BINANCE RESEARCH

Low Float & High FDV: How Did We Get Here?

MAY 2024

Table of Contents

1 Key Takeaways

- The prevalence of tokens with high valuations and low initial circulating supply has been a topic of discussion among the crypto community in recent months. This stems from concerns that such a market structure leaves little sustainable upside for traders after the token generation event ("TGE").

- Data from CoinMarketCap and Token Unlocks confirm the growing trend of tokens launching with low circulating supply and high valuations. Notably, it is estimated that approximately US$155B worth of tokens will be unlocked from 2024 to 2030. Without a corresponding increase in buy-side demand and capital flows, the substantial amount of tokens coming onto the market poses selling pressure.

- Factors such as an influx of private market capital, aggressive valuations, and upbeat market sentiment have contributed to the trend of tokens launching with high fully diluted valuations ("FDVs").

- The current market set-up makes it important for investors to be selective and discerning by considering fundamental aspects of a project, such as tokenomics, valuation, and product. Project teams may also need to consider the long-term implications of decisions made relating to tokenomics design.

- VCs continue to play an important role in our industry and can work together with project teams to ensure equitable supply distributions and reasonable valuations.

2 Market Observations

The prevalence of tokens with high valuations and low initial circulating supply has been a topic of discussion among the crypto community in recent months. This stems from concerns that such a market structure leaves little sustainable upside for traders when the TGE happens.

This concern is not unfounded. **It has become increasingly common for tokens to launch with a low circulating supply and allocating a significant portion for future release.** Under bullish market conditions, these tokens can experience rapid price appreciation due to limited liquidity available for trading at launch. However, it is apparent that this kind of price growth is unsustainable when a wave of token supply hits the market upon unlocking.

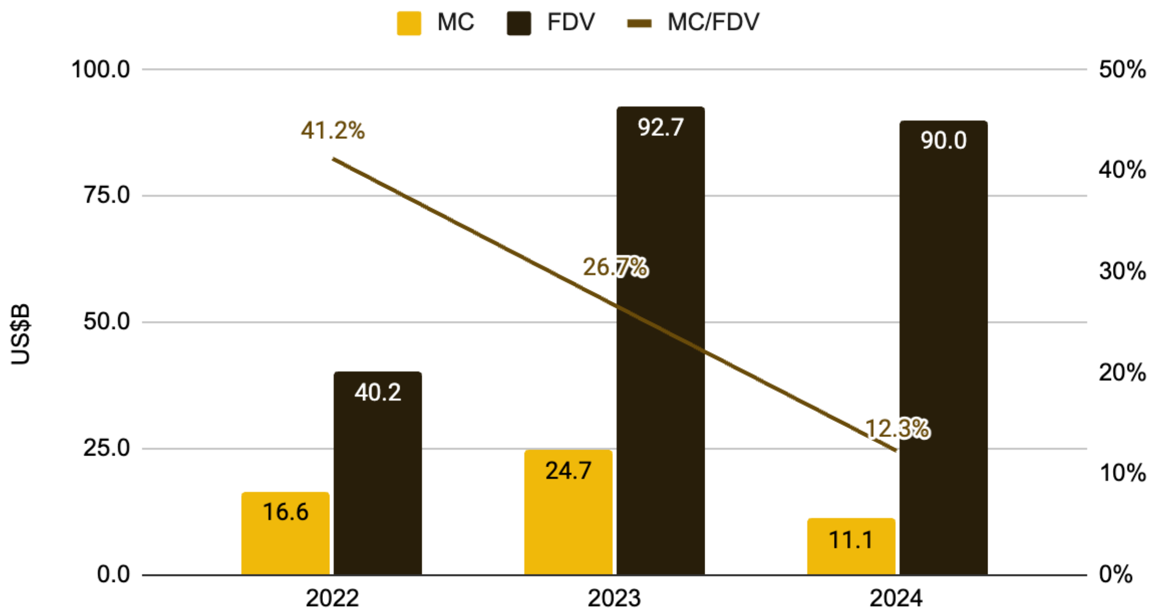
Moreover, attention is being drawn to **newly launched tokens whose FDVs are comparable to established layer-1 or DeFi tokens** that have stood the test of time and with proven user traction. Overall, market participants are now acknowledging the impact of tokens characterized by low floats and high FDVs.

