Sunnova Energy International

Q1 2020 Earnings Call Script

Operator:

Good morning and welcome to Sunnova's Q1 2020 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 at investors.sunnova.com 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:

Good morning and thank you for joining us for our Q1 2020 earnings call. Before discussing our quarterly results, let me start by saying I hope you and your family have stayed safe and healthy through these unique and challenging times. As everyone is aware, much has changed since our last earnings call, with the COVID-19 pandemic spreading across the globe creating a dual health and economic crisis.

At Sunnova, we met the COVID-19 challenges head on by first and foremost ensuring the health and safety of our customers, employees, and dealers while still delivering best-in-class service to our customers. Second, we let our dealers do what they do best, which is to be innovative and entrepreneurial. They quickly created solutions to continue originating and installing solar energy systems while remaining in compliance with all applicable health and safety guidelines. Third, we focused on ensuring the company had more than enough liquidity to make it through this crisis however long it may last. We implemented an aggressive cost cutting plan and closed on several financing transactions Rob will expand upon later in the call.

Before getting too deep into the details, let me start out by saying that despite all the uncertainty in Q1, we were still able to deliver strong quarterly results. Thanks to these strong results, as well as other influencing factors we will describe in greater detail later in the call, we are pleased to be able to reaffirm our 2020 guidance.

Throughout these difficult times, the advantage of our business model and our disciplined and focused approach has never been more apparent. While dealing with the pandemic has been challenging, it has clearly demonstrated that providing inexpensive and reliable power to our customers through our solar and solar plus storage offerings is more important now than ever before. The COVID-19 pandemic has also demonstrated the flexibility and superiority of the dealer model, which allowed our dealers to focus exclusively on what was going on in the field and tailor their actions to the local situation, while we at Sunnova were able to direct our focus on people, capital, assisting our dealers, and providing service to our customers. Finally, these uncertain times have further highlighted the importance of not only creating, but also retaining long-term contracted cash flows. These cash flows provide financial stability and the financial strength needed to raise capital in a difficult environment.

On slide 3 you will see that we closed out another quarter of strong growth. The Sunnova team worked tirelessly to increase our customer base, expand our dealer network, and boost our storage attachment rate. As a result, we were able to exceed our 2020 financial and operational estimates for the quarter.

In spite of the disruption caused by COVID-19, in Q1 2020 we still added nearly 7,000 new customers, which was our best quarter in company history, and 107% more than the number of customers we added in the first quarter of 2019.

At the start of the year we exceeded our plan origination rate, setting new records for January and February and positioning March to

be the strongest month of the quarter. While our origination pace did decline slightly due to the onset of COVID-19, we still managed not to experience a year-over-year decline in origination for the month of April. So far this month we are again experiencing strong origination growth.

This has all been made possible, in large part, thanks to our dealer model. As we saw more and more cities across America calling for stay-at-home orders, our dealers quickly and nimbly adjusted their processes by increasing their use of virtual tools to support both their sales and interconnection activities. Our dealers also worked with their respective agencies having jurisdiction to utilize electronic inspections and permitting. These actions have reduced our dealers' reliance upon face-to-face meetings, therefore allowing them to be able to continue selling our solar energy service and get new customers placed in-service. Now more than ever, the strength of the dealer model is on full display.

At March 31, 2020, the total number of dealers and sub-dealers who have partnered with Sunnova reached 191, a 23% increase from the end of 2019. Even in this environment we currently have a growing backlog of high-quality contractors who are looking to become Sunnova dealers, and an increasing number of them are asking for exclusivity.

One trend that has continued to surge throughout all of this is our storage attachment rate on origination, which we saw grow from 24% in Q4 2019 to 30% in Q1 2020. In fact, in only two short quarters we have seen that rate double from 15% in Q3 2019 to the current 30% achieved this quarter. Additionally, the ability to network and remote operate our customers' battery-enabled systems allows us to offer new energy services individually and through aggregation. In short, this pandemic caused an acceleration of what we already saw as a mega-trend for the global energy industry. In our Q4 2019 call we called 2020 the "year of the battery" and we still believe that to be true.

