Hannon Armstrong Sustainable Infrastructure Capital, Inc.

First Quarter 2022 Results Earnings Call

May 3, 2022

Presenters

Jeff Eckel, Chairman and CEO

Jeff Lipson, CFO and COO

Neha Gaddam, Senior Director, Investor Relations & Capital Markets

Operator

Greetings, and welcome to Hannon Armstrong First Quarter 2022 Results Conference Call. At this time, all participants are in a listen only mode. A question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star zero on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Neha Gaddam, Senior Director, Investor Relations and Capital Market. Thank you, and over to you.

Neha Gaddam - Hannon Armstrong Sustainable Infrastructure Capital, Inc.- Senior Director of Investor Relations and Capital Markets

Thank you, operator. Good afternoon everyone and welcome. Earlier this afternoon, Hannon Armstrong distributed a press release detailing our first quarter 2022 results, a copy of which is available on our website. This conference call is being webcast live on the Investor Relations page of our website where a replay will be available later today.

Before the call begins, I would like to remind you that some of the comments made in the course of this call are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended. The company claims the protections of the Safe Harbor for forward-looking statements contained in such sections. The forward-looking statements made in this call are subject to the risks and uncertainties described in the Risk Factors section of the company's Form 10-K and other filings with the SEC. Actual results may differ materially from those described during the call.

In addition, all forward-looking statements are made as of today and the company does not undertake any responsibility to update any forward-looking statements based on new circumstances or revised expectations. During this call, we will primarily discuss non-GAAP financial measures, which we believe help investors gain a meaningful understanding of our core financial results and guidance.

A presentation of this information is not intended to be considered in isolation or as a substitute for the financial information presented in accordance with GAAP. A reconciliation of GAAP to non-GAAP financial measures is available on our posted earnings release and slide presentation.

Joining me on today's call are Jeff Eckel, the company's Chairman and CEO; and Jeff Lipson, our CFO and COO. With that, I'd like to turn the call over to Jeff Eckel who will begin on Slide 3. Jeff?

Jeffrey Eckel - Hannon Armstrong - Chairman and CEO

Thank you, Neha, and good afternoon everyone. Today, we are pleased to report continued strong performance in the first quarter with:

- Distributable earnings of $0.52 per share, a 21% increase over last year;
- Continued growth in Net Investment Income up 41% from last year and up 10% from Q4 2021;
- A dividend of $0.375 per share

Strong NII growth contributed to this strong quarter and sets us up for a strong year. With our gain on sale revenue, in addition to NII, we demonstrate again that the HASI dual-revenue business model, built on a diverse set of clients, technologies and assets, continues to work well despite macroeconomic and industry challenges As such, we are pleased to re-affirm our prior guidance for annual growth in distributable EPS of 10% to 13% through 2024, and 5% to 8% annual growth in our dividend for the same period.

This quarter we highlight the CarbonCount of two California based solar investments, one grid-connected at .8 and one behind the meter at .2. With the same grid emissions profile, the difference in the CarbonCount is the relative costs per kW, with the grid-connected solar costs 3-4 time lower than the behind the meter transaction. Now of course there are other advantages to behind the meter solar plus storage assets such as reliability, but we believe measuring and reporting with this level of rigor on CarbonCount is where the market needs to go.

Turning to slide four, we would like to discuss some of the headline challenges that are top of mind of our investors. First, as we mentioned last quarter, the clean energy industry is continuing to adapt to rising inflation by raising PPA prices. Our clients in both grid connected and behind-the-meter segments have anecdotally reported increasing PPA pricing to end customers to manage higher capital costs and inflation. And while renewable PPAs are pricing higher, the alternative in gas-fired or utility supplied power have generally increased as well due to a near tripling of natural gas prices.

As for the impact to HASI, higher inflation has minimal impact on our portfolio due to the largely fixed priced O&M contracts. And because we price our new investments at current pricing and once the impacts of inflation on a project are understood, we can generally increase pricing with market rates. Additionally our portfolio generally benefits from higher commodity prices and retail rates to the extent there are sales into the wholesale markets. For behind the meter generation, including residential solar, the customer value proposition is improving due to rising utility rates. In fact the long term prospects for elevated natural gas prices is causing us to look more favorably on common equity investments to capture some of that upside.

