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Soluna Holdings, Inc.

2022 Earnings Power Illustration

Company Update

Transcript

Thank you for joining me. I'm Michael Toporek, Chief Executive Officer of Soluna Holdings Inc. This is our 2022 Earnings Power Illustration.

First, a bit of a legal preamble. The following presentation is completely qualified by legal disclosures on the following slides. Our goal is to share with you some of our strategic thinking and financial analysis that we use to guide to the growth of our business. The following discussion is in line with our principles of being accountable and transparent with our shoulders. We do operate in a hyper-dynamic economic environment. That's a fancy way of saying that things change quickly. Information in this presentation is based on our estimates and assumptions, which are our best guess as of today or the day of this presentation. We reserve the right to revise our point of view based on new information and changes in the business environment. Despite all this, an uncertain dynamic environment, we must plan to make operating and investment decisions. This presentation lays some of that out for your review. I'm going to flip through the formal legal disclosures, but I thought it was important to present that to you in plain English.

First page, second, third. As we committed to you, our owners, we're going to communicate with you frequently, clearly, and transparently about the company and its prospects. We've given you monthly reports on our progress. And once a year, we outlined for you an illustration of the company's potential earnings power if we're able to accomplish our goals for the year. This illustration is based on economic decisions that we'd make today, based on economics we understand and see today. I wanted to quickly reiterate certain of our key operating principles.

As many of you know, alignment of interests, transparency, and accountability are critical cornerstones of how we run our business and communicate with investors. Our alignment of interest comes from our ownership of over 30% of the common equity of the company. And we treat our public owners the same as we do our private investors. We get information to you every month that we believe helps you make investment decisions. We also are very focused on high-velocity execution at our company. And in terms of decision making rules, we are really careful on our cost of capital and our return on invested capital. And moreover, we are very cognizant of building a long term strategy beyond crypto mining that we're doing today.

Our key differentiator is that we are focused on buying curtailed energy from renewable power projects and converting it to computing. That in itself helps promote more renewable energy on the grid. We are problem-solvers for power producers.

So let's dive into the 2022 operating plan. Here are our 2022 corporate goals. I hope they're very clear for you to see. Our goal is to energize an additional 100 megawatts of power. In addition, we expect to hit three exahash by the end of the year, and we will originate 600 megawatts of additional projects, and we will seed, what I call, one megawatts of GPUs. This is the dispatchable computing I've talked to many of you about. I've talked to you about beginning a commercial effort around that, so that it goes from concept to idea where we can clearly identify customers, go to market, pricing, and everything we need to properly articulate to you a business plan onto how that scales.

Our complete capacity over the next year will hit 150 megawatts. This chart breaks it down between Edith, which is an existing facility, Marie and Sophie, which we scaled up this year, and a new facility we're going to bid out called Dorothy. You'll see a small sliver for that GPU effort. And this is the hashrate scaling. I do in this slide break out Q1 2023, for the main reason that in Q4 2022, the infrastructure costs and the compute costs are spent in Q4 2022, but the financial results will be seen in Q1 2023.

This slide should be fairly familiar to many of you. It lays out three different scenarios where you can see our revenue and contribution margin. Our contribution margin is revenue after taking into account all power costs and all direct personnel costs. So it very much reflects our unit economics. And you'll see that even at 20,000 Bitcoin, our run rate contribution margin scales and is fairly significant. The reason that's the case is because our power costs can ratchet down at nearly every site below 2.50 cents per kilowatt-hour. I believe that puts us in the top 20% of power costs on the network, which means that if crypto winter hits, producers like us, companies like us are likely to be the beneficiaries as higher power cost competitors begin to come offline.

