sunrun

Q4 2022 Earnings Call
February 22, 2023
Prepared Remarks

PATRICK JOBIN

Thank you Maria. Before we begin, please note that certain remarks we will make on this 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 Mary Powell, Sunrun's CEO, Ed Fenster, Sunrun's co-founder and co-executive chair, and Danny Abajian, Sunrun's CFO.

And now let me turn the call over to Mary.

MARY POWELL

Thank you, Patrick.

I have really been looking forward to this call to share our strong fourth quarter and full year results with you, as well as to talk about our outlook and priorities for 2023.

We ended 2022 delivering and even modestly exceeding our guidance – growing new installations by over 25% and delivering greatly increased Net Subscriber Values. We exited 2022 with nearly 800,000 customers, 5.7 gigawatts of networked solar energy capacity and $5.6 billion in Net Earning Assets.

I am confident 2023 will build on this strong momentum as the strength of our subscription model provides market share gains. The year is off to a great start. We are seeing early-funnel sales growth in January of over 30% across our entire direct business and even faster growth in California. Part of this is expected acceleration ahead of the changes in California, but it is also indicative of the broader utility rate trends which continue to rise, and the growing consumer awareness of our offering. Our strong traction is also a result of our ability to attract the best sales talent in the industry that is eager to work with the nation's leading clean energy provider, especially one that is leading on storage and innovation.

Sunrun is the clear leader providing energy as a subscription service, with over 60% share of new subscriptions across the industry. Recent trends in financing costs for loans, the growing need for advanced systems with storage, awareness of the value of service and performance guarantees, along with the uncertain economic climate, have all contributed to the growing relative advantages of our subscription offering. We are already seeing a shift in our sales activities towards the subscription offering and expect it will flow through in a meaningful way in our installation activities in the coming quarters. The customer value proposition is swinging even further towards the subscription model, as the ITC and other potential adders are only available to homeowners in this model, making solar and storage even more accessible to more customers.

Sunrun is significantly advantaged as the leader in storage deployments. We have installed more than 53,000 residential solar and storage systems across the country, more than any other company. We have developed considerable skills and capabilities communicating the value proposition of storage systems with customers in addition to gaining experience in efficiently designing, permitting and installing these more advanced projects. We believe we are also leading in procuring storage hardware given our strong relationships with multiple suppliers and our large scale. While storage supply was a constraint to growth as recently as last year, supply conditions have improved considerably for us, and we are well positioned to dramatically increase the attachment rate of storage. Storage solutions are not only a significant competitive advantage for Sunrun and differentiator in the eyes of customers and salespeople in the industry, they are meaningfully accretive to our margins.

At Sunrun we are continuing to further differentiate our offering to customers and increase our competitive advantages. Just this month we announced a collaboration with PG&E to form a 30 megawatt virtual power plant this summer, helping to provide critical base load in a repeatable way, when it is needed most. This builds on the 17 megawatt virtual power plant we announced in Puerto Rico just a few months ago. With 14 advanced virtual power plant opportunities now forged across the country, we are leading the industry and showing utilities and regulators the possibilities of leveraging our network of distributed home solar and storage systems while generating recurring revenue streams and driving increased customer value.

In the fourth quarter we demonstrated continued progress on making Sunrun faster, better, and stronger in all dimensions of the fundamentals. You can see the results of this through our record-setting Net Subscriber Value of over $16,000, which, as Danny will discuss, helped us offset so many of the interest rate pressures we faced last year. We achieved this through hard work focused on the fundamentals of cost efficiency and performance improvements along with continued price optimization, while ensuring a strong customer value proposition, even as we invest in innovation and differentiation.