In this report, we explore this market trend in more detail. We begin by detailing our observations of the increasing prevalence of tokens launching with high FDVs and discuss the potential market impacts and implications. We then analyze the root causes of this trend, particularly how activities in the private market may be contributing factors. Finally, we propose several considerations to identify and mitigate the negative consequences of this trend, focusing on suggestions tailored to investors and project teams.

2.1 Low Float, High FDV

There is an observable trend that tokens launched in recent times have done so at lofty valuations, and with low circulating supplies. This is especially evident when we compare the tokens launched in the past few years - the market capitalization ("MC") to FDV ratio of tokens launched in 2024 is the lowest. This suggests that a significant value of tokens will be unlocked in the future.

Figure 1: MC/FDV of tokens launched in 2024 is the lowest in the past three years



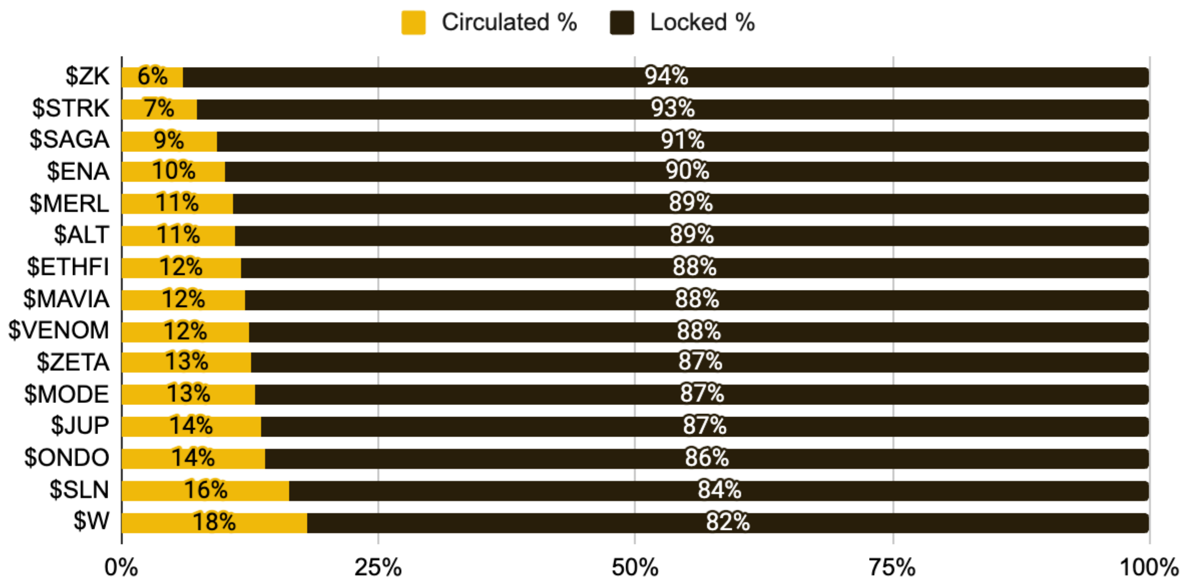
Source: Twitter (@thedefivillain), CoinMarketCap, Binance Research, as of April 14, 2024

Figure 1 presents the **market caps and FDVs for tokens launched in the past three years, highlighting a growing disparity between these metrics over time.** Notably, although we are only a couple of months into 2024, the FDVs of tokens launched in these initial months are already nearing the total for 2023, underscoring the prevalence of tokens with high valuations.

With a MC/FDV of 12.3%, the tokens launched in 2024 will have a significant amount of tokens that will come into circulation in the future. It also means that for these tokens to maintain their current prices over the next couple of years, approximately US$80B in demand-side liquidity would need to flow into these tokens to match the increase in supply. Notwithstanding changes in market cycles, this is likely not an easy feat.

Examining some of the recent token launches reveals the underlying cause of the substantial FDV figure seen in 2024. Figure 2 showcases several tokens which have launched in recent months, with the corresponding percentage of circulating and locked supply. With circulating supplies as low as 6% and none exceeding 20%, the root cause of the trend becomes evident.

