Q4 2019 Earnings Call
February 27, 2020
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 Sunrun's fourth quarter and full-year results and progress against our strategic priorities.

In 2019 we generated $102 million in cash, exceeding our annual target. We also grew our customer base by 22% while increasing adoption of Brightbox, our solar and battery service. We added as many customers as the next two largest residential providers combined.

In the fourth quarter we added 15,600 customers, representing 117 MW of deployments, a 9% sequential increase from the third quarter and the highest quarterly volume in the company's history. At a 6% discount rate, we generated $100 million of net present value and created NPV per watt of $1.13, or over $8,700 per customer.

I'm pleased to report that we have worked through most of our construction labor bottlenecks, which limited our growth last year. We've reduced the number of open positions in our installation organization from around 300 last quarter to about 100 today, in-line with our growing business. Open positions in our sales organization are now over 300, and this is typical as we ramp hiring into the busy summer season. As the leading national company, Sunrun offers purposeful and mission-driven careers and a competitive total benefits package that allows us to stand out when we recruit.

We have aspirations to lead the development of the decentralized clean energy industry and are building differentiation through customer reach, customer experience, and product differentiation. For example, an existing big-box retail partner has noted our differentiated execution capabilities, and we have the opportunity to expand into another 200 stores, which could grow our footprint with this retailer by over 20%. We are also investing in battery attachment rates and grid services business development. With many of these grid services programs, utilities will market to their customers on our behalf, and our customers will have access to new sources of value by sharing their batteries with the grid. We have announced five grid services programs and have a strong pipeline.

Attachment rates for Brightbox sales in the Bay Area were over 50% in Q4 --- a level that has persisted in response to poor utility reliability. In California they were over 35% and across all geographies, attachment rates approached 20% in our direct business. Nationally, we have now installed over 9,000 Brightbox systems. We expect Brightbox deployments to nearly double in 2020 compared to last year.

As always, we are focused on building the industry's most valuable and satisfied customer base. We maintain discipline on unit level economics and deliver long-term value to our customers. This is why we have achieved our market leading position and intend to keep it. We don't compete with dealer-only businesses who lack the capability to ensure a positive customer experience and who pay unsustainable prices. We are exercising caution around the industry's recent acceleration of the direct selling, or door-to-door sales channel, through independent sales dealers. I want to be very clear that this is an important acquisition channel, but it needs to have controls and management to prohibit aggressive practices that won't serve customers or investors over the long run. The customer acquisition channels, including retail, that we serve with our sales people are growing over 20% and will be durable and provide cost reductions over time.

In sum, we believe we have continued to build the moat around the business, have worked through our labor issues and expect to see stronger growth rates in 2020 than we did in 2019. We continue to expect long-term industry growth rates around 15% and expect we will grow at this level in 2020.

There is a groundswell building to find solutions to address the climate crisis. Sunrun is enabling this transition today, while providing households a superior energy service. There is significant interest from corporates looking to engage with Sunrun, as the category leader, to invest with us, and to partner with us to accelerate the transition to a decentralized energy system. Not only is Sunrun committed to Environmental, Social and Governance issues, which is core to our company philosophy and mission, but

ESG awareness from capital and strategic partners is building and will continue to grow. We are already a deeply carbon negative company and seek to help our customers and partners become carbon negative as well.

Operational Updates

We have also focused on many operational initiatives to deliver best-in-class customer value and to lower soft costs.

We launched our program called the 'Sunrun Way of Working' to kick off the next phase of our operational improvements. As part of these ongoing efforts, we are taking steps to reduce our installation cycle times, the time it takes from customer signature through to install. Beyond the obvious customer benefit, we believe fast cycle times are the key lever for driving down soft costs. International markets in Europe and Asia have shown that with short cycle times soft costs are as much as $7,000 less per customer. For context, this is more than the scheduled ITC step-down.

Our initial efforts were focused on improving our installation efficiency. We completed time studies while also soliciting installer input, and the results have been significant. In Q4 compared to the same period last year, we improved the construction labor efficiency by over 10%, more than offsetting wage pressures, while maintaining our high quality standards and commitment to safety, and despite increased battery attachment.

