HUT 8 Mining Corp (Q3 2023 Results)
November 14, 2023

Corporate Speakers

- Jaime Leverton; Hut 8 Mining Corp.; CEO
- Shenif Visram; Hut 8 Mining Corp.; CFO

Participants

- Michael Colonnese; H.C. Wainright; Analyst
- Joseph Vafi; Canaccord; Analyst
- George Sutton; Craig-Hallum; Analyst
- Unidentified Participant; ;

PRESENTATION

Operator^ Welcome to Hut 8 Third Quarter 2023 Financial Results Analyst and Investor Call. In addition to the media release issued earlier today, you can find Hut 8's financial statement and MD&A on the company's website at www.hut8.io, under the company's set profile at www.sedar.ca and under the (inaudible) profile at www.sec.gov. Unless noted otherwise, all amounts referred to during all are denominated in Canadian dollars. Any comments made during this call may include forward-looking statements within the meaning of applicable securities legislation regarding the future performance of Hut 8 Mining Corp. and its subsidiaries.

The statements may reflect current expectations and as such, are subject to a variety of risks and uncertainties that could cause actual results to differ materially from current expectations. These risks and uncertainties include, but are not limited to, factors discussed in Hut 8's annual information form for the year ended December 31, 2022, and the company's other continuous disclosure documents. Except as required by applicable law, Hut 8 undertakes no obligation to publicly update or review any forward-looking statements.

During the call, management may also make reference to certain non-IFRS measures that are not separately defined under IFRS, such as adjusted EBITDA, mining profit, digital asset revenue per bitcoin mined and mining cost per bitcoin. Management believes that non-IFRS in financial information taken in conjunction with IFRS financial measures provide useful information for both management and investors.

Reconciliations between IFRS and non-IFRS results are presented in the tables accompanying our press release, which can be viewed on our website.

I would now like to turn the call over to Hut 8 CEO, Jaime Leverton.

Jaime Leverton^ Thank you, Carmen. Good morning, everyone. Welcome to today's call where we will discuss Hut 8's results for the third quarter of 2023. Throughout the third quarter, we continued to mine despite headwinds from seasonal energy spikes, which drove some curtailment and increased network difficulties. We continue to work to mitigate the issues we're seeing in Drumheller, and the team made good progress in repairs, but continued to see challenges upon re-energization.

Still, we made some progress, finishing the quarter with a 7% improvement in operating capacity over the end of the second quarter. At Medicine Hat, the team utilized mutually beneficial terms in the electricity supply agreement covering the site, which provides the opportunity for both parties to continue benefiting from high prices in the Alberta power market. In our HPC business, we created some momentum in Q3 with new customer additions and growth among existing customers. Last week, we launched our on-demand cloud service for customers seeking HPC services from our GPUs with Kubernetes-based applications that can support artificial intelligence, machine learning, visual effects and rendering workloads. This service puts control in our clients' hands while reducing provisioning time from days to minutes, which is particularly compelling for those seeking shorter-term HPC projects.

This offering is currently available for our Mississauga data center, and we look forward to expanding this service to new regions and adding more services in the lease and months to end. We also have data center capacity in both Central and Western Canada that we can quickly allocate with minimal investment to accommodate clients that have up to an equivalent of 85 HGX class server chassis with GPU cards. We continue to see constrained infrastructure supply, especially for high-performance computing capacity required for intensive workloads like AI and are unique in our ability to support clients that may have their own GPUs on hand, but need access to build out infrastructure on a very high turnaround. We will continue to focus on capitalizing on these opportunities in HPC and cater to these growth areas in the coming quarters. Moving on to our treasury strategy.

You are all very well acquainted with our commitment to hoddling our Bitcoin mines. And this year, while we worked to close the transaction with U.S. BTC, we continue to have maintained our stack above 9,000 bitcoin, only selling production at opportune points throughout 2023 when we felt prices were particularly strong, such as in the last month. We have not dipped into anything mine or huddled prior to 2023, which has been very intentional. We remain bullish on Bitcoin, are committed to our treasury strategy and know that it remains a powerful differentiator for us.

With up to 10 spot Bitcoin ETFs awaiting SEC approval, we believe it's a matter of time before we see an ETF approved. BlackRock is one of the institutions on that list and has a near perfect ETF approval track record of 99.8%. We see institutions like BlackRock with approximately $9 trillion in assets under management as a meaningful bridge between traditional wealth and bitcoin once ETFs are approved. For example, last month, we saw the price of Bitcoin rally 27% on optimism around ETFs. And with these shares back 1:1 with Bitcoin, we believe that we should not only see increased demand, but also see value heading up into the right with these approvals.

