SUNRUN

Q1 2024 Earnings Call
May 8, 2024
Prepared Remarks

OPERATOR INSTRUCTIONS

Good afternoon and welcome to Sunrun's first quarter 2024 earnings conference call. All participants have been placed on mute. Please note that this call is being recorded and that one hour has been allocated for the call, including the Q&A session. To join the Q&A session after prepared remarks, please press star 1 at any time. We ask participants to limit themselves to one question and one follow-up question. I will now turn the call over to Patrick Jobin, Sunrun's Senior Vice President, Investor Relations. Please go ahead.

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.

During today's call, we will also be discussing certain non-GAAP financial measures, which we believe can provide meaningful supplemental information for investors regarding the performance of our business and facilitate a meaningful evaluation of current period performance on a comparable basis with prior periods. These non-GAAP financial measures should be considered as a supplement to, and not as a substitute for, superior to, or in isolation from GAAP results. You will find additional disclosures regarding the non-GAAP financial measures discussed on today's call in our press release issued this afternoon and our filings with the SEC, each of which is posted on our website.

On the call today are Mary Powell, Sunrun's CEO and Danny Abajian, Sunrun's CFO. Ed Fenster, Sunrun's co-founder and co-executive chair, along with Paul Dickson, Sunrun's President and Chief Revenue Officer are also on the call for the 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. We have allocated 60 minutes for today's call, including the question and answer session.

And now let me turn the call over to Mary.

MARY POWELL

Thank you, Patrick.

And thank you all for joining us today.

We are starting the year with solid momentum in the business as our storage-first, margin-focused strategy is delivering strong results.

In the first quarter we beat the high-end of both our storage and solar installation guidance, set new records for storage attachment rates, and delivered another quarter of strong net subscriber values.

Our installation productivity and success driving a storage-first strategy is delivering strong results. At the same time, sales activities in Q1 did grow slightly slower than initially expected, coming in at 13%

sequential growth in our direct business. While less than initially anticipated, this level is still consistent with our historical seasonal norm. We continue to prioritize margins over volumes, and we believe this approach will result in the highest long-term value for our shareholders.

We are reiterating our full-year storage capacity installation guidance and we are reducing our full-year solar installation capacity outlook to down 15% to flat, from our prior guidance range of down 5% to up 5%. We expect 2024 will be a strong year in terms of Total Value Generated, which will grow by over 10%. Most important, we are reiterating our Cash Generation guidance of a Q4 annualized level of $200 to $500 million.

We are confident in achieving strong growth in installation activities through the year, as the fundamental demand drivers of our business continue to be robust. Utility rates continue to rise, while solar and storage equipment costs are declining, and our operating efficiency continues to improve. Customers remain eager for clean, affordable and resilient energy to power their lives.

Storage-first Strategy & Accelerating Innovation

In the beginning of 2023, we oriented the business to be storage-first, which increases the customer value proposition and lays the foundation for future value creation from grid services. This strategy has also allowed us to capitalize on regulatory changes better than others in the industry.

In Q1, we installed storage on 50% of our new customers, up from a 15% attachment rate in the prior year. We installed 207 megawatt hours of storage in Q1, almost triple the year-ago quarter.

Storage systems provide increased customer value through enhanced resiliency and control, while providing higher margins for Sunrun. Our fleet of Networked Storage Capacity has reached 1.5 Gigawatt hours with 102,000 systems installed. Based on industry data, we represent about half of new storage installations in the United States and are gaining. In 2023 we were under 20% share of residential storage deployments across the US and by Q4 we were approximately 45%. Our fleet is growing in significance, and is already at a scale that could replace multiple polluting peaker power plants. For instance these resources could power a city like San Francisco for multiple hours, and do so daily as batteries are recharged from the sun.

While still in the early stages of commercializing these resources, we just announced two new record-setting grid service programs.

For the second year in a row, Sunrun will set a national record for the largest number of residential solar-plus-battery systems enrolled in a virtual power plant. Last year we did about a 30-megawatt program with PG&E. This year we are launching a statewide Demand Side Grid Support program that is about twice the size with more than 16,000 Sunrun customers.

