HA Sustainable Infrastructure Capital, Inc.

Third Quarter 2024 Results Conference Call

November 7, 2024

HASI Presenters

Jeffrey A. Lipson, President and CEO

Marc Pangburn, CFO

Aaron Chew, Senior VP of Investor Relations

Q&A Analysts

Jack Hurley – Mizuho Securities

Hannah Velasquez – Jefferies

Noah Kaye – Oppenheimer

Tyler Bisset – Goldman Sachs

Operator

Greetings. And welcome to HASI's Third Quarter 2024 Earnings Conference Call and Webcast. At this time, all participants are in a 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 "*" then "0" on your telephone keypad. As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Aaron Chew, Senior Vice President of Investor Relations.

Aaron Chew, Sr. VP of Investor Relations

Thank you, Operator. And good afternoon to everyone joining us today for HASI's third quarter conference call. Earlier this afternoon, HASI distributed a press release reporting our third quarter 2024 results, a copy of which is available on our website, along with the slide presentation we will be referring to today. This conference call is being webcast live on the Investor Relations page of our 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. Today's discussion also includes some non-GAAP financial measures. A reconciliation of GAAP and non-GAAP financial measures is available in our earnings release and presentation.

Joining me on today's call are Jeff Lipson, the company's President and CEO, and Marc Pangburn, our CFO, as well as Susan Nickey, our Chief Client Officer, who will be available for the Q&A portion of our presentation.

Now I'd like to turn the call over to our President and CEO Jeff Lipson….Jeff?

Jeff Lipson, President and CEO

Thank you, Aaron. And thanks to everyone joining us today for our third quarter 2024 conference call. I'm going to begin on Slide 3.

The third quarter of 2024 was another solid quarter for HASI on the key elements that drive our long-term value creation. We've closed $1.2 billion of new investments year-to-date as of 9/30. And including an active start to the fourth quarter, new investments are at $1.7 billion year-to-date, as of today.

Our managed assets have grown 14% in the last 12 months and now exceed $13 billion. New asset yields have been approximately 10.5%, year-to-date, which have increased our overall portfolio yield to 8.1%. And adjusted earnings per share of $0.52 in the quarter has driven our EPS through the first three quarters of 2024 to $1.83, representing 8% growth, over the first three quarters of 2023.

We continue to remain confident in our guidance of annual adjusted EPS growth between 8% and 10% through 2026, with our dividend payout ratio targeted between 60% and 70%, over this period. As a reminder, our long-term goal is for 10% annual EPS growth and a 50% payout ratio, by 2030.

Before we discuss the quarter in more detail, I'd like to pivot to discussing the election impact following Tuesday's results and interest rates, following today's Fed meeting. These are certainly not new discussion topics for us. In various investor forums, over the past 18 months to 24 months, I have repeatedly reminded investors that HASI can be equally successful in Republican administrations and when interest rates are higher, as we are during Democratic administrations and when rates are lower. In fact, this is not just a theory; it has already been demonstrated. We achieved strong earnings growth during the first Trump administration and have continued to thrive in this period of higher rates that began in 2022.

Turning to Page 4, a few more thoughts on the election impact. Investors tend to conclude a strong correlation between election results and the success of the clean energy industry. On one hand, this makes sense, given the heavy involvement of government in the energy markets, in general, and the influence of policy, taxes and incentives on the energy transition, in particular.

On the other hand, a closer look at the data reveals some interesting facts, as shown on Slide 4. Namely, that investment in clean energy has undergone secular growth this century that transcends political administrations.

In fact, clean energy investment adjusted for inflation has grown in every successive presidential administration, from Bush to Obama to Trump and now Biden, underscoring how the market has been propelled not only by public policy but increasingly over the last two decades, by economic factors.

The simple truth is that renewables have not only become the lowest levelized cost of energy, but also offer comparatively rapid deployment, which has helped transform them into the preferred source of incremental energy.