Tying this back to our stack, a lift in the value of our stack compared to the capital time and effort it would take to mine the same amount from this point going forward, especially 160 days or so out from the halving is a very compelling scenario and reinforces our current treasury strategy. As we have said in the past, moving forward, we hope to see positive momentum and will actively seek opportunities to responsibly work our stack to drive additional value. At the beginning of the month, we were very pleased to share that we received court approval for our stocking horse bid for four natural gas power plants in Ontario, a 40-megawatt facility in (inaudible); 110-megawatt facility in Kingston; 120-megawatt facility in (inaudible); and (inaudible) and Power facility in North Bay, which has 40 megawatts of capacity.

While the sale and investment solicitation process is underway, if our bid is ultimately declared successful, a new subsidiary of the company will become the owner of the assets of the four sites. Our partner, Macquarie, will receive a minority equity interest in the subsidiary of approximately 20% and a subsidiary of Hut 8 will be the majority owner with the remaining approximately 80%.

We believe that the strategic addition of these assets would position Hut 8 as a vertically integrated mining operation; allow us to utilize idle infrastructure and machinery; provide access to energy pricing certainty; and give us flexible energy capacity and properties for alternative uses such as traditional data center and/or AI hosting. Significantly, the facilities are expected to give us the optionality to pursue revenue-generating activity, including selling energy to the grid, mining bitcoin and powering high-demand HPC applications like artificial intelligence. This move is not only in keeping with our infrastructure first strategy, but also affords us very compelling flexibility ahead of the halving. In addition, we made considerable progress as we work toward closing our transaction with USBTC, which has been our North Star since we first announced the merger. On September 13, we announced that our shareholders overwhelmingly approved the transaction through a special vote, which is incredibly encouraging because it reflects how engaged and supportive they are of our merger of equals.

Five days later, we announced that we obtained a final order approving the plan of arrangement with USBTC from the Supreme Court of British Columbia. We also continued to file updated amendment to our S-4 with the SEC. And on November 9, the SEC declared Hut 8 Corp.'s registration statement effective, which is a significant milestone that we've been collectively working towards. Now that we have the effectiveness declaration between the SEC, we are very pleased to share that we expect to close our transaction by November 30, subject to USBTC obtaining its required stockholder approval and the satisfaction of other customary closing conditions.

Before I turn it over to our CFO, Shenif Visram, I would like to thank our investors for their continued commitment to Hut 8 and their excitement for our merger, our team for their ongoing hard work and dedication across the business and our Board for their continued support and guidance.

Thank you, and over to you, Shenif.

Shenif Visram^ Thanks, Jaime. And good morning, everyone.

During Q3, we continued to remedy the operational challenges at our Drumheller site and pursue the stocking horse bid to address our suspension of mining activities at North Bay. As both matters remain ongoing, they affected our Q3 results. We achieved revenue of $17 million for Q3 2023, a $14.7 million decrease relative to the same quarter prior year of $31.7 million. This year-over-year decrease was driven by a lower quantity of bitcoin mined partially offset by an increase in the price of Bitcoin.

Revenue from digital asset mining activities was $12.5 million as we mined 330 new bitcoin in the quarter. This compares with $27.3 million of digital asset mining revenue in Q3 2022 when we mined 982 bitcoin. The year-over-year reduction in new Bitcoin mine was driven by a combination of an increase in network difficulty; impacts of electrical issues at the Drumheller site resulting in less mining activities; the halt of GPU Ethereum mining, which we were doing in Q3 2022 until the Ethereum networks merged; and the suspension of mining activities at North Bay. The impact of revenue of less bitcoin mined was partially offset by the higher price of bitcoin reflected by the digital asset revenue per bitcoin mined of $37,800 in the current quarter compared to approximately $27,800 in the prior year quarter. Our high-performance computing business contributed an additional $4.5 million of revenue in Q3 2023 compared to $4.4 million in Q3 2022.

Q3 2023 results included revenue from new sales, which were partially impacted by client churn. Revenue from the Interior Health contract is expected to start in Q4 2023. Cost of revenue for Q3 2023 was $21.4 million lower than prior year by $24.2 million and consists of depreciation and site operating costs. Depreciation expense decreased to $10.2 million during the third quarter of 2023 compared to $25.3 million in the same quarter in 2022. The decrease was due to the lower net book value of digital asset mining assets after the recognition of the nontax impairment charge in Q4 2022.

