Sunnova Energy International
Third Quarter 2024 Earnings Prepared Remarks

Operator:
Good morning, and welcome to Sunnova's third quarter 2024 earnings conference call. Today's call is being recorded and we have allocated an hour for prepared remarks and Q&A.

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 that 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.

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

I will now turn the call over to John.

John Berger:

Slide 4: Sunnova's Priorities Remain Consistent

Good morning everyone, and thanks for joining us for today's call. I'll begin on slide 4 speaking to a format that should, by now, look familiar. As we committed previously, increasing cash generation remains a top priority, underpinned by our commitment to work with our exceptional dealer and supplier network to serve our customers, and I am proud of the results our team is delivering related to these commitments.

While the slide is familiar, you'll see that we added a commitment to serve our dealers and suppliers who often act as the face of Sunnova to our customers. Touching on each commitment:

- We provide a best-in-class platform to support our partners. The software and services we offer our dealers - and the level of service we provide our customers - make Sunnova the most attractive platform for both dealers and equipment manufacturers;
- We remain keenly focused on growing our core adaptive energy customer base as we prioritize profitable growth through higher margins and credit quality over maximizing customer count. Importantly, we've demonstrated that you can achieve both as through the first nine months of 2024 we added 76,600 customers of which nearly 80% or approximately 60,000 were solar customers;
- We are maximizing the asset-level capital we generate, demonstrated by our success closing securitizations and tax capital commitments at significantly higher levels compared to last year. Tax capital, which

includes both traditional tax equity and credit transfer funds, are up 100% year-over-year.

- We are successfully increasing our Investment Tax Credit or ITC adder utilization, up significantly as we exited the third quarter and focus on a strong close to the year. Our industry-leading decision to work with our dealers to originate all leases and PPAs after September 1st with domestic content is translating into meaningful cash flow, which I will explain in more detail later.
- And finally, we continue to drive cost efficiencies by right-sizing the organization with an emphasis on using technology and process redesign. As you'll see in our results, since the end of 2023 we've made significant progress reducing our Operations and Maintenance expenses while turning attention to G&A, which is now on a path to significant reductions as we enter the fourth quarter and position the business for 2025.

Slide 5: Win Together and Drive Results

Having recapped our priorities, the next few slides highlight our progress in more detail. Turning to slide 5, we're mindful that integral to our goal of powering energy independence is a large network of dealers dedicated to the same. This network of entrepreneurs is the backbone of who we are and allows us to leverage industry-leader expertise, managerial skills, and knowledge of local markets to attract new customers. To ensure our dealers have the right tools to succeed, we strive to provide them with a best-in-class platform with a heavy focus on software and customer service.

Giving our dealers the right tools and support helps us win together and allows us to focus on driving faster installations and service activations, which benefits our customers, our dealers, and Sunnova. Importantly, accelerating the time from origination to placing a system in service is better for our customers and better for our working capital.

Additionally, in the immediate term we have been working with our dealer network to flip the Work in Progress, or "flip the WIP", to further capture the domestic content adder on systems originated prior to our September 1st requirement for new originations and that are still pending install. I will discuss "Flip the WIP" in greater detail shortly.

Slide 6: Confidence in Cash Generation Outlook

Turning to slide 6, many of you have been following our industry for some time now and understand its seasonality and how we see the greatest demands on working capital during the third quarter, as heavy summer customer originations increase dealer payments ahead of the funding we receive from our warehouse facilities and tax capital funding.

This working capital seasonality is the primary driver for the reduction in unrestricted cash in the third quarter, and even with record originations this summer, I'm pleased that we maintained an unrestricted cash balance of over $200 million. We enter the fourth quarter well positioned to return to positive cash generation during the period, as we closed within the first full week of October a tax capital fund that provided an additional $35 million at closing. We expect to generate at least an additional $69 million of unrestricted cash this year, which will put us at or above our $100

million cash generation target for 2024. Our expanded Capital Markets team is hard at work progressing additional securitizations and tax capital funds. Mindful of the importance of transitioning in-service systems from our warehouse facilities to a long-term, fixed rate securitization, we closed a 4(a)2 private securitization this month, and look forward to closing an additional securitization - perhaps even two - this quarter.