Underlying this presentation is an assumption of flat Bitcoin price at 45,000 and increasing difficulty. This simply reflects a reality that we like to look at. It's forecasting against ourselves, but I think it's important that this is the planning scenario that we use going forward. Increasing difficulty, flat Bitcoin price. This is simply a summary of certain operating and financial metrics for your reference at a 45,000 Bitcoin price. We begin to scale in Q1 from a little over two and a half Bitcoins per day, to coming out of the year over eight Bitcoin per day, and in the first quarter of next year, over 10 Bitcoin per day. And you'll also see our average network hashrate assumptions, as well as our own hashrate and the capacity that we energize for that quarter. This is some more detailed information when we're at Bitcoin at 45,000. You'll notice that our run-rate contribution margin by Q4 2022 is at 114 million. And if you assume some level of corporate overhead of, call it, nine, 10, 11, 12 million, that gets us an EBITDA of over a hundred million dollars run rate.

Let's talk about certain benchmarking and capital allocation rules that we use to actively make our capital raising and capital deployment decisions. So how do we measure our success? We look at the return on invested capital. There are many ways to measure return on invested capital, include IRR, multiples of invested of capital, NPVs. But when looking at this business, it's fairly unique in that the range of possible outcomes is very high. It's a very high level of uncertainty over time.

So to make our capital allocation decision, the rules we've given ourselves is given reasonable economic outcomes, that means like a flat Bitcoin price, increasing hashrate, we have to be comfortably below a three year payback on a complete project. And looked at for processors alone, it's market-driven, but that payback needs to be substantially shorter. And we find looking at payback period is an important metric because we can tell what the world will look like over a shorter timeframe. And if you're depending on years three, four, and five to get your capital back, it's extremely be difficult to forecast that far out. So the shorter term paybacks on our capital is something we really do prefer.

So let's look at the payback period by the facility. And the way we count that is, is that the countdown begins once our facility is ramped and operational. And you'll see that from some of the information I'm going to show you going forward. So for example, for Edith, we already returned all our capital. And in Q4 2021, we were already returned twice our capital. And by the end of the first quarter, I expect that we'll return three times our capital. In Marie, assuming 15 megawatts of proprietary mining and 10 megawatts in our hosted JV, I expect our capital will be back in 22 months. And for Sophie, we're expecting 21 months. And Dorothy, which I'll get into significant detail on, we're expecting 26 months.

So many of you have seen this as we've put this out over time. You should expect this from us on every facility periodically, especially when it's matured. So I would expect to release actuals on Sophie and Marie by the end of the first quarter and begin to routinely update that. So with that said, here's our best guesstimate, as far as Marie and the return on invested capital. But as we move over time, these will become actual numbers and you'd be able to track us and see what we've actually delivered. It's the same thing with Sophie. Again, you will be able to track what we've delivered, our per-unit economics. This is where our capital decisions are clear for our investors to see.

And this is Project Dorothy. We're saying it's 26 months. We're being conservative. I sincerely hope it's closer to 21 or 22 months, but this is what we're forecasting, given information that we know right now. I'm hoping that we can come in later on at capital costs. And I'm hoping that our power costs end up to be somewhat lower so that we're able to deliver better numbers. But based on what we know, this is a good forecast.

So let's look at our capital expenditure budget that's required to build out our business. If you separate it out between compute and infrastructure, you'll see it computes about 227 million, infrastructure's about 60, for a total of 287 million. I also have that broken out by location. And specifically, we break down Dorothy into two phases, phase one and phase two. Phase one, share power infrastructure. But within phase one, we break down to be to 25 megawatt units. And the same thing with phase two. Phase two has shared power infrastructure, but we are down to economic units. And we'll report to you by 25 megawatt units inside each phase of Dorothy.

In addition to that, we expect to spend some money on GPUs, general technology, and you'll see all other CapEx. That CapEx is basically buying certain infrastructure for 2023, so that when we talked to you about building out, we actually have ordered the electrical infrastructure to do that. Very similar to what we did this year, so we would have the electrical infrastructure coming in so that we can build out the first half of the year's projects. Also note that this is the total CapEx spend without regard to cash generated by the business. We expect the business to generate somewhere in the range of

20 to 40 million dollars, which would reduce the external capital required to fund this level of capital expenditures.