Site operating costs of $11.2 million was lower than the same quarter prior year by $9.1 million. Within the digital assets mining operation, site operating costs reduced by $9.3 million, mainly due to lower power costs. The average mining cost per bitcoin for the third quarter of 2023 was approximately CAD 26,300 compared to approximately CAD 18,300 per bitcoin in the prior year for the same quarter. The increase was due to higher power consumption per bitcoin mined and the ongoing electrical issues at the Drumheller facility, which were partly offset by the company's decision to curtail and lower average energy cost prices compared to prior year same quarter. We incurred $2.5 million in operating costs related to the high-performance computing operation compared to $2.3 million in Q3 2022 due to increased repairs and maintenance partially offset by lower software costs.

In terms of margins, our digital asset mining operations generated mining profit of $3.8 million in Q3 2023 versus $9.3 million in the prior year same quarter. The decrease in mining profit is due to the lower quantity of bitcoin mined due to increased network difficulty, suspension of mining activity in North Bay and the ongoing electrical issues in

Drumheller, partially offset by a lower average price of power and the higher price of bitcoin compared to Q3 2022. General and administrative costs were $11.9 million for the quarter compared to $11.2 million for the same quarter prior year. The key driver in the increase was the inclusion of $2.4 million of onetime transaction costs in third quarter of 2023 related to the merger with USBTC and the stocking horse bid. Excluding these onetime transaction costs, our general and administrative costs were down $1.7 million compared to Q3 2022 and due to lower sales tax expenses and other expenses.

We recorded a net loss of $53.6 million for Q3 2023 compared to a net loss of $23.8 million in Q3 2022. In Q3 2023, we recorded a $20 million impairment loss on our deposit related to the purchase -- the power purchase agreement for the North Bay facility as a result of our power providers receivership. We also booked a $10.1 million noncash loss in the third quarter on the revaluation of our digital assets to income or loss compared to a $7.3 million noncash gain in the comparative quarter, both as a result of changes in the average price of bitcoin during the respective quarters. Q3 2023 saw an increase of net finance income expense of $0.6 million, partly due to the increased interest expense from our loan with coin-based credit that was first drawn in the second quarter of 2023. Also Q3 2022 included a noncash loss on the revaluation of warrant liability of $2.9 million.

Reflecting the operating results discussed previously, Hut 8 achieved adjusted EBITDA of negative $11.6 million in Q3 2023 compared to a positive adjusted EBITDA of $9.4 million in Q3 2022, primarily driven by a lower digital asset mining profit and a noncash revaluation loss on our digital assets. Our balance sheet remains healthy with manageable levels of debt and a cash balance of $21.1 million as of September 30, 2023. As previously announced, the company entered into a USD 50 million credit facility with coin-based credit on June 26, 2023, which has drawdowns available in three tranches.

At the end of Q3 2023, the company had CAD 47 million of loans outstanding, net of deferred financing costs related to the facility. Our bitcoin holding are marked at fair value and totaled $341.4 million as at September 30, 2023, based on 9,366 bitcoin held in reserve. Of this total, 7,259 bitcoin valued at $265 million remain unencumbered. As previously announced, the company has continued to sell Bitcoin production to help fund operations while we work on closing the merger with USBTC. In the current quarter, we mined 330 bitcoin and sold 100, resulting in our Bitcoin held in reserves increasing by 230.

Thank you. With that, I will turn the call back to our operator.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) And our first question comes from the line of Michael Colonnese with H.C. Wainright.

Michael Colonnese^ Congrats on all the progress you've made on the merger, really exciting to see there. First one for me. We're seeing a growing number of Bitcoin miners announced (inaudible) the high-performance computing space in recent months. And I know you and your team, Jamie, have really been in this space for much longer. So I was hoping to get your views on this recent trend really what differentiates Hut's approach to HPC offerings versus its peers?

Jaime Leverton^ Great question. As you alluded to, we've been at this for a very long time, kicked off with the closing of our TeraGo data center acquisition almost two years ago. And really, we spent the last number of months updating the facilities, updating the product stack and really getting ready for what we anticipated to see as an increase in market demand, particularly as it relates to artificial intelligence. And that's something that has certainly borne out over the past number of months. I think really what differentiates how Hut is looking at the business, we purchased a business that was fully built out.

So if you recall, we have five data centers across Canada, two in the Greater Toronto area, two in Downtown Vancouver and one in Colona with number of enterprise customers on both the colocation, cloud and managed services space. We've got a very, very robust infrastructure and staff that supports these clients and these product offerings. Much of my leadership team, including myself, comes from the traditional high-performance computing and data center space. So it's a business that we know well, understand well and the ecosystem that plays in that space is also very well understood by myself and the management team. So we really have seen this trend coming and believe it's important to tackle as a robust enterprise-grade solution.

