Sunnova Energy International

Second Quarter 2022 Earnings Prepared Remarks

Operator:

Good morning and welcome to Sunnova's second quarter 2022 earnings conference call. Today's call is being recorded and we have allocated an hour for prepared remarks and question and answer. At this time, I would like to turn the conference over to Rodney McMahan, Vice President, Investor Relations at Sunnova. Thank you. Please go ahead.

Rodney McMahan:

Thank you, operator. Before we begin, please note during today's call we will make forward-looking statements that are subject to various risks and uncertainties that are described in our slide presentation, earnings press release, and our 2021 form 10-K. Please see those documents for additional information regarding those factors that may affect these forward-looking statements.

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

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

I will now turn the call over to John.

John Berger:

Good morning and thank you for joining us.

Sunnova delivered solid second quarter results as we delivered where it counts the most. Growth was strong in revenue and Adjusted EBITDA, we grew our quarterly fully burdened unlevered return by 50 basis points from the prior quarter, and we increased our Net Contracted Customer Value, or NCCV, during what is typically a light quarter for NCCV growth. Additionally, we saw both our Adjusted Operating Expense on a per customer basis and our customer default and delinquency rates decline.

However, we did fall short of our expectations in customer additions primarily due to delays in receiving permission to operate, or PTO, from some utilities that we believe were stressed due to high industry growth. We also collected less than expected unscheduled principal payments on our solar loans as the economic recession and the sudden spike in mortgage rates led to a significant decline in mortgage and mortgage refinancing activities. While missing these targets was frustrating, investors should consider these shortfalls to be timing driven as we still expect to hit our 2022 customer additions target, with a more back-end weighting, and we will ultimately still collect the principal owed to us over the terms of the solar loans.

More importantly, we are able to reaffirm our 2022 guidance as well as our intermediate term major metric growth plan, the Triple-Double Triple Plan, due to the following reasons:

– The large backlog of customers we have under contract but not yet placed in service. Sunnova had its best quarter for sales in company history in the second quarter creating a significant backlog of customers which we expect to be placed in-service by the end of the year;

– The increasing traction with upselling energy services to existing customers;

– The earnings stability our long-term contracted cash flows generate that allows us to meet and, in some cases, exceed expectations for Adjusted EBITDA and the interest payments we collect on solar loans, even when customer additions fall below expectations; and

– The robust demand we are seeing for our essential energy services even in the face of waning consumer confidence as homeowners seek an offset to rapidly rising energy costs.

Slide 4 summarizes the growth in Sunnova's customers, battery attachment rate on origination, battery penetration, and dealer network.

In the second quarter of 2022, we added approximately 17,300 customers, bringing our total customer count to 225,000 as of June 30, 2022, a 40% increase in cumulative customers from June 30, 2021.

As I just noted, the delay in customer additions was primarily driven by slower than expected interconnection times in select utility areas, but was also impacted by battery deliveries scheduled to occur late in the second quarter moving into earlier in the third quarter, and accessory and service only sales ramping later in the second quarter than initially anticipated. While these factors impacted the number of customers we placed into service in Q2, we still expect to fall within our guidance range of 85,000 to 89,000 customer additions for full year 2022.

As anticipated, our battery attachment rate on origination increased in the second quarter of 2022 to 31%. More importantly, our battery penetration rate continues to grow and reached 14.2% as of June 30, 2022, inclusive of over 2,000 battery retrofits we have performed life to date. Our backlog of battery retrofit sales also grew materially in the second quarter.

Our growth continues to be driven by our dealer network, which as of June 30, 2022 stood at 986 dealers, sub-dealers, and new homes installers, only a few dealers shy of our year-end target of 1,000. We expect our dealer growth to accelerate further as we move out of the current peak selling season.

Finally on slide 4 we have updated our information on customer contract life and expected cash inflows. As of June 30, 2022, the weighted average contract life remaining on our customer contracts equaled 22.3 years, and expected cash inflows from those customers over the next twelve months increased to $432 million, an increase of 45% versus June 30, 2021.

On slide 5 we provide a summary of the broad and rapidly growing energy services we offer, centered around our vision of the Sunnova Adaptive Home, which is increasingly being demanded by both current and new customers.

When we discuss our goal of increasing the number of services sold on a per customer basis to seven by the end of 2025, these service offerings position Sunnova to achieve that goal. We derive the number of services per customer by dividing the total number of unique service transactions by our cumulative customer base which as of the end of Q2 stood at 225,000. As you can see on slide 5, we sold on average 3.84 services per customer as of June 30, 2022, compared to 3.52 when we established this goal last year.