Throughout the year we worked on streamlining our operations, leading to improved customer experience throughout the process and better productivity. We grew new installations over 25% in 2022 while only growing headcount at one-third of that rate. This was achieved through a strong focus on streamlining operations, while delivering customers a great experience and value. The average hours spent on an installation by our crews improved 23% in Q4 compared to the prior year, driven in part by a reduction of the average crew size by 12% as we found ways to be more productive and efficient while maintaining our high safety and quality standards. We also maintained strong overhead cost discipline, with G&A expenses declining more than 12% compared to last year, and reaching $1,100 per new customer by Q4, a 29% improvement year over year, showing the benefits of our scale and disciplined approach to sustainable, profitable growth.

I am tremendously proud of what our team is doing in the field each and every day for our customers, and I know we will continue to drive even more efficiency while delighting our customers in 2023.

Shifting gears to policy updates. The biggest development since our last call is the finalization of the “NEM 3.0” proceeding in California, where regulators approved an updated Net Billing Tariff. The final language was dramatically improved from the initial draft, as the regulators dropped the proposed discriminatory fixed-fees on solar customers. The new proposal will introduce variable pricing with significant reductions of the value of energy exported back to the grid during the day, dramatically increasing the value proposition of storage. As I noted earlier, Sunrun is the leader in storage solutions and is well positioned for this transition to more solar plus storage installations.

In addition to our solar offering – and solar with storage offerings for home backup – we will launch a new offering in California that incorporates storage to optimize the economics of energy produced by the solar system, reducing low-value exports and increasing self-consumption for our customers’ benefit. This system will be easier and quicker to install. We believe this new offering delivers a strong value proposition for our customers and Net Subscriber Value for Sunrun.

In the interim, prior to the new structure becoming effective in mid-April, we are already working hard to help customers sign up under the current rate structure in California to lock in even greater savings potential. We are seeing record-breaking demand in California, with early-funnel sales activities in January growing more than 30% compared to last year. Lower sales activity is expected immediately following implementation of the new tariffs, but we also expect that the combination of the pull-forward of demand into Q1 and the anticipated strong customer response to our innovative offering, will result in strong growth over the long term in this market. Combined with the strong sales-driven backlog in California, and strong demand across the country, we expect to deliver smooth and sequentially growing installations throughout 2023.

On other policy matters, we are excited by the increased opportunities created by the Inflation Reduction Act. Investing to help disadvantaged low-income communities, providing economic benefits to areas with high unemployment or that have high exposure to fossil fuel-based economies and helping encourage domestic production of advanced clean technologies are all things that Sunrun is well positioned to do. As we have discussed before, the Inflation Reduction Act established three investment tax credit adders to accomplish these objectives.

We, along with so many across the industry, were disappointed to see that so many low and moderate income Americans, and those in multi-family dwellings, will now have to wait to benefit from the LMI adders. The initial Treasury guidance released last week appears in opposition to the administration's broad goal to encourage as much solar in low income communities as fast as possible. As many in the industry have already noted, the proposed drawn-out and long mechanism to allocate the available capacity likely delays many projects, delaying and potentially risking delivering benefits to low income communities. These are the communities that need the benefits of solar energy the most, and Sunrun is particularly well-positioned to help these communities gain access to affordable, clean and predictably-priced energy at a critical time when utility rates are escalating so quickly and household budgets are being squeezed. We will continue to work with others in the industry, and with policy makers, to make sure these communities benefit in the way the IRA legislation intended.

While we are awaiting guidance from the Treasury on the other two ITC adders – for energy communities and domestic content – we are proactively taking steps today to ensure we can act quickly once clarity is obtained. For example, we have already entered into agreements for nearly 200 megawatts of module supply from a leading domestic producer in addition to meaningful supply arrangements for storage solutions produced in the US which should, in our opinion, allow a significant portion of our volume to quality for the domestic content adder, but obviously we will have to wait until official guidance from Treasury is obtained.

Concluding Comments

In summary, Sunrun continued our focus of crushing it on the fundamentals and we have the right strategy and high-energy, focused, and experienced team in place to continue to successfully navigate these uncertain times. The value proposition for customers continues to increase as utility rates escalate rapidly, and consumers demand affordable, clean and predictably-priced energy. While 2022 brought its set of challenges and we will certainly have our share of things to overcome in 2023, I am proud of our team's quick actions last year to adapt to the rapidly changing macro environment around us. At Sunrun, we see adversity as a way to help shape ourselves and make us a stronger company for the long-run. We have more work to do, so we won't be sitting idle, and I am confident that our team is up to the challenge.

