Sunnova Energy International

Q1 2021 Earnings Prepared Remarks

Operator:

Good morning and welcome to Sunnova's first quarter 2021 earnings conference call. Today's call is being recorded and we have allocated an hour for prepared remarks and question and answer. At this time, I would like to turn the conference over to Rodney McMahan, Vice President, Investor Relations at Sunnova. Thank you. Please go ahead.

Rodney McMahan:

Thank you, operator. And, good morning everyone. Yesterday we released our earnings press release and posted a slide presentation to the Investor Relations portion of our website which will be referenced during this call.

Joining me today are John Berger, Sunnova's Chairman and Chief Executive Officer and Robert Lane, Executive Vice President and Chief Financial Officer.

Before we begin, let me remind everyone that this call may contain certain statements that constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These include remarks about future expectations, beliefs, estimates, plans and prospects. Such statements are subject to a variety of risks, uncertainties, and other factors that could cause actual results to differ materially from those indicated or implied by such statements.

Such risks and other factors are set forth in our press releases and filings with the Securities and Exchange Commission. We do not undertake any duty to update such forward looking statements.

Additionally, during today's call, we will discuss non-GAAP measures, which we believe can be useful in evaluating our performance. The presentation of this additional information should not be considered in isolation or as a substitute for results prepared in accordance with GAAP.

A reconciliation of these non-GAAP measures to the most comparable GAAP measure can be found in our earnings release.

I will now turn the call over to John.

John Berger:

Thank you, Rodney.

Good morning and thank you for joining us.

2021 is off to an excellent start thanks to strong Q1 results, the quick closing of the SunStreet acquisition, and our continued ability to grow faster than the overall market. Sunnova is well-positioned for an exciting year ahead, which includes delivering on its reaffirmed full-year 2021 guidance.

On slide 3, you will see the details of our strong operational results where we grew our customer base, increased both our battery penetration and attachment rates, and continued to expand our dealer network.

Our customer growth remains healthy, as we've added 8,900 customers in the first quarter of 2021. This is before any contributions from the SunStreet acquisition which closed on April 1.

On storage, we continue to see strong demand as frustrated homeowners seek out more reliable and resilient energy solutions to combat outdated and ineffective power grids. As discussed during our last earnings call, this demand outpaced available inventory in the second half of 2020 resulting in an industry wide supply constraint in Energy Storage Systems. However, these constraints began to subside in

Q1 resulting in an increase in our battery attachment rate on origination from 19% in Q4 2020 to 23% in Q1 2021.

With this strong customer focus on reliability and resiliency, we continue to see an increasing penetration rate of storage on our full customer base. Our penetration rate now sits at 10.5% as of March 31, 2021, more than double where it stood just one year ago. We expect this rate to rise even further and could see it reach as high as the mid-to-upper teens by the end of the year on an expected customer base of roughly 200,000.

This exceptional growth is fueled by our over 500 dedicated dealers and sub-dealers. Driven by the attractiveness of the Sunnova Network, we anticipate our dealer count to grow even further in the coming quarters and be at or near 1,000 by the end of 2022.

Finally, on this slide we have added information on customer contract life and expected cash inflows. As of March 31, 2021, the weighted average contract life remaining on our customer contracts equaled 22.4 years while the cash inflows we expect to receive over the next twelve months, taking into account only our existing customer base of 116,400, stands at $266 million, or $2,285 per customer.

Turning to slide 4, we provide a summary of our Q1 2021 financial results. On our Q4 2020 earnings call we noted that we expected to capture approximately 15% of both our full-year 2021 Adjusted EBITDA and principal and interest from solar loans in the first quarter. I am pleased to report we exceeded that target, as actual Q1 2021 results were all ahead of that goal.

As expected, our cash flow results were negative for the quarter due to the typical seasonality of our business as well as the impact of large annual cash expenses exclusive to Q1. We continue to anticipate large year-over-year growth in Adjusted Operating Cash Flow for full-year 2021 as well as maintain a break-even midpoint on our Recurring

Operating Cash Flow, so investors should expect these results to be positive for the balance of the year.

On slide 5, we provide a summary of our full-year Adjusted EBITDA and the Principal and Interest we receive on solar loans from the past few years, including our guidance estimate for 2021. As you can see, we have experienced significant growth in these key financial metrics with Adjusted EBITDA expected to double between 2018 and 2021 and solar loan P&I to increase seven times over the same time period. This rapid growth, together with our anticipated issuance of a non-amortizing green bond at the corporate level, should translate directly into a significant increase in Recurring Operating Cash Flow in the coming years.

