CleanSpark, Inc.

Second Quarter 2022 Earnings Conference Call

Tuesday, May 10, 2022, 4:30 PM Eastern

CORPORATE PARTICIPANTS

Zach Bradford - *Chief Executive Officer*

Gary Vecchiarelli - *Chief Financial Officer*

Rachel Silverstein - *Senior Vice President, Compliance and General Counsel*

PRESENTATION

Operator
Good afternoon and welcome to the CleanSpark's Second Quarter 2022 Earnings Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on your touchtone phone, to withdraw from the question queue, please press "*" then "2." Please note, this event is being recorded.

I would now like to turn the conference over to Rachel Silverstein, Senior VP of Compliance and General Counsel. Please go ahead.

Rachel Silverstein
Welcome everyone. On behalf CleanSpark, Inc., thank you for joining our second quarter financial results conference call for fiscal year 2022. With us today with prepared remarks are CleanSpark's Chief Executive Officer, Zach Bradford, and Gary Vecchiarelli, our Chief Financial Officer.

On today's call, we will make forward-looking statements under the safe harbor provisions of the Federal Securities Laws. Actual results may differ materially from those contemplated in these statements. Additional information concerning factors that would cause actual results to materially differ from these forward-looking statements are contained in today's press release and in our filings with the SEC. Except as required by law, we undertake no obligation to update these statements as a result of new information or otherwise.

During today's call, we will also discuss certain non-GAAP financial measures about our performance. You can find the reconciliation of GAAP financial measures in our press release, which is in our 8-K and will be posted on our website during this call.

With that, it is my pleasure to turn the call over to our CEO, Zach Bradford.

Zach Bradford
Thank you, Rachel. Good afternoon and thank you for taking time this late in the afternoon to join our call. CleanSpark is a value-driven company that is engaged in the once in a lifetime opportunity of building the infrastructure of the new economy. And that's exactly what Bitcoin Mining is. It is infrastructure that makes a difference in the lives of millions of people across the world. And that number is growing every day, as more people are introduced to this transformational technology.

Bitcoin is an inflection point in human history and we are proud to be part of it. This has been a quarter of execution for CleanSpark, and I'm looking forward to discussing some of those accomplishments during today's call, which we aim to keep brief, informative and targeted towards those elements most important to our shareholders.

We had our most productive quarter ever in terms of Bitcoin produce, minting 899 new Bitcoin, which is a 36% increase over the previous quarter and we are on track to exceed our original hash rate expectations. Our average production per day, even if difficulties increase have surpassed 10 Bitcoin per day. And with the significant operational progress we are seeing at Norcross, we expect to see those numbers continue to tick upward.

Well, we have mined more Bitcoin than ever before. We mined them at a lower average market price, which has weighed on our revenue generation. This has been a demanding market for high growth, innovative focus companies like ours. The macro conditions all miners say, all public companies really are changing in the face of inflation, war and the pandemics aftershock, but our fundamentals are strong.

The Bitcoin project has weathered difficult macro conditions before and we expected it will emerge strong, just like us on the other side of this business cycle. In fact, is at this stage in the business cycle, where the true winners, the strong, the wise emerge, and we intend CleanSpark to be one of those winners.

We anticipated the potential for market volatility and have built these market risks into our operating models. We've organized ourselves in such a way as to accommodate significant market shifts in price and value while supporting the future of Bitcoin.

We understand the fear and uncertainty that these market conditions may bring. We saw similar Bitcoin prices just one year ago. Our preparation means that we are already ahead of the curve. We have not overextended ourselves in the terms of our commitment. In fact, we believe that the over commitments of some of our peers could eventually create opportunities for us.

As a company, we have always chosen strategy over ideology. This approach has proven to be the best route. And many of our peers are now following suit. Bitcoin has its fair share of ideological issues [ph], and to be clear, we do believe in Bitcoin. Not only as a store value or a medium of exchange, but it's something that is likely to have a truly transformational impact on society, but that belief cannot and should not ignore market reality.

Bitcoin miners should operate in a manner that is as sustainable, long lasting and enduring as the Bitcoin project in that way the strengths of the Bitcoin blockchain become our own.

