Sunnova Energy International First Quarter 2024 Earnings Prepared Remarks

Operator

Good morning and welcome to Sunnova's first quarter 2024 earnings conference call. Today's call is being recorded and we have allocated an hour for prepared remarks and the question and answer portion of the call.

At this time, I would like to turn the conference over to Rodney McMahan, Vice President, Investor Relations at Sunnova. 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 as described in our slide presentation, earnings press release, and our 2023 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 Rob Lane, Executive Vice President and Chief Financial Officer. I will now turn the call over to John.

John Berger

Before we get started, I wanted to acknowledge Rob Lane, our Chief Financial Officer. As we stated in our 8-K yesterday, Rob will be stepping down from his role as our Chief Financial Officer to pursue other opportunities. This is a decision we have arrived at together, recognizing this is a logical time for a transition.

On behalf of the Sunnova team and the Board of Directors, I want to recognize and thank Rob for his many contributions, including helping the company execute its initial public offering, our acquisition of Sunstreet, and launching the industry's first corporate green bond. We want to express our sincere gratitude to Rob for all that he has done to support Sunnova's success during his tenure.

Rob will serve as CFO through June 30, 2024, or until his successor is named, and will remain focused on supporting the key financing activities we will discuss later in the call.

This change presents an opportunity for new perspectives as we position Sunnova for continued success. Working with the Board, we have retained an outside search firm to run a full search process, which is already well underway, and we expect to share further details on his successor in the weeks ahead. Thank you, Rob. We will miss you.

Now, as we review our first quarter performance, I want to take a moment to remind everyone that our team at Sunnova remains focused on making clean energy more accessible, reliable, and affordable for both residential and commercial customers. As we will discuss shortly, we have an outstanding market opportunity in front of us, and Sunnova is positioned to capitalize on this opportunity so that we can deliver long-term value to all of our stakeholders, as power demand continues to grow.

On slide 5, we see a multi-year tailwind, driven by tremendous load growth on aging electricity infrastructure. By 2028, it is expected that the demand for power in the U.S. will increase dramatically due to the continued electrification of the economy, onshoring of manufacturing, electric vehicle adoption, and increased demand from AI, cryptocurrency and data centers. But an aging power grid means less energy reliability, and with so much growth on the horizon, the energy services that Sunnova provides will be needed for decades to come.

At the same time, we are also seeing steady increases in utility rates, as the capital needed to support and replace this aging, and frequently damaged infrastructure, becomes more expensive in the current interest rate environment.

Inflation has had a direct impact on the cost to maintain and upgrade grid infrastructure and public utility regulators continue to approve higher and higher utility rates. This scenario allows Sunnova to maintain a highly competitive and compelling energy offering. As evidenced on slide 7, a consistent and direct correlation exists between utility rates and the adoption of solar energy.

On slide 8, we see these dynamics create strong demand for our Sunnova Adaptive Energy offerings. As a company, we view these macroeconomic trends as indicators of the many opportunities ahead. Through our innovative financing, servicing, and energy management offerings, we are proud to be helping our customers protect their homes, businesses, and families.

To date, Sunnova has provided energy services to over 438,000 customers, managing 2.6 gigawatts of power backed up by almost 1.2 gigawatt hours of energy storage solutions. We have partnered with over 2,100 dealers and new homes installers in over 50 U.S. states and territories. We are doing this with industry-leading technology, both in hardware and software, which is backed by our service offerings and our entire team of dedicated employees who support our customers day in and day out.

We see the demand and recognize that as we continue to make improvements to the business, we remain committed to the core customer value proposition we centered our entire business around 12 years ago. As a leading adaptive energy services company, we are delivering a comprehensive, sustainable, and streamlined approach to energy services. With our platform, we are simplifying the increasingly nuanced landscape of energy so that our customers do not have to worry about the upfront costs, maintenance, or technical complexities of powering their homes and businesses. Instead, they rely on Sunnova as their trusted energy partner, accessing affordable, reliable, and sustainable energy solutions. We are more excited than ever to see what the future brings, and we will continue to innovate on our customer experience and work hard to support the growing energy needs of the country.

Moving to our Q1 financial results on slide 11. Mostly notably, during the quarter, we generated $18.9 million in unrestricted cash and our total cash balance remained relatively flat compared to the prior quarter, sitting at $487.5 million as of March 31, 2024. Additionally, we experienced an 11.6% decrease in adjusted operating expense per customer compared to the fourth quarter of last year, proof that the initial steps we have taken over the last few months to reduce costs are starting to bear fruit.

This quarter, we delivered $46.4 million in Adjusted EBITDA, $35.7 million in interest income, and $41.9 million in principal proceeds from customer notes receivable, which were all in line with the quarterly guidance we provided on our prior earnings call.

