Sunnova Energy International

Q2 2021 Earnings Prepared Remarks

Operator:

Good morning and welcome to Sunnova's second 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. Before we begin, please note during today's call we will make forward-looking statements that are subject to various risks and uncertainties that are described in our slide presentation, earnings press release, and our 2020 form 10-K. Please see those documents for additional information regarding those factors that may affect these forward-looking statements.

Also, we will reference certain non-GAAP measures during today's call. Please refer to the appendix of our presentation as well as the earnings press release for the appropriate GAAP to non-GAAP reconciliations and cautionary disclosures.

On the call today are John Berger, Sunnova's Chairman and Chief Executive Officer and Robert Lane, Executive Vice President and Chief Financial Officer.

I will now turn the call over to John.

John Berger:

Good morning and thank you for joining us.

We are proud to report that the strong growth we experienced in our dealer network, customer count, and single customer margins in the first quarter carried through into the second quarter. Over the last several months, we have seen the residential solar industry enter a new phase of maturation and growth, and with it, the value proposition for customers has changed. Our industry was once solely focused on savings and now it is driven by an acute customer focus on reliability and resiliency as well as savings.

This quarter, we continued to see improvements in many of our key financial metrics; specifically, stronger than expected growth in Adjusted EBITDA, the principal and interest we collect on solar loans, and our single customer implied spread or margin. Additionally, we experienced a decline in Adjusted Operating Expense on a per customer basis of 23% over the past year. We expect this trend of declining adjusted operating expense per customer to continue over the coming quarters.

On slide 3, you will see some of the details of these strong operational results where we further increased our customer base, battery attachment rate, and dealer network.

We began the quarter on a high note with the timely closing of the SunStreet acquisition and finished the quarter by placing more solar systems into service during the month of June than in any other month in the company's history.

As a result, our customer growth continues to accelerate with just over 46,000 customers added in the second quarter of 2021. With three months of SunStreet integration behind us, the rapid growth of our dealer network, and the expected launch of several new services later this year, we are increasing our expected year-over-year organic customer growth rate for 2022 from 40% to 50%. The combination of

continued operational improvements and advantage from our increasing scale is setting Sunnova up for a strong 2022.

We saw the continued instability of regional power grids increasingly push homeowners to seek out more reliable and resilient energy services. This resulted in a continued increase in our battery attachment rate on origination, which went from 23% in Q1 2021 to 28% in Q2 2021, even when accounting for the Sunnova New Homes customers we acquired. On the subject of supply chain constraints and batteries, we have seen continued improvement in availability as expected. Much of this availability is being driven by increased competition amongst battery suppliers. However, given the dramatic increase in consumer demand for reliability in their power service, we are not certain if all constraints in batteries will be eliminated by late this year or if the relief comes early next year.

Our success continues to be made possible thanks to the dedication of our 621 dealers, sub-dealers, and new homes installers across our rapidly expanding service territory. Over the last year, we added nearly 400 dealers, sub-dealers and new homes installers, and we anticipate this count to be at or near 1,000 by the end of 2022. Our brand visibility and value continues to grow, which over time, will greatly contribute to both decreasing our customer acquisition costs and increasing our customer base, giving us further confidence in our future growth estimates. Per the latter point on growth we have increased our lead generation to our dealers by over 350% compared to last year.

Lastly, on this slide we have updated our information on customer contract life and expected cash inflows. As of June 30, 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 increased from $266 million in the previous quarter to $297 million.

Turning to slide 4, we provide a summary of our Q2 2021 financial results. These strong results are expected to strengthen even further in the coming quarters as the growth in Adjusted EBITDA and the P&I from our solar loans trend higher than customer growth, especially once meter replacement spend ends and growth investment subsides. We believe our focus on service, as well as the upselling of hardware and the growth of aggregation services, such as grid services and microgrids, will result in an 80% increase in the value per customer as measured by Adjusted EBITDA together with the principal and interest we receive on solar loans by 2025.

As expected, our cash flow results improved materially from the prior quarter. Rob will discuss cash in greater detail later in the call, but it is worth noting that we continue to anticipate very large year-over-year growth in Adjusted Operating Cash Flow for full-year 2021 and we expect to achieve a break-even midpoint on our Recurring Operating Cash Flow this year.

Turning to slide 5, it is clear that customers are now expecting a long-term energy service offering that is fast and intelligent. To meet this need, we are building out our end-to-end software platform, which contains capabilities such as quoting tools for dealers, predictive service analytics for customers, and grid services software for aggregation.

We are seeing significant opportunities in grid services. To date we have seven grid service programs in place with an estimated value of at least $45 million over the next 20 years, and a pipeline with the potential for an additional $450 million in value.

It should be noted that Sunnova has the contractual right and obligation to the customer for both the service to the customer and any grid services in all of our contracts. Therefore, Sunnova retains the ownership of the relationship with the customer for years to come.