One of our defining strengths has been our infrastructure first approach to growth. We now have a line of sight on 600 megawatts of power. We expect this will enable us to power approximately 20 exahash per second, but we are starting with the infrastructure. We source low carbon power and build and source facilities before we acquire miners.

Another strength is our capital structure. After the quarter ended, we signed a $35 million financing deal with Trinity Capital. That capital is currently one of the lowest costs of capital available to us. And being non dilutive, it delivers on shareholder expectations while allowing us to finance our growth capital needs.

Lastly, I want to take a moment to mention an initiative that has been particularly important to me. Bitcoin mining is a high margin business and it is imperative that some of those financial wins are realized by employees in terms of ownership opportunities and wage gains. This is why we announced wage increases last quarter for entry level mining techs. The increase makes our workforce better paid than the workforces of even the largest technology e-commerce companies in the country. We have also started executing equity plans that bring our employees into the family of shareholders. Pride of ownership extends up and down our organization and because of that our entire team is uniquely committed to the work at hand.

As we mentioned in our last call, we have been considering strategic alternatives for the energy business. We continue to evaluate opportunity while considering the interest of our shareholders, employees and customers. We intend to focus on maximizing capital and cash flow. Over 90% of our revenues and operating profits now come from mining while we incurred losses on the energy segment. Currently, all possibilities are still on the table. But we plan to pursue the options that allow us to shore up our capital and cash flows in an expedient manner for the benefit of our shareholders. We believe this approach will allow us to shift the time and capital investments that are currently being routed to the energy segment and instead focus those efforts and capital exclusively on our mining operation.

To our long-term shareholders, our vision of abundant, clean and affordable energy future remains as clear as today we first started [ph] presented. We believe that Bitcoin mining gets us closer to that vision.

For our newest shareholders, this may be less relevant, as you were already invested in a sustainable Bitcoin mining company, but I wanted still to take a moment to explain this as transparently as possible the decisions we are making. The decisions that we believe are best for our shareholders, employees and customers.

With that in mind, I'll turn it over to Gary to discuss our financial results. After Gary's portion of the call, I'll offer some further updates on the progress we've made on the strategy we outlined in our last earnings call.

Gary the floor is yours.

Gary Vecchiarelli
Thank you, Zach. I want to begin by further echoing the comments Zach made previously. This was a quarter of operational and strategic execution. While the industry faced some macro headwinds, I believe our company has the strongest financial position in its history. With that, I'm happy to now share our financial performance for the second quarter and six month period ended March 31, 2022.

As presented in our Form 10-Q, which will be filed with the SEC today, our total revenues increased exponentially in the second quarter of 2022 versus the same quarter of the prior year. Total revenues for Q2 were $41.6 million compared to $8.1 million, representing increase of over 4 times. The overwhelming majority of this revenue was driven by our digital currency segment with revenues totaling almost $37 million. Investments in mining equipment and infrastructure, we have made to-date, have contributed to our growth in these revenues.

Our energy segment saw a healthy increase as well, growing to $4.6 million in the second quarter of 2022 from approximately $1.3 million in the same period of the prior year. The majority of this growth was due to the acquisition of Solar Watt, which occurred in the second quarter of last year. Total revenue sequentially increased approximately 1% in the second quarter versus the prior first quarter.

Revenues from the digital currency mining increased slightly, even as Bitcoin faced pricing pressure. Despite mining more Bitcoins this quarter, the average price of Bitcoin decreased in the second quarter offsetting the potential for revenue growth. The company did, however, experience revenue growth of approximately 616,000 in its energy segment, representing an increase of almost 16% sequentially between the periods.

Looking at growth profit, you will see the increase in revenues between the second quarter, this year versus the same quarter last year translated to greater profits, particularly due to the high margins that Bitcoin mining brings. Gross profit in Q2 increased to $29.5 million from $6.6 million in the same period a year ago.

When comparing the company's performance to the most recent quarter, gross profit decreased approximately $2.9 million to $29.5 million from approximately $32.4 million, representing a 9% decrease. This sequential decrease was primarily driven by the fact we had more miners in service in the second quarter, thus consuming greater energy and incurring additional direct costs.