Millions of Americans find themselves spending more time in their houses, which have become more than just homes, but also schools and offices. For all of us, having clean, affordable, and reliable power is more important than ever. Batteries provide our customers with peace of mind knowing that when their local electric grid fails them, they will still have the power they need to educate their children and work from home.

Sadly, with both wildfire and hurricane season just around the corner, we will again see the fragility of the traditional, centralized power infrastructure on full display with power outages continuing to plague consumers. As a result, we expect demand for our solar plus storage offerings will continue to increase as consumers look for energy options that provide higher energy resiliency and reliability. Most recently, the uncertainty brought upon by COVID-19 has shown us the world may be more fragile than we originally thought, magnifying the importance of being self-reliant and further proving the economic and societal value of solar plus storage.

Turning to slide 4, we provide a summary of our first quarter 2020 results, which are further expanded on slide 5. Our total customer count, Adjusted EBITDA, the principal and interest we collect on solar loans, and our Adjusted Operating Cash Flow were all above our expectations for the quarter.

On slide 6, we reflect on both our estimated net and gross contracted customer value over the previous three years. Using a discount rate of 4%, Net Contracted Customer Value, or NCCV, increased from $952 million on March 31, 2019 to $1.2 billion, or $14.41 per share on March 31, 2020.

As we have noted before, our Gross Contracted Customer Value metric represents only our existing contracted cash flow base and excludes any upside potential from renewal value, ability to up-sell existing customers, selling energy services, or any of our growth

prospects. To reach our NCCV, we subtract all debt and liabilities, both corporate and asset level, from our total present valued cash flows. As reflected on this slide, our NCCV is experiencing significant increases year-over-year which translates directly into shareholder value creation.

We have long believed the service we provide is inherently essential, which leads customers to pay in both good economic times and in bad. As we expected, during this crisis our customers have continued to pay; and to date, Sunnova customer payment behavior has not materially changed since the onset of COVID-19. The percentage of customer payables collected in April was 99.5% of the preceding twelve-months and we continue to see strong collectability into the month of May. In addition, of the few accounts that are past due, we have experienced a great deal of success in our collection efforts. The strong collectability of customer accounts will directly relate to the expected drop in the industry's long-term cost of capital as macro financial market liquidity issues subside over time.

We will also continue to reap the benefits of our increasingly attractive solar service contracts due to our practice of retaining the long-term contracted cash flows from our customers, versus those who do not retain them. This strategic decision continues to inure to our benefit as the strong payment performance of our customers further reduces our cost of capital, resulting in significant improvements to our Gross and Net Contracted Customer Value per share as we move from a PV6 to a PV4.

While I cannot promise what the future will hold, I do know that Sunnova will continue to be a leader to our customers, our dealers, our lenders, our shareholders, and the communities we serve. And thanks to the ample amount of liquidity we have secured, and the strength and flexibility of our business model, we are better positioned than anyone in the industry to not only get through this current crisis, but to navigate any additional challenges these uncertain times may bring.

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. Starting on slide 8, we recorded revenue of $29.8 million for the three months ended March 31, 2020, a period-over-period increase of $3.1 million, or 12%, thanks to our strong customer growth. As a reminder, revenue does not include the cash we receive from the principal and interest payments we collect on solar loans, so our actual cash generation will grow at a higher percentage rate than our GAAP revenue.

Adjusted operating expense, which represents the full recurring cash expenses to grow and run our service operations, also increased in response to the increase in the number of customers served to $23.6 million for the three months ended March 31, 2020. While total Adjusted Operating Expense increased, we are seeing an overall decline on a per customer basis and projected Adjusted Operating Expense per customer will be at least 10% lower for full year 2020 versus full year 2019.

