Sunnova Energy International

Second Quarter 2023 Earnings Prepared Remarks

Operator:

Good morning and welcome to Sunnova's second quarter 2023 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 2022 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 achieved record growth in customer additions in the second quarter. This outstanding performance can be attributed to the strong demand for our comprehensive suite of services, the continued growth of our dealer base, and the expansion of our addressable market and market share.

What sets Sunnova apart and fuels our growth is our unique business model, exemplified by an unwavering commitment to delivering responsive and reliable service. While solar forms the foundation of our existing customer base, we have observed a growing trend among newer consumers. We see homeowners seeking a broader range of services that go beyond panels on the roof. To meet this evolving demand, we have introduced innovative solutions such as the Sunnova Adaptive Home and the Sunnova Adaptive Business, which combine advanced technologies to optimize energy usage for homeowners and businesses, as well as Sunnova Repair Services to ensure the uninterrupted performance of solar systems without service.

Underpinning our commitment to providing exceptional customer service is our 24-hour response time for our customers, currently in four markets. We have plans to expand to seven markets by the end of this year, which is expected to cover 70% of our customer base. This rapid expansion of our 24-hour response time will help us to solidify our position as the fastest service delivery leader while expanding our Sunnova Repair Service business.

Our ability to navigate macroeconomic financial conditions, regulatory changes, and market trends, all the while focusing on the customer, is unmatched in our industry. One market trend we are actively involved in is the current deflationary environment for equipment. In the current equipment cycle, falling prices coupled with

our open equipment platform and our strong relationships with best-in-class manufacturers, has empowered us to access top-quality equipment at favorable pricing, thereby enhancing our scalability and market competitiveness.

To get a sense of how drastic price declines have been so far this year, at the end of 2022, the average equipment stack consisting of panels, inverters, and a battery for an 8-kilowatt system in one of our major markets priced around $15,100. Now, that same composition of equipment can be purchased for approximately $9,500, a reduction of 37%. This notable price shift translates to the equivalent of a 330 basis points decrease in the cost of capital, which will inure to the benefit of both the consumer, in the form of lower pricing as the majority of the cost savings will be passed through to them, and service providers like Sunnova in the form of consumer demand upside as long as the service provider has managed their inventory properly and operate an open equipment platform.

Slide 3 showcases the continued growth in Sunnova's customers, solar power generation and energy storage under management, battery attachment rate on origination, and expected cash inflow over the next twelve months.

During the second quarter, we placed over 39,000 customers into service, which brought our total customer count as of June 30, 2023 to 348,600 and brought our megawatt hours under management to 869 and total solar power generation under management to 2.1 gigawatts.

As a reminder we will count a customer only after they have been placed into service and we have an on-going economic relationship with the customer. If the economic relationship ends, we will remove from our customer count. Additionally, we will count a customer only once, regardless of the number of services we provide to them.

Our growth is fueled by our dedicated dealers. In the second quarter we added another 216 dealers bringing the total count to 1,592 as of June 30, 2023.

Our strong customer additions during the first half of the year, our continued robust originations, and our conservative customer count methodology, gives us the visibility and confidence to increase our customer additions guidance for 2023 by 10,000 customers at the midpoint, and issue preliminary 2024 customer growth guidance of 40% over 2023. Given the timing of when these customers go into service, we expect the bulk of the financial benefit of the customer additions to accrue to Sunnova in 2024 and beyond.

We are furthering our growth by upselling our existing customers additional services and are tracking this growth effort through our services per customer metric, which stands at 3.5 as of June 30, 2023. We continue to target 7 services per customer by the end of 2025.

Additionally, our battery attachment rate on origination was 32% in the second quarter; and, as of June 30, 2023, we reached 3,173 battery retrofits life-to-date.

Finally, we have updated our customer contract life and expected cash inflows. As of June 30, 2023, the weighted average contract life remaining on our customer contracts equaled 22.2 years and expected cash inflows from those customers over the next twelve months increased to $597 million.

By focusing on being an Energy as a Service company, we have successfully differentiated ourselves, and we are building a reputation for reliable and responsive service. Detailed on slide 4, Sunnova's growth strategy is built around the following key opportunities;

– In the U.S., we estimate there are approximately 108 million homes that could become Sunnova Adaptive Homes. With only a 4%

solar market penetration rate, there is significant untapped growth potential for Sunnova. By aggressively expanding our operations, we are determined to establish our presence in all 55 U.S. markets by the end of 2024 to take full advantage of this untapped opportunity. Our larger footprint will also lower our concentration risk and reduce our exposure to region-specific concerns such as the recent change in the net metering tariff in California.

