Sunnova Energy International

Q2 2020 Earnings Call Prepared Remarks

Operator:

Good morning and welcome to Sunnova's second quarter 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 second quarter 2020 earnings call.

We are pleased to report another quarter of strong results and to once again reaffirm our full year 2020 guidance.

As I will detail, our second quarter performance was characterized by strong continued growth in both our customer base and battery attachment rate. As a result, we continue to see improvements to our key financial and operating metrics, specifically a sharp decline in Adjusted Operating Expense on a per customer basis as we continue to gain operating leverage. And while our business was evolving and experiencing the fastest growth in the industry, we continued to drive down our all-in weighted average cost of capital and greatly enhanced our liquidity by closing on several key financing transactions with favorable terms.

As we have noted, Sunnova's flexible, technology-enabled service model is well-equipped to meet the challenge of COVID-19 head-on. The pandemic demanded that our industry accommodate and even embrace the acceleration of several mega-trends that require an increased reliance on technology, such as remote working and the use of virtual marketing and communication tools. As these mega-trends continue, and people continue spending more time in the home using

more electricity, homeowners remain focused on ensuring the energy they use to power their lives is clean, reliable, and affordable. We are seeing this focus manifest in increased consumer appetite for our service offerings, which we are proud to say are helping power our customers' energy independence.

On slide 3 you will see the details of another quarter of industry leading growth. We increased our customer base, expanded our dealer network, and boosted our storage attachment rate.

We continue to grow at higher rates than anyone in our category. We added approximately 6,200 new customers in the second quarter of 2020, a 54% increase from what was added in the same quarter in 2019. This increase in customer growth rate is matched by a nearly 50% year-over-year increase in Adjusted EBITDA and the principal and interest received from solar loans. These achievements demonstrate our operating leverage and Sunnova's ability to execute in the face of strong macroeconomic headwinds.

Our success was made possible by the 227 dealers and sub-dealers who comprise our differentiated, low-cost model. Because each is a local expert in the geography in which they do business, our dealers are able to respond quickly and appropriately to navigate the unique challenges in their specific markets resulting from COVID-19. Sunnova selectively added 72 dealers and sub-dealers in the first half of 2020. Their addition demonstrates the continued attractiveness of Sunnova's dealer model for successful, established entrepreneurs in our industry.

Battery attachment rates also continue to increase. Our attachment rate on origination increased from 11% in Q2 2019 to 34% in Q2 2020. We anticipated that 2020 would be The Year of the Battery; and solar plus storage is contributing to our rapid growth, adding to our profitability and to our recurring cash flow from operations.

As the number of solar plus storage system sales grows, so too does our ability to network and remote operate our customers' systems,

thus allowing us to offer even more energy services individually and through aggregation.

For Sunnova, the accelerating adoption of solar plus storage solutions represents an expansion of revenue per customer, an important step in the direction of home energy management and economic optimization; and a constructive response to grid connect charges, demand charges, time of use tariffs, and wholesale market opportunities. All of which is rapidly improving our Adjusted EBITDA and cash flow per customer.

Turning to slide 4, we provide a summary of our second 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 at or above our expectations.

Like a utility and most other essential service companies, Sunnova retains its contracted cash flows on balance sheet. By securitizing our assets and keeping both our residual cash flows and our unpledged Solar Renewable Energy Certificates, or SRECS, we are able to build value on the balance sheet today, which gives us long-term, sustainable cash flow from operations. As we originate new customers, those customers provide another layer of recurring cash flows, which further strengthen and improve the transparency and financial predictability of our business. The table on the right on slide 6 shows the growth of our Gross Contracted Customer Value, or GCCV, which represents customer and incentive cash flows net of tax equity payments and servicing fees. While the industry has historically used a standard 6% discount rate, many analysts and observers believe lower discount rates better represent the blended cost of capital available in the market today. Not only would a move from a PV6 to a PV4 more accurately reflect the cost of capital in today's markets, but it would also properly capture loan values that are artificially discounted under PV6.

Please note our GCCV metric represents only our existing contracted cash flow base, unlike similar metrics others may use. It excludes all future contract renewals, it assumes we sell no complementary products and energy services to existing customers, and it zeroes-out growth. To reach our Net Contracted Customer Value, or NCCV, we further subtract all debt and liabilities, both corporate and asset level, from our total present valued cash flows, while also adding back cash and safe-harbored inventory. Again, this assumes no future contract renewals. We do not currently have forward flow agreements, asset level equity sales, or other financings that effectively factor residual cash flows.

Both our GCCV and our NCCV are experiencing significant increases year-over-year and this translates directly into shareholder value creation.

