Q2 2024 Earnings Call
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Transcript

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Presenters

Patrick Jobin, SVP, Deputy CFO & Investor Relations Officer
Mary Powell, Chief Executive Officer
Danny Abajian, Chief Financial Officer
Paul Dickson, President & Chief Revenue Officer
Edward Fenster, Co-founder and Co-Executive Chair

Q&A Participants

Brian Lee – Goldman Sachs
Julien Dumoulin Smith – Jefferies
Moses Sutton – BNP Paribas
Joseph Osha – Guggenheim Partners
Andrew Percoco – Morgan Stanley
Kashy Harrison – Piper Sandler
James West – Evercore ISI
Robert Freeman – Roth Capital Partners
Maheep Mandloi – Mizuho
Dylan Nassano – Wolfe Research
Colin Rusch – Oppenheimer

Operator

Good afternoon and welcome to Sunrun's second 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 Investor Relations Officer. 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.

Sunrun's strategy to become the beloved, trusted provider of clean energy and storage for households across America is delivering strong results.

In the second quarter the Sunrun team set records for storage installation and attachment rates, beating the high-end of our installation guidance, while delivering solid quarter-over-quarter solar installation and net subscriber value growth. We also delivered strong Cash Generation of $217 million in Q2, recouping the tax credit transfer-related working capital investment noted in Q1.

Our primary focus is accelerating our differentiation, launching additional products and services to expand customer lifetime values, and remaining the disciplined, margin- and customer-focused leader, growing Cash Generation in the business, for years to come.

We are on track to achieve our Cash Generation objectives as we exit 2024, and are increasing Cash Generation guidance for 2025.

We are also on track to exceed the high-end of our full-year storage installation guidance this year, as our focus on storage products pays dividends faster than we even expected. Driven by our margin-focused strategy, and slightly lower sales pacing than we initially expected, we now expect our solar volumes for 2024 to be at the lower-end of our guidance range. Nevertheless, we are seeing strong sequential growth in order activity as consumer interest continues to build over this hot summer with soaring electricity rates. We continue to focus on the most margin-accretive customers. The hot summer and high utility bills are driving consumers to focus on their home energy use and related costs. Our strategy is to focus on products and geographies where Sunrun shareholders can earn a strong return while Sunrun customers experience an excellent value proposition.

Driven by these dynamics, we are increasing our storage capacity installation guidance from approximately 58% to approximately 86% growth in the year, and are narrowing our solar installation guidance to reflect the low end of our prior range, down approximately 15% for the year. We expect to see solid high-teens sequential growth in solar installations into Q3 and Q4, and to resume double-digit year-over-year growth in Q4.

We are reiterating our Cash Generation guidance of $50 million to $125 million in Q4. In addition, we are initiating even higher Cash Generation guidance for 2025 of $350 million to $600 million.

The fundamental drivers of our business continue to accelerate. Utility rates continue to rise, while solar and storage equipment costs are declining. Our operating efficiency and customer experience continues to improve. Customers remain eager to take control of their energy needs with affordable and resilient solutions to power their lives, the ultimate in independence. A Pew study issued in June affirmed what polls have said for years: the majority of Americans – Republicans, Democrats and Independents – favor expanding solar power in the United States.

Storage-first Strategy & Accelerating Innovation

Over a year ago 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 faster and better than others in the industry.

In Q2, we installed storage on 54% of our new customers, up from an 18% attachment rate in the prior year, and a four point increase from levels achieved in Q1. We installed 265 megawatt hours of storage in Q2, up 152% from a year ago, and the most we have installed in any quarter. Sunrun's experience selling, installing and monetizing storage for the grid is a clear differentiator.

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 1.8 Gigawatt hours with 116,000 systems installed.

While still in the early stages of commercializing these valuable, dispatchable energy resources, we continue to advance programs which prove their value potential. We now have more than a dozen operating virtual power plants across the country.

Just this afternoon we announced a program with Tesla in Texas. The program has already enrolled customers and will scale up while dispatching stored solar energy from at-home batteries to rapidly increase capacity on the grid during periods of high consumption. Customers will be compensated for their participation while retaining a portion of their stored energy to provide back-up power to their homes in the event of a power outage. Sunrun will also earn incremental recurring revenue for the program.

These same resources are providing tremendous value for our customers. During prolonged power outages in the aftermath of Hurricane Beryl, more than 1,600 Sunrun customers in the greater Houston area were able to keep their homes energized with more than 70,000 hours of backup energy provided by their solar and storage systems. With over 3 million homes and businesses without power, we are seeing strong demand in Texas as many are seeing the obvious value our service can provide.