– Of the roughly 4 million homes that have solar in the U.S., approximately 2.5 million of them lack a service provider, creating additional market opportunity for Sunnova through our Sunnova Repair Service business. Based on our analysis, we have determined that these systems typically require at least one truck roll every three years, resulting in a substantial revenue potential of approximately $1 billion per year when considering an average ticket price of approximately $1,100. While our current focus is on providing repair services to residential systems, there are opportunities to expand this capability to our Sunnova Adaptive Business customers and future European customers;

– The Sunnova Adaptive Business market opportunity is vast, encompassing approximately 2.6 million businesses that could benefit from our solutions. Our goal is to expand our presence into all 55 U.S. markets by the end of 2024, positioning Sunnova as a leading provider of Energy as a Service for businesses across the country;

– And finally, with an average EU energy cost of 1.61 euros per watt, and approximately 66 million potential Sunnova Adaptive Homes, and an estimated solar revenue opportunity of 462 billion euros, the European market presents a substantial opportunity for Sunnova as we look beyond the U.S. and its territories. Additionally, a move internationally will further reduce our exposure to U.S.-specific challenges and open Sunnova up to more regulatory and consumer choice-friendly markets. We will be nimble and opportunistic about

capitalizing our growth opportunities overseas, and we intend to be methodical in our approach. As of now, our 2024 customer projections do not include Europe.

In addition, we have determined that the rapidly growing Sunnova customer base, particularly the storage and load management assets, possess substantial untapped financial potential as it pertains to existing accessible wholesale markets and emerging opportunities in other wholesale markets. As highlighted in slide 5, our expanding optimization and monetization expertise extends into wholesale power, grid services, and retail energy provider services, collectively known as "Energy Services." Leveraging our Sunnova Sentient platform, and employing realistic addressable market and attachment rate scenarios, we project that Sunnova Energy Services has the capability to generate cumulative revenues of $1 billion by 2030.

With our primary focus on delivering outstanding value to our customers and shareholders, we continue to drive revenue growth, provide great service to minimize capital loss, and strengthen our brand. Our unique model serves as the foundation for these goals, allowing us to meet our customers' expectations regarding power reliability and affordability. As we move forward, we are committed to investing in innovative technologies, operational efficiencies, and logistical capabilities to enhance the quality and responsiveness of our services.

I will now hand the call over to Rob, who will walk you through our financial highlights.

Robert Lane:

Thank you, John.

Starting on slide 7, you will see our second quarter financial results.

We captured 17% of our expected annual Adjusted EBITDA together with the principal and interest we collect on solar loans in the second quarter, slightly below our guide of 20%, but keeping us in line with our 30% projection for the first half of 2023. The second quarter results came in below our initial guide primarily due to a lower-than-expected contribution from inventory sales to our dealers. Materially better credit terms from several vendors and a concerted effort to collect accounts receivable and lower inventory orders rationalized our working capital position, and we fully expect increased inventory gain on sale contributions in the third and fourth quarters.

Additionally, in the second quarter we recorded a $15.7 million impairment. A portion is due to the purchase of a product that was ultimately found to be impractical for the vast majority of residential rooftops and the manufacturer is no longer on our approved vendor listing. We will responsibly recycle what equipment we cannot donate to charities.

On slide 8 you can see the steps Sunnova recently took to strengthen its access to capital.

Thus far in 2023, we have added $255 million in additional tax equity funds as the tax equity market remains healthy. We continue to utilize tax equity partnerships; however we are engaged in several potential transactions to sell tax credits in the current quarter and in the fourth quarter in order to diversify our funding sources.

Also during the year, we have expanded our warehouse capacity by $535 million while securing amendments to keep pace with our evolving origination, entered into $611 million in asset backed securitizations, entered into a $50 million secured revolving credit

facility to support selling inventory to dealers, and announced a conditional commitment by the U.S. Department of Energy Loan Programs Office.

Included in our $510 million of liquidity as of June 30, 2023, 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, 2023, this available collateralized liquidity equaled $104 million. Beyond that, subject to available collateral, we had $215 million of additional capacity in our warehouses and open tax equity funds. Combined, these amounts represent $725 million of liquidity available exclusive of any additional tax equity funds, securitization closures, in the money interest rate hedges, further warehouse expansions, or other sources of liquidity during the year.

In addition, we expect to close at least four more amendments, extensions, and new capital sources in the next 30 days, exclusive of any publicly announced transactions.