It's very, very different compute from a Bitcoin mining data center, both in how it's operated, how it needs to be managed, how customers expect it should be serviced. It's really a different business model altogether, and we think we are incredibly well poised to be at this intersection between these two types of high-performance computing.

Michael Colonnese^ I appreciate that. And definitely (inaudible) back on this one. So it's good to see. And just as a quick follow-up, if I may. So if you could just speak to the market rates and pricing dynamics you're seeing out there right now for colocation services and cloud or GPU-as-a-Service type offerings and really how you're product stack is positioned against that sort of market backdrop?

Jaime Leverton^ Yes. I mean I touched on it in my comments earlier. We were really excited to launch our on-demand cloud portal, which kicked off a few weeks ago, and that will continue to be an area that we continue to invest in and expand because that type of on-demand capability, I think, is really important for clients and for customers looking at these types of workloads, just the ability to be able to self-provision within seconds, we think is critically important and are super excited from the early feedback that we're getting on the launch of that portal. As I touched on, we do have about a megawatt of readily available capacity and infrastructure across our data center fleet, and we continue to see data center leases totaling tens of gigawatts be signed across North America so far this year. And we believe that we're going to -- over time, we're going to see capacity start to come at a premium because it does take a long time, as you know, to build out these types of enterprise-grade data centers.

So we're very bullish on the assets that we have. We love that our data centers in Ontario and in BC are almost entirely 0 emission and renewable energy powered, which we think will continue to be an advantage in this space as well. With respect to pricing dynamics, I can't get into specifics of that, but what I will say is it's very much a supply and demand conversation. And as available supply for compute starts to become constrained. We expect that to see -- to put upward pressure on pricing in the market as well.

Operator^ One moment for our next question, please. It comes from the line of Joseph Vafi with Canaccord.

Joseph Vafi^ Nice to see progress here on the USBTC merger, really great news. Maybe you could kind of outline for us the playbook there. I mean it's been a while. I'm sure you've got some good plans in place. Do you have an outline or a playbook that you could share with us over the next few months as that merger closes?

And I would imagine you start to ramp some of that exahash capacity at the USBTC facilities? And then I'll have a quick follow-up.

Jaime Leverton^ Yes. I mean we've got quite a bit of information about the deal, which we've shared in the past and it continues to be available on our website. So I encourage those of you that want to refamiliarize yourselves with the details of the deal to refresh that deal deck. And as we touched on, so a very, very critical milestone for us was achieving the effectiveness declaration from the SEC. And as I also mentioned earlier, assuming successful USBTC stakeholder vote and other closing items we expect it to close by the end of November.

So really looking forward to getting things underway. And as we've touched on, it's very much a merger of equals. Our facility is, obviously, entirely Canadian based between the mining sites and the data centers. USBTC team focused on assets in the U.S. and both of us with a diversified strategy when it comes to revenue.

So a mix of fee-based revenue streams for us in -- with respect to high-performance computing. And then as we think about the stack down the road, as I've touched on earlier as well. And then USBTC mix of South mining of Bitcoin denominated revenue streams as well as their managed services business or managed infrastructure operations as they've historically referred to it, which is a fee-based revenue stream as well as their hosting business. So really excited in a pro forma where we continue to have the ability to kind of flex between our different lines of business and really take advantage of the different momentum and swings we see in the market across high-performance computing and (inaudible) going into the halving. And then, of course, very excited about the potential here with the power assets that we're working on in conjunction with Macquarie.

Joseph Vafi^ Great. And following up on that on the power generation assets and that stock in horse bid. Again, could you perhaps provide us a little bit of a playbook if that deal -- if and when that deal gets done, what does it mean for your operations? What does it mean for expansion of the business? Because I don't believe you were using all of that power previously.

So any color there would be helpful, too.

Jaime Leverton^ Yes. No. No, my pleasure. It is something we're very excited about. So the only facility within the four assets that are covered within that stocking horse bid that we had prior association with is the North Bay facility. So if you recall, we had just under 40 megawatts stood up at North Bay.

And so we would be looking to bring that data center capacity online as quickly as possible. And we believe that if we're successful with the stocking horse bid, we would be able to close that sometime in the next two to three months. And so we would be looking to bring the North Bay facility back up as quickly as we could. Obviously, infrastructure work needs to be completed. We need to bring the miners back to site.