In addition, the forecasted demand for power over the next several decades will inevitably result in an all-of-the-above energy strategy in this country. The corresponding elevated investment in supply to meet this demand will ensure our clients maintain strong development pipelines.

This dynamic extends not only across presidential administrations, but also across geographic lines, as well. As the table at the bottom of the slide indicates, cumulative deployments of renewable power in this country are split quite evenly between Republican and Democratic states and, in fact, lean slightly in favor of states that voted Republican in 2020.

Perhaps more importantly, investment in clean energy projects announced since the IRA was enacted a few years ago skews heavily in favor of states that voted Republican in 2020. I would note we could have used a variety of data points on this slide and they would have all resulted in the same conclusion. The energy transition is an economically viable macro trend that will continue for many decades, regardless of election results.

Turning to Page 5, a reminder that our business is not dependent on low interest rates. We continue to prove the thesis that in all rate environments—high, low, flat, steep or inverted—our business can thrive.

In 2020 and 2021, rates were unusually low, followed by a rapid increase in 2022 and 2023, during which the Fed raised interest rates by 500 basis points and the yield curve was persistently inverted. In

2024, a rate cut cycle has started again and the curve has steepened. Throughout this period of rate volatility, we have maintained a consistent and disciplined approach to interest rate risk management.

As noted on the slide, our margins have remained attractive, as we have consistently invested at an adequate spread to our debt cost. Likewise, we have consistently increased adjusted earnings throughout this period of rate volatility.

Quite simply, the lengthy track record of our business is that we generally invest at an average of treasuries, plus 5% to 6%, and now as an investment grade debt issuer, we can fund ourselves at treasuries plus 2% and 2.5%. This resulting margin has created a sustainable, predictable and consistently profitable business.

Turning from Slide 5, detailing our margin history, to Slide 6, I would like to emphasize that our outlook for margins over the next several quarters remains robust, as we continue to close transactions with double-digit yield and our long-term public bonds are trading at roughly 6.5%.

I'd also like to provide a brief update on two other items. Our CCH1 partnership with KKR continues to progress entirely within our expectations. We have closed a number of additional transactions in the vehicle in the third quarter and early fourth quarter, with no modifications of our internal processes. KKR continues to be an ideal and constructive partner, and we remain on track to complete the $2 billion investment target by year-end 2025.

Finally, I would note that our SunStrong joint venture has transitioned, and we have a new partner that has purchased 50% of the JV, following the SunPower bankruptcy. The JV continues to effectively service the legacy leases, and our corresponding asset-secured loans are performing as expected.

And with that, I will pass it to Marc to discuss the quarterly financials in greater detail.

Marc Pangburn, CFO

Thank you Jeff.

I'll start on Slide 7. Our pipeline remains at more than $5.5 billion and is well diversified, across our end markets. Listed on the right are three items I'd like to highlight.

Most notably, we anticipate onboarding approximately 10 new clients this year. These additions are across all three of our markets. I previously summarized our growth coming from three primary avenues: growing with existing clients, adding new clients and adding new asset classes. The investment this year into expanding our client base will continue to drive our future opportunities.

Next, as an example, the Grid-Connected investments in our pipeline have typically completed a two-plus-year development cycle, which requires a meaningful capital investment from our clients. Our entry point into these investments derisks both development delays and provides clarity on near-term pipeline, regardless of the political environment.

Finally, in the FTN market, we continue to see RNG as the primary driver of growth. We continue to build off our existing partnership with leaders like Ameresco, and broaden to other key players like Vision RNG, as we announced, a few weeks ago.

Our optimism is supported by the growing forecast for U.S. power demand, which we see positively impacting our pipeline and portfolio today.

Moving on to Slide 8, year-to-date we have closed $1.2 billion of transactions. As you can see in the table, these closings are well diversified among our underlying assets. Managed assets have grown to $13.1 billion and the portfolio has increased to $6.3 billion. For the year, we expect to exceed $2 billion in transaction closings, consistent with our expectations.