On slide 9 you will see our fully burdened unlevered return on new origination increased to 10.9% as of June 30, 2023, based on a trailing twelve months. On a quarter to date basis, this return equaled 11.1%. We are forecasting further increases to our fully burdened unlevered return over the remainder of the year as we have seen positive trends as this return equaled 11.6% over the last 30 days. This more recent increase is partially driven by the addition of a limited amount of IRA adders, leaving room for further gains as adder guidance improves and equipment manufacturers establish manufacturing capabilities in the United States. Additionally, we anticipate a slightly lower tax equity cost of capital in the upcoming quarters, and we have recently implemented several price increases, with additional price increases going into effect next month. With these combined factors, we are closing in on our target 12% fully burdened unlevered return.

The implied spread for the trailing twelve months decreased to 4.5% as our weighted average cost of debt over the past twelve months increased as older securitizations have fallen away, even though our

marginal cost of debt has decreased relative to the fourth quarter of 2022. Given the impending impact of our Department of Energy Loan Guarantee, with our continued extremely low capital loss rate, and market signals of falling inflation and slowing growth, we anticipate that our marginal weighted average cost of debt is more likely to fall as we approach 2024.

Slide 10 reflects the strong growth we have seen in our Net Contracted Customer Value, or NCCV. At a 6% discount rate, NCCV was $2.65 billion, an increase of 39% compared to June 30, 2022. Our June 30, 2023 NCCV at this discount rate equates to approximately $7,600 per customer and $22.76 per share. As higher fully burdened unlevered return assets start going into service, we expect this to be very accretive to NCCV in the second half of the year.

Slides 12 through 14 provide our 2023 guidance and liquidity forecast as well as our major metric growth plan, the Triple-Double Triple.

As John noted earlier, our sustained robust growth and ongoing demand have prompted us to update our customer additions guidance once again for 2023. We are increasing our guidance range by 10,000 customers at the midpoint, resulting in an updated range of 135,000 to 145,000 customer additions for the year. We anticipate that the financial impact of this increase will be fully realized in 2024 and beyond.

For the past two and a half years, we have been using gain-on-sale activities and accelerated customer payments to complement our recurring cash flows. Coming into 2023, we expected approximately 24% of our customer cash inflows to come from these activities through a combination of cash and other direct sales, such as inventory sales, repair services, new homes sales, forward flow activities, loan prepayments, and investment tax credit transfers or sales. Based on our most recent forecast we continue to estimate a similar contribution from these activities, although slightly more back-end weighted than initially estimated. This back-end weighting is primarily due to slow guidance from Treasury on the ITC sales and other parts of the IRA. As such,

there is no change to our full year 2023 Adjusted EBITDA or Principal and Interest from solar loans guidance.

As of June 30, 2023, 98% of the mid-point of our total 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.

Due to our growth exceeding expectations, we are updating our liquidity forecast, which can be found on slide 13, to include a $500 million corporate capital raise by the end of this year, primarily to fuel the outsized origination we are currently experiencing and which is driving our customer count expectations for 2024. Our current expectation is 85% of the potential $500 million of corporate capital expected to be raised by year end will be debt in the form of a high yield bond, and 15% of the $500 million of corporate capital will be common equity. However, this may change due to market conditions. As we expect this market growth trend to continue into 2024 for 2025, we felt it prudent to now plan for another potential $500 million corporate capital raise in 2024, again subject to realized growth over the next year and market conditions. We currently expect that raise to take advantage of the expected significant growth of levered cash flows to the equity to support an additional bond issuance.

As a reminder, our capital strategy is to use a combination of corporate capital, which is primarily corporate debt supported by our contracted cash flows, and asset level debt raised through the institutional asset backed securitization market. This structure gives us the lowest cost of capital with the least amount of risk. This is especially true over the past few quarters as the spreads between different credit attachment points in the ABS market are significantly wider than those observed in the corporate debt markets.

As we are refreshing our expiring S-3 securities shelf, we will also be papering an ATM program to allow us opportunistic and low cost access to equity capital with maximum flexibility over a multi-year period. In addition to the potential to utilize the ATM on an "as-needed" basis to fund opportunistic smaller acquisitions, including potential

opportunities in Europe, we may also use the program for core customer growth. However the program is used, we will be clear and transparent with the market on its potential utilization.

Over the years, we have elected to primarily retain our assets and cash flows, which has benefited us in the form of default and delinquencies coming in well below market expectations. It has also given us the ability to receive a corporate rating allowing us to issue a corporate bond and to further issue more corporate bonds as we just mentioned. Due to these benefits, we have not sold any assets out of our securitizations, a practice that will only become more accretive once our DOE loan guarantee is active. As such, it currently appears that issuing a small portion of equity and a second corporate bond by year end is the most efficient cost of capital approach to fund our rapid growth.