Figure 2: Recently launched tokens have low circulating supplies

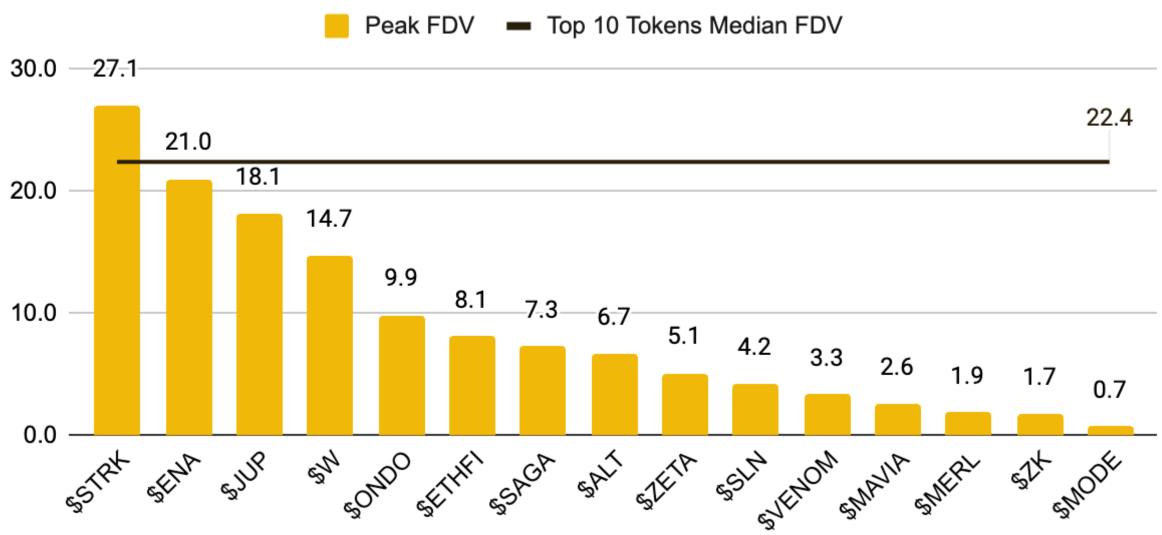


Source: CoinMarketCap, Binance Research, as of May 14, 2024

For the same amount of demand, low circulating supplies contribute to higher initial token prices given scarce liquidity, thereby driving higher FDVs.

A comparison of the peak FDVs of the same set of tokens against the median FDV of the top ten tokens in the market (excluding BTC, ETH, and stablecoins) gives a sense of the relative valuation of recently listed tokens. At their peaks, some tokens have had similar valuations to those of the largest tokens in the market, which have been around for years.

Figure 3: At their peaks, some recently launched tokens have had valuations similar to those of the largest tokens in the market



Source: CoinMarketCap, Binance Research, as of May 14, 2024

That said, it is worth noting that FDVs by themselves do not paint a complete picture and are less meaningful than FDV ratios (e.g., FDV/Total Value Locked, FDV/Revenue, etc.) which take into account operating metrics.

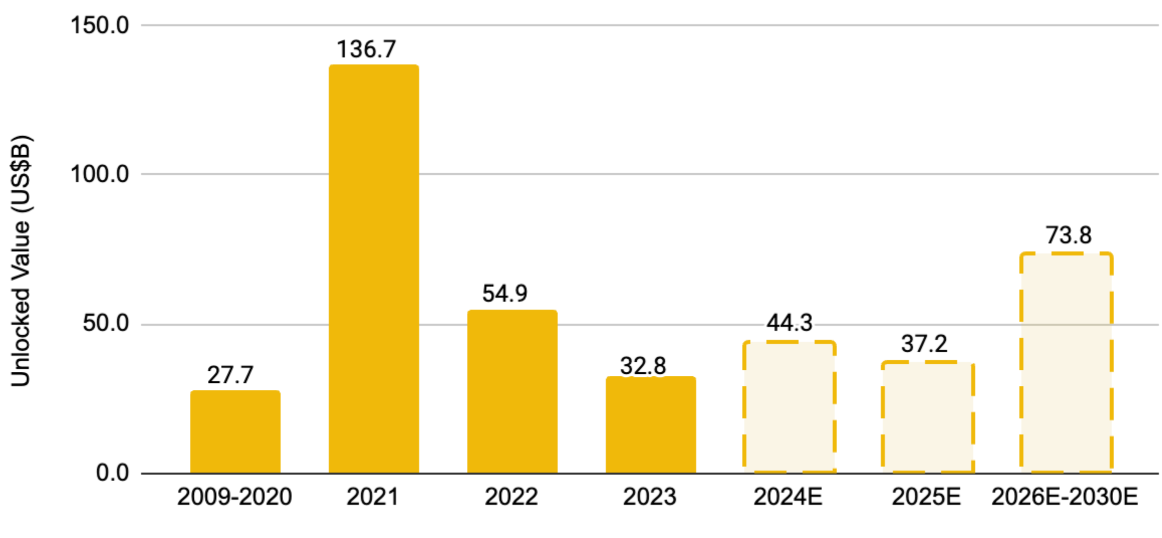
Over the past few months, numerous projects have launched their tokens, many featuring low floats and high FDVs. Due to the large number of such projects, we have selected only a few for demonstration. **Please note that this is solely to illustrate the prevalence of low float and high FDV tokens and does not reflect a negative assessment of the selected projects' value or potential, as there are many other factors at play.**