With these installation-level improvements now standardized, we have extended our focus to include the full funnel from customer signature through to scheduling the installation. These efforts include increasing technology investment, optimizing processes that we can control directly, for instance, site inspections, project management, and install scheduling, as well as externalities such as permitting.

I'd like to highlight two examples of these changes. First, we have now implemented the use of drones for our site inspections. The use of drones helps cut the total time by up to 50%, while reducing errors requiring revisits and improves the work experience of our site techs. This also adds a 'wow' factor for customers and their neighbors.

Second, in many jurisdictions, timelines are affected by the local permitting process, which can create considerable waste. One way we are tackling this waste is by driving permitting reform. There is no reason permits can't be automatically issued if they comply with industry standards, as they are in leading international markets.

The Solar Automated Permit Processing Campaign -- called SolarAPP -- will create a low-cost, seamless process. Last year the Department of Energy provided funding to multiple organizations to fast track permitting and interconnection, including funding to NREL to build an online permitting portal and partner

with leading technical building code organizations. The online portal will be piloted in ten locations by this summer. I am optimistic that over the next year or two we will have improved the process in most markets.

Las Vegas is an early adopter that instituted instant permitting and interconnection last year and now this step of the process has been reduced from 30 days in 2018 to zero in 2019. With the benefit of this change, in early January we installed a 27-panel system on a home in just five days after the customer signed up. Records are meant to be broken, and by the end of January, we were able to delight a customer by completing the installation just two days after sign-up.

These initiatives, along with a continued focus on operational excellence, are laying the foundation for substantial cost reductions in the years to come, along with differentiated and improved customer value.

Outlook

Turning now to 2020, I am excited about our opportunities to further pull away from the pack. We expect about 20% of growth in our customer base and 15% growth in new solar MWs deployed. Also, if you counted battery capacity the same way we count solar capacity, our growth rate would be about 25% in 2020. We expect the combination of cash flow generation and net earnings assets to grow faster than MW deployment growth -- for instance, about $100 million of cash generation and $190 million in net earning assets. Due to the election, other global events, and our strong balance sheet, this year we may be selective in market-timing for project finance transactions. It's possible we exit the year with more assets we haven't termed out into the capital markets, and if this is the case, we would see less cash generation but more net earning assets.

I'll now turn the call over to Bob Komin, our CFO, to review Q4 performance and to discuss guidance in more detail.

BOB KOMIN

Thanks, Lynn.

NPV

NPV in the fourth quarter was approximately $8,700 per customer — or $1.13 per watt. For the full year 2019, NPV per watt was $1.05.

Project Value

Project value was approximately $30,700 per customer — or $4.00 per watt in Q4.

Creation Costs

Turning now to Creation Costs on Slide 8.

In Q4, total Creation Costs were approximately $22,100 per customer — or $2.87 per watt, an improvement of $0.30, or 10%, from the fourth quarter of 2018. As with Project Value, Creation Costs can fluctuate quarter to quarter. 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, was $2.25 per watt, a $0.23 improvement from the fourth quarter of 2018.

Install costs for systems built by Sunrun were $1.96 per watt, flat year over year.

In Q4, our sales and marketing costs were $0.69 per watt down $.11 from Q3. Our total sales and marketing unit costs are calculated by dividing costs in the period by total MWs deployed. A higher mix of direct business results in higher reported sales and marketing cost per watt, but it also means there will be lower blended installation costs per watt over time due to the higher mix of Sunrun built systems at a lower cost per watt.

In Q4, G&A costs were $0.23 per watt, an improvement of $.02 from Q3.

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. Our platform services gross margin was $0.31 per watt in Q4, $0.05 higher than last quarter.

Our cash and third-party loan mix was 24% in Q4, slightly above recent levels, driven by increased demand ahead of the initial ITC step-down which affected those systems that are customer-owned. Leased systems are able to benefit from safe-harboring to extend the ITC at higher levels. We expect lease deployments to return to above 80% of the total mix in Q1.

The Q4 cost stack benefited from some seasonal and staffing dynamics. In addition, some geo and product mix effects resulted in both lower project value and lower costs. For 2020, we expect Sunrun built install costs to improve modestly compared to the full-year 2019, despite doubling the number of batteries installed. We expect this benefit will be roughly offset by paying higher market rates to select channel partners, resulting in a roughly stable total cost stack. We expect NPV to be consistent with 2019 or slightly better.