In addition to growing our services per customer, we have also seen an increase in non-unique transactions. These non-unique transactions consist of upsells to our existing customer base, and while they do not increase our cumulative customer count, they will assist us in our ability to achieve our NCCV per share and services sold per customer targets included in the Triple-Double Triple plan.

We currently offer twenty-nine distinct services, categorized here, to both current and new customers. As technological advancements in our industry continue to accelerate, allowing us to create a margin-rich, integrated and comprehensive energy service for our customers, we are increasingly called upon to expand the number of services we sell to meet our customers' demands as we move beyond just the solar panel.

I will now hand the call over to Rob.

Robert Lane:

Thank you, John.

Starting on slide 7, you will see the year-over-year improvement in our second quarter results. This includes a 121% increase in revenues, significant increases to both Adjusted Operating Cash Flow and Recurring Operating Cash Flow, and a 44% year-over-year increase in the Adjusted EBITDA together with the Principal and Interest we collect on solar loans. Our increase in revenue includes a change in how we have been sourcing some equipment for our dealers that resulted in $54.2 million in inventory sales revenue in the second quarter of 2022; excluding that number, our revenue increase was 39%.

While collections on solar loans increased from the same period last year, we had initially expected this increase to be even greater. As John noted earlier, we were anticipating a much higher level of principal payments from our customers during the quarter. This lag in payments was due to customers delaying unscheduled principal payments given rising interest rates, materially lower refinancings of mortgages, and overall concerns about the economy. Scheduled payments, however, were better than expected, and so we consider the unscheduled payments merely delayed, and thus there is no loss of cash value to Sunnova.

Furthermore, our second quarter 2022 Adjusted Operating Expense per customer on a trailing twelve months basis declined by 7%

compared to the first quarter of 2022 despite our continued strong investment in growth, an inflationary environment, and spending on the recently completed 5G meter replacement cycle. This was driven by our business continuing to scale and our focus on managing spending.

Slide 8 summarizes our recent financing activity and liquidity position.

The 2022 financing transactions completed to date include $167 million in tax equity funds and $653 million in asset backed securitizations. While our June securitization priced at a yield above previous issuances, even with that most recent print, our weighted average cost of debt at issuance remains well within the 400-basis points range at 4.15%.

Our total liquidity as of June 30, 2022 was $482 million, down from $703 million as of March 31, 2022. This planned utilization of liquidity was partially driven by an acceleration of work in progress as we entered the strong sales portion of the calendar. Additionally, as investors recall, in August of last year we issued the residential solar industry's first ever Green Bond. This issuance effectively prefunded our balance sheet allowing us to forgo issuing any non-investment grade tranches in our next several securitizations to better match the earnings profile of our assets to our debt maturities. As such, our liquidity glide path is on target as we work through the prefunding from the Green Bond.

Included in these numbers are both our restricted and unrestricted cash, as well as the available collateralized liquidity we could draw upon from our tax equity and warehouse credit facilities. Given available unencumbered assets as of June 30, 2022, this available collateralized liquidity equaled $118 million. Beyond that, subject to available collateral, we had $470 million of additional capacity in our warehouses and open tax equity funds. That represents just over $950 million of

liquidity available exclusive of any additional tax equity funds, securitization closures, the cash value of our deep in the money interest rate swaps, or warehouse expansions later this year, including an expansion of our loan warehouse just last week.

On slide 9 you will see our fully burdened unlevered return on new origination was 9.2% as of June 30, 2022, based on a trailing twelve months. While our returns remained flat from last quarter on a trailing twelve month basis due to lower returns in the second half of 2021, the fully burdened unlevered return for the three months ended June 30, 2022 increased to 9.7%, an increase of 50 basis points compared to the three months ended March 31, 2022. Since the beginning of the year, we have raised our returns by 100 basis points, and we expect a further increase of 30 to 50 basis points in the third quarter.

As we discussed on our last earnings call, high and rising utility rates have enabled us to raise our pricing on newly originated customers and thus allow us to offset our own increases in costs, specifically the higher cost of debt. Additionally, higher utility rates are driving even greater value to Sunnova on a per share basis by improving our customer payment performance. Currently, we are seeing just under 30 basis points in value loss from net defaults, a number that continues to decline, while the market assumes this loss rate to be closer to 120 basis points. The spread between these two assumptions equals approximately $69 million, or $0.60 per share every year and growing as we grow our contracted cash base and keep our value loss rate low.

These price increases, together with the high growth of our industry, our increasing operating leverage, and our continued growth in additional energy services should keep margins wider in the near term and position the company to push our implied spread on a trailing twelve months back towards the 600 basis points range later this year. However, as we have noted before, we model a long-term average for our implied spread in the 500-basis point range to estimate our guidance targets.