2.2 Market Impact and Implications

Launching tokens with a low circulating supply has influenced market dynamics, particularly by increasing selling pressures. According to a report by Token Unlocks, it is **estimated that roughly US$155B worth of tokens will be unlocked from 2024 to 2030**.[1] Although this figure is an estimate, the implication is clear - a significant amount of token supply is expected to be released in the coming years, and without a corresponding inflow of capital, many will be under significant selling pressure.

In light of this, understanding token unlock schedules and tracking them is essential for investors to prevent being caught off guard when a token undergoes a significant unlock.

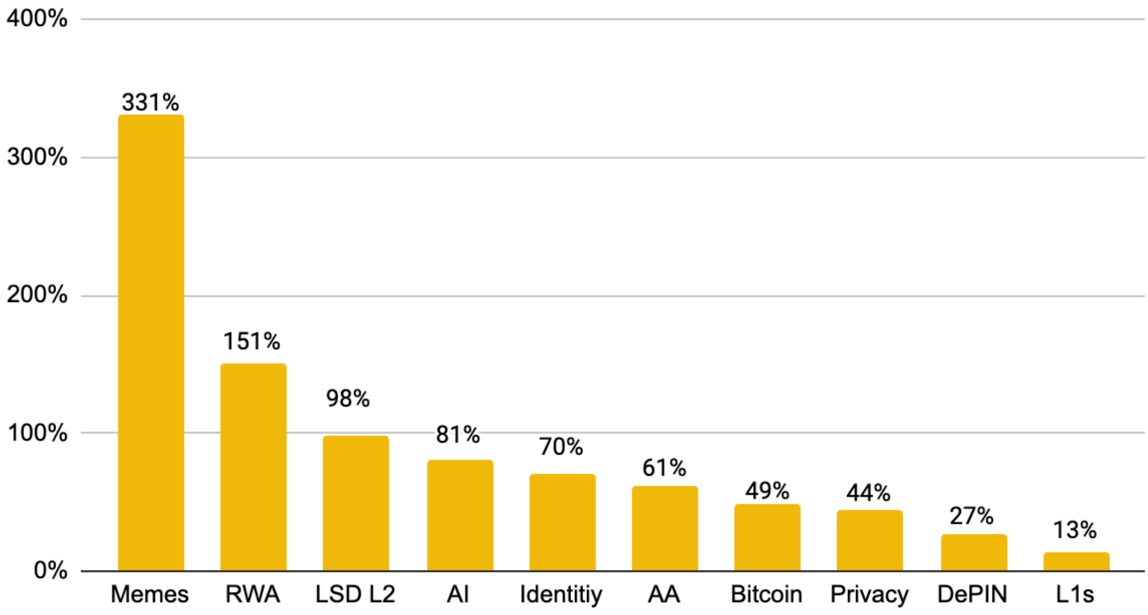
Figure 4: A total of US$155B will be unlocked in the next few years



Source: Token Unlocks, Binance Research, as of May 14, 2024

A related observation is the outperformance of meme coins year-to-date. Apart from notable mindshare and strong speculative demand, their token supply structures have also arguably contributed to the rally this year.

