HA Sustainable Infrastructure Capital, Inc.

First Quarter 2024 Results Conference Call

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HASI Presenters

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Marc Pangburn, CFO

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Q&A Analysts

Noah Kaye - Oppenheimer

Chris Souther - B. Riley Securities

Jack Hurley - Mizuho

Michael Fairbanks - JPMorgan

David Sunderland - Baird

Operator

Greetings and welcome to HASI's First Quarter 2024 Earnings Conference Call and Webcast. At this time, all participants are in listen-only mode. A brief 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 reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Neha Gaddam, Senior Director, Investor Relations and Corporate Finance.

Neha Gaddam, Sr. Director of Investor Relations and Corporate Finance

Thank you, operator. Good afternoon, everyone, and welcome. Earlier this afternoon, HASI distributed a press release detailing our first quarter 2024 results, a copy of which is available on our website. This conference call is being webcast live on our Investor Relations page of the website, where a replay will be available later today.

Some of the comments made in this call are forward-looking statements, which are subject to 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 stated. And today's discussion also includes some non-GAAP financial measures. 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 Lipson, the company's President and CEO; Marc Pangburn, CFO; and Susan Nickey, our Chief Client Officer. Susan will be available for the Q&A portion of our presentation.

Now I'd like to turn the call over to Jeff, who will begin on slide three. Jeff?

Jeff Lipson, President and CEO

Thank you, Neha, and good afternoon, everyone. Thank you for joining the call. Today is truly a milestone moment in the evolution of HASI. Since our Investor Day in 2023 roughly one year ago, we have consistently talked about a strategic emphasis on a more efficient and scalable capital structure.

Today, we announced a $2 billion strategic partnership with KKR that provides a very meaningful step towards accomplishing this goal. The partnership is an ideal pairing of HASI's ability to source, underwrite, and manage a diverse portfolio of climate-positive investments and KKR's market leadership in raising and managing sustainable core infrastructure funds.

This arrangement creates an efficient platform to hold most of our balance sheet investments going forward. We are thrilled with this partnership and the opportunities it will facilitate. We have named the partnership Carbon Count—CarbonCount Holdings 1—and we'll refer to it as CCH1 going forward.

I'll come back to CCH1 in a moment, but I'll briefly mention a few other highlights from the first quarter, including $0.68 of adjusted earnings, over 500 million of closed transactions, and a 24% year-over-year growth rate in our managed assets. We are also declaring a $0.415 dividend, and we are affirming our guidance, which had already assumed a co-investment transaction and is therefore not changing. We also had a very successful quarter upsizing and extending our debt, which Marc will detail in his remarks.

Turning to page four, I want to put today's announcement in historical context. Prior to 2013, HASI was funded almost exclusively by securitizations, typically with life insurance companies. Following the IPO, we utilized public equity to build a balance sheet with higher return investments. In 2019, we obtained corporate debt ratings and incrementally utilized the unsecured bond market.

Today's announcement provides incremental access to private infrastructure capital, supplementing all these other sources of funds. In a business like ours, diversified sources of capital are the foundation for long-term success.

This slide is a simple representation of a capital strategy that has positioned us for profitable growth even during periods of volatility and macroeconomic headwinds. Our securitization program, our balance sheet, and the CCH1 partnership will work in tandem, resulting in a powerful and resilient business.

Continuing on slide five, CCH1 has many benefits, three of which are noted on this slide. First, it will reduce our reliance on capital markets, which have experienced a high level of volatility over the past four years. Going forward, we will obtain 50% of the funding for the investments in CCH1 outside of the capital markets, substantially reducing our risk to market disruptions.

Second, CCH1 will allow us to increase our investment capacity and ultimately accelerate our growth in managed assets. This additional capacity is coming at a perfect time as forecasts of energy demand continue to be revised upward with a large portion expected to be renewable and other sustainable sources. Our additional access to capital will allow us to meet the growing needs of our clients as they continue to move forward with projects that are required to meet this increased demand.

And third, CCH1 will provide more diversity to our income statement with stable fee revenue to complement our net investment income and gain on sale income. The result of these and other benefits of the partnership is an even more dynamic and resilient HASI that is well-positioned for long-term success.

