sunrun

Q2 2023 Earnings Call

August 2, 2023

Prepared Remarks

PATRICK JOBIN

Thank you operator.

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 and Danny Abajian, Sunrun's CFO. Paul Dickson, Sunrun's Chief Revenue Officer, is also on the call for our Q&A session.

A presentation is available on Sunrun's investor relations website, along with supplemental materials. An audio replay of today's call, along with a copy of today's prepared remarks and transcript including Q&A will be posted to Sunrun's investor relations website shortly after the call.

And now let me turn the call over to Mary.

MARY POWELL

Thank you, Patrick.

Sunrun's team delivered a strong quarter. Our disciplined margin-focused growth strategy continues to position the company well for long-term success and generating cash.

Quarter Performance Summary

This quarter we beat – by a large margin – our volume guidance for Solar Energy Capacity Installed, but more importantly, we are rapidly accelerating storage adoption, growing our lead as America's clean energy company, one that delivers a superior value proposition to customers, and creates multiple value streams for our shareholders. We installed more than 100 megawatt hours of storage capacity in Q2, growing 35% compared to the prior year, and we now have more than 900 megawatt-hours of storage capacity installed across the country. We are accelerating our pace. Our storage offerings provide customers enhanced value and generate significantly higher margins for Sunrun today, while providing a foundation for considerable monetization in the years to come. Our strong attachment rate was nearly 18% of our installations across the country in the second quarter, and we expect this percentage to continue to increase rapidly.

In the second quarter, we grew our customer base to nearly 870,000 customers which represents 6.2 gigawatts of installed solar capacity. We added approximately 40,000 customers this quarter, 7,000 with storage, with an improving Net Subscriber Value of over $12,000, resulting in Total Value Generated of nearly $400 million. Our rapidly accelerating storage attachment rate presents a powerful opportunity to grow our clean energy generation business by providing at-scale power plant capabilities across America. This quarter, we again set the all-time industry record for installed solar energy capacity. This scale, combined with a rapidly increasing storage attachment rate, presents a powerful utility-scale generation solution.

We grew Net Earning Assets by over $400 million and increased our total cash position by $78 million compared to the first quarter.

These strong financial and operating results are possible because of our experienced, committed team who is executing on our disciplined, margin-focused growth strategy.

Update on California

Ok, turning to the topic I know is on everyone's minds — California.

The most important news is that we are smashing our expectations for increasing the adoption of higher-margin storage offerings in California, and nationally.

In California, we have increased our battery-attachment rate, of both backup batteries and our Shift product, to over 80%. All of our battery products store solar energy when it's generated and dispatch it when it's most valuable. Over a third of our newly-sold battery systems also perform home backup, a doubling since the start of the year. The remaining two thirds of new battery customers represent our "Shift" product in California, which offers a strong value proposition for our savings-focused customers. Let me be perfectly clear, both storage products, Battery Backup and Shift, provide superior value to Sunrun than Solar-only customers did prior to the California policy transition.

Nationally, we are seeing storage attachment rates for new sales in excess of 30%. Our leading position in providing a backup storage offering to customers generates superior and expanding margins and market share gain opportunity. As this higher mix of storage sales flows through to installations over the next two quarters, we expect strong increases in Net Subscriber Values and Total Value Generated that will offset impacts from lower near-term California volume.

Training sales representatives to sell under the new policy construct has taken time. We are seeing significant increases in sales recently as sales representatives become proficient explaining the new product opportunities, and selling a bundle with up to 80% higher customer value than before. Because of this learning process, and because we are rapidly increasing our mix of storage which takes longer to permit and install, Q3 is a transition period. We are still growing at a strong pace. Q3 installations will still be up year over year, with a more profitable mix, and our outlook for the second-half is growing 9% year over year in volume, with even higher growth in value generated.

I am confident we will look back at this moment as another proof point of how we strengthen our market position by remaining customer-focused, disciplined and methodical when the broader market is faced with a challenge.

