Q2 2018 Earnings Call
August 9, 2018
Prepared Remarks

Forward Looking Statements

Thank you operator, and thank you to those on the call for joining us today.

Before we begin, please note that certain remarks we will make on this conference call constitute forward-looking statements. Although we believe these statements reflect our best judgment based on factors currently known to us, actual results may differ materially and adversely. Please refer to the Company's filings with the SEC for a more inclusive discussion of risks and other factors that may cause our actual results to differ from projections made in any forward-looking statements. Please also note these statements are being made as of today, and we disclaim any obligation to update or revise them.

On the call today are Lynn Jurich, Sunrun's co-founder and CEO, Bob Komin, Sunrun's CFO, and Ed Fenster, Sunrun's co-founder and Executive Chairman.

The presentation today will use slides which are available on our website at investors.sunrun.com.

And now let me turn the call over to Lynn.

LYNN JURICH

Thanks, Patrick.

We are pleased to share with you Sunrun's second quarter financial and operating results along with progress against our strategic priorities.

In the second quarter we added more than 12,000 customers representing 20% growth in MW deployments. This result exceeds guidance and represents the highest quarterly volume in the company's history. In the first half of 2018, we generated $142 million of net present value and created NPV per watt of $1.03 or over $7,700 dollars per customer.

We're excited to announce that we have now surpassed 200,000 customers. For a company that is disrupting a multi-trillion dollar industry, we learned a lot from winning these first customers that will make the next million easier. Throughout the past 11 years, we have solidified our position as the industry leader with scale, brand, technology, and financial strength. I'm most excited by what the next decade means for Sunrun and the families that want a superior energy service; a service that is customized to

their energy needs, is more resilient and offers backup power, and contributes to healthier communities. Sunrun makes going solar simple and we are committed to creating an exceptional customer experience because our customers have chosen to be with us for decades.

We are reiterating our full-year guidance of 15% growth in deployments and growth in cash generation above this rate. This growth plus investments in customer acquisition and product innovation will be achieved while delivering NPV above $1.00 per watt for the full-year.

Market Leadership

The opportunities in front of us are increasing our confidence for growth acceleration and continued market leadership.

As the leading solar company in the US, Sunrun has the largest national footprint. We are capitalizing on this position by investing in our direct customer acquisition, onboarding platform, and customer experience capabilities, which we believe will increase the moat around our business and deliver a superior cost structure over time.

Our direct business grew over 40% year-over-year. This current success combined with the opportunities in front of us, which include multiple retail expansion opportunities, lays the foundation for a strong 2019 growth rate. Strategic partnerships like retail are a place where national capabilities, track record, brand and scale all matter and separate Sunrun from the pack.

We are also well-positioned to take advantage of the recent California New Home mandate. While the volumes aren't large yet, we already have new home installations and are engaged with half of the top 10 homebuilders in California.

Most importantly, Sunrun has the opportunity to be the loved energy provider for homeowners - utilities are falling short in providing what customers want.

Product Leadership

Sunrun is leading in product development to extend our value proposition to customers and the grid.

Our Brightbox home solar and battery service continues to gain traction and exceed expectations. We have installed thousands of Brightbox systems thus far and we will more than double Brightbox installations in the second half of 2018 as compared to the first half. This has caused short-term cycle time and cost headwinds, however, financial returns are attractive and the service further differentiates Sunrun as the nation's leader.

This superior energy service has been launched in seven states and Puerto Rico and already represents about 10% of our direct business. In California, well above 20% of the time our direct customers are choosing to add a Brightbox. In certain markets in Southern California, this rate is now nearly 60%. With increasing wildfires and extreme weather causing outages, we are a solution for resilient, clean power that can be rapidly deployed. For instance, customers are being told by utilities in California that they will cut off power proactively when the temperature is high and the wind is blowing. Homeowners want reliable, affordable power, and our Brightbox home solar and battery service can deliver.