We will be dealing with the dead of winter in North Bay at that time, most likely as well. So it will take some time to get us back up and running, but our intention is certainly to bring that site back online. And then the other three sites we mentioned, 40 megawatts of (inaudible), 110 megawatts in Kingston and 120-megawatt facility in (inaudible), it remains to be seen what -- how we would provision and work with those assets. But as I touched on in my earlier commentary, it gives us a lot of optionality, which we love to have control directly over the largest operating expense for a Bitcoin miner, I think, as everybody knows, is the cost of power. So having better control over power inputs with respect to these plants is very exciting.

I think there's a lot of upside as we look to the future with respect to how we see energy prices continuing to move in the market and our ability to have power assets that we can sell into the energy market and then also be in control of our own destiny with respect to how we want to use that power when it's not being utilized or needed by the grid, whether it's for bitcoin mining, high-performance computing. We've got a lot of optionality there and excited for how this may progress for us.

Operator^ One moment for our next question, please. It comes from the line of George Sutton with Craig-Hallum.

George Sutton^ And my congrats on getting through the SEC process. I know how challenging that's been. So I am curious from the USBTC side, they've made a lot of progress, including the Celsius network deal. Can you just walk through sort of what's your -- what they're bringing to the table that may have changed since the announcement and how that improves the value of the deal from your perspective?

Jaime Leverton^ Yes. We're certainly very, very excited with the progress that the team has made with the Southeast transaction. I'm not going to get into details on this call, but it is publicly available information where things stand with respect to the Celsius transaction. Certainly that -- if that is ultimately successful and close it out will be a nice addition to the new Hut (inaudible) internally. And again, as I touched on earlier, really like the diversified nature of the USBTC business, and they've certainly been growing their fee-based revenue lines since we first started talking to them almost a year ago with the managed services business, as I referenced and then the work that's being done on Celsius.

So certainly, very, very pleased with the progress that the team has made over there and really looking forward to just bringing a whole team together and continuing the growth that we've been pursuing independently together as one team.

George Sutton^ Jamie, I'm wondering, you mentioned in your prepared comments that you're looking for opportunities to work your stack. Have you contemplated synthetic swaps as a alternative to bringing the Bitcoin on your balance sheet? In other words, taking 15% of the value buying a swap and taking the other 85% to redeploy?

Jaime Leverton^ I don't think there's anything (inaudible) team haven't looked at with respect to our options long term around the stack, but let me turn it over to Shenif if you want to speak in more specifics about the swap rate in particular?

Shenif Visram^ Yes. Thanks for the question, George. I mean, obviously, we've looked at a lot of options with the rise in bitcoin price covered calls have obviously been something we've looked at very diligently once we close the transaction with USBTC, we'll be in a better position to kind of move forward with some plans we want to do. But certainly, it's on our list of items we want to work on, on leveraging our stack and creating more value for our shareholders from leveraging the stock in a different way than we've done historically at the company. So actively in pursuit of these items.

And hopefully, once we get the deals over the line, we could spend a bit more time and then share with all of you what our plans are around that.

Operator^ One moment for our next question, please. It comes from the line of Bill Papanastasiou with Stifel.

Unidentified Participant^ It's [Daniel] on for Bill today. My first question here is on your BTC treasury strategy. Are there any plan change strategy if we see an approval of a spot Bitcoin ETF?

Jaime Leverton^ So Shenif just talked about some of the research and exploration that his team is doing around options to work the stack. I'm not sure that we have any more color to add there. And with respect to the treasury management and our historic and ongoing commitment to holding bitcoin on balance sheet, I don't have any additional color to add versus what I touched on in my opening remarks.

Unidentified Participant^ Got it. Switching gears quickly here. Now we've seen an improvement in mining economics recently, can you speak to how it has or may potentially impact capital allocation decisions going forward?

Jaime Leverton^ Well, that's one of the things I love about having a diversified business model. We get to make those choices based on the active developments that we see in all of our businesses, whether it's bitcoin or high-performance computing. So I can't answer that question specifically, but that's one of the reasons we have optionality. So really, our focus is, first and foremost, on getting our transaction into USBTC (inaudible) as a combined team, we can look at what makes the most sense with respect to our next move from an organic and/or inorganic growth perspective.

Operator^ I'm not showing any further questions in the queue. So with that, I will conclude the call. A transcript of this call will be available on the Hut 8 website in the Investors section. Thank you for joining us at Hut 8 third quarter 2023 financial results analyst and investor call.

You may disconnect.

Jaime Leverton^ Thanks, Carmen. Thank you, everybody.