Our dedicated field service technicians and customer care team are increasingly providing higher quality service at a quicker pace to our growing customer base. The Sunnova-employed service team is focused on delivering unparalleled energy service quickly, accurately, and predicatively as new technologies such as batteries, load managers, electric vehicle chargers, and secondary generation enter the market. Service is becoming the crucial differentiator in the residential energy industry and Sunnova continues to position itself as the industry leader for service.

I will now turn the call over to Rob.

Rob Lane:

Thank you, John.

Turning to slide 7, you will see the continued improvement in our second quarter results over the past few years. Q2 2021 revenues are up over 90% from Q2 2019 while over the same period Adjusted EBITDA and the principal and interest received on solar loans increased by 121% and 199%, respectively.

As John noted earlier, Q2 Adjusted and Recurring Operating Cash Flows improved materially from the first quarter of this year, although they declined year-over-year. As further detailed in our 10-Q, this was because of an acceleration of certain cash expenses into the second quarter that were made in the second half of the year in 2020. On balance, we expect AOCF to be stronger for the second half of the year than originally forecasted because of lower interest expense due to the record low-cost financings we have executed this year, the higher than budgeted principal payments on loans, and the strong results from SunStreet. We also expect ROCF to be positive for the balance of the year and to end the year at breakeven a significant milestone for an industry that has yet to see a cash positive Power-Co.

On slide 8, 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 a conservative discount rate of 4%, NCCV increased from $1.2 billion on June 30, 2020, to $1.7 billion on June 30, 2021. Furthermore, in addition to increasing on an absolute basis, NCCV also increased on a per share and per customer basis over the same time frame, excluding the acquired SunStreet customers. Overall, we expect our NCCV to increase over the balance of the year.

As a reminder, both our GCCV and NCCV metrics exclude any value for growth, renewals, or upsells as they only represent our existing contracted cash flow base. While these excluded items are not reflected in our contracted customer values, they do have significant value and will become more meaningful over time as the number of services sold per customer grows.

Slide 9 summarizes our recent financing activity and cash position.

The 2021 financing transactions completed to date include three securitizations that achieved a weighted average blended yield of just over 2.5%. Our two most recent transactions represent a pivot in our financing strategy in that we elected not to issue high yield tranches of our securitizations. This allows us to take the cash flows that would otherwise be subject to highly punitive amortization and better align the debt service of the underlying assets with the cash flows they generate, thereby allowing those cash flows to move from our non-recourse SPVs to the corporate company level. In short, more cash to the equity.

Our June securitization of leases and PPAs was particularly unique in that it was the solar sector's first ever securitization re-financing collateral from a pre-existing securitization. Our July loan securitization represented another first for us, as we were able to split our securitization into both an A- rated tranche and our first ever AA- rated

tranche, which drove our weighted average spread to treasuries to an industry record 100 basis points. We are especially grateful to our debt investors, several of whom have participated in our programs since our inaugural securitization in 2017, for recognizing the high credit quality, the decreasing default and delinquency rates, and the reliability of our cash flows.

Other financing activity included a loan warehouse restructuring of $350 million and $375 million in closed tax equity funds, both of which saw improving terms. We also issued $575 million of convertible debt that enabled us to fund our growth for at least the next 18 months while giving us a bridge to a corporate level bullet maturity bond. As investors are aware, we used a portion of the proceeds of the convertible debt to purchase a capped call that effectively makes the conversion price $60 per share.

These transactions are important milestones in Sunnova's transformation of its capital structure as we believe they will accelerate the strengthening of our corporate balance sheet and lead to greatly improved Recurring Operating Cash Flow.

Our total cash balance as of June 30, 2021 was $469.1 million, up from $184.4 million at June 30, 2020, and up from $263.5 million at March 31, 2021.

This sizable increase was driven by recent debt raises undertaken to ensure the company has the working capital it needs to take full advantage of the growth opportunity in front of us and to provide the company with the balance sheet flexibility needed to complete our long-term capitalization strategy. Given available unencumbered assets as of June 30, 2021, we had the ability to borrow or otherwise draw down an additional $160 million of cash from our warehouse debt and tax equity. Beyond that, we have $600 million of additional capacity in our

warehouses and tax equity, subject to available collateral, giving us tremendous runway to fund our growth.

Those who have known Sunnova since our days as a private company know that recurring operating cash flow has always been our primary focus. We used a recent convertible debt offering to prefund the balance sheet so we can avoid the future issuance of high yield tranches in our securitizations and to ensure that we have enough working capital for growth, as we believe we currently have enough working capital for an annualized run rate of $3.0 billion of new investments.

Turning to slide 10 we have shared our sources and uses of cash for the past three years as well as our forecasted sources and uses through 2023. As investors have no doubt already verified, this presentation accounts for every dollar in our GAAP statement of cash flows on a historical basis.