Before I hit one final item, I want to express my sincere appreciation for all the Sunrun employees working so hard to create a company that is faster, better and stronger for our customers and our communities. Building the best company and helping turbocharge this consumer-led revolution in energy is only possible with the talented and committed team who is ready to lead the charge every single day.

Leadership Structure Changes

Last, but certainly not least, I also want to update you on a management change we announced today. After over 15 years in a full-time leadership capacity, Ed Fenster, who has been on parental leave since August, decided the timing was right to transition to a role where he can spend more time with his young family.

While Ed will cease having direct reports at the company he will remain very active in strategic matters.

Ed won't be quite as visible day to day, but his trusted counsel will be omnipresent, and we certainly know that he won't hesitate digging deep on topics with our team as needed.

To state the obvious, Ed has played an invaluable role in making Sunrun the market leader, and he will continue to play an invaluable role going forward. You'll continue to hear from him and he'll continue providing his wisdom, insight and leadership throughout the company in so many ways.

Thank you so much Ed! And with that, over to you.

EDWARD FENSTER

Thank you, Mary.

I am so thankful for, and impressed by, the team leading Sunrun today. It's been a great honor to have had the privilege of working day in and day out alongside the many talented people who have helped Sunrun grow and flourish from a small company run out of my attic into the nation's leading provider of solar and storage.

While being on parental leave over the last several months, I concluded that I want to spend more time with my children during these important formative years before they are in school. I also plan to travel with them for a few months over this summer.

The Company and the leadership team are both in a fantastic position. I frankly don't believe my full-time day-to-day participation is any longer key to our success, and I remain as committed as ever to that success. I will continue to be involved in key decisions, participate in management and strategy meetings, and meet very extensively with our capital providers. I am not taking on other work; I just believe the time is right for me to focus my Sunrun time in the highest value areas and to recover the balance to spend time with my family.

Company leadership is in fantastic hands. Sunrun has deep bench strength and tremendous experience across all aspects of the business. Over the last few quarters, the Company has become more operationally efficient and enjoyed significant gains in net promoter score while increasing volumes and pricing. The operating results corroborated my intuition that it is appropriate to make this transition now.

I am grateful for all your support, and I look forward to remaining part of this great company as we move forward. Speaking of which, I'd like to turn the call over to Danny to share the financial update.

DANNY ABAJIAN

Thank you so much, Ed. Working with you so closely and receiving your mentorship has been a real privilege – I appreciate that your counsel to our team is always a call away.

Today I will cover our operating and financial performance in the quarter along with an update on our capital markets activities and outlook.

Turning first to the results for the quarter.

Volumes

In the fourth quarter, Customer Additions were approximately 37,400, including approximately 27,500 Subscriber Additions. Our Subscriber Additions were 72% of our total Customer Additions in the period, a small increase from last quarter. Our recent sales activities, and the benefits from the tax credit adders in the Inflation Reduction Act, which are only available to the solar subscription model, indicate the mix of Customer Additions is likely to shift toward Subscribers more significantly in the quarters ahead. Solar

Energy Capacity Installed was approximately 275 megawatts in the fourth quarter of 2022, a greater than 25% increase from the same quarter last year.

For the full year 2022, Solar Energy Capacity Installed was nearly 1 Gigawatt, at 991 Megawatts, a 25.2% increase from the prior year, modestly exceeding our guidance. Our installation teams and partners performed incredibly well in the fourth quarter, driving strong efficiency and productivity metrics while also remaining committed to safety and high quality installations.

The increased pace of installations is allowing us to gradually work down our pipeline, which is approximately one quarter at the end of Q4. We aim to manage sales and installation activities to maintain a pipeline that optimizes our resource planning and customer experience, although we do expect our pipeline to increase in the first half of the year.