During our previous call, we noted the percentage of customer payables collected in April of 2020 was 99.5% of the preceding twelve-months. Since then we have seen that number improve to 100.4% and 100.7% for the months of May and June, respectively. These excellent collection results reinforce our belief the service we provide is essential, which leads customers to choose to continue paying us during difficult economic times, and further demonstrates our customer's payment behavior has not materially changed since the onset of COVID-19. Additionally, this strong payment performance by our customers will have a material impact on Sunnova's financial performance as it further reduces our cost of capital, providing significant cash flow upside through refinancing.

As for unit economics, we continue to see stable returns and currently expect those to continue. For instance, over the last 90 days we achieved approximately 9.7% unlevered and 8.5% fully burdened unlevered returns.

We are proud of the accomplishments and the momentum achieved during the first half of 2020 in spite of major challenges that

the COVID-19 pandemic has created for the world. Prompted by the mega-trends I noted earlier, it is clearer than ever the transition to a cleaner and more sustainable global energy industry is accelerating rapidly. In this time of exciting and fast paced transition I cannot think of a better place to be than in the renewable energy industry, particularly in the residential solar and storage space.

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 $42.8 million for the three months ended June 30, 2020, a year-over-year increase of 24%, thanks to our strong customer growth. Also experiencing a significant year-over-year increase was the principal and interest we receive on solar loans, which was $7.5 million and $6.6 million, respectively, for the three months ended June 30, 2020.

Adjusted operating expense, which represents the full recurring cash expenses to grow and run our service operations, also increased in tandem with the number of customers served to $24.8 million for the three months ended June 30, 2020. While total Adjusted Operating Expense increased, on a per customer basis, Adjusted Operating Expense declined by 12% year-over-year, which clearly demonstrates the operating leverage we are able to achieve as we grow our customer base. This decline is in spite of increased G&A relating to public company expenses, cost of sales associated with rationalizing our SREC program, and meter replacement costs that we are incurring this year and next to assure service and connectivity as wireless technology and protocols change. Additionally, we project Adjusted Operating Expense per customer on a trailing twelve-month basis will be as much as 10% lower for full year 2020 versus full year 2019.

Adjusted EBITDA for the three months ended June 30, 2020 was $18.0 million, an increase of 32% from the same period last year. In total, our Adjusted EBITDA, together with the principal and interest we received on solar loans increased nearly 50% for the three months ended June 30, 2020, compared to the three months ended June 30, 2019.

AOCF was $18.8 million in the second quarter of 2020 compared to $5.4 million in the second quarter of 2019.

Estimated NCCV as of June 30, 2020 was approximately $864 million using the industry standard 6% discount rate, up 27% from $681 million as of June 30, 2019.

As a reminder to investors, NCCV will experience seasonal and transactional induced volatility, but we still project strong 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. Overall, we expect our NCCV to increase by 10% or more over the next 2-3 quarters, again largely related to timing of tax equity deployment and securitizations.

Despite the turmoil in the financial markets brought on by COVID-19, you will see on slide 9 we were still 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 TPO securitization, multiple expansions of our third-party operated warehouse facilities, $160 million in new tax equity funds, $190 million in new convertible debt, and a $158.5 million loan securitization.

Our most recent financing transaction was our loan securitization closed June 19, 2020. Despite the current dislocation in the structured finance markets, on this most recent transaction we were still able to

achieve an implied blended yield of approximately 3.75% and an overall advance rate of approximately 87.5% on a loan-to-value basis. This compares favorably to the 3.77% blended yield and 93% advance rate we received on our lease and PPA securitization in pre-COVID February 2020 and the 3.97% yield and 90% advance rate we received on our June 2019 loan securitization. The combination of our proven track record and excellent payment performance on prior securitizations, together with our well-capitalized corporate balance sheet, strong recurring cash flows and focus on providing best-in-class customer services, resulted in extremely strong demand and pricing for this securitization.

We expect our all-in cost of capital to move lower over time as the markets continue to improve, as our track record of successful securitizations grows, as our cost of equity continues to decline, as our customers continue their historically strong payment performance in even difficult economic times, and as the market further realizes solar industry contracts are service contracts. As such, the quality of any service company's balance sheet and the existence of recurring cash flows matter greatly.

Our decision to build further liquidity into our balance sheet was the right call in this time of COVID resurgence across the country. As we are all aware, the increase in COVID infections has resulted in much more economic uncertainty than what existed during our Q1 2020 earnings call. At the same time, we are also seeing further opportunities to accelerate growth and assume industry leadership due to recently announced industry consolidation. To this end, we intend to spend an additional $2 million this year to build new technical capabilities to allow us to introduce more products, enhance lead generation capabilities, and bring operational efficiencies to the market faster than previously anticipated.

We believe our capitalization strategy of avoiding excessive leverage, keeping cash inflows on the balance sheet versus factoring

them off, and responsibly capitalizing those cash flows makes the most sense for our business as it allows us to grow long-term value and long-term cash flow simultaneously. Our capitalization strategy is well equipped to navigate challenging times, make the company more attractive to long-term investors, and bring us closer to our ultimate goal of returning capital to our common equity holders.

