Sunnova Energy International

Q4 and Full-Year 2021 Earnings Prepared Remarks

Operator:

Good morning and welcome to Sunnova's fourth quarter and full-year 2021 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.

Today I am pleased to report we closed out the year with strong financial results, a summary of which can be found on slide 3. We exceeded the top end of our 2021 guidance range for Adjusted EBITDA and Adjusted Operating Cash Flow, met our objectives for the principal and interest we collect on solar loans, and achieved positive Recurring Operating Cash Flow.

Our ability to deliver on these metrics, despite numerous challenges that impacted the economy as a whole, is a testament to the strength of our business model, our focus on increasing our operating leverage, our strong partnerships, and the importance of retaining long-term contracted cash flows. Not even the pandemic and its various surges could derail our ability to hit our financial numbers over the last two years.

We are also reaffirming our intermediate term major metric growth plan, the Triple-Double Triple Plan, which we announced in the third quarter of 2021.

Turning to slide 4 you will see this plan now consists of the following:

- An increase in customer count to approximately 400,000 by year-end 2023;
- An increase in Net Contracted Customer Value per share to approximately $37.00 by year-end 2023;
- An increase in services sold per customer to approximately 7 by year-end 2025; and
- An increase in Adjusted EBITDA together with the principal and interest we collect on solar loans to approximately $530 million for full-year 2023.

Despite current and anticipated macro-economic headwinds we remain confident in our ability to accomplish the Triple-Double Triple Plan. Driving this confidence is the following:

- Our track record of executing consistently even through market uncertainty;

- Our ability to grow the number of services we offer to homeowners, which includes, but is not limited to, energy storage systems, electric vehicle chargers, generators, and load managers;

- Our cost disciplined approach, which consists of not just limiting spending in periods of high growth, but also plans to invest more in software and automation to further reduce costs, reduce the need for more headcount, and increase our operating leverage;

- Our continued expansion of strategic partnerships such as those recently announced with Generac, ChargePoint, Home Depot, and Brinks. These strategic partnerships are the key to not only being able to offer more services to new customers but to also upsell our existing customer base; and finally

- The earnings visibility of our business model, demonstrated by the fact 67% of the mid-point of our **2023** targeted revenue and principal and interest from solar loans was locked in through existing customers as of January 31, 2022.

Slide 5 summarizes the growth in Sunnova's customers, battery penetration, and dealer network.

In the fourth quarter, we added over 18,400 customers. While this was an all-time high for organic customer adds in a quarter, it did fall short of our expectations as our Q4 customer additions were negatively

impacted by the late December uptick in the Omicron variant of COVID. This uptick affected our dealers' ability to field their installation crews and slowed down utilities granting permission to operate. As a result, our organic customer additions for the year ended December 31, 2021, was just under 54,500, which is approximately 500 customers shy of the bottom end of our guidance range.

However, these delayed customer additions, which equaled approximately 2,000 customers, have since been interconnected. As such, we are increasing our 2022 guidance for customer additions by 2,000 customers to a range of 85,000 to 89,000.

Our battery attachment rate on origination for the fourth quarter of 2021 was 22%, up from 19% in the fourth quarter of 2020, but down from 30% the prior quarter. This recent decline was primarily driven by the regional mix of customer originations in the fourth quarter of 2021. Specifically, in the fourth quarter we had higher origination levels in markets with low battery penetration, such as those in the northeast, and lower origination in markets with high battery penetration, such as our island markets. However, we have seen our battery attachment rate and our unlevered returns bounce up so far this quarter as the regional mix has normalized.

Much more importantly, our battery penetration rate continues to grow and reached 11% on a customer base of nearly 200,000 as of December 31, 2021. Also, we have performed over 1,600 battery retrofits life to date, a number we expect to double by the end of 2022.

When it comes to dealer growth we are focused on dealers of all business models and sizes from tier 1 to tier 5, from the snout all the way through the long tail. As such, over the past twelve months we have been able to add 379 dealers, sub-dealers, and new homes installers from all tiers, which brought our total dealer count to 814 as of December 31, 2021. With the recent surge in dealer growth, we now expect to exceed

our target of 1,000 dealers by the end of this year. This growth remains powered by the attractiveness of Sunnova's business model, our best-in-class technology platform, partnerships with the best equipment manufacturers in the industry, a broad suite of product offerings with all financing types, and our brand's growing ability to deliver strong lead generation to our dealers.

Finally on slide 5 we have updated our information on customer contract life and expected cash inflows. As of December 31, 2021, the weighted average contract life remaining on our customer contracts equaled 22.4 years and expected cash inflows over the next twelve months has increased to $384 million.