Recall from past conference calls that, in our discussion of ROCF, we have attempted to reclassify cash flows that are investing or financing per GAAP, but we consider more operational, into ROCF, while excluding other cash flows from operations that we consider more investing or financing in nature. Here, we complete the picture. ROCF, as we have mentioned before, is the cash flows from our existing operations. Investments in New Systems includes all investing cash flows, regardless of GAAP classification and are the same cash flows we consider in our fully burdened unlevered returns. Finally, we break out our financing cash flows into net proceeds from tax equity, net proceeds from asset level debt, which includes our warehouses, securitizations, and other non-recourse debt, and the net proceeds from our corporate capital and any potential asset sales. We also separate out items, primarily acquisition and integration costs, that are truly one-time in nature.

So what is the takeaway? Three items of note. First, ROCF is expected to grow higher than most analysts have previously predicted as a result of our capital market pivot and the execution of our long-term capitalization strategy. Second, given our projected investment expectations, as we stated when we launched the convertible debt offering, we do not believe we will need any additional corporate capital through at least the end of 2022. And third, our options for additional corporate capital in 2023 are numerous. These include issuing another bullet-maturity bond, service-retained asset sales now that we have the critical mass of cash flows and assets have appreciated, or issuing additional investment grade tranches of our securitizations.

On slide 11 we provide additional color on unit economics. As you will see, our fully burdened unlevered return on new origination was at 9.4% as of June 30, 2021, based on a trailing twelve months, while a similarly calculated weighted average cost of debt was 2.9%. This resulted in a trailing twelve months implied spread of 6.5% as of June 30, 2021, above the 5.8% spread for the trailing twelve months as of March 31, 2021. In other words, we are seeing an improvement in single customer margins leading to stronger than expected operating leverage and cash flows.

On slide 13, you will see our guidance ranges. Given the especially strong performance of our loan origination and prepayments, we are increasing our expected Principal Payments Received from Solar Loans to $62-68 million. This, together with the expected decrease in cash interest expense from both the refinancing of 2017-1 and the utilization of convert proceeds in lieu of warehouse debt, as well as the strong performance of SunStreet, has allowed us to increase AOCF guidance to $35-$45 million.

We are holding Adjusted EBITDA and ROCF unchanged as we pull forward some of the planned 2022 meter replacements and make further investments in our software platform that we believe will

accelerate our ability to lower per-unit operating costs and further enhance the dealer and customer experience in the second half of 2021 and beyond.

As we forecasted, the SunStreet acquisition closed on April 1 and we continue to anticipate 9,000 customers added in 2021 through our new homes business. Additionally, as of June 30, 2021, we have spent approximately $5.5 million of the anticipated $30 million in integration and transaction costs we expect to spend over the next two years associated with SunStreet.

As of June 30, 2021, over 95% of the mid-point of our 2021 targeted revenue and solar loans P&I are already contracted through the existing customers as of that same day.

We are maintaining our estimated year-over-year increase in 2022 Adjusted EBITDA and the principal and interest we receive on solar loans of 80% and as John noted earlier we are increasing our 2022 estimated year-over-year organic customer growth from 40% to 50%.

I will now turn the call back over to John.

John Berger:

Thanks, Rob.

Since Sunnova's founding we have been focused on doing what is right for the long-term. Our conservative capitalization strategy is predicated on accumulating enough customers and cash flows to build a firm foundation with a high amount of optionality, which we have been able to do by building a company that has billions of dollars in future cash flows locked in for many years.

In our early days, we made a crucial bet that our underlying assets, and the cash flow they would generate, would prove to be far more

valuable than the market appreciated at the time. This has clearly paid off as we now have a formidable balance sheet to drive our cost of capital even lower and pursue having the lowest cost of capital in the industry.

In addition, we are now at a point where operating leverage can be increased dramatically over the next several years. One can already see this happening by the fact our Adjusted EBITDA together with the principal and interest on solar loans, AOCF, and ROCF are increasing at a rate faster than our customer growth. In fact, we are already generating cash and long-term contracted cash flows in amounts greater than some of our competitors with larger customer bases thanks to our capitalization strategy and business model. What this equates to is that we have successfully built a long term, incredibly strong cash generation machine.

On this firm foundation we will continue to build out a new energy service company focused on delivering a better energy service at a better price. Our employees are concentrated on serving the customer and increasing the speed at which they are able to respond to their questions, concerns, and issues in the field. In fact, we improved our service duration by 15% from Q1 to Q2, and expect a further 20% improvement by the end of the year.

The technology platform we are building will enable us to provide a service that is not only fast, but also intelligent, reliable, and predictive. This same technology platform will enable us to aggregate our customers and drive even more value creation, which will deliver tremendous financial value for both ourselves and our customers.

Service is our real business - financing is a key enabler.

We are again thinking long-term and building an energy service that is reliable, quick, and enables consumers to power their own energy independence. At the end of the day, service is the crucial differentiator

in our industry and we will continue to lead in providing the best energy service.

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