Turning to page six, I'll speak about CCH1 in a little more detail. It is structured with 50% ownership by each of HASI and one of KKR's core infrastructure funds. HASI will source the investments for CCH1, consistent with our existing strategy. In fact, we are not making any changes to our investment strategy as part of this arrangement. This transaction can be viewed as an endorsement of our existing strategy and the attractiveness of the diverse portfolio that we are able to originate. We will continue to interface with our clients, both before and after an investment has closed consistent with current practice.

Each party has made a $1 billion commitment to CCH1, and we expect the $2 billion to be deployed over approximately 18 months. Two investments closed by HASI totaling just under $200 million in commitments are being utilized to seed the partnership at formation. As compensation for sourcing and managing the investments, HASI will be paid fees by CCH1.

It's fundamentally a simple structure that allows both HASI and KKR to focus on their respective core competencies and allow the partnership to benefit accordingly. More detailed information regarding CCH1 is provided in an FAQ in the appendix to the earnings materials.

Now I will turn over the call to Marc Pangburn.

Marc Pangburn, CFO

Thank you Jeff.

I'll start on slide seven. We have increased our 12-month pipeline to greater than $5.5 billion. Demand growth continues to drive investment opportunity in all of our markets. While AI is the latest trend, electrification and resiliency are long-term themes driven by a multitude of factors, including decarbonization goals, increasing extreme weather events, and the increasing reliance on electricity.

We see these themes materialize in our pipeline, our clients' pipeline, and the underlying demand for energy transition assets. As identified on the right, there has been notable growth in our pipeline for community solar, grid connected solar, and renewable fuels, while other asset classes, including residential solar, have remained consistent with prior quarters.

In Q1, we closed $562 million of transactions across six different asset classes with an average yield for on-balance sheet investments of approximately 10.5%.

Moving on to slide eight, before I jump into the slide, I'd like to highlight one change in naming convention. Our non-GAAP metric was previously referred to as “distributable,” which was a term adopted by REITs. Given our move away from the REIT structure, we will be using “adjusted” on a go-forward basis. The definition is unchanged.

Our adjusted EPS increased by 20% year over year to $0.68. Adjusted NII grew by 37% to $64 million. A significant contributor to earnings growth in Q1 is higher gain on sale, fees, and securitization income, which totaled $35 million, an 81% increase year over year. As a reminder, gain on sale is variable quarter to quarter, and we expect gain on sale during the guidance window to be consistent compared to '22 and '23.

On the right, given the updates Jeff provided on CCH1, we are reorganizing our top-line metrics into three different categories. The presentation of NII is unchanged. In future periods, income relating to our 50% ownership in CCH1 will be reflected here.

We have split our income streams relating to our capital-light activities into recurring and upfront. Recurring will be comprised of securitization income and ongoing CCH1 management fees. Upfront will be comprised of gain on sale, fees, and upfront CCH1 fees.

Turning to slide nine, we show impressive growth in both portfolio and managed assets. Our portfolio grew by 36% year over year, $6.4 billion, while managed assets grew 24% to $12.9 billion.

In future periods, our 50% ownership in CCH1 will be included in our portfolio, while the full balance will be included in managed assets. The growth of our investments is a testament to the strength of our programmatic origination platform.

On page 10, we've added ROE to our margin chart given the expansion of our capital-light activities. ROE has increased this quarter primarily due to the gain on sale discussed on slide 8. As it relates to portfolio yield and debt costs, we are showing a temporary compression due to the newly issued debt and the time delay to fully deploy these funds. This dynamic was expected and has been factored into guidance.

I'll add that we continue to see elevated returns for new transactions with Q1 transactions coming in approximately at 10.5%.

Turning to slide 11, we highlight our robust funding platform that underpins business growth with over $800 million in liquidity, minimal near-term debt maturities, and a leverage ratio of 1.9 times, our liquidity and liability management is evident. Our interest rate risk management has ensured 97% of our debt is fixed or hedged, while also managing future refinancing rate exposure.

