Sunnova Energy International

Q3 2020 Earnings Prepared Remarks

Operator:

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

We are pleased to report another quarter of strong, steady results, enabling us to once again reaffirm our full year 2020 guidance and to initiate full year 2021 guidance.

Our third quarter performance was characterized by record setting customer growth as we added more customers in the third quarter of 2020 than in any other quarter in the company's history. While this record is impressive, we expect to add significantly more unique customers in the fourth quarter.

This exceptional customer growth, coupled with our stable unit economics, and declining costs on a per customer basis, has placed us in the desirable position of being able to optimize Recurring Operating Cash Flow and company growth for 2021 and beyond. Simply put, we will either invest to grow profitable cash flows quicker or we will preserve the recurring cash flows for our shareholders.

On slide 3 you will see the details of yet another quarter of strong operational results. We increased our customer base, expanded our dealer network, and maintained a robust storage attachment rate.

We continued our rapid growth by adding over 7,000 new customers in the third quarter of 2020, a 40% increase from what was added in the same quarter in 2019. This exceptional growth is fueled by the 270 dealers and sub-dealers who power our differentiated, low-cost model. Sunnova has nearly doubled its number of dealers over the past twelve months by selectively adding 134 dealers and sub-dealers. If you are a contractor seeking a solar and storage service provider partner that does not compete with you, that offers the broadest array of products with all of the financing types - loans, leases, and PPAs - that partners with the leading energy storage and other technology providers, and that has a stable capitalization strategy, there is only one solar and storage service provider available to you and that is Sunnova. As a result, we expect to see our dealer count continue to rise during the remainder of this year and well into 2021.

Our storage attachment rate on origination increased from 15% in Q3 2019 to 34% in Q3 2020 as we continue to see strong consumer appetite for solar plus storage. The large driver of our robust storage attachment rate over the past several quarters has been our 100% attachment rate in our island markets of Guam, Saipan, Hawaii, and Puerto Rico. However, we have recently seen storage attach rates rapidly increase in select non-island markets such as Florida and California, which had Q3 2020 attachment rates on origination of 16% and 12%, respectively. In fact, to date we have sold storage service in 17 states and territories.

In addition to providing battery storage to new customers, we have also been busy retroactively adding battery storage to previously solar-only customers. Since we began offering storage as a service, we have performed 883 battery retrofits through September 30, 2020, for both Sunnova and non-Sunnova customers alike. We expect to double this amount over the next two quarters.

Turning to slide 4, we provide a summary of our third quarter 2020 financial 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.

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. This translates directly into shareholder value creation. Using a discount rate of 4%, NCCV increased from $1.1 billion on September 30, 2019 to $1.4 billion on September 30, 2020. This equates to approximately $15.63 per share as of September 30, 2020, which is nearly a 17% year-over-year increase. This increase clearly shows our rapid growth is creating value for shareholders.

Please note both our GCCV and NCCV metrics represent only our existing contracted cash flow base after MSA fees, which we collect and use to service the contracts, and after payments to tax equity providers. It excludes all future contract renewals, it assumes we sell no complementary products and energy services to existing customers, and it assumes no growth. While these items are not reflected in our contracted customer values, they do have value and will become more meaningful to Sunnova as the number of services sold per customer grows. Later in the call I will expand upon these additional service opportunities and provide an overview of how we expect them to grow over time and what impact they will have on our NCCV.

As for unit economics, we continue to see stable returns and expect those to continue. For instance, over the last 90 days we achieved approximately 9.7% unlevered and 8.6% fully burdened unlevered returns. As you can see through the slight improvement in our fully burdened unlevered returns, we have seen improved single customer net margins. We accomplished this through scaling our sales overhead by increasing our nominal per quarter customer growth.

At Sunnova, we believe in consumer choice, which is why we offer our customers the broadest portfolio of service offerings in the industry. Recently, we have seen loans make up a larger percentage of our contract mix going from 27% of originations in June to over 40% in October. We expect this trend to continue into next year and have set our 2021 guidance accordingly.