On slide 6, you will see both our Gross Contracted Customer Value, or GCCV, and our Net Contracted Customer Value, or NCCV, are experiencing significant increases year-over-year. Using what is now a conservative discount rate of 4%, NCCV increased from $1.2 billion on March 31, 2020 to $1.8 billion on March 31, 2021. This equates to roughly $16.62 per share as of March 31, 2021, which is approximately a 15% increase from March 31, 2020. We continue to see NCCV per customer and services per customer trending higher.

While the NCCV per share calculation is relatively straight forward, it excludes any value for growth, renewals, or upsells. Given that these cash flows are financed almost entirely with debt, whose interest rate we continue to lower, and presently sits below the 4% discount rate used to calculate NCCV, we view this as a metric that is well below any reasonable valuation floor for our common shares. As such, we encourage investors to consider other valuation methodologies such as those that utilize cash flow metrics or consider attaching a multiple to a forward estimate of our Adjusted EBITDA and the Principal and Interest we receive on solar loans.

Although these metrics, especially NCCV, vary in growth quarter-to-quarter due to financing transactions, one-time items, and growth intensity we do expect these metrics to grow at or above the rate of our customer growth when viewed over several years. The growth in Adjusted EBITDA and the P&I from our solar loans should trend higher than customer growth once meter replacement spend ends and growth investment abates in the coming years.

Earlier this month, Sunnova published its inaugural ESG report, detailing the company's strategy and performance on material ESG themes. As noted on slide 7, this report is aligned with leading ESG frameworks, including the Sustainability Accounting Standards Board and the United Nations Sustainable Development Goals.

As I have said from the beginning, I founded Sunnova to deliver a better energy service at a better price, and to make a positive difference in the lives of our customers, community, and the world. I firmly believe that we have a moral imperative to make the world a better place for future generations and at Sunnova, we intend to do just that by leading to a cleaner and more sustainable energy future.

Since inception through the end of 2020, Sunnova systems have generated 2.4 billion kWh of clean energy resulting in 1.7 million metric tons of CO2 avoided. Not only do our systems help address climate change and avoid pollution, but they also provide our customers with affordable and reliable power that they can feel good about.

While we believe that our core business is fundamentally more environmentally sustainable than the old energy paradigm, we also believe it is important to not rest on our environmental strengths alone, but to also focus on being a good corporate citizen and making a positive difference in the communities where we operate. We are proud to support high-quality and good paying jobs in both Houston and across the United States and its territories. In addition to supporting green jobs, we have also supported our communities in times of need, such as after

Hurricane Maria struck Puerto Rico. In the aftermath, Sunnova was there to support power service recovery efforts by donating panels and batteries to families and nonprofits in need. To this day, we remain by far the largest residential solar and storage service provider on the island.

We are also committed to upholding strong corporate governance practices and conducting business the right way as our core values of Service, Synergy, and Sustainability underpin our corporate culture. We look forward to continuing our work on ESG and will continue to communicate our progress over time. We welcome your feedback on our first report as we enhance our strategies for long-term ESG performance.

I will now turn the call over to Rob to walk you through our financial results, our recent financing activities, and our guidance in greater detail.

Rob Lane:

Thank you, John.

Turning to slide 9, you will see the momentum we have gained in our first quarter results over the past few years. For instance, Q1 2021 revenues are up 55% from Q1 2019 while over the same period Adjusted EBITDA and the principal and interest received on solar loans increased by 58% and 237%, respectively.

As John noted earlier, Q1 historically generates negative Adjusted and Recurring Operating Cash Flows which you can see reflected on this slide. However, the year-over-year trend remains up and to the right as we gain operating leverage.

Slide 10 summarizes our recent financing activity.

The 2021 financing transactions completed to date include our first solar loan securitization of the year in February that was sized at $189 million and achieved a weighted average blended yield of just over 2%.

Other financing activity included a loan warehouse restructuring of $350 million and $75 million in new closed tax equity funds. We have additional commitments of approximately $500 million of tax equity that we expect to close in the near future.

We will continue to work with lenders to properly finance the company with the goal of increased near-term cash flow to the corporate balance sheet. To facilitate this we remain focused on the issuance of a green bond within the next few months which should help turn our strong Adjusted EBITDA and P&I growth into strong Recurring Operating Cash Flow.

Our total cash balance as of March 31, 2021 was $263.5 million, up from $169.2 million at March 31, 2020 but below our all-time quarter-end high of $377.9 million at December 31, 2020. This decline since the end of last year was primarily driven by over $30 million in securitized debt pay-downs, intentional under-borrowing on our warehouse facilities, the timing of tax equity contributions relative to fund-specific construction milestones, the overall seasonality of cash flows as previously discussed, and a high level of EPC spend fueled by our robust growth that made up approximately 84% of the company's total cash outflows for the quarter. In summary, this change in cash primarily reflects our usage of working capital to facilitate our high rate of growth.

