https://www.wsj.com/articles/behind-the-celsius-sales-pitch-was-a-crypto-firm-built-on-risk-11656498142

◆ WSJ NEWS EXCLUSIVEFINANCE

Behind the Celsius Sales Pitch Was a Crypto Firm Built on Risk

The lender had little cushion in the event of a downturn or mass withdrawals, investor documents show

By Eliot Brown Follow *and Caitlin Ostroff* Follow

June 29, 2022 6:22 am ET

Celsius Network LLC CEO Alex Mashinsky built his cryptocurrency lender into a giant on a pitch that it was less risky than a bank with better returns for customers.

But investor documents show the lender carried far more risk than a traditional bank.

The lender issued numerous large loans backed by little collateral, according to Celsius investor documents from 2021 reviewed by The Wall Street Journal. The documents show that Celsius had little cushion in the event of a downturn, and made investments that would be difficult to quickly unwind if customers raced to withdraw their money. Celsius didn't respond to requests for comment from the Journal.

Celsius had $19 billion of assets and roughly $1 billion of equity as of last summer, before it raised new funds, according to Celsius investor documents from 2021 reviewed by the Journal. The median assets-to-equity ratio for all the North American banks in the S&P 1500 Composite index was about 9:1, or about half that of Celsius, according to data from FactSet.

For banks, that ratio is of great importance: Regulators look at it as an indicator of risk. For unregulated companies like Celsius, the ratio of 19-1 is particularly high given that some of its assets were investments in the extremely volatile crypto sector, said Eric Budish, an economist at the University of Chicago's business school who studies cryptocurrencies. Large banks often have ratios near Celsius's, but they hold much more stable assets and have access to central-bank loans for ready cash.

"It's just a risky structure," Mr. Budish said of Celsius. "It strikes me as diversified as the same way that portfolios of mortgages were diversified in 2006," referring to a feature of the 2008 financial crisis. "It was all housing—here it's all crypto."

The five-year-old company is now one of the highest profile crypto firms fighting for survival, as the sector is struggling amid a plunge in cryptocurrency values. Last week, Celsius tapped consultants to advise on a potential bankruptcy filing, the Journal previously reported. That followed the company's June 12 freeze on all withdrawals, citing "extreme market conditions."

Celsius's future is being watched closely in a market that features a web of crypto financial firms lending to each other, where many investors fear contagion. With sliding crypto prices, crypto investors are being asked to put down more collateral on their loans to prevent liquidation.

Crypto broker Voyager Digital issued a default notice to Three Arrows Capital after the hedge fund failed to make payments on its loan of $675 million. The hedge fund suffered heavy losses on the collapse of the cryptocurrency TerraUSD. Last week, rival lender BlockFi said it had struck a deal for a $250 million line of credit from a cryptocurrency exchange amid concerns by its own depositors. Smaller firms have frozen withdrawals, too.

Founded in 2017 by Mr. Mashinsky, Celsius surged amid the crypto boom to become one of the biggest crypto lenders, with more than $12 billion in deposits. Customers, wooed by high interest rates, flooded in, while venture capitalists showered it with money.

Contrasts with banks were at the center of Mr. Mashinsky's public persona. Mr. Mashinsky frequently said Celsius passed along 80% of its lending revenue to customers in the form of its high yields. He often wore a black T-shirt reading, "Banks are not your friends."

Compared with banks, "we have much less risk, but we've managed to deliver high single-digit, low double-digit numbers," Mr. Mashinsky told the YouTube channel CTO Larsson in August. Mr. Mashinsky said on a podcast last month that while "normally in panic, everybody runs to the bank and withdraws their money because they're afraid the bank is going to fail," Celsius had proven different in crypto downturns, as its business increased.

With growth rocketing upward, the company raised $750 million last fall in a round led by venture-capital investor WestCap and Canadian pension fund Caisse de dépôt et placement du Québec. The funding, which could have lowered Celsius's leverage ratio depending how it was deployed, valued the company at more than $3 billion.

Key to Celsius's fundraising pitch was its fast-growing profits. Celsius gave projections to investors last spring showing deposits would top $108 billion in 2023, and revenue would hit $6.6 billion, according to documents it provided to investors in advance of raising money. It forecast that its earnings—before accounting for charges such as interest or depreciation—would be $2.7 billion in 2023, more than six times its 2021 profit projection.