With California's market massively underpenetrated, we expect sales will accelerate further as our teams continue to optimize how they sell our offerings in the new environment and demand continues to build following the dramatic pull-forward we saw early in the year leading up to the transition. Despite slower than anticipated sales in May, sales in June and July ramped at strong month-over-month rates in our direct business. We are down about a third compared to last year in July, with our direct business performing significantly better, and are seeing strong week over week improvements exiting the month. As consumers adjust to the new regulatory environment, and understand the value proposition that we are able to offer, I am confident this trend will continue, and we are on track for strong year-over-year growth in California.

While California gets lots of attention, it's important to note the benefits of running a diversified business which operates in many markets. Sales activities outside of California have been robust, growing by 25% in Q2 compared to the prior year, and this growth rate has been maintained through June and July. The bottom line is demand remains robust outside of California, California is improving, and we are offsetting the near-term volume dip in California with a mix of much-higher margin offerings. Our growth and value creation story is on track.

Driving Innovation, Expanding Differentiation

Shifting to an update on our other strategic priorities.

Our goal is to meet customers where they are on their clean energy independence journey and provide solutions to improve their lives. Our strategy is to integrate the best and most differentiated offerings available, and as appropriate, either develop these offerings alongside our partners or build the capabilities to fulfill them directly in-house.

Sunrun's leading work to aggregate residential batteries and form valuable, distributed power plants continues to advance. Our exclusive partnership with PG&E, called Peak Power Rewards, is the largest residential distributed power plant of its kind in the United States. Over the last quarter we grew that program further by adding 1,000 customers – we now have 8,500 customers participating with up to 34 megawatts available for dispatch. Starting yesterday, our participating fleet of home batteries has been supporting the grid by dispatching during critical peak times. The value of enrolling in the program, both for our customers, and for Sunrun, is compelling – both on a per customer basis and as a meaningful source of additional recurring revenue. As part of their enrollment in this program, customers receive $750, which is entirely 'found money, an additional and meaningful value above their initial expectations when subscribing with Sunrun. Together with our customers and PG&E, we are proving the value of our rapidly growing fleet of dispatchable energy assets.

As previously announced, we secured an exclusive contract with Puerto Rico's utility company, PREPA, to deliver 17 megawatts of baseload, daily-cycling power. Separately, working through the policy and regulatory process over the last five years, we have helped develop a rapid emergency response program that will be the first of its kind in the U.S., providing localized power when blackouts are impending. Sunrun stands ready to provide our distributed power plant services from thousands of customer rooftops as soon as the program is finalized in the coming months.

These programs are so important – expanding the value proposition for customers and providing incremental, recurring revenue streams to Sunrun, which are largely not reflected in our metrics today. Our growing experience with grid services increases our conviction that we can realize $2,000 or more in per customer NPV from these assets, and the need for these programs will only increase as the grid ages and climatic events further strain its capabilities.

Of our nearly 870,000 customers, 65,000 have batteries today, representing 7% of our fleet. We expect to launch storage offerings for the remaining 93% of our customers in 2024 with a retrofit offering, while simultaneously increasing our attachment rate of batteries for new customers. We also plan to launch a storage-only offering to meet the demand from customers looking for resiliency but whose home might not be ideal for solar. Many look at Sunrun as a solar company, but we are now in a unique position to build a massive, nimble, controllable energy generation company that can also provide energy storage, advanced energy control technologies, smart panels from SPAN, EV charging and enable “mobile back-up storage” from electric vehicles, such as our partnership with Ford. Our dedicated, experienced sales teams provide a strategic advantage for Sunrun to lead in commercializing these opportunities.

Lunar Energy, the venture we invested in alongside SK Group, unveiled details of their first product in June. We are so excited to work with Lunar as a key partner to accelerate home electrification. We expect Lunar’s initial storage offering to be available in the coming quarters and their advanced grid services platform is a key differentiator for us as we build massive distributed energy plants across America.

SnapNrack, the independent solar racking technology company we own, also continues to innovate with leading solutions, including fast direct-to-deck mounting options for rooftop solar systems - called TopSpeed. SnapNrack’s products are sold broadly to the industry and leveraged by our teams as they dramatically increase installation efficiency.

