

Hut 8 Mining Corp

First Quarter 2023 Financial Results, Analyst, and Investor Call

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Canaccord — Analyst

Bill Papanastasiou

Stifel — Analyst

PRESENTATION

Operator

Welcome to Hut 8's first quarter 2023 financial results, analyst, and investor call.

In addition to the media release issued earlier today, you can find Hut 8's financial statements and MD&A on the Company's website at www.hut8.io, under the Company's SEDAR profile at www.sedar.com, and under the Company's EDGAR profile at www.sec.gov.

Unless noted otherwise, all amounts referred to during this call 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's Mining Corp and its subsidiaries. The statements made reflect current expectations and, as such, are subject to a variety of risk and uncertainties that could cause actual results to differ materially from current expectations. These risks and uncertainties include, but are not limited to, the 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 statement.

During the call, management may also make reference to certain non-IFRS measures that are not separately defined under IFRS, such as adjusted EBITDA and mining profit. Management believes that non-IFRS 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's CEO, Jaime Leverton. Please go ahead.

Jaime Leverton — CEO, Hut 8 Mining Corp

Thank you so much, Colin. Good morning, everyone, and thank you for joining us to discuss Hut 8's results for Q1 2023.

As you will have seen in the release, we began the year with some complications on the broader level, including a steadily increasing difficulty rate and high energy prices. At our Drumheller site, high energy input levels at the site have been causing equipment failures. In response, we began implementing multiple versions of custom firmware across all of our miner models. This firmware is designed to lower the power supply's maximum output voltage, ensuring our equipment operates within safe limits.

Our teams at both Drumheller and Medicine Hat are actively engaged in repairing damaged equipment and remediating the issues at site. We are actively increasing repair staff, are adding an additional repair centre shift, and have procured new hardware to expedite repairs and accelerate the speed at which we bring miners back online. At this point, we expect to have the site restored within 10 to 12 weeks. We are closely monitoring the situation and will continue to make the necessary adjustments as needed to restore, safeguard, and optimize our equipment. At the same time, our operations team is actively finalizing options to operationalize the bulk of the approximately 7,000 miners that were removed from our North Bay site.

We were also pleased to report an all-time operating high for our Medicine Hat site of 1.72 exahash after energizing nearly 1,000 additional miners transferred from our North Bay site.

As previously discussed, 428 Bitcoin were sold in Q1 to continue to support our operational costs. We are not abandoning the HODL strategy, far from it, and continue to be the Company with the largest unencumbered, self-mined amount of Bitcoin held in reserve.

In addition to managing our operations, we are laser-focused on completing our transaction with USBTC and have made solid progress on that front. We recently filed an amended S-4 Registration Statement with the SEC, confirming that New Hut's expected installed self-mining capacity will be 7.02 exahash, a nice bump from the 5.6 exahash which we previously disclosed, thanks to energizing additional miners at USBTC sites.

USBTC entered into a settlement with the city of Niagara Falls in early April, concluding all claims and paving the way to resuming mining activity at the site. We also received a no-action letter from the Canadian Commissioner of Competition, which confirms they do not intend to challenge the transaction before the Competition Tribunal.

And finally, the waiting period under US HSR antitrust legislation with respect to the business combination expired in early March, which is another step toward closing the transaction.

Over the past quarter, discussion has increased around the halving, which is now less than a year away. In that context, our business combination with USBTC is a very strategic one.

Under New Hut, we will create geographic diversity in our self-mining business, which will include differentiated energy sources in Texas, New York, and Nebraska. We plan to improve efficiencies at the miner level by using USBTC's proprietary purpose-built software that can identify and mitigate machine and energy price issues in real time.

We will have flexibility for growth in new fiat revenue lines of business, including the 220-megawatt hosting business and 680-megawatt managed infrastructure operations business, with opportunities to amplify it further.

I believe that in a post-halving world, single-threaded miners are more likely to struggle to stay competitive and will have more exposure to diminishing returns given the continued increase in global

hashrate and the expectation that more sovereign nations and large enterprises with deep pockets will continue entering the mining space. We believe that having business lines that are CapEx-light and scalable will prove to be a great benefit after the halving. Until then, we will continue to strategically grow our stack of Bitcoin. We will also work on capturing increasing HPC market share.

This week, we launched vulnerability scanning for current and future customers, which leverages automated tools and techniques to assess and identify potential security vulnerabilities before they can be exploited by hackers. We are also focused on growing our HPC customer base in the AI space. Our liquid stack, other GPUs, and additional infrastructure sets us apart from traditional data centre peers in this space, and we are able to manage the shorter-term, higher-demand requirements of these unique customers.