Next, as most of you are aware, the anti-circumvention investigation initiated by the Department of Commerce is creating disruption in the solar supply chain with the threat of retroactively imposing tariffs on panels imported from South East Asian suppliers. This is primarily affecting grid connected solar projects due to their tighter PPA pricing and the sheer volume of panels those projects require. On our grid-connected pipeline we are fortunate to have large companies as clients who have generally been able to source panels from unaffected supply chains. Will there be softness in the solar pipeline 6 to 9 months out? I think that is inevitable, yet manageable, given the diversity of our origination platform across the clean energy landscape.

The success of grid-connected wind and solar development over the last few years has not been matched by investment in transmission systems to move the power to the load. This congestion and basis risk causes pricing mismatches under

some PPAs, leading to revenue shortfalls from plan. We have experienced some of this with our portfolio and have adjusted our expected yield accordingly. The preferred nature of many of our grid-connected assets is a significant mitigant, but not a perfect mitigant for an industry-wide problem that is getting the attention it deserves from the industry

Finally, the brutal war on Ukraine by Russia is a reminder that energy security is national security. This should be a clear message that, notwithstanding the near term challenges of the clean energy industry I have just been discussing, we should not lose sight that the clean energy industry is the only viable path to both energy independence and climate change mitigation, further reinforcing our investment strategy.

Moving to slide five, we provide an update on our 12-month pipeline, which we continue to report as greater than $4 billion. Consistent with last quarter, the bulk of our pipeline remains behind-the-meter and is weighted toward energy efficiency. The grid-connected portion is weighted toward solar projects that are either operating, in construction or in late-stage development, and have mitigated the anti-dumping issues we just discussed. Lastly, our sustainable infrastructure pipeline continues to present opportunities in environmental restoration, and in newer asset classes such as transportation, standalone storage and renewable natural gas.

Now, I'll turn it over to Jeff L. to detail our portfolio performance and financial results.

Jeffrey Lipson - Hannon Armstrong Sustainable Infrastructure Capital, Inc. - CFO

Summarizing our first quarter results on slide six, we recorded Distributable Earnings per share of $0.52, had a strong quarter of Distributable Net Investment Income of over $42 million, and recorded Gain-on-sale of approximately $22 million. On a year-over-year basis, we continue to demonstrate substantial growth in our Distributable Net Investment Income and steady realization of Gain-on-sale fees, as our dual revenue model continues to bolster our Distributable EPS. In the upper right, we note Distributable EPS year-over-year growth was 21% resulting from growth in both Equity Method Investment income and interest revenue. In addition, as shown on the lower right, our Gain-on-sale from securitized assets for the first quarter was $22 million, representing an 8% increase year-over-year. Lastly, Distributable Net Investment Income was over $42 million in the first quarter, reflecting year-over-year growth of 41%, driven by a larger Portfolio and ongoing strong margins. Our Net Investment Income is expected to grow each quarter as we add assets to the balance sheet, providing ongoing stability and visibility into our future earnings growth. Therefore, we are affirming our guidance of 10% to 13% compound annual growth in Distributable EPS through 2024.

Turning to slide seven, we detail our $3.7 billion balance sheet portfolio as of the first quarter of 2022, which has grown 28% from $2.9 billion over the last year. Our portfolio now includes over 320 investments across eight asset classes, with a weighted average life of 18 yrs. With no asset class comprising more than 30% of the portfolio, the diversity of our business remains a strength particularly in a period in which certain asset classes are more impacted by the aforementioned macroeconomic trends. Lastly the forward looking portfolio yield at quarter-end was 7.3% down from 7.5% at year-end. This reduction was primarily the result of a change in distributable earnings accrual rates for two grid-connected projects due primarily to congestion in the Southwest Power Pool, which resulted in a modest reduction of our long-term IRR expectations for these investments. These investments continue to perform within our expectations and the grid-connected portfolio will likely benefit long-term from higher natural gas prices. Consistent with the past several quarters, our overall portfolio continues to perform very well with 99% of our investments performing within our expectations.