Operating Efficiently & Leading with Financial Strength

We are focused on maximizing value for our shareholders by delivering strong margins which will support meaningful cash generation. Margins are expected to expand significantly in the coming quarters from pricing, product mix, and go-to-market decisions, a continued focus on operating efficiency, and tailwinds from ITC adders, hardware cost improvements, and a general easing of inflationary pressures.

We continue to make meaningful advances in our operational efficiency metrics, growing installation volumes while maintaining or reducing staffing levels throughout the organization. While there are numerous initiatives underway, a few noteworthy ones include our national roll out of our shift to job site delivery of equipment which enables job site reporting for our installation crews. We are seeing strong improvements in labor efficiency, employee satisfaction, and safety metrics from this process change.

We also recently made a meaningful investment in Artificial Intelligence. It’s too early to quantify potential benefits, but we believe it presents a unique opportunity to drive increased cost efficiency, reduced cycle times and improved customer experience.

As an example of our efforts to prioritize margins and balance growth, we recently optimized our strategy to encourage stronger uptake of storage across the country. We also reduced our direct operations footprint in Arizona, shifting to an Affiliate Partner-led go-to-market approach.

We are committed to driving meaningful cash generation in this business. We are targeting annual run-rate recurring cash generation of $200 to $500 million or higher in future quarters as further margin improvements are realized. Danny will expand upon this in his section.

At Sunrun, we are focused on managing both margins and volumes to maximize cash generation, as the ultimate and most clear value we can create for our shareholders. Importantly, we underwrite our new originations with a hurdle rate in excess of current capital costs. Sunrun has operated through a variety of cycles over its 16-year history, and has proven, time and again, to be the prudent operator that can drive sustainable, value-generating growth.

Celebrate our people

Last, but certainly not least, I want to celebrate our teams across the country, in the field and offices, who are helping accelerate this customer-led revolution in energy, and practicing our strong culture of doing it safely and efficiently. I am so thankful for the contributions from each and every Sunrunner who is helping drive this transformation.

This quarter, I would like to recognize outstanding performance from our Las Vegas branch which is our top-ranking team in the country, as measured by our safety, productivity, *and* customer satisfaction metrics. I also want to recognize our entire team for driving a world class Net Promoter Score of 68 at the time of install, comparable to the top brands in the country. I also want to thank our California sales teams who have continued to outperform our peers, drive a higher-margin mix, while providing a great customer experience. Crushing it on all of these operating fundamentals of our business is critical to driving long term value. We are proud of your contributions and your leadership at Sunrun!

With that, let me turn the call over to Danny for our financial update.

DANNY ABAJIAN

Thank you, Mary.

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 on slide 10.

Volumes

In the second quarter, Customer Additions were approximately 39,800, including approximately 32,400 Subscriber Additions. Our Subscription mix represented 83% of our deployments in the period, a meaningful increase from 78% last quarter and the highest level in two years. Our recent sales activities, and the forthcoming 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 continue to shift more toward Subscribers in the quarters ahead. Solar Energy Capacity Installed was approximately 297 megawatts in the second quarter of 2023, a greater than 20% increase from the same quarter last year, and significantly exceeding our guidance of 270 to 290 megawatts. Our installation teams executed well in the quarter and our Affiliate Partner channel outperformed significantly in Q2, as the strength of our subscription model captured increased share among dealers in the industry.

We have now installed over 65,000 solar and storage systems. We expect storage installations will grow rapidly in the quarters ahead and attachment rates will increase meaningfully as our recent sales are well in excess of 30% nationally, for reasons Mary mentioned earlier on the call. Our backup battery offerings carry higher margins, typically by several thousand dollars per customer. We also expect our Shift offering to achieve margins that are higher than prior solar-only margins received in California under NEM2.

We ended Q2 with approximately 869,000 Customers and 725,000 Subscribers, representing 6.2 Gigawatts of Networked Solar Energy Capacity, an increase of 21% year-over-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 Q2, our Annual Recurring Revenue, or ARR, stood at over $1.1 billion, up over 25% over the same period last year. We had an average contract life remaining of nearly 18 years.

