Sunnova Energy International

FY 2020 Earnings Prepared Remarks

Operator:

Good morning and welcome to Sunnova's fourth quarter and full year 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 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.

We are pleased to report we closed out the year with another quarter of strong results, which allowed us to achieve our 2020 guidance objectives. This makes 2020 the second consecutive year we have met our increased guidance targets, demonstrating the strong forward visibility and predictability of our business even through nearly a year of the pandemic.

In the fourth quarter of 2020, we experienced record setting growth as we added more customers than in any other quarter in the company's history, eclipsing a record set just last quarter. As we move through 2021 we will continue to focus on optimizing Recurring Operating Cash Flow or ROCF through exceptional customer growth, stable unit economics, declining costs on a per customer basis, and our declining cost of capital.

On slide 3 you will see the details of our strong operational results where we increased our customer base and greatly expanded our dealer network.

We continued our rapid growth by adding approximately 29,000 customers in 2020, which is a 57% increase from the number of

customers added in 2019. This exceptional growth is fueled by our 435 dealers and sub-dealers who continue to power our differentiated, low-cost model. We have nearly tripled our number of dealers over the past twelve months by selectively adding 280 dealers and sub-dealers in that time frame. This robust dealer growth is driven by the attractiveness of Sunnova's business model and technology platform to successful, established entrepreneurs in the industry. The benefits of becoming a Sunnova dealer are more apparent than ever as reflected by the fact that nearly half of the 280 dealer and sub-dealer additions in 2020 occurred in the fourth quarter.

On storage, life-to-date, we have now performed over 1,100 battery retrofits - an increase of 226 from September 30, 2020. Our storage attachment rate on origination decreased from the previous quarter primarily due to supply constraints in the Energy Storage System or ESS market as we saw demand greatly outpace available inventory over the past several months. However, we are glad to report that we have seen the battery supply constraints subside over the last few weeks as battery manufacturers ramp up production and new ESS providers enter the market. As a result, our storage attachment rate has been improving over the last few weeks.

When considering how we have progressed in creating value with our storage service offerings we believe a better metric is the storage penetration rate on our full customer base which nearly tripled in 2020 to 9.2%. We expect the penetration rate to increase into the mid to upper teens by the end of the year on a base of what we expect to be roughly 200,000 customers.

Turning to slide 4, we provide a summary of our 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 within guidance ranges despite the unique challenges we faced in 2020. While many companies retracted their guidance, we never wavered from the targets we set even

though we raised our targets just days before the global pandemic impacted all our lives. This achievement was made possible by our flexible, technology-enabled service business model and the quick response of our dealers to modify the way they do business, which allowed for Sunnova to not only survive but thrive in this environment.

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 what is now a conservative discount rate of 4%, NCCV increased from $1.2 billion on December 31, 2019 to $1.7 billion on December 31, 2020. This equates to roughly $17.00 per share as of December 31, 2020, which is approximately a 20% increase year-over-year and a 29% increase since our IPO. These increases in NCCV per share clearly show that despite our torrid growth we are creating value for shareholders. Looking forward, we expect NCCV per share to experience more gradual increases in 2021 due to the SunStreet acquisition. However, we fully expect that trend to pick up as we anticipate NCCV per share to increase more rapidly once the accretive nature of the SunStreet acquisition fully takes hold in 2022.

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 customers, and after payments to tax equity providers. It excludes all future contract renewals, it assumes we sell no complementary products or energy services to existing customers, and it assumes no growth of our customer base. While these items are not reflected in our contracted customer values, they do have a significant value and will become more meaningful to Sunnova as the number of services sold per customer grows. And while a discount rate of 4% is the lowest rate we use in our contracted customer value calculations, even that rate assumes a higher cost of capital than what the market is

currently reflecting given the fact our latest securitization achieved a roughly 2% cost of capital on the fully burdened cost stack.