Alongside the strong execution in the first quarter, we further strengthened the debt platform with an upsize and extension of three bank facilities: our revolver; term loan A; and CP facility. This aggregates to a borrowing capacity of greater than $1.6 billion and the maturity extensions are detailed in the box on the lower right. With our activities this year, we have provided ourselves the flexibility to opportunistically approach the debt markets for further 2025 refi extensions.

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

Jeff Lipson, President and CEO

Thanks, Marc. On page 12, we share a few sustainability and impact highlights from the first quarter. We published our best-in-class 2023 Sustainability Impact Report, donated $2.5 million to the HASI Foundation to support Climate Justice initiatives, and achieved independent verification of Scope 3 Category 15 emissions.

Let's wrap up on slide 13. Our strategy continues to produce strong results despite the higher interest rate environment and other real or perceived headwinds. The elevated demand for energy will continue to facilitate an emphasis on supply, particularly from renewable and sustainable sources, which will create increasing opportunities for the business to invest.

The CCH1 transaction is the optimal structure with an ideal partner and is occurring at the perfect time, allowing us to scale our business. On our Investor Day, we discussed reducing our reliance on equity raises. And last quarter, we discussed the trajectory of our payout ratio and our intention to retain more capital as one step in this direction.

Today's announcement is another significant step in that direction as we continue down the path of executing on our stated goals. Today, HASI is a powerful enterprise and better positioned for long-term success with an even more diversified access to capital.

I thank our outstanding team for closing the CCH1 transaction and several other important initiatives this quarter. And I welcome our new partners from KKR as we jointly provide capital to the energy transition.

That concludes our prepared remarks. Operator, please open the line for questions.

Operator

Thank you. We will now be conducting a question and answer session. If you'd like to ask a question, please press star one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star two if you would like to remove your question from the queue. For participants to the speaker equipment, it may be necessary to pick up your handset before pressing the star keys.

Our first question is from Noah Kaye with Oppenheimer & Co.

Noah Kaye - Oppenheimer

All right, well, thanks for taking the questions. And congratulations on closing the investment with—the structure with KKR. And I think the FAQ that you provided in the appendix is really helpful. So that avoids me having to ask those questions.

But I will ask one question related to the structure, which is, is there any color we can get on the yield or return profile threshold for investments that would go into the structure? Are there any stipulations or parameters that we should think about for the types of investments that will go in.

Jeff Lipson, President and CEO

Thanks, Noah, for the question. I think the best way to think about the structure is that it will be very consistent with the HASI underwriting across the board, including risk and yield. And so I don't think you should think about CCH1 as having a different yield than our balance sheet otherwise would have. So we're really not changing our outlook on the business or the way we source investments.

Noah Kaye - Oppenheimer

Okay. A question around the balance sheet and specifically the real estate investments. The balance sheet real estate investments have kind of gone from $350 million in 2Q down to almost nothing. And just can you give us a little bit more color on the rationale for unwinding the exposure there and whether or not real estate as an asset class is one that you will continue to add to? Certainly, it seems like a lot of the on-balance sheet going forward will be equity method, but just trying to get some color.

Marc Pangburn, CFO

Thanks, Noah. Yes, we continue to seek new investments within the solar real estate asset class and like that asset class a great deal. New assets that are originated today in that asset class are generally securitized. They are, relative to what goes on to our balance sheet today, somewhat low yielding and somewhat highly levered.

And so that is a much better asset to go through our securitization program. And what you're seeing on the reduction in real estate on the balance sheet is us rotating out of those on-balance sheet programs into the securitization platform.

Noah Kaye - Oppenheimer

Yeah. And at the same time, just to sneak one more in. I mean, you did grow your financing receivables balance, right? So that suggests that that asset class, you're still finding opportunities to get the kind of yields that you spoke to, that you referenced in your prepared remarks. Just trying to understand the types of receivables that would carry these types of rates.

Marc Pangburn, CFO

Sure, when it's receivables, it really just goes into our loan bucket, which is applicable really to all of our asset classes.