We also have now enrolled nearly 1,800 customers in our Puerto Rico virtual power plant. Our resources have been dispatched nearly a dozen times – helping to prevent rolling blackouts and keeping the power on for all Puerto Ricans – not just our customers.

The fact that we are running these two successful programs shows that VPPs can rapidly scale all across the country. Last month, a Brattle Group study concluded that virtual power plants could save California consumers $550 million per year.

We also continue to innovate with AI, enhanced customer experiences, new products, adding batteries to existing systems, EV charging, and of course early renewal opportunities. The team is busy innovating to extend Sunrun's differentiation in the market even as we dial up our focus on efficiency and cash generation.

Driving Operational Efficiency

We are making clean, affordable and reliable energy accessible to families across America with the most pro-consumer offerings, and delivering the best customer experience and service in the industry. Being the chosen, trusted provider to deliver this clean energy future is critical. As a testament to our approach, our customer Net Promoter Scores at the time of installation continue to increase, exceeding 75 points this quarter.

We are driving this great customer experience and investing in innovation while *also* dramatically increasing operating efficiencies.

Our crew labor productivity has improved by 5% compared to the prior year, even as we more than tripled our mix of more complex battery jobs. Our efficiency gains installing systems with batteries are particularly impressive, improving 30% year-over-year.

Overall headcount in our installation organization is down 5 percentage points more than the change in volumes.

In addition, general and administrative costs have declined slightly year-over-year and continue to be a fraction of that of peers, even as we accelerate the pace of innovation, highlighting the tremendous scale advantages we derive and sizable barriers to entry in the space.

We are also driving increased efficiency and improved quality through the organization from leveraging artificial intelligence. We have already started using AI to improve the speed and accuracy of system design, pipeline management, and material handling. We are increasingly encouraged by how AI can improve our operating efficiency and customer experience even further.

Growth in AI and the voracious energy consumption that comes with it will drive even greater need for Sunrun's fleet of solar and battery systems. The International Energy Agency forecasts power demand from datacenters in the US will increase 60 terawatt hours by 2026 to account for nearly 6% of total US electricity demand. Electric grids will need to procure more power to meet this need, especially at peak times, and distributed flexible renewable resources will be one of the solutions. Much of this growth is also coming from companies who are eager to use clean energy to meet their environmental objectives.

Celebrate our people

Before handing over to Danny, I want to take a moment to celebrate some of our people who truly embrace the power of solar energy to make a real difference in our world. Thank you to our leading teams in Houston, Texas! Our top ranked installation crew, led by Jonathan, and direct to home sales team in the quarter based on safety, quality, battery attachment rates and customer experience were in Texas this quarter. Thank you all for your contributions and 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 9.

Volumes

We have now installed over 102,000 solar and storage systems, with storage attachment rates reaching 50% of installations nationally during the first quarter of 2024. We expect storage attachment rates to remain around this level throughout the remainder of the year. This higher mix of storage has driven improvements to our Net Subscriber Value as backup storage offerings carry higher margins.

During the quarter, we installed 207 megawatt hours of storage capacity, well above the high-end of our guidance and almost triple the same quarter last year. Our total networked storage capacity is now over 1.5 gigawatt hours.

In the first quarter, Solar Energy Capacity Installed was approximately 177 megawatts, also above the high-end of our guidance range of 165 to 175 megawatts. Customer Additions were approximately 24,000, including approximately 22,000 Subscriber Additions. Our Subscription mix reached 93% of deployments in the period, an increase from 92% last quarter and the highest level in many years.

We ended Q1 with approximately 957,000 Customers and 803,000 Subscribers, representing 6.9 Gigawatts of Networked Solar Energy Capacity, a 16% increase 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 Q1, our Annual Recurring Revenue, or ARR, stood at over $1.4 billion, up 30% over the same period last year. We had an average contract life remaining of nearly 18 years.

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

Turning to slide 10.

In Q1, Subscriber Value was approximately $50,800 and Creation Cost was approximately $38,900, delivering a Net Subscriber Value of $11,891. This strong result was from increased efficiency and a beat on volumes.