Adjusted EBITDA for the first quarter of 2020 was $6.2 million, down from $8.1 million during the same period last year. This decrease is primarily driven by the growth in our customer loan portfolio as the costs associated with these loans are allocated to Adjusted EBITDA while the cash collected is represented outside of Adjusted EBITDA. That customer cash inflow is the principal and interest payments from our solar loans, which were $6.4 million and $4.4 million, respectively, for the three months ended March 31, 2020, nearly double the amounts from last year.

As we laid out on our Q4 2019 earnings call we made a few changes to how our Adjusted Operating Cash Flow, or AOCF metric is

calculated. As investors are aware, we use AOCF to adjust items that are more investing or financing in nature out of operating cash flow, as well as to move cash flows that are more operating in nature, but classified per GAAP as investing or financing, back into operating cash flow. Starting this year, we are backing out realized interest rate swap breakage income and expense we incur at a securitization, as we consider this a financing cost that would not occur except for moving assets from a warehouse or term facility into a securitization. We consider these costs in our projections for net cash proceeds from investing and financing. We are also subtracting out cash received for inventory sales, which is just for items such as batteries that we pre-purchased for our customer loans. We believe these changes give investors a clearer picture of the operating cash flows.

AOCF was lower in the first quarter of 2020 compared to the first quarter of 2019, primarily because of increased interest expense from our larger asset portfolio and changes in our working capital. However, we are forecasting an increase of approximately 100% year-over-year in AOCF.

Estimated NCCV as of March 31, 2020 was approximately $895 million using the industry standard 6% discount rate, up 26% from $709 million as of March 31, 2019.

On a quarter-over-quarter basis, NCCV improved slightly as increases in customer value and increased tax equity deployments were largely offset by interest rate hedge breakage costs associated with our TPO securitization in February and the seasonally lower cash flows of the first quarter relative to the rest of the year. As a reminder to investors, NCCV will experience seasonal and transactional induced volatility, but we still project value creation along the lines of what we discussed last quarter. Changes in working capital and interest rate hedge breakage fees will cause some fluctuations to these rules of value creation from time to time.

On slide 9 you will find a summary of our year-to-date financing activities. While the financial markets, including the ABS market, have experienced a great deal of turmoil over the past several weeks, I am pleased by the progress the finance team has made to successfully navigate this challenging environment. Thanks to their tremendous efforts, as well as the efforts of our debt and equity investors, we were able to execute on several important financing transactions that will ensure Sunnova has the capital it needs to continue funding its high level of growth.

The 2020 financing transactions completed to date include a $412.5 million securitization, two expansions of our third party operated warehouse facilities, $150 million in new tax equity funds, and a $190 million convertible debt facility, assuming the full exercise of the investment option.

Going forward, we will target a range of 55% to 60% of debt to assets for the company's capitalization, including subsidiaries. This range will serve as a rough guide to our long-term capitalization and will be dependent in the short-term on financial market pricing of various securities and maintaining liquidity targets. Our primary goal remains recurring cash flow to our common equity, and we believe this is only accomplished by a balanced approach to capitalization.

Consistent with this philosophy is the new convertible debt we raised that, on an as-converted basis, gives us a pro forma debt to asset ratio of 55% as of March 31, 2020 and is immediately accretive to NCCV on a PV6 basis. We believe that this corporate capital will provide adequate working capital for our rapid growth through the end of 2021 and possibly beyond. It also provides the capital we may need if debt capital markets do not continue to improve, or even worsen. As we move forward in time, the company is naturally deleveraging by paying down its front-end loaded debt amortization, having its tax equity facilities flip once tax equity investors receive their returns, and by paying off its renewable energy credit hedges. Due to this corporate

capital and natural deleveraging, in addition to our confidence in continuing our operating leverage improvement, we expect the company to maintain this capitalization range for the next several years. Even under strained financial market scenarios over the next two years, we currently see this corporate capital as being adequate. However, we will be opportunistic in our approach to the equity and equity-linked markets only to the extent that transactions, like this one, will be accretive to Recurring Operating Cash Flow per share and NCCV per share metrics.