Naturally as Bitcoin prices increase and decrease, the company's gross margin will also be affected. As you will note, our gross margins contracted between the two sequential periods decreasing from 79% in the first quarter to 71% in the second quarter, which is directly attributable to the fluctuations in Bitcoin pricing.

It is worth noting that large gross margins have decreased due to direct influence of Bitcoin pricing, we have seen no incremental cost of revenue that is concerning. The efficiency of our mining operations continues to improve month-by-month. We have no concerns about material increases to our cost of revenues in the near term.

Moving to the next slide. You will see the operating leverage of our business model continued through the second quarter. For the second quarter 2022, net income turned slightly negative to a loss of $170,000 from net income of $7.4 million the same quarter last year. The large swing compared to last year was primarily driven by unrealized gain on derivative security, which approximated $8.4 million.

Sequentially, the company saw reversal to a slight net loss as well. Net loss of $170,000 reverse net income in the preceding first quarter of approximately $14.5 million. This decrease was primarily driven by lower Bitcoin prices in the second quarter. The company realized a loss of approximately $2.8 million on sale Bitcoin in the second quarter. And this loss is due to the fact that Bitcoin earned in prior periods was recorded at a higher dollar value compared to the time when company…when the company converted Bitcoin to US dollars.

It's also worth noting that with the decrease in Bitcoin prices, the impairment expense was also lower in the current period, decreasing almost 90% from $6.2 million in the first quarter to $811,000 in the second quarter.

Now, adjusted EBITDA is a non-GAAP metric, which management uses to determine the cash flow produced from operations. Reconciliation of adjusted EBITDA to net income can be found in our earnings release and Form 8-K. You will see the theme of profitability continued as adjusted EBITDA was $22.5 million for Q2, an increase of more than 10 times over the second quarter from last year, which was approximately $1.9 million. Sequentially, the company saw just EBITDA decreased slightly by approximately $1.8 million from Q1 to Q2. Again, the primary factors which contributed to the decrease in sequential adjusted EBITDA were lower average Bitcoin prices and higher costs of revenue associated with producing a greater number of coins.

I'd like to make a few final comments regarding our second quarter operating expenses when compared to the first quarter. Payroll expenses saw an increase approximately 90% [ph] in Q2 compared to Q1 accounting for a $1.7 million difference. The company made efforts in the second quarter to reduce the cash burn in the energy segment and most of this difference is related to severance paid for reduction force in the energy segment employees and prior executives.

Additionally, we saw increases in general administrative expenses of $1.3 million, which primarily relates to stock-based compensation. This increase was directly driven by a full quarter of stock based grants, as well as an impact from severance related stock-based compensation. I'd also like to point out that did on the last call that we remain subject to various accounting rules surrounding the valuation of stock based comp.

A significant portion of this non-cash expense relates to stock compensation, which either has strike prices significantly out of the money or represents market or performance based awards, which have yet to be achieved. We are currently analyzing financial reporting impact for a stock-based compensation plan, as we look to align this non-cash expense with the economic realities of the insurance.

Professional fees saw a decrease of almost 73% or 2.4 million between the periods. As a first quarter included significant expenses related to the preparation and filing the company's Form 10-K and its first time compliance with certain provisions within the Sarbanes-Oxley Act.

When you combine professional fees, payroll expenses and G&A expense, these indirect cash expenses only increase the combined 3.8% or $540,000 between the periods. Much of that increase is taken into consideration in adjusted EBITDA as one-time expenses.

We do not believe that the trajectory of the indirect costs will continue into future quarters is our business model does not require proportionate increases in indirect costs or overhead to support greater revenues. Management continues to use the adjusted EBITDA metric to evaluate its operations, and we expect adjusted EBITDA margins to remain high, so as long as Bitcoin prices cooperate.

Turning to our balance sheet, we're approximately $1.9 million of cash on hand at March 31. Additionally, we own 420 Bitcoin, with a book value over $17 million, bringing the company's total liquidity to approximately $19 million. The company converted 1,111[1] Bitcoin to US dollars during the quarter to pay for growth CAPEX and operational expenses. We stated on the protocol, we expect to maintain minimal cash amounts on hand.