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. Year-over-year, Sunnova's revenues and adjusted EBITDA are up 22% and 23%, respectively. When viewed together with the principal and interest we receive on our solar loans, our Adjusted EBITDA and P&I increased 44% year-over-year, which compares favorably to our 37% increase in net customer count.

Slide 9 summarizes our recent financing activity.

In 2020 Sunnova raised over $2 billion in new financing, highlighted by $800 million in new securitizations, $415 million in new tax equity funds, multiple expansions of our third-party operated warehouse facilities, and a new $60 million purpose-built loan facility. We also raised $339 million in equity and convertible debt, the latter of which, as of this week, has all been converted to common stock.

Additionally, while we have been raising the capital to grow the business, we have also been paying down previously issued securitizations to the tune of $77 million in principal in 2020. Our securitized debt is structured with a much shorter term compared to the average contract life of our service offerings, which leads to heavy amortization on the front end. This results in a significant increase in shareholder value as the securitization ages, which grows both NCCV per share and ROCF metrics. We expect pay downs to further increase this year.

There is increased appetite for the low-risk, long-term, utility-like cash flows we generate. What is more subtle, and this is something which we can take a bit more credit for, is the way in which investors are appreciating and rewarding the strong underwriting criteria, credit performance, corporate balance sheet, and the great customer service that Sunnova provides regardless of contract type.

For example, just last week Sunnova closed on its first solar loan securitization of the year. This transaction was sized at $189 million, saw opening-bid interest more than 12-times the opportunity available to investors, and achieved an industry-leading 2.08% weighted average cost of capital, including its A tranche, which priced at a 1.8% coupon. That is the best the industry has seen to date, hands down.

Slide 10 puts this latest securitization success in context. Sunnova has issued eight securitizations since its first ABS in 2017. Each successive securitization has yielded a lower weighted average cost of capital than its predecessor. As a result, we have been able to drive down the weighted average cost of debt since our first securitization.

The current weighted average cost of debt represents approximately 100% of our fully burdened cost for each new customer as represented by our recent securitization. This means that as we achieve positive ROCF, any corporate capital we require is a small portion of our working capital. Because of the ITC extension in late December, we did not need the corporate capital for safe harbor, and are therefore comfortable with our current liquidity despite our significant growth rate and pending acquisition of SunStreet. However, we will be opportunistic with regards to corporate capital and we will look to maintain our long term debt to asset ratio of 55-60%, measured over several years.

Turning to slide 11, the reason we retain our residuals and prefer not to sell off our cash flows is to flow value to our corporate balance

sheet through capturing more margin through loan payoffs and fewer defaults.

Right now, our most punitive securitization, in terms of both interest expense and amortization sweep, is 2017-1, so one of our first steps will be to put those assets into a new securitization, market permitting, by the middle of this year. This will allow us to re-finance and re-securitize this de-risked pool of collateral while dramatically lowering both the interest rate and the amortization sweep. We expect this first step in refinancing to further increase ROCF.

We are also working with our lenders to modify our warehouses to reflect both the increased quality of our asset credit metrics and the demand from the securitization markets. As we look to our new securitizations, we are working to increase the advance rate on the investment grade tranche, primarily by continuing to focus on customer service, securing customer payments, and increasing loan payoffs.

As we grow and mature, Sunnova intends to continue methodically directing more and more cash flows to the balance sheet. We intend to continually thicken these cash flows by incorporating structural improvements to our securitizations. We believe this will put us in the best position to be able to issue a green bond within the next 18 months.

On slide 12 we provide additional color around unit economics. For the full year 2020 our fully burdened unlevered return on new origination was at 8.7%, while the weighted average cost of debt from the three securitizations we priced last year, including our June securitization that helped reopen the market, was 3.6%. This resulted in a 5.1% achieved spread in 2020. Our fourth quarter fully burdened unlevered return was 9.7%.

We think a great deal about what the proper metrics are for this business. As we have discussed in the past, we use a number of legacy metrics that can become misleading when applying numerators and

denominators that do not match up, or when costs are addressed without any context as to the true return on investment.