Many of you have seen this before. We do have a variety of financing options that we consider from time to time. Equipment financing, debt financing at the project level, debt at the corporate level or some sort of secure credit facility. I've talked to you about equity partnerships, preferred equity, and common equity. Let's look at the pluses and minuses of some of these. I'm not going to get into too much of detail. Equipment financing, known cost, no dilution. It's expensive and short amortization period, but the thing we like about it is it's secured by a defined pool of assets. It's not a corporate credit. The next piece is a corporate credit or a larger secure debt facility that tends to have lower interest cost, easier amortization. In exchange, there's probably some warrant attached to it to make up for that. Project equity, we've talked about. We like that in that allows us to monetize our IP.

We're earning money on another party's capital. It helps us grow the company and build out our pipeline while minimizing dilution. It's complicated. The world of partners isn't huge, we already have some commitments for it. And we need to really balance our use of this with corporate ownership, because we do need to scale up our business. We like preferred equity, no dilution, no amortization or principle payments, but there is a required dividend payment. And common equity, it's the most flexible instrument. It doesn't require repayment, but does provide for some level of dilution of our ownership.

When we talk about the capital expenditure budget, it's important that our investors understand that we consistently will assess the economics of the capital cost and the opportunities to deploy that capital to achieve excellent returns. Market environment and I don't just mean capital market requirement. I mean the Bitcoin ecosystem from equipment and expenditures to hashrate to Bitcoin prices will determine if we're seeing the rates of return necessary to justify raising additional capital. Also, one quick way to reduce the size of the capital that we're spending is to change the equipment mix. We're seeing very, very good returns on things like the WhatsMiner M20 in terms of short payback periods. It's not nearly as power-dense as the S19s, but in terms of filling our facility with shorter payback equipment, it's extremely economical and requires significantly less capital that I have in this budget here.

Also, we have something the market needs. We've got plugs. We've got low-cost plugs. So can we structure an advantageous hosting relationship? We can. And we demonstrated that the pricing we got before had under one year payback for our infrastructure. Are we going to duplicate that again? Probably not. But can we get a payback on our infrastructure in one and a half years? Absolutely. And the beauty of the payback of one and a half years on our infrastructure is that's a long-lived asset. We could run that infrastructure for 20 years. We have purpose design buildings that are solid, that will last a long time. So imagine building out a 20-year asset and making an economic arrangement with someone to use that asset for, call it, a year and a half, call it two years, and have them pay for the entire value of constructing that asset.

That's extremely advantageous. So by taking advantage of changing the equipment mix to something less power-dense, but probably a higher return on invested capital and perhaps seeking a hosting arrangement, we can dramatically ratchet back the amount of capital we need to raise. Can we take it down to 100, 110, 120? Absolutely. Can we take it down to 200? Absolutely. So we're not a raise capital, any price, grow to the moon group. We're focused on the cost of capital, growing efficiently, growing intelligently in a way where we're raising capital effectively and deploying it effectively, not simply sending orders to Bitmain at market prices. On this slide here I talk about, again, the various forms of financing and the pricing that we're seeing in the marketplace for these sorts of things. Obviously, the markets are very dynamic especially for financing our sector.

So this is based on information we know today from the marketplace, we're having active discussions on each of these things. And I think we're spending particular emphasis of our time is on the corporate debt on the secure debt facility is on terms where we can get 50 to 100 million at a time at a lower interest rate, something in the eight, nine, 10% with very easy amort over four years.

For example, no amort the first year, light amort the second, slightly heavier the third, and then finishing out the fourth with a bullet payment. We're mindful of fixed charge coverage. It's important to us. And in order to compensate the lender on top of a lower coupon, there might be some PIK. So for example, instead of a 10% coupon, maybe we negotiate a lower cash coupon, a PIK to take them to 10%, and some warrant coverage to compensate them for the additional flexibility they've given us relative to something like the short-term equipment financing. Those are active dialogues. I cannot commit to them turning into a financing transaction, but that is something we're aggressively pursuing. We're looking at all of the options on this page, and I would expect to report to you as we close in on some of these and get them done.