Jeff Lipson, President and CEO

Yeah. I would say just to even take that a step further, most of what we do in resi solar, for instance, most of what we do in RNG, are loan in form and therefore will show up in the receivables line in the balance sheet.

Noah Kaye - Oppenheimer

Very helpful. I'll pass it on.

Jeff Lipson, President and CEO

Thank you.

Operator

Our next question is from Chris Souther with B. Riley.

Chris Souther – B. Riley

Hey, guys. Thanks for taking my questions here. Just on the elevated gain on sale in the quarter, is that related to KKR, or the real estate sales, as the driver there? Just wanted to kind of see what had caused the elevated numbers there in the quarter.

Jeff Lipson, President and CEO

Chris, it was it was more the latter. The KKR transaction just closed and had no impact on the first quarter.

Chris Souther – B. Riley

Okay.

Jeff Lipson, President and CEO

And will have no impact -- will have no impact going forward on the gain on sale line. So a big part of that was what Marc spoke about a moment ago, rotating some of these real estate investments from on-balance sheet to off balance sheet.

Chris Souther – B. Riley

Got it. Okay. That makes sense. And then, as we're looking at the economics of the KKR partnership, the FAQs, obviously, very helpful. But should we think about the origination and management fees with that partnership as similar to the securitization business has been historically? Or is it materially different?

And then just kind of a follow up around that is you mentioned on the last call, and then again on this call, not needing incremental gain on sale. So I guess KKR upfront origination doesn't count as gain on sale, but I kind of took that to mean, you know, episodic upfront revenue was not going to be the main driver around the guidance going out to 2026.

So I'm just kind of curious is the episodic upfront stuff, it's just between now and the end of 2025. So that's the reason doesn't change 2026 is because it would all be set up by the end of 2025? Or am I thinking about that incorrectly with like the timing?

Jeff Lipson, President and CEO

All right. Because there are a few things in there to unpack. I'll maybe answer the first part of the question, and Marc can answer the second part. So for the first part of the question, there's no relationship between the gain on sale, fees, and the orientation and size of those fees and the fees related to CCH1.

One is very market driven around the yield on the underlying investment versus the cost of funds from the LifeCo that we work with. And it is variable depending on those factors. The fees in this vehicle are generally fixed in nature where we'll get an upfront fee for each investment and we will get a management fee based on the balance, which presumably will go up over time. So I wouldn't in any way equate those.

To the second part of your question, I'll let Marc answer that.

Marc Pangburn, CFO

Sure. So, Chris, I think you're referring to my commentary where I identified the gain on sale remains variable and also tied our forecast to the guidance window. And the main message we're trying to communicate there is we continue to forecast a consistent level of gain on sale as it relates to guidance. And while we have an elevated amount of gain on sale this quarter, just by nature of the income stream, it is lumpy by nature and will move up and down quarter by quarter.

Chris Souther – B. Riley

Okay, got it. That's helpful. I'll hop in the queue. Thanks, guys.

Jeff Lipson, President and CEO

Thanks, Chris.

Operator

Our next question is from Maheep Mandloi with Mizuho.

Jack Hurley - Mizuho

Hi. Jack Hurley here online for Maheep. Slide 15 of the deck provides a lot of the detail on the CCH1 partnership and answers a lot of the initial questions, so thanks for that. The key question remaining is if the three-year guidance includes any of other similar transactions with other private infrastructure capital providers? And also does the KKR transaction impact any of your equity or debt needs?

Jeff Lipson, President and CEO

Well, to the first part of the question, we wouldn't need to close on any other co-investment partnerships in order to achieve our guidance. I think the point I was making was a transaction like this was already contemplated, so it doesn't change our existing guidance.

To the second part of the question—which I'm sorry, I'm now forgetting.

Jack Hurley - Mizuho

Does it impact to your equity or debt needs?

Jeff Lipson, President and CEO

Oh, the equity needs. Yeah. Okay.

Jack Hurley - Mizuho

Yeah.

Jeff Lipson, President and CEO

So I think a simple framework for that is that it's a 50-50 partnership. Without this partnership, all those investments would have gone on our balance sheet. So a strawman of that is it reduces our equity needs by 50% is I think the best way to think about it.