One that has always befuddled us is Net System Value or NSV, often expressed in a per-watt basis. As we have mentioned in the past, we feel this metric is increasingly less useful to investors, especially as the numerator expands to include such items as batteries that are measured in kilowatt hours and items like load management hardware and new roofs that have no official energy value. Loans present another issue altogether, as the net system value metric does not properly capture the repayment rates and, therefore, loan growth will inaccurately decrease NSV. Add in other factors, such as significant differences across states and stand-alone storage and secondary generation, and neither NSV per system nor NSV per watt provide investors with the insights that might have existed in a single-state, solar only, lease and PPA only market. Therefore, we will end on a strong NSV showing in the fourth quarter and discontinue the calculation and disclosure of this metric going forward, as we believe that disclosing the fully burdened unlevered return provides much greater insight for investors as to the value creation per dollar invested.

On slide 14, we are raising our 2021 guidance. We now expect customer additions of 55,000 to 58,000. The primary driver of this increase is approximately 9,000 new customers we project to add through our planned acquisition of SunStreet. This represents nearly a 100% planned increase in customer growth compared to 2020. At the same time, we expect total services per customer will decline slightly as the existing SunStreet customers on average have received fewer services than Sunnova's legacy customer base. We expect services per customer to rise again once we have an opportunity to offer the full suite of Sunnova services to both existing and new SunStreet customers.

We expect the financial uplift from SunStreet to really hit its stride in 2022. Nonetheless, we are also increasing our 2021 Adjusted EBITDA and Recurring Operating Cash Flow guidance due to higher

growth, deleveraging, higher than expected cash flow, and the acquisition of SunStreet. We are moving the midpoint of our ROCF forecast to breakeven, and believe we are in an excellent position to be potentially ROCF positive in 2021 and fully expect significant ROCF growth in 2022 and beyond.

We are maintaining our guidance on the Principal and Interest received from solar loans, as solar loans are not generally sold in the new home market, and we are maintaining our guidance range for Adjusted Operating Cash Flow or AOCF. Although we do expect the increase in Adjusted EBITDA, as well as our extremely strong interest rate on our most recent securitization, to accrete to AOCF, we also expect to increase the advance rate on our warehouses, which will increase our working capital interest expense. As the stronger borrow should enhance our liquidity, we believe this is a prudent move in this interest rate environment.

We expect to spend approximately $30 million in integration and transaction costs on SunStreet over 2021 and 2022. We will closely monitor these costs and be fully transparent with their progress going forward. These expenses are included in our liquidity forecast.

While the addition of SunStreet is moderately accretive to 2021 financial metrics, we expect to see a more material impact in 2022. 2021 will be a partial year of ownership, and it will take some time for the impact of customer growth to manifest in the financial results. But we believe that scaling the business, keeping down costs, and adding SunStreet will result in a 75% increase in our 2022 Adjusted EBITDA plus the principal and interest we receive on solar loans compared to 2021. Further, we are maintaining our year-over-year increase in customer growth of 40% for 2022 over our revised 2021 levels.

We are highly confident in our ability to hit our 2021 targets, just as we did in 2020 and 2019. The nature of our business provides excellent visibility which is reflected in the fact that approximately 82%

of the mid-point of our 2021 targeted revenue and solar loans P&I are already contracted through existing customers as of January 31, 2021.

Based on our forecast we expect to capture approximately 15% of our Adjusted EBITDA and P&I in the first quarter of 2021, increasing to 25% in Q2, 30% in Q3, and 30% in Q4. We expect our customer additions to occur more toward the back half of the year with approximately 30% of our forecasted customer additions weighted to the first half of the year with the balance over the last six months. This is primarily due to the timing of the SunStreet acquisition, the battery supply situation, and the onboarding of new dealers in the first half of the year.