We will use this corporate capital and our strong balance sheet to drive down our cost of capital at the asset level. There is a growing realization that solar industry contracts, in all forms, are inherently service contracts, and as such are highly dependent on the performance of the service platform company. This realization will continue to increase the asset investors' focus on the quality of the service company's balance sheet as well as its recurring cash flows that are not dependent on the capital markets. There is a balance between corporate and asset level capital that is optimal for the lowest long-term cost of capital that we expect to achieve in the coming quarters.

In this difficult environment, we are grateful to our investors who see the importance of having sufficient liquidity and a well-funded balance sheet, coupled with our strong recurring operational cash flows and a continued focus on deleveraging.

Turning to slide 11 you will find our full year guidance for 2020.

As John noted earlier in the call, we are pleased to be able to reaffirm our guidance ranges for 2020 as they remain unchanged at:

- Customer additions of 28,000 - 30,000
- Adjusted EBITDA of $58 - $62 million
- Customer principal payments received from solar loans, net of amounts recorded in revenue, of $32 - $36 million
- Interest received from solar loans of $17 - $21 million
- Adjusted operating cash flow of $10 - $20 million

Our ability to reaffirm guidance was made possible by the strength and flexibility of our business model, our disciplined and concerted approach to running the business, and the steps we took early in the pandemic, which resulted in cost cutting measures. These cost rationalizations included eliminating all non-critical expenses, reducing our reliance on third-party contractors, and renegotiating contract terms with certain vendors.

Further contributing to our high level of comfort in reaffirming guidance is the fact that our business model provides excellent visibility into future cash flows. By retaining our customers, we now have 91% of the mid-point of our 2020 targeted revenue, and principal and interest received from solar loans, locked-in from existing customers as of May 1, 2020.

Propelling our growth and giving even further visibility into our guidance are our unique technology partnerships, our growing list of distinctive and innovative product offerings, and the fact that we are uniquely agnostic to financing types for our service offerings.

It is important to remind everyone once again that at Sunnova we don't count a customer until they have been placed into service, meaning they have received permission to operate from the local authorities having jurisdiction and we are receiving monthly payments.

On our Q4 2019 earnings call we noted that based on our forecast used to set guidance, we expected to capture approximately 10% of our Adjusted EBITDA and principal and interest from solar loans in the first quarter of 2020. I am happy to report we exceeded that target, as actual Q1 2020 Adjusted EBITDA and principal and interest from solar loans equaled $17 million, or 15% of the mid-point of our 2020 guidance. Based on our most recent forecast, for the balance of the year, we now expect to capture at least 25% of our Adjusted EBITDA and principal and interest from solar loans in the second quarter of 2020, increasing to

approximately 30% in Q3, and the remaining balance in Q4. As for customer growth, we expect our customer additions to continue to occur fairly evenly throughout the year with approximately 45% of our forecasted customer additions happening during the first half of the year while the remaining 55% should occur over the last six months.

In addition to reaffirming our more formal guidance, we are also updating our high-level 2020 projected cash proceeds found on slide 12.

As you will see, our projected cash flow from existing operations, which is our Adjusted Operating Cash Flow less corporate capex, remains unchanged at $5 - $15 million.

The box on the right includes all of our EPC costs, including our dealer network bonus payments, payments for work in progress and inventory, as well as our financing. The financing includes proceeds from tax equity, net securitization proceeds, debt amortization payments, and the recently raised convertible notes.

When we compare our expectations for growth financing with where we were almost a quarter ago, much has changed, especially with respect to the ABS markets. Even as base rates have lowered, spreads have widened and expectations for advance rates have come down. This means that for the BB rated tranches, interest rates are expected to be higher than what we executed in our February securitization resulting in lower proceeds. And while we see that market continuing to improve, it could still be several months or quarters before we return to the levels we saw just three months ago when we priced our 2020-1 financing. Further, the lower base rate means that we would also expect to have higher hedge breakage costs relative to where we were earlier this year.