Adding to Celsius's leverage was money borrowed from others including Tether International Ltd., which issues a cryptocurrency pegged to the U.S. dollar. As of last summer, Celsius had a credit facility for up to $1.1 billion from Tether, which itself was an early investor in Celsius with a 7.8% stake in the lender as of last spring, Celsius told investors.

A spokeswoman for Tether said that there is no link between the company's investment in Celsius and Tether's reserves or stability. She added that the credit facility has been liquidated with no losses to Tether, without saying when and why it had been liquidated.

Celsius's appeal to consumers lay with high interest rates offered on their deposits. Customers parking their crypto with Celsius were rewarded with annual yields up to 18.6% on some cryptocurrencies and 7.1% on stablecoins—cryptocurrencies pegged to the dollar—that was much higher than rates of about 0.1% offered by many U.S. bank savings accounts.

Like a bank, Celsius was able to pay yields to customers largely by making money through lending at even higher yields to others.

One of its biggest units was lending to other crypto financial businesses, including digital-asset manager Galaxy Digital and institutional crypto-lending firm Genesis, Celsius told investors. Celsius projected in May 2021 that institutional lending would bring in about $290 million of revenue for the year, more than one-quarter of total revenue, the documents reviewed by the Journal show.

While banks like loans to be overcollateralized—homeowners taking out a mortgage post their house as collateral, which is valued at more than the loan—Celsius required its business borrowers to post only an average of about 50% collateral on its $2.7 billion of loans as of last spring, the documents show. Undercollateralized lending is considered a risky practice, one that was more generous than that of many of Celsius's competitors.

Celsius used some of that collateral to borrow more money itself, a process known as rehypothecation, adding additional risk.

While regulators push big banks to keep some of their assets in categories such as cash or bonds that can be liquidated quickly, Celsius had large portions of its assets tied up investments in financial products that are difficult or impossible to cash out of quickly, adding to its vulnerability in the event of a wave of withdrawal.

Many of these investments were done through a technique called "staking" cryptocurrencies, which is akin to a certificate of deposit account at a bank, in which Celsius was guaranteed a high interest rate in exchange for not being able to access the cryptocurrencies for months.

One of Celsius's such investments was known as Synthetix, offering Celsius around 23% annual yield, though Celsius had to keep the money in the investment for about a year, according to one of the documents. Celsius owned $90 million of Synthetix's tokens as of May.

Another big investment was related to the cryptocurrency ether. Celsius recently placed at least $470 million in so-called Lido-staked ether, an investment product managed by Lido Finance that prohibited Celsius from quickly removing its assets, the Journal previously reported. Staked ether is tied up until the long-delayed release of a new version of the Ethereum blockchain that the Ethereum platform said would happen "soon" but didn't specify a date.

Celsius's investor documents said it had $3.7 billion in assets as of spring 2021 in a broad category of staking and decentralized finance, which includes other forms of crypto lending.

Other Celsius investments included its own bitcoin-mining operation and a futures-arbitrage practice. The falling price of bitcoin has eaten into bitcoin miners' bottom line in recent months.

Smaller crypto lenders are facing problems similar to Celsius's, with their investments tied up amid a wave of margin calls and withdrawals. Given that lenders often borrow from other lenders, companies throughout the sector are rapidly depleting on-hand cryptocurrency reserves, analysts say.

Many see notes of past banking busts. Contagion was a feature of the 2008 global financial crisis, when bank-lending practices—including rehypothecation—left them short on cash.

"None of this is new. We're just kind of repeating everything we've done before," said Joe Abate, a research analyst at Barclays.

—Additional reporting by Vicky Ge Huang.

Write to Eliot Brown at Eliot.Brown@wsj.com and Caitlin Ostroff at caitlin.ostroff@wsj.com

---

Cryptocurrency Markets

Related coverage, selected by the editors

The Crypto Party Is Over

Where Does Crypto Go From Here?

Behind Celsius Sales Pitch Was a Lender Built on Risk

Man Behind TerraUSD Has a New Coin for You

Hedge Funds Are Betting Against Tether

A Crypto Bankruptcy Could Be Investors' Nightmare

The Stablecoin Price Crash Explained

Bitcoin: What to Know Before Investing