Turning to slide eight, we detail our Q1 portfolio reconciliation. We funded over $160 million of investments resulting in Portfolio growth of 5% from year end. Funding expectations of previously closed transactions is shown on the right with over $675 million expected to fund through end of 2023. To be clear, the amounts in this table reflect closed but unfunded transactions, and are entirely incremental to the portfolio growth we expect from our > $ 4 billion current pipeline.

On slide 9, we highlight our successful offering in April of $200 million Carbon Count Exchangeable Notes. These notes carry a coupon of 0% and mature in 2025. The investors have an option to either exchange the notes for stock at a 32.5% premium subject to dividend adjustments which at closing was $56.54, or receive accreted principal at 3.25% per annum at redemption. Given the volatile capital markets backdrop, we are pleased with the terms of this financing. We also issued $50m of equity in the quarter at an average price of slightly above $48 per share. With cash proceeds from the notes and the shares, combined with availability in our credit facilities and CP program, our total available sources of liquidity increased to greater than $930 million. We have no material debt maturities until 2025, as we continue to manage our market risk by utilizing modest leverage, laddered debt maturities and diverse funding sources.

Turning to slide 10, we reiterate our management of interest rate risk, which is not unique to our business; and we take this risk very seriously in our enterprise risk management processes. Our Investment Portfolio of over $3.7 billion is comprised of fixed rate loans and equity method investments with yields that are largely unaffected by changes in interest rates. Combined with our debt which is 96% fixed rate, our existing balance sheet is largely insulated from near-term changes in interest rates. The chart on the left demonstrates our historical ability to actively manage our interest rate risk and grow Distributable Earnings. Since 2014 (our first full year as a public company), neither the level of rates nor the shape of the yield curve has meaningfully diminished our ability to grow earnings. This is in part because we actively manage our balance sheet and securitization program to maximize our ROE which was 11.5% in Q1. The graph on the right shows our margins have been maintained as our yield has been steady (despite a competitive investing environment) while our cost of funds has decreased. As noted earlier, our yield is a bit lower this quarter, but our margins continue to be strong as our interest expense (as a percent of our average debt balance) continued its downward trend in the quarter. Given current market conditions, we expect incremental term debt issued in 2022 would likely be above our current cost-of-debt; however, we expect our aggregate margins to remain relatively consistent and sufficient to achieve our guidance. We also expect these margins will facilitate continued strong growth in Net Investment Income. Finally, I'd note our securitization strategy has functioned well during our 40 year history, including in much higher interest rate environments, so we remain confident that we can continue to utilize this source of capital as part of our funding and market risk strategies.

In conclusion, earnings growth remains robust, our guidance is affirmed, and our market risk and capital market strategies remain sound.

With that, I will turn the call back over to Jeff.

Jeffrey Eckel - Hannon Armstrong - Chairman and CEO

Thanks, Jeff.

Turning to slide 11, we continued efforts to improve CarbonCount methodology and were pleased to recognized by Fast Company for our innovations in climate solutions investing.

On the social front, our Foundation advanced several climate justice initiatives, covering efficiency upgrades for non-profits, advancing our Climate Corp fellow program. the funding of resilience hubs in Baltimore, and supporting an online climate education library.

Finally, we encourage you to take a deep dive into our 2021 Impact Report, which includes many new disclosures and details on the progress of our various ESG initiatives and is now posted on our website, along with our new and improved Proxy.

We'll conclude on slide 12.

- First, over our 9 years as a public company, we have demonstrated that our dual-revenue business model continues to grow earnings in a variety of macro environments and we are well positioned to continue that growth in the future
- Second, our commitment and credibility in ESG attracts and retains the best talent committed to making a positive impact, leading to high employee retention, which in turn improves our operating leverage and our ability to solve client problems, a direct benefit to shareholders.
- Finally, our pipeline of climate solutions investment opportunities is large and growing. The growth is driven by the twin priorities of addressing climate change while improving our and Europe's national energy security, an enormous addressable market for years to come.

With that, I'll ask the Operator to open the line for questions.

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