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.

Slide 8 shows the period over period changes in our key financial performance metrics. Across the board, our results improved on the back of our significant customer count increases and the fact that our business continues to scale on an adjusted operating expense per customer basis.

On slide 9 you will see a summary of several important financing transactions completed during the year to ensure Sunnova has the capital it needs to continue funding its high level of growth.

The 2020 financing transactions completed to date include just over $570 million in new securitizations, $235 million in new tax equity funds, multiple expansions of our third-party operated warehouse facilities, a new $60 million loan facility, and $190 million in convertible debt, much of which has already been converted to common stock.

If market conditions continue to be favorable, we anticipate closing an additional securitization in the coming weeks.

As investors no doubt recall, we were one of the few companies who maintained guidance throughout the pandemic this year and one of only an handful of renewable companies to do so. On slide 11, we once

again confirm our 2020 guidance ranges, which is a testament to the predictability, scalability, and flexibility of our business model.

Unchanged from last quarter's call, we still expect our Adjusted EBITDA and the principal and interest we receive from solar loans, to trend towards the upper end of guidance and AOCF to trend towards the lower end. Again, this bifurcation is because of growth-related initiatives that have increased interest expense as working capital needs have increased, as well as marginally increased spending for growth and efficiency projects to accelerate growth and value creation.

In the previous earnings call, we introduced guidance for Recurring Operating Cash Flow, or ROCF. As a reminder, 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 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 including approximately 40% of our overhead and all of the interest paid on working capital. ROCF then looks at the cash flow created or consumed by existing customers and assets after debt service and service expenses. Put another way, we generate new services into our utility at roughly break-even, while ROCF measures the cash flows from our utility. The balance of our cash consumption is directly related to the working capital required for the high growth of our business.

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.

Turning to slide 12, we are introducing 2021 full-year guidance of:

- Customer additions of 42,000 - 48,000
- Adjusted EBITDA of $77 - $83 million
- Customer principal payments received from solar loans, net of amounts recorded in revenue, of $57 - $63 million
- Interest received from solar loans of $28 - $34 million
- Adjusted operating cash flow of $20 - $30 million
- Recurring operating cash flow of $(15) - $5 million

We have a high level of comfort in hitting our 2021 targets as the nature of our business provides excellent visibility. This visibility is reflected in the fact that approximately 80% of the mid-point of our 2021 target revenue and principal and interest we receive from solar loans will be locked in through existing customers as of December 31, 2020.

In our previous earnings call, we introduced a customer growth target of 40% for 2021 and 2022. Using the mid-point of our 2021 customer additions we are now anticipating that growth target to exceed 50% for the upcoming year. For 2022 we will continue to estimate a conservative customer growth rate of 40%. Our ability to lead the industry in growth rate continues to be a major component of our success. Later in the call John will dive deeper into how we are driving and thinking about that growth.

Our customer base and business model is expected to continue to produce industry leading operating leverage. As a result, even with

meter replacement costs of $5 million in 2020 and $11 million in 2021, we expect to reduce our adjusted operating expense per customer by as much as 35% between 2019 and 2022.

Looking forward, we expect ROCF to be positive in 2022 and beyond. In fact, we would have expected to reach positive ROCF ahead of schedule in 2021 if not for our decision to replace our 2g and 3g meters next year, to invest in measures to increase efficiency, uptime, and power production in order to further decrease our already low delinquency and capital loss rates, and investments to further increase our forward growth. This is normal tension every high growth company manages balancing between higher growth and generating larger cash flows to the equity. This same tension is shown in our per customer cost reduction pace in that the rate of the reduction would be much quicker if we limited growth investments and lowered our growth rate.