Slide 6 lists out our recently launched service goals, which will provide our customers a level of service unparalleled in the industry and one that is a must for the Sunnova Adaptive Home™. Launching first in select key markets, we have established a goal to provide service within 72 hours for our solar-only customers and within 24 hours for our solar plus storage customers. In addition to these service goals, earlier this week we launched Sunnova Repair™ Services, which aims for 50% gross margins and expands our best-in-class service beyond our current customer base to homeowners in desperate need of repairs to their solar systems but who do not have a service provider.

Responsive 24-hour service, new and improving hardware technologies to provide both energy supplies and manage energy demands, and the Sunnova software platform will bring about a superior energy experience for homeowners who are frustrated with the increasing cost and decreasing reliability of their grid power provider. We will accomplish the goal of the Sunnova Adaptive Home™ by accelerating the build-out of our software platform, continuing to build up our highly experienced and professionally managed service team, and improving our logistics capabilities.

Slide 7 illustrates this vision for the future, the Sunnova Adaptive Home™, which will integrate a large suite of energy services to make clean energy even more affordable, reliable, and resilient. With the right mix of technologies from multiple equipment manufacturers integrated into a single Sunnova software interface, our customers will have the option when it comes to staying connected to the centralized grid or not. It is this option that an increasing number of homeowners are seeking in the wake of bad regulatory policies, increased power outages, and the rising cost of centralized power. By giving our customers the freedom to use very little utility power or even "cut the cord", they can eliminate the need for net metering and avoid solar taxes in the form of high fees from centralized power monopolies.

To make this a reality we will roll out additional key strategic partnerships and continue to invest heavily in both our software platform and in redefining service to our customers. All of which can be accomplished while achieving our Triple-Double Triple plan as these investments are included in our forecast.

Before turning the call over to Rob, I want to briefly point out slide 8. Over the past several weeks and months, these have been among the top areas of investor concern. We have summarized our positions with and responses to these challenges. We would be happy to discuss any of these in further detail during Q&A.

I will now hand the call over to Rob.

Robert Lane:

Thank you, John.

Turning to slide 10, you will see the continued improvement in our results over the past few years. 2021 revenues are up 84% from 2019, while over the same period Adjusted EBITDA increased 78% and the principal and interest we collect on our solar loans nearly tripled.

Thanks to these strong financial results, we were able to continue to produce industry leading operating leverage. In 2021 alone, we reduced our adjusted operating expense per customer by 15%. We expect to further increase our customer margins through a combination of additional cost declines and increased cash inflows per customer.

Slide 11 contains both our Gross Contracted Customer Value, or GCCV, and Net Contracted Customer Value, or NCCV. As the slide reflects, we are experiencing significant increases to these metrics. We think of NCCV as our blow-down or roll-off value as it only includes locked in contracted cash flows on customer contracts with a weighted average life of 22.4 years and excludes any value for growth, renewals, upsells, state and national incentive appreciation, or other upsides.

Our NCCV represents what we could conservatively achieve in cash flows, given we have locked in our debt terms, over the course of the next 22 years. Another way to think about it is NCCV represents a discount of $8 to $9 billion in customer payments, absent any upside, less debt and tax equity payments. This is then discounted by locked in interest expense, a conservative estimate of service costs, and a value loss estimate for defaults.

We continue to deem a 4% discount rate for our GCCV and NCCV as conservative as our weighted average cost of debt for 2021, which represents approximately 100% of our fully burdened cost of each new customer, equaled 2.7%. Additionally, the existing long-term cash inflows that make up our NCCV calculation are locked in and thus not impacted by rising interest rates.

In just three years' time NCCV went from $957 million as of December 31, 2018, to $2.1 billion as of December 31, 2021. The amount of NCCV at the end of 2021 equates to approximately $10,800 per customer and $18.56 per share, with cash on the balance sheet making up $3.46 of the per share amount.

Slide 12 summarizes our recent financing activity and liquidity position.

In 2021 Sunnova raised over $2.5 billion, highlighted by $876 million in new and refinanced securitizations, $437 million in new tax equity funds, a restructured loan warehouse facility of $350 million, $575 million in convertible debt, and a $400 million green bond, a first for the residential solar industry. Additionally, while we have been raising capital to grow the business, we have also been paying down previously issued debt to the tune of approximately $121 million in principal in 2021.

Turning to this year, we have already raised $150 million in tax equity funds and priced our first securitization of 2022 just last week. This latest securitization was sized at $298 million and despite recent concerns over rising interest rates was able to achieve a 3.1% blended coupon, again below our PV4 discount rate for NCCV. As a reminder, our capitalization strategy locks in our asset level debt and there are no maturities on our corporate debt level until 2026.