Just last week, we announced the operation of the nation's first vehicle-to-home power plant using a small group of customer-owned bi-directional electric vehicles. Initiated by forward-thinking regulation, and in partnership with Maryland's largest utility, Baltimore Gas and Electric, this program utilizes all-electric Ford F-150 Lightning trucks to deliver power this summer during peak demand times.

These programs build on many others we are operating, including the Demand Side Grid Support program initiated by regulators. This virtual power plant is being actively used to support California's power grid. Just last month during a heat wave, over 16,000 Sunrun customers' solar-plus-storage systems dispatched power during peak hours, supplying the grid with an average of 48 megawatts each night exceeding the capacity of several costly and polluting gas-fired peaker plants in California. Home solar and battery systems are modernizing and strengthening the electric grid. With forward-thinking regulation these resources could lower the cost of the overall grid for all users. As a reminder, California has 14,000 megawatts of power plants that are used less than 5% of the time.

Lifetime Value Opportunities

We are quickly becoming a multi-product company that offers a suite of clean energy products to our customers in a bundled, easy-to-finance way. By continuing to invest heavily in service and providing a leading customer experience, we are able to monetize opportunities to provide additional services to our large base of customers for decades into the future. We are proud of our customer-first approach, evidenced by a continued increase in customer Net Promoter Scores at the time of installation, which this quarter reached 76 points, up over five points in the past year.

We have invested time and resources to develop products and learn from pilots to best inform our strategy to harness these opportunities. On slide 7 we highlight our focus – including renewals, repowering customers with new equipment that meet increased energy needs, installing batteries for existing solar-only customers to provide energy resilience, networking systems to form virtual power plants, and providing electric vehicle charging, or even bi-directional, solutions. We are seeing strong traction – for instance, we have over 1,000 orders by existing customers to add batteries. While we just recently launched this, orders are growing at a rapid rate.

Market Opportunities

I want to spend a minute discussing developments with a public peer who recently announced their market exit and restructuring. This presents an opportunity for Sunrun to continue our industry leadership and gain share in a financially disciplined and measured way.

We are engaged in conversations with many of their former dealers and are selectively onboarding partners that share our vision and commitment to provide the best customer experience.

We have been an established leader in the new homes business for many years, and are engaging with many large national homebuilders about joining the Sunrun platform. In July we announced the addition of two strong leaders and industry veterans, who most recently led the new homes business at SunPower. We expect strategic growth in the new homes segment in the coming quarters, driven by our leading platform, expanded leadership team, and long track record of being a reliable, trusted partner for homebuilders.

This dislocation will provide opportunities for competitors as well, especially new entrants in the financing segment eager for volume. We continue to see irrational pricing and immature controls from some of the entrants, but have also seen some indications that as they have gained more experience, they are adjusting pricing and controls accordingly. We continue to hear from our partners that they value Sunrun most for being a sustainable, reliable partner, and that has led to strong, long-term relationships. We deeply value these partners and our shared vision of success, particularly some of our longest-standing and largest partners.

Celebrate our people

Before handing over to Danny, as always, I want to take a moment to celebrate some of our people who truly embrace the power of clean energy and the desire to connect customers to the cleanest energy on earth. Thank you to our leading direct-to-home sales team in Los Angeles, thanks so much to our team members Adler, Rich, and Jon, for delivering on safety, quality, battery attachment rates and customer experience, delivering some incredible results this quarter.

I also want to celebrate the team at SnapNrack, our independently-run business which is proudly manufacturing premium solar racking in the United States, creating jobs and helping improve the efficiency of Sunrun's installation activities and those across the industry. The team is busy innovating and ramping production of US-made equipment to help the entire industry, including Sunrun, meet domestic content standards. Thanks so much, Troy, Charles, Aroon and team.

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 11.

Volumes

We have now installed over 116,000 solar and storage systems, with storage attachment rates reaching 54% of installations nationally during the quarter. We expect storage attachment rates to remain at or above this level throughout the remainder of the year. This higher mix of storage continues to drive Net Subscriber Values higher as backup storage offerings carry higher margins.

During the quarter, we installed 265 megawatt hours of storage capacity, well above the high-end of our guidance and an increase of 152% compared to the same quarter last year. Our total networked storage capacity is now approximately 1.8 gigawatt-hours.

In the second quarter, Solar Energy Capacity Installed was approximately 192 megawatts, within our guidance range of 190 to 200 megawatts.

Customer Additions were approximately 26,700, including approximately 25,000 Subscriber Additions. Our Subscription mix reached 95% of deployments in the period, an increase from 93% last quarter and again the highest level in many years.

We ended Q2 with 984,000 Customers and approximately 828,000 Subscribers representing 7.1 Gigawatts of Networked Solar Energy Capacity, a 14% 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 Q2, our Annual Recurring Revenue, or ARR, stood at almost $1.5 billion, up 27% 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 12.