Slide 10 reflects the strong growth we have seen in both our Gross Contracted Customer Value, or GCCV, and NCCV. As of June 30, 2022 NCCV was $2.4 billion discounted at 4%, an increase of 41% compared to June 30, 2021. Our June 30, 2022 NCCV at this discount rate equates to approximately $10,800 per customer and $21.16 per share.

At a 6% discount our June 30, 2022 NCCV was $1.9 billion, or $16.64 per share, an increase of 48% since June 30, 2021 and our June 30, 2022 NCCV at a 5% discount rate was $2.1 billion, or $18.74 per share.

These current per share values demonstrate that even at a higher discount rate Sunnova is receiving little to no credit for either its platform, customer optionality, or expected growth.

Looking back further, our net contracted customer value on a per share basis is up approximately 60% since our IPO three years ago this week. Over these three years this growth on a per share basis, regardless of discount rate used, has been accelerating and we expect that trend to continue.

Beginning on slide 12 through slide 14 you will find our detailed 2022 guidance, liquidity forecast, and our major metric growth plan, the Triple-Double Triple Plan. There are no changes to these estimates as we remain on target as it relates to both our liquidity forecast and our overall guidance.

Regarding the uncertainty around a potential Investment Tax Credit extension, neither Sunnova's 2022 guidance, nor the Triple-Double Triple Plan, are dependent on any extension as one was never included in our assumptions.

As of June 30, 2022, over 95% and approximately 75% of the mid-points of our 2022 and 2023 targeted customer revenue and principal

and interest we expect to collect on solar loans was locked in through existing customers as of that same day, respectively.

As John mentioned, our second quarter origination created a significant backlog of customers who have signed up for our services, but are not included in our customer count as we do not count an originated customer in our cumulative customer count until they have been placed into service. While receiving permission to operate was slower than we would have preferred in Q2, we have seen PTO's start to free up in July, adding to our confidence that these originated customers will be interconnected in the coming months, and thus added to our customer count, before the end of the year.

Finally, despite concerns about the housing market, our new homes business continues to generate new customers and take market share in key territories.

I will now turn the call back over to John.

John Berger:

Thanks, Rob.

As customer payment performance becomes more of a concern in less essential and more mature industries, Sunnova's performance has improved as our customer delinquency, default, and value loss rates are at all time company lows and continue to improve. We believe we are seeing this improvement because our customers are experiencing a level of energy savings greater than ever due to utility rates being significantly higher today than they were when their contracts were originated. This utility rate escalation not only further incentivizes our customers to prioritize paying their Sunnova bill, but also entices other homeowners to make the switch to solar and the many other energy services we offer.

While regulatory debates, supply chain gridlock, and geopolitical tensions have created a steady stream of negative headlines that have weighed heavily on our equity valuation, these headlines have had little to no impact on Sunnova's operations, growth, or financial performance.

Since we have had a more pessimistic view of the global economy for some time, including predicting a recession two earnings calls ago, we have taken certain steps over the past several quarters to prepare Sunnova for many of the challenges seen today. This includes raising significant liquidity in 2021 well before the recent interest rate hikes, locking in matching debt for historical growth, keeping inventory on our balance sheet to provide a safety net for our dealers to meet unwavering demand, vetting and adding new equipment manufacturers to our approved vendor list to further insulate ourselves from equipment constraints as they arise, and finally, prioritizing service to ensure our customers remain happy, paying customers who will engage us when ready to add new energy services.

While some in the investment community have begun to question the outlook of our industry in both the near and mid-term, we remain bullish due to the following reasons:

– We have a sizable backlog. As of today, we have originated all the customers needed to meet our 2022 customer additions guidance and have begun to originate for 2023.

– We expect hydrocarbon prices to stay relatively high despite a recession, which will therefore drive strong consumer demand for our energy services;

– We have demonstrated our pricing power in a material way and expect that ability to continue;

– We expect our cost of capital to slow its growth relative to rising utility rates or even decline in the near-term as the recession impacts the global economy;

– We expect our service offerings, global software platform, service capabilities and capacity, and geographic growth to be more mature in 2023 providing us even greater earnings and cash flow growth; and

– We expect to continue the trend of decreasing our costs on a per customer basis, a trend that will escalate now with the completion of the 5G meter replacement cycle.

Finally, it is difficult to ignore the recent wildfires, heatwaves, and flooding around the world, including record summer temperatures in our home state of Texas. To combat these challenges, the world is in desperate need of clean, resilient, and reliable energy more than ever. At Sunnova, we are working diligently to bring solutions to the global energy crisis trifecta - energy affordability, energy security, and climate change - by providing an unparalleled energy service to help homeowners gain true energy independence in the face of growing economic hardship and climate change realities.

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