Furthermore, scaling our operations plays a pivotal role in enhancing our operating leverage. Although we have observed increases in operating expenses over recent quarters, we anticipate the rate of increase of expenditures will reach its peak by year-end resulting in improved operating leverage beginning in 2024. The revenue and margin growth is following this spending, which was and is primarily directed towards initiatives such as software development to enhance both the customer and dealer experience and energy services. Investments were also made to bring our service response times from multiple weeks and in some cases months to 24 hours in most cases for at least 70% of our customer base. These investments are coming to an end as we expect to be at our desired service levels by year end.

Before turning the call back over to John, I wanted to give more visibility on Sunnova's NCCV metric and the embedded levered cash flow profile over the next several years. Per our analysis, we expect to generate $100 million per year of levered cash flows for the next ten years, increasing to $170 million per year beginning in year 11. This is inclusive of our current capital loss rate and servicing our corporate and convertible bonds, but does not include assets currently not in securitizations, accessory loans, service revenues, and other gain on sale activity, or expenses. We expect that this will:

- Cut our existing ABS debt in half by 2031 through scheduled amortization payments and continuation of our capital loss rate;

- Generate significant cash to the equity to allow even further pay downs of debt above the scheduled payments or issue a dividend;

- Expand our levered cash flow profile to follow directionally with the rapid increase of our asset base which is currently expected to triple by the first quarter of 2025;

- Provide the option to monetize forward cash flows to pay down debt faster; and

- Assist in bringing our debt to asset ratio back down to our targeted 55-60% over time.

I will now turn the call back over to John.

John Berger:

Thanks, Rob.

As we celebrate our 4th IPO anniversary this week, we reflect on the remarkable growth our team has achieved since becoming a public company. Driven by our commitment to enabling energy independence through clean, affordable, and reliable energy services, Sunnova is steadfast in its pursuit of financial and operational excellence. Our dedicated team is comprised of individuals who possess extensive knowledge of the renewable energy landscape and who share a profound passion for creating a positive impact both globally and on our bottom line.

Embracing a collective entrepreneurial mindset, we capitalize on opportunities, expand to new markets, and adapt swiftly to the evolving dynamics of our industry.

Our growth has been remarkably strong, outstripping our original expectations. For example, our originated capital for June of 2023,

compared to June of 2019, the month prior to our IPO, was 700% higher. The customer growth during the same time period was 800% higher. This month alone, every 72 hours we have been originating the same amount of value that we originated during the entire month of June of 2019.

Our critical advantage as an Energy as a Service leader is supported by service, scale, and the retention of long-term contracted cash flows.

Sunnova's growth is propelled by multiple factors across various key areas. In terms of geography, we have a goal of being in all 55 U.S. states and territories for both residential and business markets by the end of 2024. Additionally, international expansion further positions us for substantial geographic risk mitigation and growth opportunities.

As a leading Energy as a Service provider, Sunnova offers a comprehensive, sustainable, and streamlined approach to energy services for homes and businesses. We simplify an increasingly complex and multifaceted service offering. With our approach, customers no longer need to worry about the upfront costs, maintenance, or technical intricacies of how they power their homes and businesses. Instead, they can rely on Sunnova as their trusted energy partner, gaining access to reliable, affordable, and sustainable energy solutions.

With the Sunnova Adaptive Home, we are pioneering innovative services that integrate solar power, battery storage, energy control and management technologies, electric vehicle charging, generators, and more for the consumer. This comprehensive approach not only makes clean energy more affordable but also enhances reliability and resiliency, enabling us to meet the evolving needs of our customers.

By providing exceptional service and addressing our customers' unique needs, we have distinguished ourselves as a leader in the market and are fostering lasting customer loyalty and sustainable revenue streams. This customer-centric approach not only fuels the growth and prosperity of our company but also bolsters our long-term cash flows by minimizing our capital loss rate and increasing our cash flow per share.

Moreover, our ability to deliver this level of service at scale, in an industry that has historically overlooked service issues, further drives profitable growth that is capital light and highly scalable.

Finally, our financing strategy contributes significantly to our growth trajectory. By adopting an agnostic approach to lease, loan, or PPA contracts, we provide diverse financing options to our customers. Moreover, our software-supported systems facilitate seamless transition between different contract types, empowering our dealers to adapt swiftly to market demands and drive solar adoption throughout our market coverage.

Our growth engines are firing on all cylinders, or discharging on all batteries, to modernize the saying.

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