One other positive item I'd like to highlight, portfolio growth reflects our asset rotation initiative, where we have rotated out of more than $400 million of investments, which were on the balance sheet at a weighted average yield of less than 6.5%. We also rotated out of these investments at a gain. Replacing these lower-yielding investments with higher-yielding investments will drive a more profitable company into the future.

On Slide 9, given the size of our portfolio, it takes time for new investments to impact our overall portfolio yield, but you are starting to see that impact with the portfolio yield rising to 8.1% from 8% a quarter ago and 7.9% last year. In addition, while higher interest rates have increased our cost of debt relative to 2023, it's worth noting that it has declined incrementally from 5.7% in Q1 of '24. Meanwhile, ROE year-to-date has grown to 12.4%, with the rise supported by our gain-on-sale transaction.

Turning to Slide 10 to cover our financial results. For Q3, we are reporting adjusted EPS of $0.52 and a GAAP EPS loss of $0.17. Year-to-date '24 versus '23, we grew adjusted NII to $192 million, up 20%. Recurring capital light income to $19 million, up 43%. And upfront capital light income to $65 million, up 19%. Year-to-date, our adjusted EPS has increased 8% over the prior year period.

There are two items I'd like to explore further. First, the GAAP loss was driven by mark-to-market impacts related to power contracts for some of our underlying project investments. These power contracts provide revenue stability to the project. As power prices increase, the projects are worth more, but the power contracts are worth less. Over time, these projects will sell power at higher rates, offsetting the mark-to-market impact.

Second, gain-on-sale has been consistent when viewed in annual cycles, but will vary quarter-to-quarter, as seen in Q3. We remain on track to meet or exceed our prior commentary around being generally in line with ‘22 and ‘23 gain-on-sale.

Wrapping up my section on Slide 11, our balance sheet at the end of the quarter leaves us in an excellent position to achieve our near-term growth targets. At September 30, our liquidity was $1.3 billion and our debt-to-equity ratio remained at 1.8 times, comfortably in our 1.5 times to 2 times target range.

As you can see on the chart on the right, there have been no major changes to our laddered maturity profile with no significant near-term maturities, and the $200 million convertible note due next year can be paid off with our revolver. As a reminder, we expect our investment-grade status to enable us to refinance our ‘26 and ‘27 bonds with longer tenors. We have positioned the company well to capitalize on what is a traditionally a very busy quarter at year end.

With that, I’ll pass it back to Jeff for closing remarks.

Jeff Lipson, President and CEO

Thank you, Marc.

Turning to Slide 12, as always, we detail various sustainability and impact items, including a top-tier sustainability assessment from S&P, the greenest specialty finance designation by Newsweek, and our reaching a cumulative 8 million metric tons of annual carbon emissions avoided, annually.

And finally, wrapping up on Slide 13, the energy transition continues to be an extraordinary investment opportunity, providing an enormous addressable market and attractive returns. HASI remains uniquely positioned to benefit, given our experience, expertise and recent improvements in our access and cost of capital. I would like to thank our talented team for another outstanding quarter, as we look forward to closing out another successful year in 2024.

Operator, please open the line for questions.

Operator

Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press “*” and then “1” on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press "*" and then "2" if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset, before pressing the star keys. One moment please while we poll for questions.

The first question we have is from Jack Hurley of Mizuho Securities. Please go ahead.

Jack Hurley – Mizuho Securities

Hi. I just had a quick question regarding the technology partners. How big is RNG in the FTN market, relatively speaking, and can it support—if there's any declines in the solar and wind market? And then I have one follow-up, if I may.

Jeff Lipson, President and CEO

The RNG market is very large and growing. And I think there's been an acknowledgement that natural gas is going to be a big part of the energy future. So, the idea of converting, obviously, waste to gas and dairy products and landfill to renewable natural gas has become a very big business, and a lot of the large developers and even large private equity firms are making big investments in renewable natural gas.