Ultimately, several factors moving in tandem give us confidence in affirming our full-year unrestricted cash build and the longer-term outlook for the same. Specifically, these factors include:

- A greater contribution from the domestic content adder which significantly increased our weighted average ITC rate beginning in September when we instituted our domestic content dealer requirement for all new TPO originations;
- Higher-margin systems originated earlier in the year receiving permission to operate;
- Additional cost savings and efficiencies from our technology platform and scale; and
- Less working capital needed, as we better align our growth spending with various tax capital and warehouse funding schedules.

Affirming our full-year and multi-year cash guidance positions us well to address our upcoming debt maturities, which as Eric will discuss, we expect to include a combination of opportunistic pay-downs and a regular-way refinancing of any remaining, both of which we are currently discussing with our banking partners.

Slide 7: Demonstrated Path to Positive Cash

We've included Slide 7 to underscore the basis of our confidence to achieve our cash generation targets, and we thought it important to highlight the multi-year trend that reflects the success of our stated priorities in action. Here we have focused on the seasonally relevant 3rd quarter of each year and are showing the spread between customer agreements and incentives revenues and the change in unrestricted cash, excluding proceeds from the corporate capital we raised in each of the prior third quarters. You can see that the change in unrestricted cash relative to the aforementioned revenue has progressed from negative 5.8 times in the third quarter just three years ago to nearly at parity this quarter and - based on our expectations - inflecting to a positive net generation as we end the year with multiple levers available to achieve this outcome.

Slide 8: Industry Leader In Driving Conversion to Domestic Content

Turning to slide 8, by now you are well aware that a meaningful contributor to our cash generation forecast are the ITC adders... something we have prioritized throughout the year, even going back to closed tax equity funds to monetize their value retroactively, which sets us apart from others in our space. I'm proud of how our teams who worked together to "stack that cash" and as we look ahead to areas of focus this quarter, I'll highlight the two key initiatives I mentioned earlier.

First, we have led the industry by working with our dealers to ensure that all lease and PPA systems originated beginning September 1st meet the eligibility requirements to qualify for domestic content. Doing so has significantly increased our weighted ITC rate on origination by 17% to

42.2% in October versus the average for July and August, and we expect further increases as we round out the year, targeting a weighted average of approximately 45% in 2025 and 2026. You'll recall that each 1% increase in our weighted average ITC rate, on a full-year basis, generates approximately $50 million of additional cash.

Second, is “flipping the WIP” whereby we add domestic content qualifying equipment to systems originated but not yet fully installed prior to our September 1st domestic content requirement. To date, we've flipped systems worth $3 million of additional cash to Sunnova.

Slide 9: Expense Reductions - Emphasis on Process and Team Design

Rounding out my highlights of the progress we've made towards our key commitments, Slide 9 show the progress we've made to reduce our O&M and G&A expenses. Reflecting the benefits of scale, amplified by our focus on process improvement and use of technology, we've reduced these expenses as a percent of revenue by 48% and 5%, respectively. We have additional reductions in the fourth quarter, some significant related to G&A, made evident on the graph as you see these reductions increase to 65% and 35%, respectively. The team is demonstrating that they can do more with less, and I applaud the drive they bring to work each day.

Slide 10: Bipartisan Support for the IRA

Turning to slide 10 and before I turn the call over to Eric, I’d be remiss if I didn't take a moment to recognize that we're talking only days before an important election… one that has created some uncertainty around our industry, prompting many questions from our investors. You have asked

me how a new Administration on either side of the aisle would impact our current business and outlook. While we all see and feel the polarization, I focus on the reality more than the rhetoric. The reality is, powering energy independence through the expansion of solar production enjoys bipartisan support on many levels. Investment in clean, efficient and reliable energy infrastructure that insulates consumers from electricity cost inflation is just one of the many benefits and one on which we can all agree.