With respect to liquidity, we continue to see Bitcoin as a store of value. We have not purchased any Bitcoin with proceeds from the recently executed Trinity financing. We use those proceeds strictly for growth capital over the next few months, and the majority of the cash we received the closing still remains in our bank account. I feel this is important to note today, particularly given the slide in Bitcoin price over the last several weeks.

On a final note, I want to turn your attention to our machine commitments as of March 31. We have remained commitments for almost 13,000 additional state-of-the-art bid miner S19 series machines, which will add 1.3 exahash per second to our total hash rate. On these commitments, we have already funded deposits of almost $67 million, which will be applied to future deliveries. And I want to point out that this $67 million is already paid for using proceeds previously raised through conversion of Bitcoin and issuance of equity in 2021. The remaining cash commitment for the deliveries is approximately $20 million for which we will be using

[1] *During the earnings call, the number of bitcoins converted was mistakenly stated as 720; this transcript has been updated with the correct number*.

proceeds from the recent Trinity financing. We expect to take delivery monthly through October of this year.

As Zach discussed in our last earnings call, we expect stable price pressure on the cost per terahash due to supply chain issues being resolved, additional competition in the space, as well as macroeconomic conditions. While these current commitments will allow us to exceed four exahash per second, we're diligently working on securing the necessary number of miners to see through the Lancium agreement.

Additionally, we are actively looking to obtain the capital required for the Lancium expansion with debt as our first option. We have been transparent about our capital strategy, expect to apply what we refer to as smart leverage for balance sheet while utilizing the other levers of converting Bitcoin and only if necessary, using equity. We believe we have a very strong balance sheet and have prioritized the efficient utilization of our assets. This means we do not expect miners to be sitting idle for long periods nor do we want to over leverage our balance sheet with capital that is not put to work.

Zach, back to you.

Zach Bradford
Thanks, Gary. Before transitioning to the Q&A portion of today's call, I will briefly touch on our operational strategy. As I mentioned at the beginning of this call, we have put strategy over ideology, which has placed us in an enviable position to navigate current market volatility. Allow me to reiterate our capital infrastructure and ESG strategies.

We've adopted a capital strategy that yields operational excellence and it's rooted in the realities of our business. Take for example, our announcement last year that we would start using some of the Bitcoins we mine finance our growth in operations. The decision was met with mixed reaction. Since then, many of our peers have followed suit with one major difference. While we sold when Bitcoin was in the 60s, 50s and 40,000s, our peers are now being forced to sell when Bitcoin is in the 30s. Some of them have paired that with issuing equity at extremely low relative share prices.

We continue to execute a huddling strategy, the imperative word being strategy. We intend to hold Bitcoin and grow our Bitcoin reserves over the coming quarters, but we won't blindly accumulate Bitcoin at the cost of diluting our shareholders and taking on unnecessary debt.

Our infrastructure strategy is another example of how we are making calculated choices that benefit us now and in the future. We put infrastructure first by securing power and facilities before securing machines, which is what we have done with Lancium.

As we predicted in Q1, basic cost per terrahash has gone down at machines with nowhere to be plugged in, have begun to enter the market. At the same time, innovative technologies are becoming available that are making Bitcoin mining more efficient. We are well-positioned to take advantage of these cost savings and efficiency gains.

Speaking of Lancium, I'd like to take a moment to discuss why we chose them as a partner. Like Lancium, we shared the belief that Bitcoin mining is essential for transitioning the US economy away from fossil fuels. Lancium's clean campuses encourage the development of new renewable energy generation, while bringing flexibility and stability to the power grid. Through our partnership with them, we expect to have 50 megawatts operational with Lancium by the end of the calendar year, with another 150 megawatts operational in spring of 2023. We then have the option for an additional 300 megawatts that would bring the total capacity with Lancium to 500 megawatts.

We expect this additional capacity would be built out in 2023 and ultimately would result in power to support bringing us up to approximately 20 exahash per second. With this power to back our growth in place, we continue to look…we also continue to look for new locations, which we intend to own and operate ourselves.