The quality of the solar asset classes, especially Sunnova's assets and our strong customer payment behavior, is not reflected in the current financial market conditions. However, the new corporate capital gives us significant flexibility to potentially fund the higher end of the advance rate on our balance sheet for now and wait until we have been able to

demonstrate our collections and performance to the capital markets through more payment cycles. That would give us the opportunity to finance deeper into the stack at much more favorable terms next year, effectively time-shifting the full securitization. There is, of course, still significant potential for us to improve these numbers this year if the market and its view of Sunnova's paper continues to improve.

In the meantime, the convertible notes allow us to finance the top of the asset stack regardless of where ABS advance rates settle, enable us to drive competitive pricing and terms in the asset level capital markets, provide needed working capital as our growth continues to accelerate, and provide us with a capital cushion to withstand more potential financial market shocks well through 2021 and possibly beyond.

As we look forward, and consistent with what we are hearing from investors, we expect to transition this slide to one that focuses more on generating positive Recurring Operating Cash Flow, or ROCF, which as we noted on our last earnings call is equal to revenues and other customer cash inflows less the principal and interest we pay on our debt. We also subtract out the service-related expenses and allocated overhead, which together account for approximately 60% of our cash costs. We believe positive ROCF will be achieved in the $3.8 to $4.8 billion asset range sometime in 2021 or 2022. We continue to see that goal as achievable in that asset range and timeframe due to our continued growth, stable unit economics, and ability to raise capital even amid a challenging environment. This marries up with our targeted leverage and keeping, rather than selling off, our customer cash flows. By keeping cash inflows on the balance sheet and responsibly capitalizing those cash flows, we believe we are very well positioned to achieve our ROCF positive goal while still accreting value on an NCCV per share basis. Simply put, we plan to grow long-term value and long-term cash flow simultaneously. Like you, John and I are shareholders

first, and we plan to increase value to our common equity with a view toward long-term sustainable cash flows and true value creation.

I will now turn the call back over to John to provide closing remarks.

John Berger:

Thanks, Rob.

As we have repeatedly discussed, we strongly believe that due to the inclusion of batteries, and other technologies in our service offerings, along with our focus on using standard financial metrics, that unit level returns should be expressed in terms of unlevered yields.

Our year-to-date asset level returns, including leases, PPAs, and loans, have dipped slightly to approximately 9.75% due to contract type and geography mix. However, due to actions taken last quarter we expect these returns to quickly move back towards our 10% target.

For fully burdened unlevered single asset returns we would also include the sales and marketing portion of our overhead spend, working capital interest expense, and the indirect sales expenses that are incurred. Currently, we estimate that our fully burdened asset level returns, inclusive of loans, are between 8.25% and 8.75%. Without including loans, the fully burdened single asset returns would be even higher.

Our unlevered asset level returns have been relatively unchanged for several quarters and we expect that trend to continue. Our fully burdened asset level returns have been trending higher over the last several quarters due to increasing operating leverage and we expect that trend to continue as well.

Additionally, the unlevered returns exclude any potential increase in value for such items as the renewal of a contract, providing customers energy services, or a battery or other up-sell opportunities.

It is important to note that between our ROCF and our fully burdened unlevered returns that there are no cash expenses excluded. Investors have a full, complete, and straightforward picture of all our expenses and the resulting cash generation.

In closing, while the past several weeks have been filled with uncertainty, they have also been filled with hope, determination, ingenuity, and compassion for one another.

With ample liquidity, increasing customer growth and battery attachment rates, strong collectability of customer payments, the achievement of positive ROCF just on the horizon, and a superior business model designed to weather any storm, Sunnova is well positioned for 2020 and beyond.

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