In the second quarter we entered Puerto Rico through channel partners, offering residents the freedom to create their own energy and enjoy backup power during outages. We also officially launched Brightbox in Florida.

Sunrun continues to advance the role distributed energy resources will play in the country's future energy system. Together with National Grid we are already active in California and have recently started to work on a small program in Massachusetts where certain customers are able to participate in grid services. We are encouraged by the growing interest from utilities and regulators.

Financial Strength

In addition to our market and product leadership, we continue to deliver strong financial performance. As a result of our capital allocation discipline and financing strategy, we are cash flow positive, even while investing in future growth and product leadership, and have maintained a strong balance sheet.

I'll now turn the call over to Bob Komin, our CFO, to review Q2 performance and to discuss guidance in more detail.

BOB KOMIN

Thanks, Lynn.

NPV

Customer NPV in the second quarter was approximately $7,400 - or $0.98 per watt.

In the first half of the year, NPV per watt was $1.03, in-line with our target levels, despite the headwinds from tariffs and tax reform, along with the investments we are making to accelerate our direct business and product leadership.

Project Value

Project value per customer was approximately $31,100 - or $4.10 per watt in Q2, and for first half 2018 was $4.32 per watt.

As a reminder, project value is very sensitive to modest changes in geographic, channel, and tax equity fund mix. We expect project value will decline slightly over time, but with costs declining more, although in the short run there can be quarterly fluctuations. For instance, in Q2 we had a higher mix of lower value, and also lower cost, projects in our channel business that affected our metrics. We expect project value will return to levels more consistent with recent trends in Q3.

Creation Costs

Turning now to creation costs on Slide 6.

In Q2, total creation costs were approximately $23,700 per customer - or $3.12 per watt and were $3.29 for the first half of the year. Similar to project value, creation costs can fluctuate quarter to quarter. Creation costs per watt were 7% lower year-over-year. We expect creation costs will return to levels more consistent with the last few quarters in Q3, and expect them to show modest declines for the full-year even with the module tariff impact and as we continue to invest in growth in our direct business, as Lynn described.

As a reminder, our cost stack is not directly comparable to those of peers because of our channel partner business. Blended installation cost per watt, which includes the costs of solar projects deployed by our channel partners, as well as installation costs incurred for Sunrun-built systems, improved by $0.35 year-over-year to $2.35 per watt, largely due to the higher mix of lower value and lower cost projects in our channel business, as I mentioned earlier. In the first half of 2018, total installation costs were $2.48 per watt. We also expect installation costs will return to levels more consistent with recent trends in Q3.

Install costs for systems built by Sunrun were $1.95 per watt, reflecting a $0.08, or 4%, year-over-year increase. Most of this increase is related to a higher mix of batteries. We expect the adoption rate of home batteries to continue to increase which will carry a higher per-watt cost, but also a higher project value.

In Q2, our sales and marketing costs were $0.69 per watt, reflecting a $0.08 improvement from Q1. We are pleased to report that we are seeing strong sales efficiency improvements year-over-year. Our total GAAP sales and marketing expenses increased 40% year-over-year, but our volumes in the Sunrun direct business grew at a faster rate.

Our sales and marketing unit costs are calculated by dividing the costs we record in the period by total MWs deployed. Most of these expenses relate to our direct business and these sales activities occur somewhat earlier than the related systems are deployed. When we are growing direct sales rapidly this causes reported unit sales & marketing costs to increase. A higher mix of direct business will result in higher reported sales and marketing cost per watt over time, but this also means there will be lower blended installation costs per watt over time due to lower channel business mix.

In Q2, G&A costs were $0.25 per watt, a $0.04, or 14% improvement. In Q2 G&A costs per watt excluded a non-recurring item of $1.9 million for settlement of the consolidated state court class action lawsuit related to the IPO.