In Q2, Subscriber Value was approximately $49,600 and Creation Cost was approximately $37,200, delivering a Net Subscriber Value of $12,394. This strong result was from higher battery attachment rates, efficiency and sequential growth in volumes. Although Subscriber Value decreased slightly in Q2 due to a smaller average system size relative to Q1, we expect this trend to reverse in Q3 and Q4 with higher average system sizes. If measured on a per-watt basis to normalize for system size, Subscriber Value per watt increased slightly from Q1.

Our Q2 Subscriber Value and Net Subscriber Value reflect a blended Investment Tax Credit of approximately 35%, again reflecting the portion of our deployed systems qualifying for the energy communities and low-income ITC adders.

Total Value Generated, which is the Net Subscriber Value multiplied by the number of Subscriber Additions in the period, was $310 million in the second 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 approximately 7.5% in Q2. 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 7.5% discount rate, Net Subscriber Value was $7,075 and Total Value Generated was $177 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, lower hardware prices, labor efficiency and operating leverage from strong sequential volume growth.

On slide 13, we detail the tailwinds from ITC adders.

In Q2, 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.

Proceeds from domestic content adders are expected to be realized in the coming quarters, including a retroactive monetization of a portion of 2023 and year-to-date 2024 installations. We were encouraged to see the updated guidance in May, which should allow for a strong majority of our installations to qualify for this adder within a few quarters, and increase our weighted average ITC level to around 45% in 2025.

Gross and Net Earning Assets

Turning now to Gross and Net Earning Assets and our balance sheet on slide 15.

Gross Earning Assets were $15.7 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, and distributions to project equity financing partners, all discounted at a 6% unlevered capital cost.

Net Earnings Assets were $5.7 billion at the end of the second quarter, up approximately $430 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 products and services to our customer base 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 Balance and Cash Generation

We ended the quarter with over $1 billion in total cash, an increase of $259 million compared to the prior quarter.

Cash Generation was $217 million in Q2, which included the recovery of timing-related items, most notably the $181 million reduction in Q1 proceeds as a result of the transition from traditional tax equity to tax credit transfers.

Capital Markets & Capital Runway

Turning to our capital markets 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. To navigate potential and unexpected economic conditions and volatility, we have been prudent to extend facilities early and proactively.

As of today, closed transactions and executed term sheets provide us with expected tax equity capacity to fund over 313 megawatts of projects for Subscribers beyond what was deployed through the second quarter.

We also have over $1 billion in unused commitments available in our non-recourse senior revolving warehouse loan. This unused amount would fund approximately 373 megawatts of projects for Subscribers. Our strong debt capital runway allows us to be selective in timing term-out transactions.

Since the start of the year we have closed three 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 June, we closed an $886 million ABS transaction, representing the largest ever securitization for Sunrun and the residential solar industry. We also arranged a subordinated financing on the portfolio. The Class A non-recourse senior debt, comprising both publicly- and privately-placed tranches, was rated A+ by Kroll. The Class A notes had a higher rating than precedent ABS transactions with comparable advance rates, evidencing the higher quality of our portfolios. The spread of 205 basis points on the public tranche represented a 35-basis point improvement from our previous comparable ABS transaction in September 2023. The advance rates on the portfolio were 73% for the Class A notes, and 83% cumulatively when including the additional subordinated financing.

As previously noted, in February we issued $483 million in convertible notes due in 2030 and concurrently commenced repurchases of our 2026 notes. To date, we have repurchased over $266 million, or two-thirds, of our 2026 convertible notes. This amount includes repurchases of $50 million in July. We will continue to be disciplined and selective with repurchases.

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 highly creditworthy 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 18.

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 our costs.

Storage Capacity Installed is expected to be in a range of 275 to 300 megawatt-hours in Q3. This represents approximately 64% growth year-over-year at the midpoint. For the full-year, we are increasing our storage guidance to a range of 1,030 to 1,100 Megawatt-hours, representing 86% growth at the midpoint, an increase from our prior guidance range of 800 to 1,000 Megawatt-hours.

Solar Energy Capacity Installed is expected to be in a range between 220 and 230 megawatts in Q3. At the midpoint, this represents 17% growth from Q2.

For the full-year, we expect Solar Energy Capacity Installed to decline approximately 15%, in-line with the low-end of our prior guidance range. We believe this guidance still represents market share gains underpinned by the strength of our subscription offering and our disciplined go-to-market approach. We also expect year-over-year growth to be positive starting in Q4.

Given our focus on increasing Net Subscriber Values through product mix, additional ITC adders, and cost efficiencies, we expect our Net Subscriber Values will be materially higher in the second half of the year relative to Q2 levels.

Because we have been increasing unit economics, Total Value Generated growth will be at least 15 percentage points higher than solar installation growth.

