'You'll See Liquidations': Post-FTX, Crypto Data Centers Face An Uncertain Future

November 27, 2022 | Dan Rabb, Bisnow Data Centers Reporter (https://www.bisnow.com/author/dan-rabb-496530) (mailto:dan.rabb@bisnow.com)

Operators of cryptocurrency mining (https://www.bisnow.com/tags/cryptocurrency-mining) facilities are fighting to stay afloat as the price of bitcoin (https://www.bisnow.com/tags/bitcoin) continues to plummet, but a prolonged crypto winter could present opportunities for those who manage to survive.

Fallout from the implosion of cryptocurrency (https://www.bisnow.com/tags/cryptocurrency) exchange FTX has had a devastating impact on already struggling bitcoin miners.

Companies that mine bitcoin or operate the facilities where miners host their computer equipment —or, in many cases, that do both — are struggling to keep their heads above water as the scandal surrounding FTX has eroded investor confidence in all things crypto and driven the already-discounted price of bitcoin down even further. Experts foresee bankruptcies and liquidations in the months ahead.

But while the crypto mining sector may see significant consolidation, some miners and hosts with cheap power and few debt obligations may be better positioned than many of their competitors to survive this extended downturn. Some may even be primed to thrive and grow opportunistically in a sector that could soon be flooded with distressed assets. And while most investors are now keeping the entire crypto sector at arm's length, some are already making bets on who these winners and losers will be.

“We’re going to see a pretty massive reshuffling of the deck chairs,” said Barry Kupferberg, managing partner at Barkers Point Capital Advisors. “There’s going to be a rejiggering of the whole field, but there are some who can probably take advantage of this.”

FTX, along with its affiliated crypto trading firm Alameda Research, imploded in early November (https://www.nerdwallet.com/article/investing/ftx-crash) amid allegations of widespread financial malfeasance. A company that at the end of October was the world’s third-largest crypto exchange and seemingly a beacon of the sector’s legitimacy had filed for bankruptcy by Nov. 11, its founders under federal investigation (https://fortune.com/2022/11/14/federal-prosecutors-investigating-ftx-collapse/) in a rapid collapse that has been painted as crypto’s version of Enron (https://time.com/6234801/ftx-fallout-worse-than-enron/).

The fall of FTX also further tanked the price of Bitcoin and other cryptocurrencies, which had already lost around a third of their value since the start of the year. Between Nov. 6 and Nov. 9, the price of bitcoin fell from over $21K to less than $16K, a 26% decline.

This latest drop in bitcoin prices — and the realization that the end of the so-called crypto winter may be far in the future — has been a shock to the system for crypto miners and hosts, many of whom were already struggling with bitcoin prices that barely exceeded the cost to produce them.

The decline of bitcoin from its $60K highs a year ago has coincided with a global energy crisis that has driven up the cost of power, by far the largest expense for miners. Add in rising interest rates (https://www.bisnow.com/tags/rising-interest-rates) and significant debt service from rapid expansion and even some of the industry’s largest players found themselves under water.

Compute North, one of the largest operators in the bitcoin mining space, filed for bankruptcy (https://www.bisnow.com/nashville/news/data-center-bisnow-national/major-cryptocurrency-miner-files-for-bankruptcy-115553) in October, even before FTX’s collapse. Experts say the FTX-linked decline in bitcoin prices is going to drive more operators into the red.

“Just do the simple math: With bitcoin trading at $16K there’s almost no margin or even a gross margin for many of these guys with seven or eight cent electricity, which is about average for them,” Kupferberg said. “I suspect we may see a situation where people are just not going to be able to even reorganize. I suspect you’ll see liquidations.”

The miners who are in the most trouble are those without the liquidity to ride out the storm and who have significant debt service payments that are eating into whatever margins they have, if they exist at all, Kupferberg said.

At the height of the crypto craze, many miners took on heavy leverage in order to expand quickly and stake out their share of a booming market that seemed to be climbing ever higher. Now, unless these companies are somehow able to restructure their debt obligations to push payments down the road, have an unusually low cost of capital or are somehow able to access enough liquidity to survive until the price of bitcoin rises again, it could be lights out.

"Crypto is a nascent space, and in the last couple of years when a lot of these businesses were capitalized, it was like capitalizing an oil company assuming there will be $100 oil forever — a lot of them were spun up and raised money in what I would classify as a bit of a fervor around crypto," said Jake Roberts, an associate with TPH&Co. "If you're predicating your business on being able to service debt at a sustained $40K or $60K bitcoin price and it ends up sustaining at $16K or $20K for a long period of time, it's going to be troublesome."