Before I turn it over to our CFO, Shenif Visram, I would like to thank our board for their support and guidance, our executive team for their leadership, our team for their execution across the business, and our investors for their continued commitment to Hut 8.

Thank you, and over to you, Shenif.

Shenif Visram — CFO, Hut 8 Mining Corp

Thanks, Jaime, and good morning, everyone.

Q1 was a challenging quarter from an operational perspective as we worked through the electrical issues at Drumheller and explored options for our miners that were displaced from our North Bay site due to the ongoing legal disputes. Both of these had an impact on our Q1 results.

We achieved revenue of \$19 million for Q1 2023, a \$34.3 million decrease relative to the same-quarter prior year of \$53.3 million. The year-over-year decrease was driven by a combination of lower

Bitcoin mined and reduction in the price of Bitcoin, which more than offset the incremental contributions from the high-performance computing business we acquired at the end of January 2022.

Revenue from digital asset mining activities was \$14.5 million as we mined 475 new Bitcoin. This compares with \$49.3 million of digital asset mining revenue in Q1 2022 when we mined 942 Bitcoin. The year-over-year reduction in new Bitcoin mined was driven by a combination of impacts of the electrical issues at the Drumheller site resulting in less mining activity; the completion of GPU mining, which we were doing in Q1 2022; and an increase in network difficulty.

Our high-performance computing business contributed an additional \$4.5 million of revenue in Q1 2023 compared to \$3.3 million in Q1 2022. The increase was due to having one extra month of revenue in the current quarter. It is worth noting that Q1 2022 revenue included revenue from low-margin products and services that were eliminated during Q2 2022.

Cost of revenue for Q1 '23 was \$25.2 million, lower than the prior year by \$11.7 million, and consists of depreciation in site operating costs.

Depreciation expense decreased to \$10.9 million during the first quarter of 2023 compared to \$18.4 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 non-cash impairment charge in Q4 2022. This reduction was partially offset by a \$1.3 million increase in additional depreciation from the HPC business.

Site operating costs of \$14.4 million was lower than the same-quarter prior year by \$4.1 million. Within the digital asset mining operation, site operating costs reduced by \$4.8 million, mainly due to lower power costs.

The average cost of mining each Bitcoin for the first quarter of 2023 was approximately C\$25,100 compared to approximately \$18,000 per Bitcoin in the prior year for the same quarter. The increase was due to higher power consumption per Bitcoin mined, increased energy prices, and ongoing electrical issues at the Drumheller facility, which was partly offset by the Company's decision to curtail and increase efficiencies in the miners deployed compared to the prior-year same quarter.

We incurred \$2.4 million in operating costs related to the high-performance computing operation compared to \$1.6 million in Q1 2022, due to the one additional month of operations in the current quarter.

In terms of margins, our digital asset mining operation generated mining profit of \$2.6 million in Q1 '23 versus \$32.9 million in the prior-year same quarter. The decrease in mining profits is due to the reduction of Bitcoin price, increased network difficulty year over year, and the ongoing electrical issues at Drumheller.

General and administrative costs were \$24.3 million for the quarter compared to \$11.5 million for the same-quarter prior year. The key drivers in the increase was the inclusion of one-time transaction costs in the first quarter of 2023 related to the merger with USBTC, along with one-time costs related to the decommissioning of our North Bay site.

We recorded net income of \$108.5 million for Q1 '23 compared to net income of \$55.7 million in Q1 2022.

In Q1 '23, we booked the gain on the reevaluation of our digital assets of \$134.8 million due to the increase in Bitcoin prices since December 31, 2022. No gain was booked in the same-quarter prior year.

Q1 '23 included a loss on the reevaluation of warranty liability of \$0.1 million. Q1 2022 included a gain of \$54.1 million. Excluding these two items in both periods, net income in the current quarter was \$27.7 million lower than prior-year same quarter due to the lower revenue from Bitcoin mining and the inclusion of transaction costs related to the USBTC merger.

Reflecting the operating results discussed previously, Hut 8 achieved adjusted EBITDA of negative \$3.7 million in Q1 '23 compared to a positive adjusted EBITDA of \$27.1 million in Q1 2022.

Our balance sheet remains healthy, with minimal debt and a cash balance of \$15.9 million as at March 31, 2023. Our Bitcoin holdings are marked at fair value and totalled \$352.4 million as at March 31, 2023, based on 9,133 Bitcoin held in reserve.

As previously announced, the Company will be selling Bitcoin production to help fund operations while we work on closing the merger with USBTC. In the current quarter, while we mined 475 Bitcoin, our Bitcoin held in reserve increased by 47 as the remaining 428 were sold.

Thank you. With that, I will turn the call back to our Operator for analyst Q&A.