Our total liquidity as of December 31, 2021 was $831 million, down from $951 million as of September 30, 2021, and up from $386 million as of December 31, 2020. This recent decline in total liquidity was driven by an increase in working capital during the fourth quarter of 2021 to support our growth plan.

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 December 31, 2021, this available collateralized liquidity equaled $439 million as of December 31, 2021. Beyond that, subject to available collateral, we had $381 million of additional capacity in our warehouses and open tax equity funds. That represents over $1.2 billion of liquidity available exclusive of any

additional tax equity funds, securitization closures, or warehouse expansions including transactions closed in 2022.

Turning to slide 13, we have updated our sources and uses of cash for 2021 actuals, reaffirmed the previous 2022 forecast, and made minor adjustments to our 2023 expectations to reflect our current forecast.

Our 2021 actuals came in mostly as expected with the exception of lower than anticipated investments in new systems. This variance was due to actual EPC costs being lower than anticipated, which reflects higher than expected unlevered returns and a delay in battery and other upsells.

On slide 14 you will see for full year 2021 our fully burdened unlevered return on new origination was 9.1%, while our weighted average cost of debt over the same period was 2.7% resulting in an implied spread of 6.4%. The slight dip in our fully burdened unlevered return compared to the prior quarter was driven by the same regional mix that impacted our battery attachment rate. Since battery enabled systems generate a higher fully burdened unlevered return, any decrease in attachment will put downward pressure on our return for that given quarter. As John mentioned earlier, we have seen stronger battery attachment rates and returns so far this year.

On slide 16 you will find our 2022 guidance. As noted earlier we are raising our 2022 customer additions guidance range by 2,000 customers to bring our targeted additions for this year to between 85,000 and 89,000. We are keeping our financial targets unchanged from where they were set in our last earnings call.

We expect to capture 12% of our 2022 Adjusted EBITDA together with the principal and interest we collect on solar loans in the first quarter, increasing to 25% in Q2, 32% in Q3, and 31% in Q4. We expect our customer additions to occur more evenly with

approximately 45% of our forecasted additions happening during the first half of the year.

As of January 31, 2022, 81% of the mid-point of our 2022 targeted revenue and principal and interest we expect to collect on solar loans was locked in through existing customers as of that same day.

I will now turn the call back over to John.

John Berger:

Thanks, Rob.

In 2021 we achieved scale in origination and captured very healthy margins. We delivered strong financial and operational results and grew our business by expanding into new service territories, increasing our product mix, and offering more services to our customers.

For 2022 we expect to see continuing improvement in our overall supply chain, especially batteries, and that will allow us to clear our battery backlog no later than April of this year. Our focus on investing in our software platform and automating our operations will further improve our operating leverage and drive additional cost reductions.

As centralized utilities rapidly increase their rates, we will be able to provide homeowners significant savings while providing an energy service that is more reliable, more resilient, and more environmentally sustainable.

As of January 2022, our customers are saving an estimated 23% to their respective utility rates and we estimate that percentage of savings to increase even further as utility rates are expected to rise an additional 6% or more over the remainder of this year. We also could see a scenario where dramatically higher hydrocarbon prices could push some utility rates higher by 40% or more this year alone. These rising utility

rates are further stimulating our growth as even more homeowners look for a better energy service at a better price.

More importantly, there is a relationship between how much consumers are saving relative to the utility rate and the default rate of our contracts. It should be noted that because the default rate affects the value of our customer contracts, but never the debt balance, a relatively small movement down in the default rate will materially improve total cash flows to Sunnova. Even with the annual price escalators embedded in many of our PPA and lease contracts, which provides us with a significant increase in our expected revenue over time, we are still well below the anticipated and realized utility rate increases.

As Rob mentioned earlier, we priced our first securitization of the year last week, the pricing of which puts the implied spread between our fully burdened unlevered return and our cost of capital somewhere in the low to mid 500 basis points range, which we previously indicated is more in line with our long-term targets and internal budgeting. With that said, given that we believe we have the lowest cost of capital thanks to our strong balance sheet, and we have been and will continue to instruct our dealers to increase pricing to customers in response to the rapidly rising utility rates I mentioned earlier, we feel strongly our implied spread will be back in the 600 basis points range in the coming weeks and months. Despite our position as the industry leader in growth, we remain focused on optimizing margins and volume in order to maximize cash flow and NCCV per share value creation.

Finally, even with a potential recession on the horizon we are still confident in our ability to achieve the objectives under the Triple-Double Triple Plan. Remember, we are an energy company that provides an essential service to high credit quality residential customers. A service that is needed in any economic environment and one that will get even more valuable against a backdrop of rapidly rising energy and utility prices.

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