Our customer base and business model is expected to continue to produce industry leading operating leverage. This was reflected by the fact our adjusted operating expense per weighted average customer declined by just under 10% in 2020. We expect this metric to continue to decline on a per customer basis, even with the meter replacement costs of just over $10 million in 2021 and $9 million in 2022. In total, we expect to reduce our adjusted operating expense per customer by an additional 25% between 2020 and 2022 even after updating our forecast for significant increases to growth in 2021 and 2022.

I will now turn the call back over to John.

John Berger:

Thanks, Rob.

Last week we announced a definitive agreement with Lennar Corporation, one of the nation's leading home builders, to acquire SunStreet, their residential solar platform. In addition to our acquisition of SunStreet, we will also become Lennar's exclusive residential solar and storage service provider for all new home communities across the country. This all-stock transaction and partnership will position Sunnova

as a market leader in the home builder space as well as a leader in the development and management of microgrids.

Slides 16 through 18 provide an overview of the acquisition, partnership, and SunStreet itself, as well as a summary of the advantages of the agreement.

The three main reasons we acquired SunStreet were to significantly increase our growth both in new customers and through the upselling of existing customers, to reduce costs per customer more quickly, and to build a partnership around what we see as the ultimate end point for our industry, microgrids for large scale communities.

Beginning on slide 20 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. As more energy technologies converge in the home, residential solar, battery storage and energy management are quickly transitioning from being disjointed product sales to a managed, integrated technology service from Sunnova. By utilizing the latest technologies in solar, storage, secondary generation, and demand control, we are turning our customers' homes into partially or even fully self-sufficient nano-grids, whereby our customers will no longer need to solely rely on centralized power to power their lives.

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.

On slides 21 and 22 you will see how we plan to scale these nanogrids to deliver grid services and then ultimately into microgrids to deliver consumer, grid, and community value. As we develop these community microgrids we will be able to provide even more energy savings, energy resilience, and energy independence.

An example of grid services is our recent clearing of 85 megawatts in the ISO-New England Forward Capacity Auction, the largest deal in our industry's history.

Our ability to win capacity in a competitive auction with the largest aggregation of distributed renewables to date demonstrates our commitment to leading the energy transition in the region. More importantly, Sunnova is looking forward to supporting ISO New England on their path to a clean, resilient power system, while providing homeowners with the affordable and reliable energy they deserve.

Overall, Sunnova's commitment priced at nearly $3 per kilowatt month across the region, which translates into a first-year value of approximately $2 million and approximately $38 million of gross value across the 20-year term, assuming similar pricing and cleared megawatts.

This win is a convincing demonstration of our growing scale and the ability to create long term value for shareholders with the software and services that make up the Sunnova Network and platform.

We remain firm in our conviction that the transition to distributed solar plus energy storage technologies will be one of the most significant events of our lifetime, and we are proud to be at the forefront of bringing these energy solutions and opportunities together for homeowners to create a cleaner and more resilient new energy future. Sunnova's founding vision was to be amongst the world's first and largest wireless power companies where we would create value for our shareholders, our customers, and our communities, while making a positive and substantial impact upon the world by redefining the way people source and use energy. And as you can see, we are bringing this vision to life through efficient execution and the build-out of our energy service and software platform - the Sunnova Network.

And as demonstrated by last week's energy crisis here in our home state of Texas, the time for a better energy service and distributed energy

service offerings is now. We feel strongly that the current discussion shouldn't be solely centered around renewables versus fossil fuels—it should be about the power of decentralized generation and services and how we can bring homeowners the most affordable, sustainable, and reliable energy they need. The energy paradigm is shifting from being highly centralized to more decentralized, and eventually looking more like the internet does today. Instead of having 100% centralized resources and control, intelligence is pushing to the grid edge with endpoints taking on generation, energy management, and grid support roles. 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 personalized to the consumers it serves. Whether it’s wildfires in California, hurricanes in Florida or winter storms in Texas, now more than ever it's clear the way we power our homes and businesses must change.

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