We have now installed over 53,000 solar and storage systems. We expect storage installations will grow rapidly in the quarters ahead and attachment rates will increase meaningfully. Storage solutions not only provide customers increased value from energy rate optimization and backup power capabilities, but they carry higher margins, typically by several thousand dollars per customer. As Mary highlighted, our ability to satisfy demand for storage installations with superior operational fulfillment is a clear differentiator for Sunrun in the marketplace.

We ended Q4 with approximately 797,000 Customers and 667,000 Subscribers, representing 5.7 Gigawatts of Networked Solar Energy Capacity, an increase of 21% compared to the prior year. Our Subscribers generate significant, recurring revenue with most under 20- or 25-year contracts for the clean energy we provide. At the end of Q4, our Annual Recurring Revenue, or ARR, stood at over $1 billion with an average contract life remaining of over 17 years.

Subscriber Value, Creation Cost, Net Subscriber Value & Total Value Generated

During 2022, we successfully demonstrated our adaptability and financial resiliency in the face of persistently high inflation, a historic speed of interest rate increases, a dynamic supply chain and a large installation backlog. We implemented significant pricing increases throughout the year behind double digit utility price inflation, as utilities passed their own increases in labor, fuel, and capital costs through to their customers. Because the trajectory of utility price increases were similar to our price increases for new customers, we maintained an attractive value proposition and sustained high demand. We found and created ways to offset rising input costs with improved operational efficiency.

In Q4, Subscriber Value was approximately $46,300 and Creation Cost was approximately $29,800, delivering a Net Subscriber Value of $16,569, a healthy increase from $13,259 in the prior quarter.

Total Value Generated, which is the Net Subscriber Value multiplied by the number of Subscriber Additions in the period, was $456 million in the fourth quarter.

From Q4 2021 to Q4 2022, our Subscriber Value increased by over $9,000, or approximately 25%, while our Creation Cost remained approximately flat despite sharply higher equipment prices and general inflation. Our Net Subscriber Value more than doubled from approximately $7,000 year-over-year. As a reminder, starting in Q3, our Subscriber Value reflected the benefit of a 30% tax credit as opposed to 26%, provided by the passage of the Inflation Reduction Act in August.

Each quarter, we provide ranges for advance rate, measured as a percentage of contracted Subscriber Value, that reflect current capital costs. We finance our systems upon installation with tax equity and project-level non-recourse debt, which monetizes a portion of our Subscriber Value. Our advance rate ranges allow investors to approximate proceeds from all sources, net of fees, and gauge the obtainable net cash unit margins on deployments. From Q4 2021 to Q4 2022, our advance rates fell substantially from a range of 95 to 100 percent to 75 to 85 percent. However, because we also increased our contracted Subscriber Value by over $8,200 over the same period, our estimated proceeds per customer increased by $700, using the midpoints of these two ranges.

Given today's higher cost of capital environment, commencing with 2023 reporting, we anticipate increasing our discount rate assumption from 5%, which we used in our reporting throughout 2022, to 6%. As you can see on slide 12, adjusting the discount rate higher by 1% would lower the total Subscriber Value, and thus Net Subscriber Value, by approximately $3,600 in Q4. Because proceeds per customer are already based on market rates, our advance rate in Q4 as a percentage of contracted Subscriber Value would increase to approximately 80 to 90 percent.

Gross and Net Earning Assets, Cash Balance

Turning now to Gross and Net Earning Assets and our balance sheet.

Gross Earning Assets were $12.4 billion at the end of the fourth quarter. Gross Earning Assets is the measure of cash flows we expect to receive from customers over time, net of operating and maintenance costs, distributions to tax equity partners in partnership flip structures, and distributions to project equity financing partners, discounted at a 5% unlevered capital cost.

Net Earnings Assets were nearly $5.6 billion at the end of the fourth quarter, an increase of $487 million or 10% from the prior quarter. Net Earning Assets is Gross Earning Assets, plus cash, less all debt.