Figure 5: Meme coins have emerged as the best performing narrative year-to-date



Source: Dune Analytics (@cryptokoryo_research), as of May 14, 2024

Most meme coins have all their tokens unlocked and circulating at the TGE, which eliminates selling pressure from future dilutions. Many have MC/FDV ratios of 1 at launch, indicating that holders will not suffer from further dilutions due to token emissions. This structure has played a partial role in the appeal of meme coins, especially as awareness of the implications of significant token unlocks increases. Although the success of meme coins should not be exclusively attributed to a disdain for tokens with low floats, it is **apparent that retail investors have shown significant interest in meme coins**, even if the tokens may lack utility.

In a manner reminiscent of the well-known "GameStop short squeeze" event in the stock market, many retail investors perceive meme coins as a means to counter the institutional advantages gained from participation in private rounds. This is because meme coins are typically launched in a way that is accessible to anyone, with little opportunity for institutional participants to acquire tokens at a low cost ahead of time. Consequently, meme coins have emerged as a significant narrative in the current market, consistently drawing attention with their large trading volumes and strong price movements.

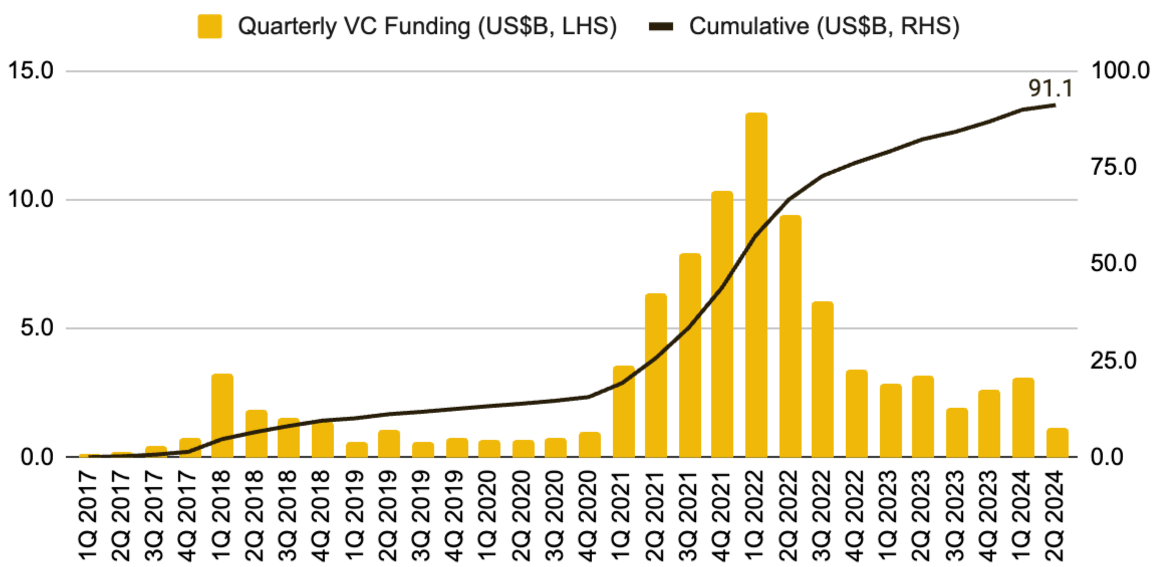
3 How Did We Get Here?

High valuations, coupled with constant selling pressure from token unlocks, are structurally negative for token prices. Yet as observed in the previous section, such a scenario has become more common in recent years. A few factors have contributed to this.

3.1 Influx of Private Market Capital

Venture capital ("VC") funds have increasingly solidified their position as pivotal players in the crypto investing landscape. Notwithstanding natural fluctuations in capital invested due to market cycles, the inflow of VC capital into the crypto sphere has been on a steady ascent. Total VC funding in crypto projects since 2017 has surpassed US$91B, a testament to the rising prominence of VCs in providing projects with necessary funding.

Figure 6: Cumulative VC funding since 2017 has surpassed US$91B



Source: The Block, Binance Research, as of May 13, 2024.

However, the marked increase in investment has also resulted in a corresponding rise in the influence of VC funds in terms of shaping crypto market valuations. As more funds flow into the space and as VCs participate in more deals, they inherently drive up valuations.