Let's talk to you a little bit about each location and telling you its status and what we're hoping to get done there for the year. Edith's a mature site, steady-state operations. We had a great run mining RVN coin. It halved in January 2022. We've moved to a couple other alt coins that are slightly less profitable, but we're repurposing our GPUs and we expect to have continued strong performance there. Marie, in our prop mining, we're about 174 petahash. Our host at JV is fully up and running in 270 petahash. We have some, as I mentioned in my flash, transformer upgrades going on in January to move of us from just under 21 megawatts to 25 megawatts by the end of January. So I expect we'll be going full bore there with 25 megawatts lit up by the end of January. Our proprietary mining continues to grow rapidly. We have the plugs. The miners are on order, they're coming in, and we do expect to hit our near-term targets.

Sophie team did an amazing job. Delivered on time, on budget, energized 25 megawatts by the end of 2021. Construction's done, office and warehouse finishes are in progress. The miners are on our order to hit our near-term targets that are coming in. We're plugging them in and mining and we will hit our near-term targets. Let's talk a little bit about project Dorothy. Project Dorothy is 150 megawatts in potential capacity. We intend to build out 100 megawatts so that it's co-located at a wind farm in Texas. We've broken it out into two phases, each of 50 megawatts. And each phase has a shared infrastructure. Within those phases, we've broken it down into 25-megawatt units. We're modeling in $27 per megawatt-hour cost. I would hope and possibly expect that that would come in significantly lower than that. Our 2022 plan lays out the timing of that.

And let me share that with you on the next page. Let me share with you some of Dorothy's key milestones, what we expect to do and by when. In February and March for phase one, we expect to break ground. By May through June, we expect to energize the first 25 megawatts of phase one. And July and August, we expect to energize the second 25 megawatts of phase one. In June, July, we expect to break ground on phase two. And we expect to be energizing, September through October, 25 megawatts of the first part of phase two. And the second part of phase two, November through December. Let's talk a little bit about origination and pipeline. We have a significant pipeline of projects. So some investors have asked me why we've taken in third party project equity. Why do we need it? The goal is to establish a structure that's attractive to investors, yet gives us a significant portion of the upside once their capital is returned.

And so if many of the projects in our pipeline come to fruition, we're not faced with having to fund the equity for those projects purely out of corporate dollars. We developed a group of investors that understands our structure, understands that we're very strong operators, and has experienced positive returns with us on our projects. And they can scale up to help fund equity in many of these projects, so that we have an opportunity to make the choice in particular projects, how much corporate capital goes into the equity and how much third party capital comes into the equity. Again, bouncing off our cost of equity and the opportunity for our investors to earn returns on other people's invested capital. This is a handy page that summarizes our key operating targets for 2022. Rip it out, stick it on your bulletin board, take a look at it, see how we do.

I wanted to thank you for joining me today. And in this appendix, I'd just like to run you through some of, what I call, these heat maps. They help you look at some revenue and contribution margin sensitivities over time as we build out our facilities. I've talked to certain investors that have requested this kind of sensitivity analysis. And in response, they request, I felt compelled to include this, to help our investor community assess our economics in different hashrate and Bitcoin pricing environments. So again, thank you for this opportunity to talk to you about how our business is doing. And please feel free to contact us with any questions or a desire for additional information. Have a good evening.

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To supplement our consolidated financial statements, which are prepared and presented in accordance with GAAP, we use the following non-GAAP financial measures: non-gaap revenue, contribution margin, adjusted cost of cryptocurrency revenue and adjusted EBITDA contribution. The presentation of this financial information is not intended to be considered in isolation or as a substitute for, or superior to,the financial information prepared and presented in accordance with GAAP.

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Numbers presented BEFORE the release of Form 10-Q for fourth quarter ended December 31st, 2021, are monthly estimates and subject to change upon final accounting adjustments and entries. These monthly estimates are presented as an illustration of management’s review of key metrics that help in understanding the performance of the Company. Readers are strongly encouraged to review this presentation in connection with the Company’s Quarterly Report on Form 10-Q for the period ended March 31, 2021, Company’s Quarterly Report on Form 10-Q for the period ended June 30, 2021, Company’s Quarterly Report on Form 10-Q for the period ended September 30, 2021, and the Company’s Annual Report on Form 10-K for the year ended December 31, 2020.