We also continue to see steady year-over-year growth in our Net Contracted Customer Value, or NCCV. Assuming a 6% discount rate, NCCV was $3 billion, an increase of 15% compared to March 31, 2023. Our March 31, 2024 NCCV per share was $24.34, assuming the same discount rate.

Over the last few months, we have also made several exciting strategic announcements.

In January, we announced the opening of our Adaptive Technology Center in Houston. Equipped with cutting-edge energy testing and integration technologies, this center allows our engineering teams to innovate and integrate various technologies seamlessly. It also empowers our service technicians to troubleshoot field issues in a controlled environment, enhancing our service response times when visiting our customers' homes.

In late March, after years of working with The Home Depot to empower customers with cost-effective energy solutions and ensuring dependable and resilient power, we were thrilled to announce our strategic partnership whereby we will now be the sole provider of solar and battery storage services in The Home Depot stores across the United States and its territories. This agreement provides consumers with access to the Sunnova Adaptive Home™ energy offerings in over 2,000 Home Depot stores.

Lastly, in early April we announced the growth of our virtual power plant network. Powered by our Sunnova Sentient technology platform, our customers' systems, and the clean power produced, continues to help offset the need for utilities to use heavily polluting fossil fuel power plants during peak demand periods. In return for their demand battery response and contribution, our customers are compensated for the power supplied by their batteries in most programs, creating a win-win for the customer and the community. As our customer base continues to expand, we are at a pivotal moment in enrolling customers into these programs and we look forward to sharing more details in future earnings calls.

Recognizing the current state of the industry, our immediate focus remains on increasing cash generation and maintaining our margins. This has only sharpened our focus on maximizing asset-level capital, driving cost efficiencies, further leveraging ITC adders, and re-focusing on core adaptive energy customers, all of which we will discuss in greater detail in the subsequent slides.

Turning to slide 14 you will see our total unrestricted cash balance was up compared to the end of last year. We have remained active in the asset backed securitization market with two issuances in February totaling $453 million, and our securitizations are trading well in the secondary market, which gives us confidence in a strong ABS environment for solar. We expect to continue to access the securitization market this quarter, and throughout the year, as investor appetite remains strong.

We also continued to be active in the tax equity market with the closure of a new $195 million fund in February and increased funded commitments of $58 million throughout the quarter to previously established funds. Additionally, while our large TEP 8-B fund closed in December, it was not funded until March of this year, providing us with significant liquidity in the first quarter. As the shift from loans to leases and PPAs continues, driven by macro-economic conditions and ITC adders, we expect that tax equity will make up a larger component of our total financings.

We are generating more proceeds from asset-level financing than we have in recent years. We believe there are three main dynamics at play that will support this: the first is more asset backed securitizations per year and monetizing those securitizations beyond the investment grade credit attachment points; the second, increased utilization of tax equity driven by the shift from loan financing to leases and PPAs; and third, accelerating the overall pace of asset-level financing.

First, on more securitizations. We have done four securitizations per year for the last three years and we expect to complete at least six securitizations in 2024. Also, since Q4 2023 we resumed the practice of issuing beyond the investment grade credit attachment point by monetizing the Class C Notes in our asset backed securitizations in addition to the Class A and Class B Notes. This change in our securitization approach allows us to increase our net proceeds.

Second, on our customer mix shift towards more solar leases and PPAs. This is an advantage for us, as leases and PPAs benefit from higher total advance rates than loans due to their ability to utilize tax equity, recently enhanced by the ITC adders.

Lastly, we are focused on accelerating the pace of our asset-level financings by working with our dealers and internal resources to bring assets into service quickly. Closing securitizations at a faster pace allows us to take advantage of higher advance rates, net of hedge breakage, when we securitize.

Moving to slide 16 we detail the trend in our unit economics, spanning across multiple different interest rate environments in only three years.

Taking a step back, our value proposition is comprised of many things, including cleaner, safer, and more reliable energy, but one of the biggest advantages to our customers is savings. Given the increase in utility rates, we have been able to continue delivering savings to customers, while at the same time increasing our pricing. This has allowed us to achieve a healthy spread in a rising interest rate environment.

This dynamic is illustrated by the trend of our implied spread over the last three years. We have always said that we target a 500-basis point spread long term. In 2021, in a lower rate environment, we delivered an implied spread of 6.4%. As interest rates rose into 2022 and 2023, so too did our cost of debt, doubling from 2021 to 2022. Though we dipped below our spread target in 2022, our pricing changes in 2023 allowed us to increase our fully burdened unlevered return, and generate an implied spread of 5.6%, 60 basis points higher than our target.

Over the last three years, in a host of different rate environments, we have been able to average a 5.5% implied spread while still delivering savings for our customers. We believe that this is indicative of the sustainability of our business model.