<u>Subscriber Value, Creation Cost, Net Subscriber Value & Total Value Generated</u>

Turning to slide 12.

In Q2, Subscriber Value was approximately $44,700 and Creation Cost was approximately $32,400, delivering a Net Subscriber Value of $12,321, in-line with our guidance of a sequential increase to the $12,000 figure in Q1. Our Q2 Subscriber Value and Net Subscriber Value both continue to assume a 30% Investment Tax Credit and thus exclude any margin upside associated with the tax credit adders.

Although the ITC adder for Energy Communities will apply retroactively to January 1, 2023, we again did not reflect this value in our Net Subscriber Value for Q2 as we work through the implementation with our systems and complete all necessary steps with our capital providers, but expect to begin doing so in Q3. We currently estimate the Energy Community adder will apply to approximately 15% of new installations, even without adjusting our current geographic footprint.

We are seeing easing supply chain conditions and substantial unit cost reductions across our key hardware components, which should start to flow through our reported costs over the next few quarters as we work through our higher-cost inventory. On a like-for-like basis for a 7.5 kilowatt solar with backup battery system, hardware costs are expected to decline by nearly 15%, or nearly $2,000 per system, over the next few quarters. These beneficial trends may be obscured by an increasing mix of storage, which carries higher net margins, but will increase hardware and install costs and therefore impact Creation Costs.

Total Value Generated, which is the Net Subscriber Value multiplied by the number of Subscriber Additions in the period, was $399 million in the second quarter. This represents an almost doubling compared to the prior year, even without adjusting for the less favorable discount rate used this year.

Our present value-based metrics are presented using a 6% discount rate, which we last updated from 5% to 6% last quarter. As a reminder, we generally prefer not to update the discount rate frequently to enable ease of comparison across periods. Instead, we provide advance rate ranges that reflect current interest rates, enabling investors to calculate the obtainable net cash unit margins on our deployments. In addition to providing this heuristic, this quarter, for direct clarity we have added a pro-forma Net Subscriber Value using the capital cost observed for the quarter. In Q2, our average capital cost was approximately 7.25% which, on a pro-forma basis, results in Net Subscriber Value of $8,104 and thus Total Value Generated of $262 million, which is up 31% compared to Q2 of last year, which was presented using a 5% discount rate.

As Mary mentioned, our financial underwriting already takes into account a cost of capital well in excess of 6%.

Gross and Net Earning Assets, Cash Balance

Turning now to Gross and Net Earning Assets and our balance sheet on slide 13.

Gross Earning Assets were $12.6 billion at the end of the second quarter. Gross Earning Assets is the measure of cash flows we expect to receive from Subscribers over time, net of operating and maintenance costs, distributions to tax equity partners in partnership flip structures, and distributions to project equity financing partners, all discounted at a 6% unlevered capital cost.

Net Earnings Assets were over $4.4 billion at the end of the second quarter. Net Earning Assets is Gross Earning Assets, plus cash, less all debt. Net Earning Assets increased by over $400 million this quarter, driven by strong Net Subscriber Values and more favorable working capital dynamics compared to the prior period, as we reduced inventory. Value creation upside from future grid service opportunities, and selling additional high value electrification products and services to our long-term customer base, are not reflected in these metrics.

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 securities, or floating-rate loans that have been hedged with interest rate swaps. As such, we do not adjust the discount rate used in Net Earning Assets to match current capital costs for new installations.

We ended the quarter with $921 million in total cash, an increase of $78 million compared to the prior quarter.

Capital Markets & Capital Runway

Turning briefly to our capital markets activities and outlook on slide 16.

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 330 megawatts of projects for Subscribers beyond what was deployed through the second quarter. Following transactions after the quarter closed, Sunrun has $400 million in unused commitments available in its $1.8 billion non-recourse senior revolving warehouse loan, to fund approximately 150 megawatts of projects for Subscribers. This strong capital runway allows us to be selective in timing our capital markets activity.