Our ESG commitments also reflect our approach to strategy, over ideology. We are committed to low carbon energy and believe that Bitcoin mining plays a role in that transition…low carbon economy. We power our facilities with hydro, solar, wind, nuclear and even some natural gas, which we offset with renewable energy credits.

There is a strong market argument for using and building renewable energy. And in fact, our peers are now coming to see this as true. Trinity miners are now making efforts to clean up their acts and transition to low carbon energy.

Leading Bitcoins transition to low carbon energy is one reason we partnered with the Sustainable Bitcoin Standard. Their mission is to make Bitcoin the most sustainable asset class in the world by using market based incentive.

Bitcoin is digital gold without the harmful effects on the environment, but only when it is sustainably and responsibly mined. While we believe there is a clear moral [ph] directive to mind Bitcoin with low carbon resources, pairing it with these market based incentives, is a clear winner that we are proud to support.

In respect to our other ESG commitments, we are in the process of rolling out our ESG portal on our investor website. The portal is a one stop source for our disclosures and other information that are relevant to rating agencies and ESG minded investors.

While we don't support mandate, we do believe that the Bitcoin mining industry must lead the adoption of cleaner energy before governments mandated for us. The choice is to be self-governed or be governed. We choose to be self-governed.

Lastly, let me conclude my prepared remarks by thanking my colleagues and the CleanSpark teams that have made our successes possible. For those of you who are listening right now, I want you to know that you are doing an excellent job. We have carried out impressive work over the last quarter.

Our Atlanta teams have worked around the clock and continue to work around the clock to get our immersion cooled facility at Norcross 100% operational. I am profoundly grateful to all of you. Thank you for being part of the CleanSpark team.

Operator, this concludes our prepared remarks. We'd now like to open the line for questions.

QUESTION AND ANSWER

Operator
We will now begin the question and answer session. To ask a question, you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pickup your handset

before pressing the keys. To withdraw from the question queue, please press "*" then "2." We will pause momentarily to assemble our roster.

The first question is from Tyler DiMatteo of BTIG. Please go ahead.

Tyler DiMatteo
Hi, everybody. Good afternoon. Thanks for taking the question. Zach, if I could just go back to the comment you made about owning and operating there is maybe some other locations. What would the timeline be there, and would we look for that to be immersion cooling or what would that look like? Have we had those conversations?

Zach Bradford
Hi, Tyler. Thanks for joining, appreciated. Yes, I can address that at a high level. So, we're looking at multiple sites right now, and we are at a level of evaluation on several of those. It would be our attention that we would lean towards immersion cooling at future sites. I think that is an important part of where the industry is going as a whole. And if you look at the miners and the importance of keeping them around long term, increasing their longevity, increasing their performance, it's more likely than not that we really wouldn't be leaning into immersion, if chosen technology for future say.

Tyler DiMatteo
Okay, great. So then would we think about maybe relocating the coin mint rig, the 11,000 there or so or would we end up just the rigs we purchase then think about deploying them straight to immersion?

Zach Bradford
Yes, I think, we want to keep our options open. We would look to deploy our miners at the lowest cost areas, right? Our goal is to maximize the value. Now, if miner prices go the direction we think they're going to go, then we would be adding miners to the fleet and growing our exahash from there. If market conditions change and it makes more sense to relocate miners, then we'll make that choice. Again, what we want to be able to do is take market conditions real time and make smart decisions on how we do that. But ultimately, we're here to grow revenue and to grow value for the shareholders. So, I think the options are both possible options on the table. But that's how we're viewing it right now, is to really take real time market decisions when we actually pulled the trigger on it.

Tyler DiMatteo
Okay, great. Well, that's all I have. I will turn it back to the queue. Thanks for taking the questions guys. Appreciated.

Zach Bradford
Thanks again, Tyler.

Operator
Again if you have a question, please press "*" then "1." There are no other questions at this time. This concludes our question and answer session. I would like to turn the conference back over to Rachel Silverstein for closing remarks.

CONCLUSION

Rachel Silverstein

Before we end today's earnings call, I would like to remind everyone that this call will be available for replay later today. Please refer to today's press release for dial-in and replay instructions available via the 8-K or the company's website. Thank you for joining.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.