Additionally, in the first quarter of this year, even as our cost of debt increased, it was more than offset by an increase in our fully burdened unlevered return, and we saw an increase in our spread, back up above the 6% mark.

However, we recognize that strong unit economics can only be part of the story. Therefore, we are continuing to drive further cost efficiencies in the business. In the first quarter of 2024, our adjusted operating expenses declined roughly 6% quarter over quarter, or $6.6 million. This decrease in total adjusted operating expense was the first decrease in this metric since 2020 and was driven by our initial efforts to reduce costs and to further drive efficiencies in our business. Moving forward we will utilize our technology platform and scale to continue driving costs per customer down, as evidenced by the 11.6% reduction in the first quarter.

Another dynamic we are monitoring is the monetization of the Investment Tax Credit adders introduced in the Inflation Reduction Act.

In addition to the base 30% tax credit, increasingly we are seeing the ability to access the adders allocated to building in energy communities, providing service to low-income individuals, and the push for more domestic content in equipment. For 2023 we saw little uplift from these adders, as the year's weighted average ITC with adders was only 31.5%. This was due to limited implementation guidance on the adders from the U.S. Treasury last year. With the guidance we have received this year, and with more to come shortly, we expect we will be able to increase our weighted average ITC to somewhere between 36 and 40% by the end of 2024.

As you can see here on slide 18, we estimate that a 1% increase in the weighted average ITC rate would generate at least an additional $30 million in cash proceeds in 2024 based on the fair market value of the lease and PPA systems we expect to place into service this year.

And lastly, we are re-focusing on our core adaptive energy customers.

The left side of slide 19 shows our customers deployed per year. While we expect flat growth in overall customer additions in 2024, we still expect the number of megawatts we deploy this year to increase. This is due to a shift in our expected customer mix in 2024 as we refocus our capital expenditure investment on core adaptive energy customers.

Also, our solar additions in 2024 are expected to be much more heavily weighted towards lease and PPA customers, which as I discussed is advantageous for our cash generation as well as our margins. This renewed focus on our core adaptive energy customer will help us to make progress against the priorities I previously mentioned, while also providing us the adequate scale necessary to fund the business through asset-level financing. I also want to be clear: there is more than enough market demand, despite economic challenges, to continue to recognize the benefits that scale has for our business. With that, let me now turn the call over to Rob.

Robert Lane

Thanks, John.

Turning to slide 21 you will see that we are tempering our outlook on customer additions for 2024 from the prior range of 185,000 to 195,000 down to 140,000 to 150,000. This reduction is in no way indicative of any lapse in demand for our offerings but is instead a proactive move we are taking to right size our growth. As John mentioned earlier, scale is important to our business, but we are being much more intentional about the kinds of customers we are adding. We believe this approach to customer additions, focused on our highest value customers and offerings, while limiting growth in some areas of our business that do not provide the highest returns, will better position us to achieve our customer cost reduction and cash generation goals.

Aside from our customer additions, we are reaffirming all our 2024 guidance figures including adjusted EBITDA, interest income, and principal proceeds.

Turning to slide 22, in the first quarter, we generated $23 million in levered cash flows, which is comprised of residual cash flows from securitized customer contracts, all MSA fees, and proceeds from unpledged SRECs and grid services.

The EPC costs that make up our investment in systems totaled $561 million.

We generated roughly $627 million in asset level financing, and used $20 million of cash on corporate interest expense, leading us to a net increase of $19 million of unrestricted cash in the quarter.

Now moving to our full year forecasts for 2024 and beyond. The more focused approach to our customer additions impacts the guidance we set last quarter, reducing our levered cash flows, but also our investment in systems and the amount of proceeds from asset level financing. As we said last quarter, we still anticipate being cash neutral for 2024, and continue to expect strong cash generation in 2025 and beyond.

And before I turn the call back over, John, I just want to say what an honor it has been to work beside you and the entire Sunnova team for the past five years. While I will remain a dedicated Sunnova customer and shareholder, I am excited to close out my tenure as CFO and pass the torch in the coming months.

I'll turn the call back over to John for closing remarks.

John Berger

Thanks, Rob.

In closing, Sunnova is well equipped to manage our balance sheet through the remainder of 2024, while also setting us up for increased cash generation moving forward. Though elevated interest rates have made for a challenging short-term macro picture, overall, there is more than enough demand to continue adding to our customer base in an economic and sustainable manner.

As we look to the remainder of 2024, we are encouraged by the rapid progress we've made already in the first quarter and will continue to take steps to transform the energy landscape, challenge the status quo, and offer customers a better energy service at a better price to help meet society's ever-increasing energy demands, all the while maximizing shareholder value.

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