Q&A

Operator

Thank you, Jaime and Shenif.

We will now move on to the Q&A portion of the call. If you'd like to ask a question, press *, then the number 1 on your telephone keypad. If you'd like to withdraw your question, please press *, followed by 2. If you're using a speakerphone, please lift the handset before pressing any keys.

One moment for your first question.

And your first question comes from Mike Colonnese from H.C. Wainwright. Mike, please go ahead.

Jaime Leverton

Good morning, Mike.

Mike Colonnese — H.C. Wainwright

Hi. Good morning. Thank you for taking my questions. Morning, guys. How are you?

Jaime Leverton

Fantastic. Thank you.

Mike Colonnese

So great. Great. Well, yeah. First question for me, you mentioned Drumheller is operating at 15 percent of installed capacity currently. If you could just remind us of the total installed capacity at the site currently, and if any portion of your mining fleet has been permanently damaged from the ongoing energy issues at the facility.

Jaime Leverton

We believe everything will be able to be fully repaired in that 10-to-12-week interval. And the Drumheller site operates at just under 900 Petahash at full capacity.

Mike Colonnese

Got it. Got it. That's great to hear things will be back up online in the near term here.

And then, Jaime, you mentioned some interesting comments there on the post-halving environment in your release and, again, in your prepared comments. Could you elaborate more on your expectations for diminishing returns for the mining industry after the next halving and your thoughts around some of these new entrants that could come into the space?

Jaime Leverton

Yeah. I mean, I think we've seen new entrants continue to come into the space even during these difficult bear market conditions. We continue to see network hashrate hitting all-time highs. And from my perspective, just based on what we're hearing and continuing to see, I think that that hashrate is going to continue to grow. We know that there are some sovereign nations that have started to mine directly themselves. We think that's a trend that is going to continue. And we think we're going to see new entrants come into the space over the next short to medium term, in particular from the oil and gas sector.

So obviously, the halving brings a 50 percent reduction in the block reward, and with our expectation that we're going to continue to see new entrants that have lower sensitivity, in some cases, to operating expenses and, in some cases, access to deep pools of capital. And I think for us, we're very focused on having a diversified strategy that allows us to continue to self-mine while also introducing new fiat-based revenue streams. So obviously, it started with our HPC business last year. And USBTC has done a great job building out their hosting business as well as the new category, which is managed infrastructure operations.

So we very much like the optionality the diversification gives us in a post-halving world. And as I mentioned, we continue to believe in holding our Bitcoin on balance sheet and think that that will continue to be a source of advantage for us as we move past the halving.

Mike Colonnese

Really interesting colour. Appreciate your views, and good luck with completing the merger here.

Jaime Leverton

Thank you so much. I really appreciate it, Mike.

Operator

Your next question comes from Joseph Vafi from Canaccord. Joseph, please go ahead.

Joseph Vafi — Canaccord

Hey, guys. Good morning.

Jaime Leverton

Morning, Joe.

Joseph Vafi

Hey, Jamie. Thanks for taking the questions.

I was just wondering, going back to comments on cost per Bitcoin, if you could kind of perhaps parse out how much of the electrical infrastructure issue at Drumheller drove that price of Bitcoin, cost-per-Bitcoin produced, up versus perhaps energy prices. And then I'll have a follow-up.

Jaime Leverton

Shenif, over to you for that one.

Shenif Visram

Yep. Thank you, Jamie. Thanks for the question.

So when we kind of looked at the Drumheller location, it was a combination of issues. So where we did see power rates increase was specifically in that location. At our Medicine Hat location, year over year, our power costs per kilowatt hour were roughly the same. So the bulk of the increase from a power-rate perspective was in the Drumheller location.

The other piece that we saw the increase in the overall cost is just the number of kilowatt hours we're using to actually mine the Bitcoin, which is really a reflection of the network growth across the Bitcoin, along with the fact that some of our more productive miners were offline in Drumheller as we fixed them.

So that's kind of at a high level what drove the increase there. Happy to take on a follow-on if needed.

Joseph Vafi

Sure. That's good colour. And then maybe just on the USBTC merger. I know you're in the middle of it still. Could you provide us maybe perhaps a timeline around when that amended document went into the SEC? And how extensive was their commentary first time around? Just trying to get a feel for perhaps the scrutiny of the SEC maybe putting on this before it gets done.

Jaime Leverton

Yeah. I mean, we submitted the updated S-4 nearly three weeks ago. And we can't give specific colour to SEC commentary. I can say that we're still working toward closing the transaction in late Q2, possibly early Q3, just given where we are in the process.

Joseph Vafi

Sure. That's enough colour, Jaime.