Our Q1 Subscriber Value and Net Subscriber Value now reflect a blended Investment Tax Credit of over 35%, benefiting from expanded eligibility for the energy communities ITC adder and the portion of our deployed systems eligible for the low-income adder.

Total Value Generated, which is the Net Subscriber Value multiplied by the number of Subscriber Additions in the period, was $262 million in the first quarter.

Our present value-based metrics are presented using a 6% discount rate, but our financial underwriting already accounts for our current cost of capital, which was in the 7.6% area in Q1. As a reminder, to enable ease of comparison across periods, we generally do not update the discount rate frequently. 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, we provide a pro forma Net Subscriber Value using the capital cost observed for the quarter.

At a 7.6% discount rate, Net Subscriber Value was $6,593 and Total Value Generated was $145 million.

We expect additional tailwinds to Net Subscriber Value in future periods from the following variety of factors: more favorable business mix, increased realization of ITC adders, and lower costs from hardware price reductions, labor efficiency and operating leverage from strong sequential volume growth.

On slide 11, we detail the tailwinds from ITC adders and hardware costs.

In Q1, we recognized a weighted average ITC of approximately 35%, the equivalent of approximately half of our systems qualifying for the energy communities or low-income adder. During the quarter, the government expanded the qualification criteria for the energy communities adder. Approximately 35% of our current installations now qualify, compared to 13% before the expansion. While the energy community adder expansion was favorable, our expectation for the portion of our systems that qualify for the low-income adder going forward has been lowered from 26% to 18%, given the current inefficiencies in the program design and implementation.

While we continue to receive proceeds from the energy communities adders, proceeds from the awarded low-income adders are delayed given the slow government process.

Proceeds from domestic content adders are expected to be realized in the coming quarters. Guidance on what will qualify for the domestic content adder has been issued, but we are still awaiting further clarity from additional rulemaking processes some time this year.

Combined, these three adders could represent up to $450 million or more in additional annual run-rate cash proceeds.

We continue to see decreasing prices for key hardware components, which are gradually flowing through our reported costs as we finish consuming our higher-cost inventory. On a like-for-like basis for a 7.5 kilowatt solar with backup battery system, by the end of this year, hardware costs are expected to decline by over 18%, or nearly $2,500 per system, from their peak in the second quarter of 2023. 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 increase Creation Costs. Additionally, we are monitoring recent developments with certain US manufacturers petitioning for new tariffs. Modules, however, represent less than 10% of our total Creation Costs and the history of various trade disputes has demonstrated the impact has been manageable as the global supply chain is dynamic over time.

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 $15.0 billion at the end of the first 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 $5.2 billion at the end of the first quarter, up approximately $200 million from the prior quarter. Net Earning Assets is Gross Earning Assets, plus cash, less all debt. Net Earning Assets does not include inventory, or other construction in progress assets or net derivative assets related to our interest rate swaps, all of which represent additional value. The value creation upside we expect from future grid service opportunities and selling additional electrification products and services to our customer base, including our storage retrofit offering, are not reflected in these metrics.

We programmatically enter into interest rate hedges to insulate our capital costs from adverse near-term fluctuations. The vast majority of 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.

Cash Generation

We ended the quarter with $783 million in total cash, a decrease of $205 million compared to the prior quarter.

Q1, which is typically the weakest quarter for Cash Generation due to volume seasonality, was further impacted by one-time costs from financing activities we completed in the quarter, as we discussed on last quarter's call, as well as delayed timing of incentive monetization. Cash Generation was negative $311 million in Q1, which included approximately $317 million of one-time costs and timing-related items, as we have outlined on slide 14. Excluding these items, adjusted Cash Generation was positive $6 million in the quarter.

The financing activities we opted to pursue in Q1 resulted in $107 million of one-time cash impacts. These included fees paid for the 2030 convertible debt issuance and purchase of the capped calls to mitigate dilution, fees paid on the extension of our recourse working capital facility, and fees paid on the extension of our non-recourse warehouse facility and an associated reduction to the facility's advance rate.

In Q1, we made a significant transition from traditional tax equity, where all cash is typically provided at or just before installation, to tax credit transfer, where funds for tax credits often come quarterly in arrears. This transition was primarily responsible for a reduction in Q1 tax equity proceeds of approximately $181 million.