To illustrate the effect batteries are having in our cost stack, in 2019 Brightbox hardware costs were about $0.09 per watt of total Sunrun-built installation costs. In 2020, with new battery capacity more than

doubling, we estimate battery costs will become $0.20 to $0.25 per watt of total Sunrun-built installation costs. If you exclude these additional battery costs, we would expect to see an 8% unit cost reduction.

Deployments

In the fourth quarter we deployed 117 MW.

Financial Statements

Turning now to our balance sheet.

We ended the fourth quarter with $363 million in total cash.

Quarterly cash generation was $22 million after adjusting for safe harboring activity of $27.5 million and the repurchase of common stock of $5 million. We define cash generation as the change in our total cash less the change in recourse debt and other adjustments, including our safe harbor program, business acquisitions, and common stock repurchases. For the full year 2019, we generated $102 million in cash. Cash generation can fluctuate significantly due to the timing of project finance activities.

Guidance

Moving on to guidance on Slide 9.

We expect full-year deployments to grow approximately 15%. We expect unit economics, or NPV per watt, to be at or above last year's level.

In the first quarter, we expect deployments to be approximately 102 MWs.

Now let me turn it over to Ed.

EDWARD FENSTER

Thanks, Bob.

Today I'm going to discuss capital costs, asset performance, and recap our investment tax credit safe-harbor program.

First, I'm pleased to share that capital costs for residential solar assets continue to decline. Market data points now clearly support a weighted average cost of capital of less than 5%. Measured at a 5% capital cost, total net earning assets would be approximately $2 billion, or about 30% more than when measured at 6%. At 5%, contracted net earning assets would be approximately $580 million, or about 55% greater than when measured at 6%. At 5%, our 2019 additions to net earning assets would have been $191 million, 62% greater than when measured at 6%. And finally, at 5%, our full-year NPV per watt would have been about $1.35/watt, or $10,700 per customer, about 30% greater than when measured at 6%.

In addition, I am pleased to share that ABS lenders and the key ratings agency are beginning to note that our pools are performing better than peers', both in the loan and lease arenas.

This month, we are entering the company's 13th year, and across all those years, we have collected 99 cents on every dollar billed. Although it takes many years for our superior customer value proposition, consultative sales practices, and high construction quality to manifest themselves in long-term observable data versus peers, we believe that time is soon upon us.

Since December 2018, we've raised $834 million in three public ABS transactions. We expect our next transaction will be ready for market in the second half; however, given the election, other global events, and our strong capitalization, we may delay it, or other transactions, into 2021, if we believe doing so will result in better execution. We may also execute a smaller-than-usual transaction earlier than usual. The company continues to generate healthy margins, which when paired with our project finance execution, should lead to significant growth, both in cash and book value.

Finally, I'm pleased to confirm we are successfully executing our safe harbor acquisition and financing efforts. Materially all safe-harbor products have been received, and we continue to expect we will be able to qualify approximately 500 MW of the projects at the 30% ITC level. We are currently deploying fully safe harbored projects in our direct business, and we are implementing their use in our channel business. At December 31, our equity investment against this strategy peaked at $27.5 million, or less than 6 cents per watt. This investment represents about one-third of the incremental tax credit we expect to receive when deploying this equipment. This inventory also helps insulate us should any coronavirus-related supply disruption develop.

Cash Generation

Finally, year-end cash was $363 million. Total cash, less recourse debt, adjustments for a business acquisition, safe harboring activity and the repurchase of common stock, increased $102 million in 2019.

Capital Runway

Turning finally to our pipeline, our project debt and tax equity runway each extend into the fourth quarter.

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, the expected size and timeframe of our stock repurchase program, operational and financial results such as growth, value creation, cash generation, Megawatts Deployed, investment tax credit safe harbor strategy, estimates of gross and net earning assets, project value, estimated creation costs, gross orders and demand, and NPV, the assumptions related to the calculation of the foregoing metrics, our expectations regarding our growth, financing activities, potential sales partnerships and channels, and financing capacity, and factors outside of our control such as public health emergencies and natural disasters. 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 interest rates; 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; our continued ability to manage costs associated with solar service offerings; our business plan and our ability to effectively manage our growth and labor constraints; 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.