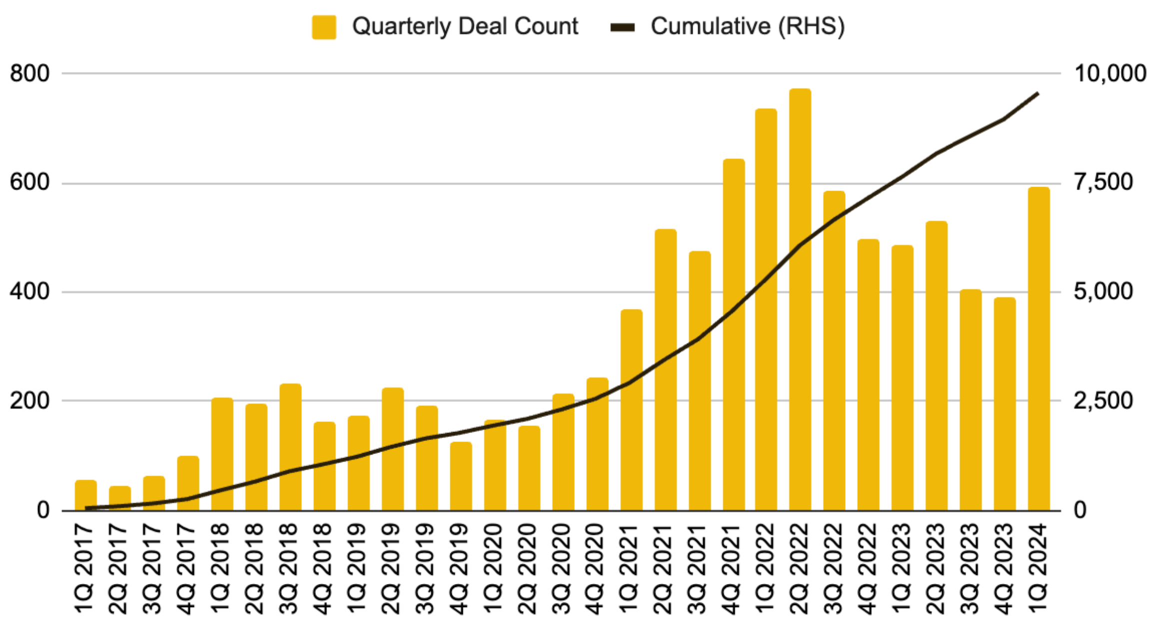
As a result, by the time tokens are launched in the public market, they would have already been bidded up in price and valuation. Effectively, **massive private market raises lead to multi-billion dollar valuations at launch**, making it more challenging for public market investors to profit from future growth.

3.2 Aggressive Valuations

The strong market performance this year has fuelled market sentiment and driven more aggressive deal making activity. This has resulted in some investors becoming increasingly willing to write cheques at higher valuations.

Considering that multi-million dollar valuations are a norm, being discerning about valuations might, on the contrary, make a VC look bad to their limited partners ("LPs") as that would mean sitting out on the majority of deals when deal making activity is high. While market activity is still lower than the peak in 2022, the number of crypto deals in 1Q 2024 has increased by 52.1% QoQ and is the highest it has been in nearly two years.

Figure 7: Deal making activity has gone up this year



Source: The Block, Binance Research, as of May 13, 2024.

Additionally, VCs are incentivized to continue deploying capital during the bull market. As long as the music does not stop playing, **higher valuations boost performance metrics of VC funds**. Furthermore, for projects, raising significant funds at high valuations is beneficial because it provides them with working capital without significant dilution. It also demonstrates strong support from "smart money".