Given the increased scale of our business, we plan to upsize and extend our non-recourse warehouse loan in the coming few quarters, as we have done several times before. We are also actively evaluating various options to expand routes to efficiently monetize tax credits, including the substantial amount of tax credit adders we expect, by leveraging the new tax credit transferability provisions from the Inflation Reduction Act.

We currently see project-level capital costs at approximately 7.25%, which is a weighted average of our non-recourse senior and subordinated debt. Our cost of capital indications are informed by both realized terms on our transactions as well as observable market data, such as longer-term Treasury yields as a proxy for our base rate and credit spreads across numerous transactions completed by us and our peers.

The deep relationships we have cultivated with many capital providers in multiple markets, our recognition as a high-quality sponsor, and the strong performance trends of our customers, affords us access to attractively-priced capital. Demonstrating this access, last week we closed a portfolio term-out involving a private senior securitization and a subordinated loan. Together with these financings, year-to-date, we have closed almost $2 billion in project-level capital commitments.

Outlook

Turning now to our outlook on slide 17.

We continue to guide 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. Last quarter we noted we might be around the high end of this range, but we now feel comfortable reiterating this range, as we plan for a persistently higher interest rate environment, our decision to exit certain lower margin markets, increased install cycle times from growth in storage attachment rates, and a slower than expected recovery in California. We continue to believe the market is very underpenetrated and can sustain long-term growth rates of 15%. In this strong long-term demand backdrop, our priority is to generate cash by continuing to increase customer values through growing storage adoption, among higher value products and services, and growing our scale and efficiency further.

In Q3, we expect Solar Energy Capacity Installed to be in a range of 255 and 275 megawatts. This decrease from the second quarter's level reflects the decline in California order volumes in Q2, which will impact installs in Q3. Our success in achieving substantially higher storage attachment rates on our sales nationally also results in longer install cycle times, which creates near-term lags to the rate of installation completions as storage attach rates migrate upward.

We expect Net Subscriber Values to be materially higher in the second half of the year compared to the first half, driven in large part by the much higher Net Subscriber Values from backup battery systems factoring into our mix, particularly in Q4 when we expect to see the strongest Net Subscriber Value of the year. We anticipate including the Energy Community ITC adders starting in Q3, while we expect the Domestic Content and Low Income adders are most likely to benefit us starting in 2024, although their benefit could materialize sooner. Offsetting these gains will be less favorable fixed cost absorption in Q3 resulting from lower volume, and potential near-term headwinds in our equipment distribution business.

Recent interest rate increases, inflationary pressures, and working capital needs have prevented us from generating meaningful cash generation. We responded to headwinds decisively with higher pricing and operating efficiency improvements. Since the start of 2022, the increases in cost of capital reduced realizable proceeds by greater than $1 billion, and we faced higher input costs and a dynamic supply chain environment which resulted in a higher inventory balance. Given our actions, we are now targeting annual run-rate recurring cash generation of $200 to $500 million or higher in future quarters as further margin improvements are realized.

As we have described in the past, because we finance our growth using tax equity and non-recourse project debt, we measure cash generation as the change in our cash balance, excluding any changes to our parent-level debt, equity, and equity-like financings, as we highlight on slide 15. Because project finance timing can be lumpy, cash generation can also be lumpy quarter to quarter. We expect to provide more details on cash generation, including more specific guidance on timing, in the coming quarters, but want to be clear that this is the financial outcome we plan to deliver.

With that, let me turn it back to Mary.

MARY POWELL

Thanks, Danny.

I am so appreciative of our hard-working team whose incredible passion for the work we do and commitment to our purpose helped deliver another strong quarter of results. Our team is laser focused on accelerating the strong momentum, embracing this massive shift, and extending our lead as America’s clean energy company, driving continued efficiencies across the business, and generating more value for our shareholders, our partners, and our customers.

Operator, let’s open the line for questions.

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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, 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; trends or potential trends within the solar industry, our business, customer base, and market; 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; and factors outside of the Company’s control such as macroeconomic trends, bank failures, 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, interconnection limits, and fixed fees, 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; 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.