Jack Hurley - Mizuho

Okay, thanks a lot. And if I may, one more follow-up. How should we think about the economics around the transaction with other structures that you—for you guys? And then we keep hearing about a lot of renewable projects, constructions being pushed out by a few quarters for various regions, interconnection challenges, and other things. Are you guys seeing any impact to your pipeline because of this? And does that require you to move focus more to the behind the meter segment, for example?

Jeff Lipson, President and CEO

Well maybe I'll take the second part of the question first, and Marc can take the first part. So we are seeing periodic and episodic delays in certain projects, but it's not been material. We tend to work with the largest developers who've had less challenges than some others.

And some of the transactions we do are also capital recycling. So the project is already built and they're simply recycling capital into the next project so you wouldn't have any delays there. So any delays we're seeing aren't material to our revenue, aren't causing us to reconsider our guidance. So they've been relatively minor. And I'll let Marc answer the other part of the question.

Marc Pangburn, CFO

Sure. And just, I think the question was just generally around the economics of CCH1 and to reiterate what Jeff said, it's a very simple 50-50 structure. And so whatever investment would have gone on to our balance sheet but instead goes into the CCH1 partnership, we'll earn 50% of that through our ownership interest. And then in addition to that be paid, again, some upfront and ongoing management fees.

Jack Hurley - Mizuho

Thanks. I'll hop back in the queue.

Jeff Lipson, President and CEO

Thank you.

Operator

Our next question is from Mark Strouse with JPMorgan.

Michael Fairbanks - JPMorgan

Hi, this is Michael Fairbanks on for Mark. Thanks for taking our questions. On CCH1, is there any color you can provide on how the exclusivity piece works? Also, I know it doesn't change the overall investment strategy here, but is there a certain asset class within the portfolio that this structure is best suited for? Is it more kind of all-encompassing?

Jeff Lipson, President and CEO

I would say it's more all-encompassing. The exclusivity we would describe as limited exclusivity. I think you should think of it as we're showing them most of what we are sourcing for the balance sheet. And they are, in some cases, committed based on some pre-agreed upon criteria. And in other cases, have the ability to decline transactions and in those cases, we can do them on our own. So I think that's the framework.

Michael Fairbanks - JPMorgan

Great. Thank you.

Jeff Lipson, President and CEO

Thank you.

Operator

Our next question is from Davis Sunderland with Baird.

Davis Sunderland - Baird

Hey, Marc. Hey, Jeff. Thanks for the time. Appreciate you taking the question. Surprise, surprise, another KKR question. I just wanted to ask if in the guide you -- or you noted that in the guide, there was a joint investment that was already contemplated in the guidance. Maybe was it forecasted that this would come to fruition as early as it did or maybe any details you can share about how this came to be would be helpful. And then I have one quick follow-up.

Jeff Lipson, President and CEO

Sure, David. Thanks for the question. You know, I think the main point there is that by the time we were issuing our guidance in the February call, we were engaged in early conversation with KKR and we're able to model what we thought the partnership would become and included in that guidance number. So now that it closed, we don't need to change it. I think that's the key point.

Davis Sunderland - Baird

Okay, good. That makes sense. And then lastly, I think, Noah may have already asked this, so apologies for the repeat, but just wanted to clarify. Is there any different risk threshold or any other, I guess, restrictions or outlines for the assets in that CCH1 that we should contemplate? Thank you.

Jeff Lipson, President and CEO

Thanks for the question and definitely not. So I'll go back to what I said in the prepared remarks that our business and the way we source, underwrite investments, the way we price risk, it is all unchanged and this in many ways is an endorsement of that strategy. In that the objective here is to have HASI do what it's always done and allow KKR to participate in that business, not change the business. So that's the way to think about it.

Davis Sunderland - Baird

Okay that's great. Thanks, Jeff.

Jeff Lipson, President and CEO

Thank you.

Operator

Ladies and gentlemen, we have reached the end of the question-and-answer session and are out of time for today's call. Thank you for your participation. You may disconnect your lines at this time.

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