearly states that DPN's only asset was its acreage in Texas and makes no reference to other work performed by the company or other assets.

> **Section 3.06 No Operations.** Since July 8, 2019, the Company has not had any business operations or material assets other than the Helios Site.

The sale document also states that there are no operational or environmental permits required. Our land appraisal also states there are no zoning or land use restrictions on the property. Peter Wall cited "municipal and environmental planning" as among the benefits of the DPN deal but we assume this cannot have amounted to much work.

> (b) The Company is not required to obtain or maintain any Permits to hold its assets.
>
> (b) No Environmental Permits are necessary for the Company's ownership, operation or use of the assets prior to the date hereof.
>
> Source: SEC

DPN may well have done preparation work at the Texas site but we are sceptical that the value of that work was sufficient to justify Argo paying up to $17.5 million for land worth $168,000. The enormous premium paid for this land makes us question whether Argo's management is prudently spending shareholders' money.

5. Investment in Pluto

[12] https://www.youtube.com/watch?v=ebIrLYQwHgg
[13] https://www.sec.gov/Archives/edgar/data/1841675/000110465921107653/tm2115473d12_ex10-5.htm

Argo has invested £8,362,500 of shareholder funds in Pluto Digital, a crypto technology company that raised about $40 million earlier this year. Peter Wall is currently "Starfleet Chairman of Advisory Excellencer"[14] at Pluto (whatever that means).

Wall said earlier this year that Pluto was "rocketing to its IPO on the London Aquis Exchange, with a target of late May for its admission"[15]. That IPO still hasn't happened. Wall has since gone quiet on the subject and during a post-AGM Q&A session on YouTube[16] said he could not speak for Pluto, despite his role as Starfleet Chairman.

Argo initially trumpeted the Pluto deal but has since said little about it, leaving us to wonder what investors have to show for their money.

6. ePIC Fail

Argo signed an $8 million deal to buy mining rigs from ePIC Blockchain Technologies in February 2021. Argo subsequently said that ePIC's technology was too "limited" and the parties amended the agreement[17]. Argo's $5 million deposit was left with ePIC to be applied to the future purchase of ePIC machines, or to be transferred into ePIC common stock or repaid.

This seems like an odd deal and has resulted in Argo shareholders subsidising ePIC via what is, in effect, an interest-free loan of $5 million. If ePIC's technology wasn't good enough to buy, why would Argo want to be given ePIC stock? And why leave cash with ePIC on the hope that its technology might one day be worth having?

While ePIC sits on Argo's $5 million in cash, Argo is borrowing money at rates of 8.75% and 11.5% a year. Surely the cash would be better off in Argo's bank account until ePIC can demonstrate that its equipment has improved. This arrangement seems like a good deal for ePIC and a poor one for Argo. Again, we question whether management is making prudent use of shareholder funds.

7. GPUone Fails

On 29 November 2020, Argo converted a loan note with GPUone Holdings (valued at C$2.3 million) into Class A shares. GPUone was the operator of several crypto mining facilities in Canada and, in February 2021, Argo agreed to buy two facilities in Quebec. The price paid was C$8.26 million, which came from existing deposits with GPUone, and $368,870 in cash.

[14] https://plutodigital.com/team/
[15] https://www.theblockcrypto.com/news+/122698/the-argo-blockchain-mafia-is-pushing-crypto-onto-londons-public-markets
[16] https://www.youtube.com/watch?v=yWCXktQ--0c
[17] https://polaris.brighterir.com/public/argo_blockchain/news/rns/story/wkln4yx

GPUone then sold its remaining New Brunswick facility a few weeks later to crypto miner. GPUone ceased trading and Argo reported a loss on investment in its third quarter results of \$1.01 million (\$750,000)[18] from the Class A shares it held. This appears to have been another unsuccessful investment by Argo.

8. Release of Inside Information

On 4 November 2021, Argo Blockchain released a statement[19] stating that executives had potentially passed material non-public information to a fund manager, who then shared this information on Twitter. This embarrassing episode suggests that Argo's management may not understand basic corporate governance requirements.

9. Boardroom Churn and Lack of Oversight

On 8 November 2021, Argo announced that Colleen Sullivan would step down as a board director after just three months with the company. Argo said she was moving to a new professional opportunity that did not allow her to sit on its board.

Sullivan is the fourth board member (of five) to leave the company so far this year, exceeding the three who resigned last year. That's a total of seven departures in less than 24 months.

Sullivan's departure follows chairman Ian MacLeod and directors James Savage and Marco D'Attanasio, who left in July. MacLeod had managed 18 months on the board; Savage 16 months; and D'Attanasio just 12 months. Argo did not specifically say why the directors were leaving but Peter Wall thanked them for their contributions, which had been "pivotal in establishing Argo thus far".

But we question whether Argo's directors can provide oversight and represent shareholder interests if they are sticking around for such short periods of time?

With the departure of MacLeod in July, Peter Wall has become interim chairman. No replacement has yet been announced leaving Wall to run the company as chairman and CEO, in breach of UK corporate governance guidelines[20].

One of Peter Wall's first acts as interim chairman was to recommend to investors a new executive incentive plan[21]. One of the main beneficiaries of the plan would likely have been

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[18] https://polaris.brighterir.com/public/argo_blockchain/news/rns/story/xj340kw
[19] https://polaris.brighterir.com/public/argo_blockchain/news/rns/story/xq7k3kw
[20] https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf
[21] https://argoblockchain.com/wp-content/uploads/2021/08/Argo_Notice_of_GM.pdf

the chief executive - Peter Wall. Two-thirds of investors voted the incentive plan proposal down at a general meeting[22].

Given the litany of problems outlined above, we believe it is essential for Argo to bring in a strong chairman and directors who will stick around for more than a few months.

Ends.

[22] https://polaris.brighterir.com/public/argo_blockchain/news/rns/story/xj3701w