We are working to close new funding that will resolve the working capital headwind, all of which we expect to close before the end of the quarter. With these closings, we will fully recover the working capital investment that we made in Q1.

In Q1 we deployed systems that are expected to contribute $30 million in Cash Generation from the low-income ITC adder. While many systems have met all conditions, monetization remains delayed given the timing of government processes. Later this quarter, we are expecting to monetize the receipt of delayed ITC adders through a combination of additional tax equity funding and debt proceeds.

Capital Markets & Capital Runway

Turning to our capital market activities.

As we discussed last call, we were very active in Q1 arranging capital to support our growth and further optimizing our balance sheet by extending maturities. It is prudent to extend facilities early to navigate potential and unexpected macroeconomic conditions and volatility.

In February, we successfully extended and upsized our non-recourse revolving senior warehouse facility to support our scale. This facility funds assets temporarily before we raise long-term financing, principally in the asset-backed securitization market. We increased the size by $550 million, from $1.8 billion to $2.35 billion, and extended the maturity by approximately 3 years from April 2025 to February 2028. The effective credit spread increase of 50 basis points was commensurate with recent movement in the securitization market for term out transactions with similar advance rates. The facility continues to have a diversified set of nine relationship lenders. We also achieved certain other improved terms that afford more flexibility to fund our anticipated future product and geographic mix.

Our team also continues to execute tax equity transactions, including structures that facilitate ITC transfers to a deepening pool of large buyers. As we discussed on the last few calls, the traditional tax equity market has been tighter recently, which we believe is resolving now that tax equity investors have adapted their approaches to structuring deals in this new environment. In addition, we continue to build an active pipeline to sell tax credits to corporate buyers for ITCs that are generated when systems are placed into service.

As of today, closed transactions and executed term sheets provide us with expected tax equity capacity to fund over 331 megawatts of projects for Subscribers beyond what was deployed through the first quarter. We expect to expand this runway during Q2.

Sunrun also had $593 million in unused commitments available in its non-recourse senior revolving warehouse loan at the end of the quarter. This unused amount would fund approximately 214 megawatts of projects for Subscribers. Our strong debt capital runway allows us to be selective in timing transactions.

Since the start of the year we have closed two ABS transactions. Sunrun's industry-leading performance as an originator and servicer of residential solar assets continues to provide deep access to attractively priced capital.

In February, we closed an ABS transaction with a private credit investor and arranged subordinated debt financing on the portfolio. The $361 million non-recourse senior debt was rated A- by Kroll and was priced with a 232.5 basis points spread. This demonstrated yet another improvement in capital costs, with spreads declining from our last securitization in September that was priced with a 240 basis points spread. We placed a $109 million subordinated loan on the portfolio as well. The all-in full-stack weighted average cost of capital on this portfolio was approximately 7.5% and resulted in a cumulative advance rate, as measured against our contracted Subscriber Value metric, of over 80%. The use of private credit investors shows the strong interest in our assets from a growing and broad set of investors.

In April, we closed a $230 million securitization to refinance existing debt on a portfolio of seasoned assets. The non-recourse senior debt was rated A by Kroll and was priced at a credit spread of 195 basis points, a 37.5 basis point improvement from our private securitization in February and 45 basis points lower than our securitization in September 2023. The latest execution represents the lowest spread achieved for similarly rated transactions across the sector since 2021.

The portfolio is jointly owned by National Grid and Sunrun following their project equity investment in 2017, with National Grid receiving the majority of cash flows through 2042, including the significant net cash proceeds from this refinancing. Importantly, however, this transaction highlights our continued deep access to capital, at improving terms, and demonstrates the favorable market for refinancing seasoned assets we have originated and serviced. This bodes well for the significantly sized portfolios of seasoned assets that we will refinance in the coming years.

Moving to the parent capital side. During Q1 we took actions to extend maturities and optimize our parent balance sheet.

In February, we closed an extension of our recourse working capital facility. We reduced the size from $600 million to $447.5 million, with an option to upsize the facility to $477.5 million prior to September 30, 2024. We amended the facility to extend the maturity from January 2025 to November 2025. We also included a feature that will further extend the maturity to March 2027 – should we meet the requirements for this provision, which include addressing the maturity of the convertible notes due in February 2026.