So for a business like ours that prides itself on diversity, it can become a meaningful part of our business. I wouldn't necessarily compare it to wind and solar from a size perspective. We'll very likely continue to do wind, solar and RNG. But I think it's emerging as a very large market.

Jack Hurley – Mizuho Securities

Thanks. And can you remind us of the rate hedges and the impact of rising interest rates on your earnings power, relatively speaking? And then, if anything, you can provide regarding SunStrong for the new OEM partner. Any cost savings there possible, as you get a new partner on board?

Marc Pangburn, CFO

Sure, Jack. Thanks. This is Marc. We have implemented a few different styles of hedges on our liability portfolio, primarily either current swaps that are in place for some of our floating rate facilities, namely the TLA and the revolver. And then we also have forward starting swaps in place to hedge out the base rate for the refinancing of our future liabilities, primarily the '26 and the '27 swaps.

So in terms of earnings power, the hedges that are in place today on our floating rate facilities are generally in the money and supporting earnings. And then on the forward starting swaps, it's primarily focused around just ensuring we are maintaining a duration profile that fits more closely with the asset side by extending those '26 and '27 further in time.

On SunStrong, the partner that Jeff was referring to came in and bought the equity interest. In terms of servicing the lease portfolio, the JV will continue to do that on a go-forward basis and has largely transitioned away from SunPower.

Jack Hurley – Mizuho Securities

Got it. Thanks.

Operator

The next question we have is from Julien Dumoulin-Smith of Jefferies. Please go ahead.

Hannah Velasquez - Jefferies

Hey. This is Hannah on for Julien. Thank you for the question. So, when it comes to RNG as a part of the portfolio, how do you all think about limiting your exposure to some of the volatility associated with the RIN credits? As I understand, some of these RNG projects are used for transportation offtake.

Jeff Lipson, President and CEO

I think the primary way we insulate ourselves a bit from RIN risk is that in our RNG business, we are senior debt. So we've underwritten these transactions from a cash flow and coverage perspective. And it's not that we don't have any RIN risk, but I think by being senior debt with good cash flow coverage, we have somewhat mitigated the RIN risk.

Hannah Velasquez - Jefferies

Okay, got it. Thank you. And then just one last question, really quick. I was a bit late for the call, so I don't know if you all talked at all about the KKR partnership, if you announced any projects funded out of that JV or maybe how we would see that reflected in some of the statements. Thank you.

Jeff Lipson, President and CEO

Sure. We did touch on it very briefly to say that we have in the third quarter and early fourth quarter added additional investments to the vehicle, and that the vehicle is operating exactly as designed and the partnership is working quite well. As the vehicle gets larger, we'll have more disclosure. But for now, it remains relatively small, so there's not a lot of specific disclosures we're making just yet on the assets in the vehicle.

Hannah Velasquez - Jefferies

All right. Thank you.

Jeff Lipson, President and CEO

Thank you.

Operator

The next question we have is from Noah Kaye of Oppenheimer & Company. Please go ahead.

Noah Kaye - Oppenheimer

Hey. Thanks for taking the questions. Maybe housekeeping follow-up on that last one. I think in the press release, there is a line around the, I think it's $74 million held in co-investment vehicles. Is that the right number to be looking at in terms of the assets that are currently from a HASI perspective in that co-investment vehicle?

Jeff Lipson, President and CEO

That's the--yes, Noah, that's the KKR dollar amount. That's the KKR portion of the vehicle that's disclosed in that table. And when I said we'll have more disclosure, I just meant in terms of what—and that's the funded disclosure. There's a fair amount of commitments in CCH1 that have not been funded yet, so I'll make that clarification, as well. And when I said we'll have more disclosure, we might have a more descriptive rather than just a balance there, over time. That's what I meant in the previous question.