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 once again 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

For the full year, we continue to expect our Adjusted EBITDA and the principal and interest we receive from solar loans, to trend towards the upper end of guidance. We have also elected to marginally increase our spending for growth and efficiency projects that we believe will accelerate our growth into the second half of the year and well into 2021. At the same time, we expect Adjusted Operating Cash Flow to trend to the lower end of our guidance range. This is due to a number of factors, including our investments in growth, the impact of convertible note interest, higher working capital utilization as a result of our growth, our decision to delay certain securitizations as the structured finance market continues to improve, and an increase in our borrowing capacity in our asset warehouses. We currently expect 2021 to generate strong

growth in AOCF and we will give guidance for 2021 during our next earnings call.

Our business model provides excellent visibility into future cash flows giving us comfort in reaffirming guidance. By retaining our customers, we now have 95% of the mid-point of our 2020 targeted revenue, and principal and interest from solar loans, locked-in from existing customers as of June 30, 2020. For some additional perspective, we expect that our existing assets will continue to provide approximately $200 million of annual customer cash inflows, inclusive of revenues, principal and interest from solar loans, and SRECs, over at least the next five years. Any new customers that we add will, in turn, add another layer of revenue and customer cash inflows.

We are introducing a customer growth target of 40% for 2021 and 2022. This target reflects our expectations regarding growth and technology adoption in excess of what was anticipated pre-COVID. Our customer base and business model is expected to continue to produce industry leading operating leverage. As a result, even with meter replacement costs, we expect to reduce our adjusted operating expense per customer by approximately 35% between 2019 and 2022. Annually we expect to see year-over-year decreases of at least 10% in 2020 and 2021 and another 15-20% in 2022.

In addition to reaffirming our previously released 2020 full year guidance, we want to provide some quantitative color around Recurring Operating Cash Flow, or ROCF. ROCF is revenues and principal and interest from solar loans less the principal and interest we pay on our permanent debt, including securitizations and corporate-level debt. We also subtract out service-related expenses and allocated overhead, which together account for approximately 60% of our annual SG&A and service cash costs.

As John had previously mentioned, we are able to generate new assets at, more or less, cash flow neutral on a fully securitized basis after taking into account sales-related operating expenses. ROCF, then, looks

at the cash flow created or consumed by existing assets after debt service and service expenses. We believe ROCF is an important measure of our financial performance and gives investors greater insight into how we are increasing our operating leverage and reducing risk for our debt and equity holders. Together with our NCCV at PV4, which more accurately captures the capital costs of our leases and loans versus a PV6, ROCF gives investors a clear view of value creation after all expenditures and costs of permanent debt are taken into account. As a growing company, we will expect to continue to be a net consumer of working capital, but the trend in ROCF continues to be up and to the right.

For full year 2020 we estimate ROCF will be between $(20) - $(5) million. As you can see, our focus on long term, recurring cash flow is approaching a historical industry milestone of positive ROCF as we near critical scale. Looking forward, we expect ROCF to be close to neutral in 2021 and positive in 2022 and beyond. In fact, except for meter replacement costs, we would have expected to reach positive ROCF in 2021.

Our ability to hit this important milestone is largely driven by our utility-like capitalization structure strategy which should be familiar to global infrastructure and utility investors. Utilizing this structure signifies the residential solar and storage service industry is moving towards a more stable phase of industry growth that can withstand political and macroeconomic challenges. Thanks to this capitalization model, we believe we are unique in the industry in terms of our ability to refinance our contracted assets at a much more favorable cost of capital as this cost continues to steadily drop, thereby increasing future cash flows to our equity.

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

John Berger:

Thanks, Rob.

We continue to experience the fastest growth in the industry and have armed ourselves with the necessary liquidity and business model to continue this exceptional growth into next year and beyond. We have been able to achieve this tremendous growth while keeping our unit economics stable, reducing our operating expense on a per customer basis, and maintaining our focus on long-term, recurring cash generation. Thanks to these achievements and focus we are now at the critical tipping point of achieving scale as demonstrated by our ROCF momentum and projections.

Sustainability is not only a core value at Sunnova, but a top priority. From driving innovation in residential solar and storage service opportunities for consumers, to inspiring positive social change within the communities we serve, we are united in our commitment to sustainable business practices and well-positioned to advance corporate social responsibility within the solar industry.

At Sunnova, we see ourselves as a technology enabled service company - a wireless power company - reinventing the way energy is generated and consumed. We are a company that will deliver opportunities to people throughout the world and change the way they energize their lives. We will endeavor to lead this dramatic change through a relentless focus on serving our customers, our dealers, and our stockholders. With a local focus and a global vision, we aim to create a reliable energy future that will transform the world for the better.

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