Also in February, we issued $483 million in convertible notes due in 2030. Since the issuance of the 2030 convertible notes, we have repurchased another $82 million of our 2026 convertible notes. To date, we have now spent $175 million to repurchase over $205 million of these notes. Less than half of the 2026 notes now remain outstanding. We will continue to be disciplined and selective with repurchases, given alternative high-yielding capital uses.

Our intent is to maintain a strong and healthy balance sheet. The recourse financings and bond repurchase activity in Q1, including all related fees, increased our cash by $102 million and increased our debt by $125 million. With continued repurchases of the 2026 convertible notes, or retirement at par at maturity, we expect net recourse debt to be little changed. We have also prudently extended maturities while mitigating dilution with the capped call.

When we think about our balance sheet, we prioritize a strong cash position and use of asset-level non-recourse debt financing. This strategy provides the lowest cost capital to finance cash-flow producing assets backed by high-credit consumers, and to use parent recourse debt that is appropriately sized and balances maturity dates, cash interest costs and flexibility.

<u>Outlook</u>

Turning now to our outlook on slide 17.

The underpenetrated nature of our market gives us confidence we can sustain robust growth throughout this decade. In this strong long-term demand backdrop, our priority is to generate cash by continuing to increase customer values through growing storage adoption and other higher value products and services, and by reducing costs by driving further efficiencies across the business.

While sales activities in Q1 were slightly less than we previously anticipated, we are seeing strong demand signals and expect a material pickup to occur in Q2, leading to an inflection point with meaningfully higher installations in the second half.

Storage Capacity Installed is expected to be in a range of 215 to 225 megawatt hours in Q2. This represents 105 to 115% growth year-over-year. For the full-year, we are reiterating our guidance for Storage Capacity Installed to be in a range of 800 megawatt hours to one gigawatt hour, reflecting 40% to 75% growth year-over-year.

Solar Energy Capacity Installed is expected to be in a range between 190 and 200 megawatts in Q2. At the midpoint, this represents 10% growth from Q1. Because of the pull-in of demand in California in early 2023, year-over-year comparisons are less relevant in Q2. We are confident that Q1 volumes will mark the low point in the year and we expect robust sequential growth into the rest of the year.

For the full-year, we expect Solar Energy Capacity Installed year-over-year growth to be in the range of down 15% at the low-end to flat at the high-end. This updated range reflects recent sales activities and outlook. We believe this guidance still represents market share gains underpinned by the strength of our subscription offering and our disciplined go-to-market approach.

Our growth in the value we create with this volume will be much larger. We continue to forecast Subscriber Values will increase by greater than 10% in 2024 as we increase our mix of higher-value offerings, and input costs decline, resulting in growth of Total Value Generated of greater than 10% in 2024.

Turning to slide 18.

We remain committed to driving meaningful cash generation as we execute our margin-focused and disciplined-growth strategy.

We are reiterating our Cash Generation outlook. We are guiding Cash Generation to be positive on a quarterly basis for the remainder of the year, with Cash Generation in Q4 at an annualized run-rate of $200 to $500 million. This run-rate will be expanded upon on an annual basis into 2025. We have outlined our current set of assumptions underpinning this outlook on the bottom of slide 18. The most notable variable is the realization of the domestic content adder: the low-end of the guidance range assumes no domestic content adders while the high-end assumes these adders are obtained. We currently expect a large portion of our storage systems to qualify for the domestic content adder.

With that, let me turn it back to Mary.

MARY POWELL

Thanks, Danny. I want to again express my appreciation to the entire Sunrun team. Your continued commitment to providing our customers and communities with clean, affordable energy to power their lives and to create value for all of our stakeholders is what drives us forward.

Our rapid transition to a storage-first company is extending our differentiation, driving enhanced margins, and delivering the best value to customers.

Operator, let’s open the line for questions.

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Forward Looking Statements

regarding the Company's storage and energy services businesses and anticipated emissions reductions due to utilization of the Company's solar energy 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.