Overall, our ROCF is growing faster than our customer growth due to our ability to increase operating leverage as previously discussed, our continued decline in our all-in cost of capital, and our natural deleveraging driven by front-end loaded amortization schedules. And soon, our ROCF will be further propelled by tax equity flips and debt refinancings.

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

John Berger:

Thanks, Rob.

At Sunnova our goal is to be the best source of clean, affordable and reliable energy with a simple mission to power energy independence so that homeowners have the freedom to live life uninterrupted. To achieve this goal we are reinventing the way energy is generated and consumed by offering homeowners a better energy service at a better price.

Beginning on slide 14 you will see how energy options for homeowners have evolved over time from the traditional energy service model, reliant entirely upon centralized electric grids, to the new energy paradigm of distributed solar and solar plus storage. Looking forward, by utilizing the latest technologies in solar, storage, secondary generation, and demand control, we are endeavoring to turn our customers' homes into partially or even fully self-sufficient nano-grids, whereby our customers will no longer need to completely rely on centralized power and have gained true energy independence.

We are aggregating these nano-grids into what we call the Sunnova Network. This network will create value for consumers, Sunnova stakeholders, and even the centralized grids.

Slide 15 provides a listing of Sunnova's array of current core offerings, which already includes a wide variety of services. For example, all of our customers benefit from our Sunnova Protect comprehensive service plan, which provides both maintenance and system monitoring. Additionally, as our battery penetration rate increases, more customers are benefiting from the reliability and resiliency of our Sunnova SunSafe solar plus storage service offering. Over the next several quarters, we expect our core offerings to continue to grow, as we offer even more energy services to our existing and new customers. This includes, but is not limited to, electric vehicle charging, energy management solutions, and secondary generation.

Before further exploring the impact of our expanding energy offerings we want to quickly define some terminology. Sunnova defines a service as a transaction that Sunnova, or Sunnova's designee, performs in exchange for a fee from the customer and is counted for the duration of the customer relationship so long as that service is still in effect. Furthermore, a customer relationship is defined by the presence of at least one active agreement such as a service plan, or a similar offering.

As noted on slide 16 we currently provide on average 3.6 services per customer, which equates to approximately $14,000 of Net Contracted Customer Value generated per customer. As we begin to provide more holistic energy offerings, it is only natural the number of services per customer will continue to increase. As a result, we estimate by 2025 we will be providing anywhere between 5 to 9 services per customer. This, in turn, will increase the amount of NCCV per customer we generate by an additional amount anywhere from between $15,000 to $17,000 for customers with 5 services, to $18,000 to $20,000 for customers with 7 services, and $21,000 to $23,000 for customers with 9 services. Our goal is to sell 7 services per customer by the end of 2025, or nearly double our current services per customer.

Another example of our expanded energy service offerings can be found in our recent qualification to participate in the ISO New England Forward Capacity Auction. This ability to participate in capacity markets and other grid services will drive even further value for both Sunnova and its customers.

A key to our success has been and will continue to be our industry leading growth, which allows us to achieve the scale necessary to dramatically lower our cost per customer and as a result further improve our single customer net margins.

In closing, as technology continues to rapidly improve, residential solar is quickly transitioning from being a product sale to a service sale. There are a growing number of hardware technologies that are being integrated with software by large scale energy service providers, such as Sunnova, and this integration is going to help make the power industry - the grid - look more like the internet. Instead of having 100% centralized assets with command and control and no intelligence at the endpoints of the system, the U.S. power industry is heading towards a hybrid of centralized and decentralized that will become more durable, more reliable, more decarbonized, and more useful to consumers. For Sunnova, as this vision is realized, it has opened further growth

opportunities for us to create and sell more energy services to our existing customers, creating further value for our customers and shareholders. Our vision has been that we would go from just putting panels on a roof, to adding solar plus storage, to integrating load control and EV charging, to essentially creating a nano-grid system on our customers' homes - all of which facilitates our long-term vision of becoming a global wireless power company.

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