If we look specifically at the Inflation Reduction Act as a proxy for evaluating both party's priorities, we see many of its key provisions appeal to both sides. Whether it's the jobs it creates, the GDP growth it stimulates, the competition it provides to traditional utilities, its contribution to ever increasing demands for energy - and importantly, clean energy - including that needed to power AI and data centers, improving reliability and modernizing our energy grid for the digital age. We can all agree these dynamics position Sunnova as part of a solution that both sides desire for our great country.

With that, I'll turn it over to Eric.

Eric Williams:

Thanks John and good morning everyone. Having joined the Sunnova team only four months ago in June, I can say that I've learned a lot and done so alongside some outstanding professionals.

As you reflect on John's comments and the materials we have shared prior to this call, my hope is that you see this year's hard work become the foundation of delivering our outlook. Much of the heavy lifting is behind us - reflected in the pace of closing deals and our success capturing ITC adders - which demonstrates our transition is already largely complete. Our expanded and enhanced Capital Market's team can now execute more quickly and with better structures.

It is worth highlighting that we previously net consumed cash to the tune of approximately $1 billion each year, even after investing and financing activities. We have now positioned Sunnova to move beyond merely operating as cash neutral, instead providing credible visibility into significant, positive unrestricted cash generation.

I recognize the team's accomplishment is no small thing, that is - to transition from consuming cash at a significant clip to becoming a cash neutral platform. Taking something cash neutral to cash positive often has less resistance. Having completed ten debt financings this year and four tax equity financings with more in the pipeline, we have the tools we need to deliver on our 2025 and 2026 cash goals.

You'll recall that last quarter, I affirmed one of my near-term priorities is to simplify the way we articulate our business to current and potential stakeholders. A step in that direction, I am sure you noticed fewer adjusted GAAP numbers with a greater emphasis on the trends you can observe in our reported results. Having joined Sunnova from the Oil & Gas industry where Non-GAAP measures are heavily relied upon and where many have existed for decades with many companies harmonizing around their use, I am certainly not opposed to the concept of Non-GAAP, though I understand the importance of using discretion when defining such a measure. Accordingly, we've sunset our use of Adjusted EBITDA and Adjusted OpEx, and I'll talk more about an alternative measure that I'm tracking as I continue to give thought to helpful ways to discuss our results and measure our performance.

Slide 12: Financial and Operational Results

But before I dive deeper into that topic, I'll start on Slide 12 with a few highlights from our reported results. Starting with revenue, which at $235 million is up nearly $16 million or 7% sequentially and $37 million or 19% year-over-year. Our interest income of nearly $40 million rose 9% and 26% sequentially and year-over-year, respectively.

With our emphasis on cash generation and debt repayments, we also show principal proceeds of nearly $44 million which, while they fell sequentially due to seasonality as customers sometimes use their tax refunds in the second quarter to make prepayments, we see a $3MM or 7% rise year-over-year. Coming up, I'll mention our full-year outlook for

principal proceeds and the recent increase in prepayments, which you'll find we expect to be up year-over-year and trending higher.

Not surprisingly, our revenues, interest income and principal payments are higher thanks to the addition of 30% more customers and an increase in the gigawatts of solar power and megawatts of energy storage we manage that are up over 25% and nearly 60%, respectively on a year-over-year basis.

As John mentioned earlier, we remain focused on growing our core adaptive energy customers, adding just over 20,000 such customers in the third quarter, bringing our cumulative solar customer count up to 365,000. Factoring in these additions we now manage 2.9 gigawatts of solar power and 1,556 megawatt hours of energy storage. Also quite impressive, we are nearing the half-million customer mark with our total customer count at just under 423,000.

Finally, taking into consideration our current customer backlog and what we have placed in service in October, we expect the fourth quarter to see a significant step up in customer additions. As such, we continue to expect total gross customer additions for 2024 to fall within our guidance range of 110,000 to 120,000 customer albeit towards the lower end of the range. I'm pleased with this outcome given our team's intentional emphasis on originating business with strong margins and underpinned by strong credit quality.