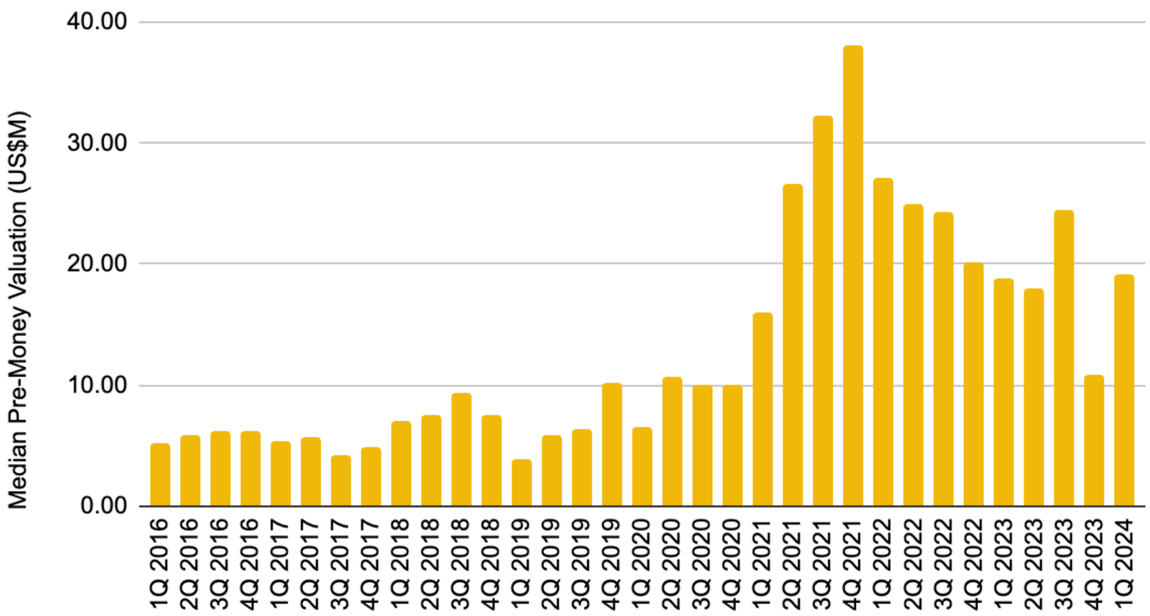
Overall, raising capital at a high valuation in private rounds means that stakeholders are motivated to launch the token publicly at an even higher FDV.

3.3 Upbeat Market Sentiment

With the crypto market capitalization up by 61% in the first quarter of the year, the market sentiment during this period has understandably been very positive. **Coinmarketcap's Fear and Greed index was in the "Greed" and "Extreme Greed" zone for 69 out of 91 calendar days in the first quarter.**[2] Correspondingly, project teams were able to leverage this positive investor sentiment, enabling them to raise funds at higher valuations in the first quarter.

This is evident from the increase in valuations in the first quarter. Specifically, pre-money valuations of VC-backed crypto firms rebounded over 70% quarter-on-quarter ("QoQ") in 1Q 2024. This indicates that, on average, projects were able to raise the same amount of capital with reduced dilution compared to the previous quarter.

Figure 8: Pre-money valuations rebounded in 1Q 2024



Source: PitchBook Data, Inc., Galaxy Research, Binance Research, as of March 31, 2024

4 Considerations

4.1 For Investors: Fundamentals Matter

The current market set-up makes it increasingly important for investors to be selective and discerning. The probability of making sustainable returns by "ape-ing" into new tokens is low, considering that many projects have high valuations right out of the gate. Most of the upside and easy money would likely already have been made by early private market investors.

Be it investing in private rounds or when the token undergoes its TGE, investors should conduct thorough due diligence and establish their own investment process. A non-exhaustive list of fundamental metrics and aspects that may be worth looking into include:

- **Tokenomics:** The importance of unlock schedules and vesting periods should not be underestimated as they directly affect the amount of token supply entering the market. Without a corresponding increase in demand, there will be excessive selling pressure weighing down on token prices.
- **Valuation:** FDV provides a general sense of scale but is not very meaningful by itself. Evaluate valuation ratios (e.g., FDV/revenue, FDV/Total value locked, etc.) relative to other competitors and relative to itself over time.
- **Product:** Consider where the project is in the product life cycle (e.g., whitepaper vs.product is live on mainnet)? Is there product-market fit? Observe user activity (e.g., daily active addresses, number of daily transactions, etc.).
- **People:** This encompasses the team and the community. What are the backgrounds of the founders and how do they contribute to the project? How engaged is the community and what are they most excited about for the project?