Many in the mining sector are in survival mode, turning to any means available to reduce debt and access the liquidity needed to operate at a loss long enough to ride out a protracted downturn that has no end in sight.

On a Nov. 9 earnings call, Stronghold Digital Mining CEO Greg Beard described a frantic companywide scramble to return 20,000 mining rigs to creditors in a matter of days in order to extinguish $57M in debt. The company also refinanced its remaining debt to push payments two years down the road and add liquidity to the balance sheet. Stronghold has also begun selling some of its self-produced power back to the grid instead of using it for mining.

Miners like Stronghold may be getting creative to stay afloat, but many across the sector are likely not going to survive the downturn, experts say. Core Scientific (https://www.bisnow.com/national/news/data-center/crypto-crash-has-currency-miners-putting-some-development-on-hold-113112), one of the largest miners, is expected to file for bankruptcy (https://www.forbes.com/sites/rosemariemiller/2022/10/27/core-scientific-unable-to-pay-bills-warns-of-bankruptcy/?sh=d480f845c4b6) in the weeks ahead. And even those at the helm of large crypto mining firms say it's not a question of if others will follow, but of how many.

“We've seen a number of announcements come out from various parties in this space that are struggling on the leverage side of their business, so I do think over the next six to 12 months, we inevitably will see consolidation,” said Jaime Leverton, CEO of Hut8 Mining, on the company's third-quarter earnings call this month.

“On the back of what we're seeing happen with FTX and Alameda, we don't really understand what the contagion is going to be as a result of that and don't know where all of the exposed counterparties are," Leverton added.

Regardless of how long crypto winter lasts, access to cheap power will be the other major determinant of who is able to survive. The cost of fossil fuels like oil and natural — and thus the cost of power from most utilities — has skyrocketed in recent months, and miners reliant on these energy sources face an uphill battle.

But others have managed to insulate themselves from this energy volatility to varying degrees, obtaining some or all of their power directly from wind or solar (https://www.technologyreview.com/2020/02/27/905626/how-texass-wind-boom-has-spawned-a-bitcoin-mining-rush/) farms, hydroelectric dams (https://bitfarms.com/) or nuclear power plants. (https://cumulusinfra.com/) They have secured this power with relatively stable pricing, either through agreements with providers or by generating the power themselves.

In an operating environment where margins are slim, Roberts said these companies have a leg up.

“I'd be more interested in guys who have long-term contracts or guys that are able to produce their own power and have some sort of control over costs," Roberts said. “At the end of the day, in a commodity business — and theoretically that's what bitcoin is — cost is going to be the ultimate factor in success here.”

Although it has been less than a month since the FTX collapse, some operators that may be well-positioned to survive the downturn are already looking at how to take advantage of a distressed sector, looking for value plays that will improve their market position in a shrinking industry. And investors seem willing to bet on at least some of them.

In mid-November, despite the chaos in crypto land, Australian miner Arkon Energy acquired Hydrokraft AS (https://www.coindesk.com/business/2022/11/17/startup-arkon-energy-raises-28m-to-further-expand-into-bitcoin-mining/), a 60-megawatt data center in Norway powered by renewables, for $28M. Crypto host Applied Digital — formerly Applied Blockchain — raised $100M earlier this month (https://www.forbes.com/sites/mariagraciasantillanalinares/2022/11/21/applied-digital-shifts-gears-starts-100-million-fund-to-buy-crypto-mining-machines-for-its-data-centers/?sh=112961ee6045) to snap up distressed mining hardware and received a $15M construction loan (https://ir.applieddigital.com/sec-filings/all-sec-filings/content/0001144879-22-000081/0001144879-22-000081.pdf) to expand its mining operations in Texas. Properties sold off as part of Compute North's bankruptcy quickly found eager buyers (https://decrypt.co/114900/bankrupt-compute-north-sells-1-55m-assets-flared-gas-bitcoin-miner) that plan to continue mining on the sites.

Miners like Bitfarms with relatively strong balance sheets are already presenting themselves to investors as poised for opportunistic growth in a distressed sector, with CEO Geoff Morphy telling analysts the company is “truly well-positioned to take advantage of emerging opportunities and be a consolidator in the industry.”

“You might actually be having a pretty good time if you have a competitive cost of electricity and a capital structure that allows you to not have to pay a lot of it back to the capital right now. If you have those two things you might be able to take advantage,” Barkers Point Capital's Kupferberg said. “The shock has been so quick, but this kind of thing is happening slowly, and I think it will accelerate as more people get comfortable that there is a bottom to the market.”

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