We also anticipate adjusting the discount rate used to calculate Gross Earning Assets from 5% to 6% to be consistent with the changes in how Subscriber Value is calculated. On slide 11 we provide Gross Earning Assets and Net Earning Assets pro-forma using a 6% discount rate.

We ended the quarter with $953 million in total cash.

Capital Runway

We continue to maintain a robust project finance runway. As of today, closed transactions and executed term sheets provide us with expected tax equity capacity to fund over 400 megawatts of projects for Subscribers beyond what was deployed through the fourth quarter. Sunrun also had $837 million in unused commitments available in its $1.8 billion non-recourse senior revolving warehouse loan at the end of the quarter to fund over 320 megawatts of projects for Subscribers. This strong capital runway allows us to be selective in timing our capital markets activity.

Outlook

Turning now to our outlook.

We expect growth in Solar Energy Capacity Installed to be between 10 and 15 percent for the full year 2023, which we believe will result in market share gains. We currently see more upside opportunity than downside risk in achieving growth in this range, but feel it is best to err on the cautionary side early on in the year. Even with the tremendous sales activities we are currently seeing, our conservative stance is influenced by the mid-April transition to the new Net Billing Tariff in California, extended cycle times with higher storage mix, timing uncertainty with the implementation of ITC adders, and our ongoing pricing adjustments and go-to-market optimization efforts.

We expect our storage attachment rate will increase significantly in 2023 from approximately 15% in 2022.

The strong sales growth we are seeing, coupled with the increasing mix of storage, is likely to extend cycle times and increase working capital needs, but we will remain focused on prudently managing our backlog and working capital, without forgoing the tremendous opportunity to extend Sunrun's lead in 2023.

In Q1, we expect Solar Energy Capacity Installed to be in a range of 215 and 225 megawatts. The first quarter is typically seasonally lower than the fourth quarter, as you can see from nearly all of our historic results over the years, due to lower selling activities exiting the prior year and more weather-related installation limitations and shorter days entering the new year.

We expect Net Subscriber Value to be approximately $10,000 in Q1 using a 6% discount rate, and to increase sequentially throughout 2023. For comparability, using a 5% discount rate, Net Subscriber Value would be over $13,000 in Q1.

Our focus is on delivering profitable growth, efficient operations and strong unit margins, while navigating a fluctuating interest rate environment. Our discipline has served us well for the last 15 years, and we believe will serve the company, and our stakeholders, well in the current economic paradigm.

__Capital Markets__

Turning briefly to our capital markets activities and outlook.

As we've shared before, we regularly enter into interest rate swaps to hedge capital costs on our newly installed customers. We are principally exposed to interest rate fluctuations between customer origination through shortly after installation. Around the time of installation, our systems are financed with project-level non-recourse debt. Nearly all of this financing is insulated from near-term interest rate fluctuations, as our debt is either fixed-coupon, long-dated debt securities or floating-rate debt that has been hedged with interest rate swaps.

At the end of 2022, Sunrun executed an $835 million term out financing, consisting of a $600 million non-recourse syndicated bank facility and a $235 million subordinated debt facility, supporting a 335 megawatt portfolio of systems. The team executed this transaction particularly well, delivering senior loan pricing at an initial credit spread 100 basis points below recent solar loan securitization transactions observed in the sector at that time, and a cumulative advance rate exceeding the high end of our guidance range of 85%. Because the advance rate on this portfolio benefited from previously placed in-the-money interest rate hedges, we expect the advance rate in our next term-out transaction, which does not carry such benefit, to be slightly lower.

Cost of capital has trended favorably over the last few months as credit markets have improved. We continue to observe our capital costs in the mid-six to mid-seven percent area. Consistent with this cost of capital range, we expect advance rates on our newly deployed portfolios to still be between 75 and 85 percent of contracted Subscriber Value calculated using a 5% discount rate, or 80 and 90 percent against contracted Subscriber Value calculated using the new 6% discount rate.