On slide 11 we provide additional color around unit economics. As you will see, our fully burdened unlevered return on new origination was at 8.9% as of March 31, 2021, based on a trailing twelve months, while a similarly calculated weighted average cost of debt was 3.1%. This resulted in a trailing twelve months implied spread of 5.8% as of Q1 2021, above the 5.1% spread for full year 2020.

As a technology-enabled service company, we focus on the long-term relationships we have with our customers, which serves as both our value driver and cash flow engine. Looking at our margins across all

services and service contracts, we estimate that, net of allocated overhead, we achieve approximately 60% of our net spread from financing our service contracts and approximately the remaining 40% from all our other service offerings. We have seen this split move more towards a lower percentage generated from the financing of customer contracts as the number of and contributions from Sunnova's non-financing services grows and expands, a trend we expect to continue for the foreseeable future. We estimate that we achieve a gross margin of 50% on our service revenues.

While unit economics can fluctuate quarter-to-quarter we expect to continue to see improving fully burdened unlevered returns. This is true regardless of any changes to average system size, regional mix, or even contract mix, such as the shift we are currently seeing away from leases and PPAs to more loans. As we have noted on numerous occasions, we are finance contract type agnostic and thus are just as happy to add a customer under a loan contract as we are a lease or PPA. Furthermore, no matter what type of contract a customer chooses, all customers benefit from the peace-of-mind that comes with Sunnova Protect, Sunnova's comprehensive service solution.

Additionally, we will also target similar or greater returns on any new service offerings that become available, such as electric vehicle chargers and secondary generation, which are expected to launch by the end of this year.

On slide 13, you will see our guidance ranges which remain unchanged from when they were raised in our last earnings call. We continue to be highly confident in our ability to hit our 2021 targets thanks to the inherent predictability in our business model and stronger than expected first quarter results. As of March 31, 2021, approximately 86% of the mid-point of our 2021 targeted revenue and solar loans P&I are already contracted through existing customers as of that same day.

As we forecasted, the SunStreet acquisition closed at the very beginning of Q2 and thus we continue to anticipate 9,000 customers added in 2021 through our new home business. Additionally, as of March 31, 2021 we have spent approximately $4 million of the anticipated $30 million in integration and transaction costs we expect to spend over the next two years associated with SunStreet.

On our last earnings call we estimated that our Adjusted EBITDA and the principal and interest we receive on solar loans will increase by 75% in 2022 compared to the midpoints of our 2021 guidance. I'm happy to report after our most recent forecast update we now estimate this increase will be closer to 80%. We are also maintaining our year-over-year increase in customer growth of 40% for 2022 over our 2021 levels, although we are becoming increasingly more constructive on our 2022 growth.

Finally, we remain focused on bringing down our costs on a per system basis which we did in the first quarter of 2021 and expect to continue to do so in the coming quarters. As such, even with meter replacement costs of $10.5 million in 2021 and $9 million in 2022 we continue to expect a 25% reduction in adjusted operating expense per system between 2020 and 2022.

I will now turn the call back over to John.

John Berger:

Thanks, Rob.

Until recently our industry was dominated by a solar only sale that primarily focused on saving homeowners money as compared to the centralized monopoly power rates. Storage and the increasing consumer demand for a more reliable and resilient power service has catalyzed our industry to move towards an integrated, multiple technology solution sale. This is the wireless power service that we have been building for a

number of years and to which the industry as a whole is beginning to pivot towards.

To serve customers with a wireless power solution and make it as efficient and worry free as possible is a significant technological, logistical, and operational undertaking. Sunnova has been, and is continuing to, invest in software capabilities that enable such services to be delivered to consumers. In addition, platform companies, such as Sunnova, are providing an increasing amount of services and scalability to originators and installers and closely partnering with the best equipment innovators and providers in the world to create and deliver these integrated technology services to homeowners.

We have woven these software and service capabilities together to create an interconnected platform that we call the Sunnova Network. As we obtain an increasing amount of scale, we can better utilize the Sunnova Network's combination of software and services to enable certain aggregation capabilities and to create additional value for not only our customers, but also our dealers and equipment partners. It is the cohesion of these three key components - software, services, and aggregation - that creates tremendous value for our dealers, equipment partners, and most importantly our customers.

Sunnova, along with its dealer and equipment partners are increasingly building bigger moats against competitors, including the existing centralized utilities. Our unique capitalization strategy has also reached a major tipping point that will produce greater cash flow to the shareholders of Sunnova. Since our founding we have focused on doing what was right over the long-term, and now that patience and investment is paying off with significant competitive advantages and greater cash flows for years to come.

With that, operator, please open the line for questions.