Rather than aggressively chasing the next shiny token, taking the time to evaluate fundamentals will help identify and avoid any jarring red flags and pitfalls. As Warren Buffet once said, "Only when the tide goes out do you learn who has been swimming naked." Everything usually seems well and good until the music stops playing. Avoid being the bag holder.

4.2 For Projects: Think Long-Term

Running a project is no easy task considering the numerous facets and stakeholders to consider. Decision making is intricate, and it is impossible to satisfy everyone. That said, we believe that one of the guiding principles for decision making is to think long-term.

- **Tokenomics:** Launching a token with a low float and high FDV may help with initial price pumps due to limited token supply. However, the subsequent unlocks can put substantial selling pressure on the token. Loyal token holders of the project (who are arguably one of the most important groups of the community) suffer. Poor token performance may also deter new ecosystem participants from joining the network due to declining incentives.

  In this regard, token allocation, unlock, and vesting schedules should be carefully considered. While tokenomics is likely more art than science and there is no magic number or methodology, it is clear that recently launched tokens have significantly low float as observed in Figure 2. To mitigate the risks associated with sudden increases in supply, teams and investors can consider token burning mechanisms, aligning vesting schedules with set milestones, and to increase the initial circulating supply during TGE.

- **Product:** While tokens can help capture mindshare and are a good user acquisition tool, a viable product is key to value creation, user retention, and sustainable growth. Having at least a minimum viable product prior to TGE will help investors and users better understand the value proposition of the project and determine product-market fit. In the best case scenario, launching a product with significant user traction can facilitate a successful TGE by boosting confidence and attracting high quality investors and users. In the longer term, the product augments the intrinsic value of the token and contributes to token price performance.

With the rebound in fundraising activity in Q1, project founders have been able to capitalize on an uplift in sentiment to command higher valuations. However, while it intuitively makes sense to raise funds at a high valuation (who would say no to raising the same capital with less dilution?), it comes with longer-term implications. Projects that have raised funds significantly above the intrinsic value will have to justify the premium in the future in subsequent private rounds or in the public market. Failing which, token prices will likely trend lower and towards their true value. Investors incur losses and project teams may struggle to reverse community sentiment.

5 Closing Thoughts

Tokenomics is undoubtedly one of the most important considerations for investors and project teams. Every design decision comes with its set of benefits and trade-offs. While launching tokens with low initial circulating supply may drive initial price pumps, the steady unlocking and emission of tokens create selling pressure, weighing on long-term performance. If such a trend becomes an industry norm, sustainable growth will be increasingly difficult without a corresponding inflow of capital to match the billions of token unlocks in the coming years.

VCs continue to play a crucial role in our industry and coins backed by VCs are not categorically bad. Project teams and VCs should work together to ensure equitable supply distributions and reasonable valuations.

References

1. https://token.unlocks.app/reports
2. https://coinmarketcap.com/charts/#fear-and-greed-index

New Binance Research Reports

Macro Thoughts: Not All Doom and Gloom

An analysis of stagnation concerns and the impact on crypto

The Future of Bitcoin #2: Tokens

A dive into Bitcoin's new fungible token standard: The Runes Protocol

Monthly Market Insights - May 2024

A summary of the most important market developments, interesting charts, and upcoming events

Q1 State of Crypto: Market Pulse

A compilation of key charts and insights on the market

About Binance Research

Binance Research is the research arm of Binance, the world's leading cryptocurrency exchange. The team is committed to delivering objective, independent, and comprehensive analysis and aims to be the thought leader in the crypto space. Our analysts publish insightful thought pieces regularly on topics related but not limited to the crypto ecosystem, blockchain technologies, and the latest market themes.

Jie Xuan Chua, CFA

Macro Researcher

Jie Xuan ("JX") is currently working for Binance as a Macro Researcher. Prior to joining Binance, he worked as a Global Investment Specialist with J.P. Morgan and had prior Equity Research experience at various fund houses. JX is a CFA charterholder. He has been involved in the cryptocurrency space since 2017.

Brian Chen

Macro Research Intern

Brian is currently working for Binance as a Macro Research intern. Prior to joining Binance, he worked as a DeFi researcher at a financial service startup and a Web3 education organization. He holds a Master of Finance degree from the University of California, Irvine ("UCI"), and has been involved in the cryptocurrency space since 2021.

Resources

Read more here

Share your feedback here