The longstanding relationships we have cultivated with many capital providers in multiple markets, our reputation as a high-quality sponsor, and the consistently strong payment performance trends of our customers through multiple economic cycles, affords us ready access to capital and allows us to be selective with our transactions. Our next term-out transaction will likely be in the securitization market, as opposed to the bank market, due to much-improved conditions in that market to start the new year.

With that, let me turn it back to Mary.

__MARY POWELL__

Thanks, Danny.

I am so appreciative of our hard-working team whose adaptability and commitment to our purpose helped deliver an amazing year of transformation for Sunrun in 2022. I am confident that our momentum will continue into 2023 as we focus on the fundamentals to make us faster, better and stronger for the benefit of our beloved customers, our amazing employees, the hundreds of communities we operate in across the country and our financial partners.

With that, Operator, let's open the line for questions.

*****

sunrun

Forward Looking Statements

This communication contains forward-looking statements related to Sunrun (the “Company”) within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995. Such forward-looking statements include, but are not limited to, statements related to: the Company’s financial and operating guidance and expectations; the Company’s business plan, trajectory, and expectations, market leadership, competitive advantages, operational and financial results and metrics (and the assumptions related to the calculation of such metrics); the Company’s momentum in its business strategies including its ESG efforts, expectations regarding market share, total addressable market, customer value proposition, market penetration, financing activities, financing capacity, product mix, and ability to manage cash flow and liquidity; the growth of the solar industry; the Company’s ability to derive value from the anticipated benefits of partnerships, new technologies, and pilot programs; anticipated demand, market acceptance, and market adoption of the Company’s offerings, including new products, services, and technologies; expectations regarding the growth of home electrification, electric vehicles, virtual power plants, and distributed energy resources; the Company’s ability to manage suppliers, inventory, and workforce; supply chains and regulatory impacts affecting supply chains; the Company’s leadership team and talent development; the legislative and regulatory environment of the solar industry and the potential impacts of proposed, amended, and newly adopted legislation and regulation on the solar industry and our business; the ongoing expectations regarding the Company’s storage and energy services businesses and anticipated emissions reductions due to utilization of the Company’s solar systems; anticipated, or potential impacts of the COVID-19 pandemic and its variants; and factors outside of the Company’s control such as macroeconomic trends, public health emergencies, natural disasters, acts of war, terrorism, geopolitical conflict, or armed conflict / invasion, and the impacts of climate change. These statements are not guarantees of future performance; they reflect the Company’s current views with respect to future events and are based on assumptions and estimates and are subject to known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from expectations or results projected or implied by forward-looking statements. The risks and uncertainties that could cause the Company’s results to differ materially from those expressed or implied by such forward-looking statements include: the Company’s continued ability to manage costs and compete effectively; the availability of additional financing on acceptable terms; worldwide economic conditions, including slow or negative growth rates and inflation; volatile or rising interest rates; changes in policies and regulations, including net metering and interconnection limits, or caps and licensing restrictions and the impact of these changes on the solar industry and our business; the Company’s ability to attract and retain the Company’s business partners; supply chain risks and associated costs; the impact of COVID-19 and its variants on the Company’s operations; realizing the anticipated benefits of past or future investments, partnerships, strategic transactions, or acquisitions, and integrating those acquisitions; the Company’s leadership team and ability to attract and retain key employees; changes in the retail prices of traditional utility generated electricity; the availability of rebates, tax credits and other incentives; the availability of solar panels, batteries, and other components and raw materials; the Company’s business plan and the Company’s ability to effectively manage the Company’s growth and labor constraints; the Company’s ability to meet the covenants in the Company’s investment funds and debt facilities; factors impacting the home electrification and solar industry generally, and such other risks and uncertainties identified in the reports that we file with the U.S. Securities and Exchange Commission from time to time. All forward-looking statements used herein are based on information available to us as of the date hereof, and we assume no obligation to update publicly these forward-looking statements for any reason, except as required by law.