Finally, when we calculate creation costs, we subtract the GAAP gross margin contribution realized from our platform services. This includes our distribution, racking, and lead generation businesses as well as solar systems we sell for cash or with a third party loan. We achieved platform services gross margin of $0.16 per watt, in-line with recent trends.

Deployments

In the second quarter we deployed 91 MW, above our guidance of 88 MW, reflecting 20% year-over-year growth.

While we don't manage the business for a particular mix between channel partner and direct, our direct business is growing at a strong rate and is the platform that enables Sunrun to be the desired partner for large national strategic and retail partners. The direct business is also the platform behind the Comcast partnership and where we have focused our initial Brightbox sales and installation efforts.

Our cash and third party loan mix was 13% in Q2, also in-line with recent levels, and consistent with our outlook of low to mid teens.

Liquidity, Balance Sheet & Cash Flow

Turning now to our balance sheet.

Our liquidity position remains strong. We ended Q2 with $270 million in total cash, an 11% or $27 million increase from last quarter.

We continue to forecast our cash generation will grow 15% or more - which would be $50 million or higher for 2018. Quarterly cash generation can fluctuate due to the timing of project finance activities, so we provide forecasts on a multi-quarter basis.

We define cash generation as the change in our total cash less the change in recourse debt. Also please note that our cash generation outlook excludes any strategic opportunities beyond our current plans.

Guidance

Moving on to guidance on Slide 8.

We remain confident in our full-year guidance of 15% growth in deployments and unit economics of $1.00 NPV or higher.

In Q3 we expect to deploy 100 MW, reflecting 10% sequential growth from Q2. Our full-year guidance implies just over 13% sequential growth from Q3 to Q4 or just over 20% year-over-year growth for the second-half.

Now let me turn it over to Ed.

EDWARD FENSTER

Thanks, Bob.

Today I plan to address three topics:

- The benefits in the next decade of June's IRS guidance to margins, especially to providers of residential solar-as-a-service;
- Changes during the quarter to Gross and Net Earning Assets; and, finally,
- Our near-term capital strategy and pipeline.

IRS Clarity on Commence Construction

First, on Slide 9, I want to illustrate how the recent guidance issued by the IRS regarding the Investment Tax Credit will make managing the step-downs of the investment tax credit especially comfortable and we believe will cause increased market share for solar as a service.

This June, the IRS clarified that by incurring at least 5% of project costs in advance -- for instance, through advance purchases of inventory -- a company can delay the step-downs in the investment tax credit. In the most extreme example, by making a large advance purchase in December 2019, we could continue to claim a 30% investment tax credit through December 2023, rather than have it phase down to 26% in 2020, 22% in 2021, and 10% in 2022. While we have not finalized our strategy regarding this opportunity, the rule is clearly a favorable development for the Company as it presents more options to extend the higher tax credit levels. Our strong balance sheet and relationships with capital providers position us well to benefit from this guidance.

In addition, the ability to delay the step downs of the investment tax credit through this guidance exists only for solar systems owned by businesses, such as Sunrun. It does not exist for homeowners buying and owning systems themselves. Although businesses and homeowners both enjoy a 30% tax credit today, the business and individual tax credits exist in different sections of the Code and are subject to different phase-out schedules and rules. As such, we would expect to see an industry-wide mix-shift of volumes from customer-owned toward leased begin in 2020, when individuals buying directly would face a 26% tax credit and solar service providers like Sunrun could benefit from a 30% tax credit. This advantage would peak in 2022, when individuals would receive no tax credit and solar service providers like Sunrun would benefit from a 22% to 30% tax credit. Thereafter, this advantage would settle at 10%, as solar service providers like Sunrun enjoy a 10% permanent investment tax credit, but the individual tax

credit expires in December 2021. GTM estimates that approximately half of the market today is customer-purchased systems.