Noah Kaye - Oppenheimer

All right. Thank you. Just pointing out that gives us a starting point. So to reiterate $2 billion of originations for the year, given the year-to-date, just talk to us about the visibility to doing roughly $700 million, this quarter. Were you able to get a substantial portion of that done already? What's sort of the confidence level there?

Jeff Lipson, President and CEO

Sure. It was in the very early moments of my script. You may have missed it, but I did—

Noah Kaye - Oppenheimer

—yup, apologies.

Jeff Lipson, President and CEO

—say that we're at $1.7 billion, as of today. So we did have quite an active October and an early part of November. So I think we have very good visibility on closing out the rest of that amount to get to $2 billion.

Noah Kaye - Oppenheimer

Okay. Excellent. And then I guess the last one, I think the previous question touching on the refi, just to unpack it a little bit further, now that you have investment grade credit rating, we are seeing that showing up in the bonds here. But certainly as we see some of the movements around the yield curve and longer-term notes go a bit higher, how does that change your thinking at all about managing asset versus liability duration risk and the timing of when you might go to market around the refi?

Marc Pangburn, CFO

Sure. Thanks, Noah. It's Marc. The fact that the long end of the curve might be moving around doesn't necessarily change our approach to managing interest rate risk. What we—I think we've mentioned this a few times—but we generally focus on a duration approach where our asset cash flows generally fall in the 10-year zip code. And so, we like to focus on either issuing 10-year bonds or when we're in the high-yield market at shorter tenors, attaching these forward starting swaps to extend that duration.

So, our goal is to minimize the impacts of those curve movements on our business. And then on the front-end side of that, it's as Jeff already talked about, focusing on that T-plus investing approach or investing at T-plus on average, 5%.

In terms of timing for the market, that's less around movements on the rate curve and more focused on managing our liquidity. And of course, we have a sizable revolver, which gives us flexibility to go to market when the market is relatively attractive. So it's more of an opportunistic approach.

Noah Kaye - Oppenheimer

Right. Maybe just sneak one more in. I apologize because I think for some folks it's been a number of quarters since we actually saw a GAAP equity method loss. I think the last time was 4Q '22. So just for all of our benefits, the simple answer here is that the projects should be worth more because power prices have gone up, but the contracts don't reflect that yet.

They have to re-contract and so there'll be more revenue later on, but you have to mark it as a loss from an HLBV method, right? So essentially, the assets you're invested in are now more valuable. Is that a fair way to think about it?

Jeff Lipson, President and CEO

Yeah. The power contracts are essentially treated like hedges and are mark-to-market, whereas the actual underlying assets, projects are not. So, those assets will realize the benefit of higher power prices over time, whereas on the contracts that are mark-to-market and flow through in the period.

Marc Pangburn, CFO

Great. Appreciate the clarification. Thank you.

Marc Pangburn, CFO

Thank you.

Jeff Lipson, President and CEO

Thanks, Noah.

Operator

Ladies and gentlemen, just a final reminder, if you would like to ask a question, you're welcome to press "*", and then "1". We will pause for a moment to see if we have any further questions.

We have a question from Brian Lee of Goldman Sachs. Please go ahead.

Tyler Bisset – Goldman Sachs

Hey, guys. This is Tyler Bisset on for Brian. Thanks for taking our question. I have just one question on the pipeline. It looks like you had a strong shift towards Grid-Connected and a shift away from BTM. Anything to call out on driving that?

Jeff Lipson, President and CEO

Not really. The pipeline can get a little lumpy, particularly on the Grid-Connected side, as we typically look at some larger transactions there. So some quarter-to-quarter movements between BTM and Grid-Connected should not necessarily be interpreted as a long-term theme. I don't think there's really much of anything to read in there.

Tyler Bisset – Goldman Sachs

All right. Thank you.

Jeff Lipson, President and CEO

Thank you.

Operator

At this time, there are no further questions. And with that, this concludes today's conference. Thank you for joining us. You may now disconnect your lines.

###