And then, maybe we get a little more deep-dive update on how USBTC is doing right now and perhaps some progress they made in the quarter here before the merger. Thanks a lot, guys.

Jaime Leverton

Yeah. So I touched on as much as I can touch on, which is we're now expecting 7.02 exahash on the other side of a successful merger from a self-mining perspective. And then I also touched on the successful resolution that they had at the site in Niagara Falls. So that's really as much as I can give with respect to their progress over the last three months.

Joseph Vafi

Sure. That's great. Thanks a lot, Jaime.

Jaime Leverton

No. My pleasure. Thanks, Joe.

Operator

Your next question comes from Bill Papanastasiou from Stifel. Bill, please go ahead.

Jaime Leverton

Morning, Bill.

Bill Papanastasiou — Stifel

Hi, guys. Hi. Good morning. Thank you for taking my questions.

Just had some questions related to kind of the outlook of the market and Bitcoin. Recently, we've seen an increase in the appetite to mine Bitcoin outside of North America. Jaime, perhaps you can speak to how management views geographic diversification and whether it's becoming an increasing importance to the Company. And have there been any markets recently that—I've seen exahash come online—that have caught your attention?

Jaime Leverton

Well, look, I think for us, we were the only scaled publicly traded miner that had operations entirely based in Canada. And so, for us, when we were looking at the merger partner that we thought made the most sense, bringing geographic diversity was certainly a key component of that. And in the case of USBTC, that brings some diversity within the US as well, their sites being in Nebraska, Texas, as well as New York. And so, certainly, that was our primary jurisdiction that we were looking to expand into and really looking forward to getting to the other side of this transaction.

I've looked at a number of geographies over the last couple of years. And I think the energy crisis has really changed some of those dynamics and markets that may have been more interesting to me prior

to the energy crisis. I think we are seeing an increase of hashrate and interest coming out of South America, which is a more recent expansion of development. And as we've seen recently, interest really in all things blockchain and crypto is very much at the forefront within the UAE. And we expect to see that focus and attention continue.

Bill Papanastasiou

Great. Thank you for that.

And then for my second question, if I may. We've recently seen significant demand for block space with introduction of ordinals and kind this new token standard, BRC-20, which has led to substantial increases in transaction fees and has greatly benefitted the Bitcoin miners. It's also caused a significant amount of debate in the community on whether the base blockchain should be used to settle JPEGs or things that don't pertain to transactions. I'm just wondering, hoping that you could share your thoughts on the matter and its implications to the network and Hut 8 in the long run.

Jaime Leverton

Yeah. Look, we're very excited about the promise of ordinals, which is truly the first iteration of this type of transaction that we think we'll eventually continue to see on the blockchain. As you're kind of alluding to, we did see production double on May 7th/8th, when transaction fees hit a two-year high because of the ordinals activity. As we move closer to the halving, we do think an increase in the volume and amount of transaction fees provides a good incentive for miners like us to continue securing the network.

And frankly, this has been a debate that's existed really since the beginning. We know that the last Bitcoin won't come into circulation until the year 2140. But when it does, miners will be entirely dependent on transaction fees in order to continue to have that monetary incentive to process

transactions and secure the Bitcoin blockchain. So I think for us to kind of see, for the very first time, transaction fees hit a level equivalent to block rewards in this most recent cycle of ordinal activity is encouraging for the long-term prospects of the network and certainly the long-term viability of miners that are coming into this space, or will continue to come into this space, over the next hundred years or so.

So I think, yeah, that's really our perspective. I think obviously this debate about block size is an age-old one when it comes to Bitcoin. And I think what we'll see over the short and medium term is a significant increase in development across the ecosystem on layer 2s, and we'll have to get more efficient in how we manage this type of activity in the Bitcoin ecosystem. But I think it's really, really exciting for us as an industry to see so much innovation and development happening directly on Bitcoin.

Bill Papanastasiou

Thank you, Jaime. I've asked several management teams that same question, and yours has been the most well-informed.

Jaime Leverton

Well, thank you.

Bill Papanastasiou

They're calling you the guru. That's all the questions I have.

Jaime Leverton

Oh, that's so lovely. Oh, my gosh. Thank you so much. That's great.

Operator

There are no further questions at this time. I'll turn it back to you, Jaime, for closing remarks.

Jaime Leverton

Okay. Well, look, thank you so much, everybody, for joining us on the first quarter 2023 call, and we look forward to continuing to update you as things progress over the balance of the year. So again, thank you for your time this morning.

Operator

This concludes the call. A transcript of this call will be available on the Hut 8 website in the Investor section.

Thank you for joining us at the Hut 8's first quarter 2023 financial results, analyst, and investor call. You may now hang up.