Importantly, this guidance makes managing the step down of the investment tax credit even easier. Assuming we raise consumer prices by approximately 2% per year -- in the face of expected retail rate escalation of about 3.6% in our main markets -- we only need to achieve just under 4% annual cost reductions to maintain our 2018 margins in 2024, under a 10% tax credit. To be clear, we think we can do significantly better. Historically, we have achieved 9% annual cost reductions for the last three years. Since inception, we have managed through federal and state subsidy reductions three times the size of the full step down between today and the 10% ITC.

Gross & Net Earning Assets

Turning now to Slide 12.

In Q2, Net Earning Assets grew slightly while cash increased $27 million to $270 million.

Net Earning Assets is our way to describe the value of the cash flows to Sunrun shareholders after payments to tax equity and debt counterparties. Because there is different accounting treatment for different tax equity structures, I want to point out where you can find the components on the financial statements to calculate these figures. This quarter we used a structure called a pass-through, which we haven't used in several years, so I want to explain how to unpack it. Tax reform has made pass-throughs more competitive with partnership flips, so we may use more of them in the future.

The pass-through financing obligation used to calculate Net Earning Assets is reduced by $36 million, which is the portion of the liability we expect will be eliminated when the pass-through financing provider receives investment tax credits on assets it has funded. At that time, the $36 million would be recognized as revenue. Due to its short-term nature, this amount is reflected in the current portion of the pass-through financing obligation.

In a pass-through financing, we book the value of tax benefits on the revenue line. For partnership flip structures, because GAAP requires it, we book the value of tax benefits at the bottom of the P&L, as a loss allocated to non-controlling interests. For pass throughs, we book the value of tax benefits upon receipt of interconnection permission from the local utility. For partnership flip structures, we book this value earlier: beginning at deployment. As such, in a period such as this one, where we begin to use a pass-through, income moves above the operating income line, but lags. This effect resulted in the depressed EPS in the second quarter. Each method generates net income to Sunrun common shareholders, although under GAAP, the timing and geography is different.

Near-term capital strategy & pipeline

Turning to our upcoming capital strategy and pipeline.

As we shared on the prior call, we expect the remaining annual cash-build will occur in Q4 due to project finance timing, but also increased operating leverage. As such, we expect principally to increase net earning assets, rather than cash, during Q3.

We believe we will achieve the best possible execution by sequencing our transactions first in the public senior debt market; next, if applicable, in the subordinated debt market; and finally, to the extent desired, in the project equity market. We are still on track to generate at least $50 million of cash this year. Our 2018 outlook does not require refinancing of post-flip assets, which opportunity is still on the come for 2019. Between operational growth and refinancing opportunities, cash generation could double to $100 million next year.

Our debt and tax equity capital commitments already provide runway into next year.

With that, I'll turn the call back over to Lynn.

LYNN JURICH

Thanks Ed.

Let's open the line for questions please.

*****

Forward Looking Statements

This script contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995, including statements regarding our market leadership, competitive advantages, investments, market adoption rates, our future financial and operating guidance, operational and financial results such as growth, value creation, MW deployed, estimates of gross and net earning assets, project value, estimated creation costs and NPV, and the assumptions related to the calculation of the foregoing metrics, as well as our expectations regarding our growth and financing capacity and our strategic partnership with National Grid. The risks and uncertainties that could cause our results to differ materially from those expressed or implied by such forward-looking statements include, but are not limited to: the availability of additional financing on acceptable terms; changes in the retail prices of traditional utility generated electricity; changes in policies and regulations including net metering and interconnection limits or caps; the availability of rebates, tax credits and other incentives; the availability of solar panels and other raw materials; our limited operating history, particularly as a new public company; our ability to attract and retain our relationships with third parties, including our solar partners; our ability to meet the covenants in our investment funds and debt facilities; and such other risks identified in the reports that we file with the U.S. Securities and Exchange Commission, or SEC, from time to time. All forward-looking statements in this script are based on information available to us as of the date hereof, and we assume no obligation to update these forward-looking statements.