Slide 13: Redefining Key Performance Metrics

Now I'll turn back to my earlier point about revisiting our Key Performance Metrics and our use of Non-GAAP Measures. Recognizing that we constructed both Adjusted EBITDA plus ITCs and Adjusted OpEx to serve as measures that illuminated the value we create for stakeholders, I felt it appropriate to look for alternative, less-adjusted ways to convey the same point, most importantly the value we derive from ITCs that are note fully captured on our income statement. For those of you who found the prior performance measures useful - whether in full or in part - we provide in the appendix to our earnings slide all of the components we previously used to calculate both measures, so please use those that are most helpful to you.

As a newcomer to the industry, I sought to understand Sunnova's business relative to other market participants - looking for both similarities and differences. What I found was interesting.

In simplistic terms, I've come to understand that firms like ours create value for shareholders in three ways:

- First, through the origination of financial paper, whether through securitizations or tax capital,
- Second, through servicing solar and related assets and
- Third, by retaining equity value in the long-term, cash-generating assets we install and service for our customers.

It's the latter that demonstrates John's vision of Sunnova competing with traditional utilities to provide energy independence for our customers.

Essentially, I see these items as the three legs of Sunnova's value proposition.

I'm sure you're familiar with how we measure the value we create through originating financial paper, though this too is something I'm reviewing with an eye to enhance, which I'll talk about shortly and is the implied spread between our Fully Burdened Unlevered Return less our weighted average cost of debt.

Regarding the second, I'll share that as I was getting to know John during the interview process - I was struck by his conviction that Sunnova is - at its core - a service company and not a financing company. Whether you acquire one of our systems through a lease or through a loan, we are committed to providing you reliable power. John's commitment to service is intricately linked to the upcoming third leg of our value story.

Our team not only maintains our customers' systems, we also service systems for others as Sunnova Repair Services or SRS, which generates strong margins and leverages some of the fixed costs associated with retaining a dynamic group of uniquely-skilled talented service professionals.

Moving to the third value driver: the equity value we retain in the largely 25 to 35 year assets we install and service for our customers. Some peers in the sector choose to build their business less around this component as evidenced by their selling a larger portion of the assets' equity through further levering the underlying assets or outright selling their loans.

Sunnova has taken the approach of using the least expensive form of capital - which for a period was corporate debt - to invest in and retain meaningful ownership of these long-lived, cash-generative assets. Thus, if you look at Sunnova's Consolidated Statements of Redeemable Noncontrolling Interests and Equity, you'll see what we've summarized on slide 13.

Over the past 4 years, from third quarter of 2020, shortly after the Company's IPO, to this quarter, Sunnova's Stockholders' Equity - represented by the dark blue bars - is up in absolute terms nearly 150%, and when adjusted for the common shares we've issued over this period of time, our Stockholders' Equity is up 80% per share from just under $8 to over $14. It's important to recognize that even as we report GAAP net losses through our Consolidated Statement of Operations, something interesting is happening within Equity where certain events, such as the "FLIP" of a Tax Equity Partnership, result in the transfer of value from Redeemable Non-Controlling Interests ("RNCI") and Non-Controlling Interests ("NCI") into Sunnova's Stockholders' Equity.

While for a period of time, this long-term value sits within the jointly owned Tax Equity partnerships classified as RNCI or NCI, importantly, Sunnova has valuable interests in them as evidenced by the two Case Studies we've included on this slide as examples. In these instances, when the Tax Equity Partnership "Flipped," Sunnova added a combined $110 million (or about 90 cents per share) to its Stockholders' Equity.

Importantly, under GAAP, this $110 million of value transferred to Sunnova's shareholder as an addition to retained earnings (or more specifically as a reduction to accumulated deficit), never flows through our Consolidated Statement of Operations. Yet, our Accumulated Deficit has fallen from approximately $500 million in 2020 to just $1.5 million as we closed the third quarter.

If you look at some of our peers in the space, you'll see the direction of travel is not only the inverse, but inverse in a meaningful way. I believe this differentiation made visible in our Stockholders' Equity demonstrates the investments we made using a mix of asset-level and corporate-level debt have added significant, long-term value for our shareholders. We will realize that value through our retained equity ownership in the cash-generating assets, which provide Sunnova the opportunity in the future to deliver growth, yield or a mix of both for our investors.

Accordingly, I believe using the GAAP measure of Total Stockholders' Equity per Share is a useful one to highlight the value we create for our investors.

As we interact over the coming weeks I welcome your feedback and I will continue to reflect on this and other Performance Measures that I believe will help others' understand and evaluate our business. I'll add that I am keen to identify a useful measure focused on margins and our cost discipline, so please stay tuned as we potentially introduce additional measures in the future.

Slide 14: Loan Prepayments : Trailing Upward

Moving on to slide 14. I mentioned earlier that while we saw a slight dip in the quarter-over-quarter Principal Proceeds, it's important to remember that the sequential change is affected by a seasonal increase in prepayments as customers use their tax refunds to reduce their loans. Importantly, you can see our full-year expectations of $190 million exceed the full year of 2023 by over 20%.

While Lease and Power Purchase Agreement customers comprise over 90% of our current originations, as of September 30, 2024, Sunnova's largely static loan portfolio exceeded $4 billion and includes more than $1 billion of amounts largely related to an Original Issue Discount. Catalysts like home sales, debt consolidation using home equity, or simple refinancings as interest rates fall collectively unlock meaningful cash flow that reduces our debt.

On this slide, we've included an illustrative prepayment to demonstrate how they enhance our cash flows, and the line graph highlights that in just the last two months, the recent 50 basis point interest rate cut acts an inflection point where we now see a 20% increase in prepayments versus our forecast. We believe this trend could continue in a positive direction as we close out 2024 and look ahead to 2025.

Slide 15: Fully Burdened Unlevered Return and Implied Spread

On Slide 15, I’d like to provide a quick update on our fully burdened unlevered return and implied spread. You can see our spread dipped a bit

in the third quarter as some of the tax equity we originated in the quarter priced lower and our last couple of securitizations priced higher than those prior. However, you see a sharp improvement as we enter the fourth quarter thanks to several factors including closing a private securitization that priced nicely inside our last public deal, higher contributions from tax capital as we increase adder utilization and our work to accelerate In-Services as John mentioned earlier.

Before I turn to guidance and having discussed the three legs of Sunnova's value story underpinned by our heightened emphasis on serving our dealers, customers and cash generation, I'd like to link back to John's comments as they relate to how we're thinking about our 2026 corporate debt maturities. With confidence in our ability to grow our unrestricted cash balance through the drivers we've discussed enhanced by this significant prepayment opportunity, in the coming quarters, we expect to use a combination of opportunistic debt repurchases - and a regular way refinancing of any remaining amounts - to address our upcoming maturities.

To this end, having added some new senior leaders to my Capital Markets team and being new to the Company myself, we headed to New York last month to meet with our banking partners and begin conversations aligned with this strategy. We are in the process of refreshing our corporate models with our 2025 budget and long-range plans, and we look forward to working with them to achieve a great outcome.

Slides 17: Cash Generation Guidance

As I round out my prepared remarks, I'll turn to slide 17, which we added in response to requests that many of you made of us, which we believe provides insight into, and sensitivities to, the assumptions that underpin our cash generation targets, so I hope you find this useful.

Ultimately, our progress driving ITC adders higher and doing so more quickly than expected, coupled with our high-margin core customer focus, price increases, and a more efficient cost structure, position us to reiterate the cash generation guidance we shared last quarter: specifically unrestricted cash generation of $100 million in 2024, $350 million in 2025, and $400 million in 2026.

On that positive note, I'll turn the call back to John for closing remarks.

John Berger:

Thanks Eric.

In addition to everything we discussed today, it is important to remind everyone the current macro-environment is prime for Sunnova to take market share and expand its footprint in a very under penetrated industry. Power demand and utility costs are increasing, equipment costs are declining, and catastrophic weather events, which expose the vulnerabilities of the centralized grid, are driving demand for our energy service solutions.

Our team continues to deliver outstanding service to our customer base while remaining focused on our key priorities and proving to our investors our ability to increase our cash generation.

I am confident in our ability to continue to execute on these priorities. We have made significant progress in our business, which has only been strengthened by the macroeconomic tailwinds that will bolster Sunnova's industry-leading adaptive energy services.

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