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 for Q4. We expect Cash Generation to be positive in Q3, $50 to $125 million in Q4, and now $350 to $600 million in 2025. On slide 19, we have outlined

sensitivities related to key variables that would affect our achievement. We now expect a large portion of our solar-only systems, in addition to our storage systems, to qualify for the domestic content adder starting later this year and into 2025. We will provide more concrete expectations for amounts and timing of initial receipt of domestic content adders during the coming quarters. Our 2025 Cash Generation guidance reflects an approximately 45% average ITC.

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.

Operator

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

So that we may address as many questions from as many participants as possible, we ask that you limit yourself to one question and one follow-up. If you have additional questions, you may re-queue, and, time permitting, these questions will be addressed.

Our first question comes from the line of Brian Lee with Goldman Sachs. Please proceed with your question.

Thank you. Our first question comes from the line of Brian Lee with Goldman Sachs. Please proceed with your question.

Brian Lee

Hey, everyone. Good afternoon. Thanks for taking the questions and kudos on the solid cash generation here. I guess first question on that front, just given it's such a focus for you now and for the overall market as well. How are you thinking about capital allocation priorities, especially into 2025, as you think about now the significantly higher and absolute levels of cash gen you're talking about?

And then just given the wide range, what are some of the biggest win factors for the '25 outlook for cash gen? Is it rates? Is it mix, etc.? And just what's sort of in your control versus what's not in your control, if we're trying to kind of handicap your potential to reach the higher end of some of those cash generation targets? And then I have a follow up.

Danny Abajian

Hey, Brian. It's Danny. I'll take the second part of the question first, and I'll just generally refer to slide 19 of the presentation, where we do kind of zero in on the three primary factors if we're trying to think through sensitivities. They are the ITC realization rate, the cost of capital, and the battery attachment (inaudible). Those are the principal three we've highlighted in the past as well. And we've, per point or quarter point of change in each of those, we've indicated the degree of sensitivity. So I'd refer you there for those big three.

There are a bunch of other items noted around, mostly timing, I would say, in the bucket of not entirely within our control always, at all times. So that could have some intra quarter variability around incentive monetization, capital markets timing. Just as a general reminder, we do about three to four term-out transactions a year, so the timing for those will matter. And generally, other working capital. I mentioned incentives, rebates, the ITC monetization, the timing of cash received by transaction. I would put those all in the timing buckets, in addition to the three primary factors.

On the capital allocation question, we'll continue to evaluate the best options and remain disciplined around that. I'd say apparent (ph) deleveraging to better position the balance sheet, will become a focus that will drive higher available liquidity, clean up the balance sheet, which we think will drive shareholder value meaningfully if we do that, and then the remainder, the balance will be put to best use with best use being determined at the time. Buybacks and other uses would be a consideration, of course, some of which would be board level decisions considering the best use of the time.

Brian Lee

OK. That's awesome. Great color. Maybe one for Mary since you brought it up in your prepared remarks. Just obviously real time development around some of your peers not doing very well in the marketplace, potential for share gain for you. Given the better cash flow prospects, you talked about gaining some share. How would you factor in adding incremental growth and spending money on that as a priority for capital allocation in '25, just on the solar side? Obviously, you're doing very well on the storage side already, but given you're also talking about being back to double digit year-on-year solar growth exiting this year, seems like you might have a tailwind into '25. What are sort of the spending priorities/needs you might be looking at there? Thank you.

Mary Powell

Yeah, Brian, good to chat with you. Yeah. So just to reiterate, again, we're going to continue our disciplined, margin focused approach and strategy. So yes, certainly what is happening is providing some opportunity for us, some market opportunity. As I said in my remarks, I mean, we were really thrilled to have, really two industry veterans and leaders join our new homes team. And we are talking to some of, really the most significant builders in the market. And so we're progressing those kinds of conversations and looking at ways we can continue to grow in our margin focused way, measured way that delivers what we're after, right, which is volume and margin and cash generation.

So that's, like, you're not going to see any change. That's what our focus is on while we also continue to really drive, continue to drive, efficiencies in the business. So I'm really proud of what the team has done, both on the customer experience side, from an NPS perspective, but also from an efficiency perspective, as we have also done in the operations of the company.

We've been in the new homes business for some time. We've been in the business of working with really important partners. So, we also see some opportunity. We've had a number of affiliate partners reach out to us. And so again, we're really pleased to be having those conversations and continuing to build out the momentum we have in the business towards, again, that margin accretive profitable growth.

So Paul, I don't know if there's anything you want to add to that?

Paul Dickson

Yeah, I would maybe say just similar as we've talked about in the past on the viewer side of the business, we're seeing people migrate more to safe harbor, safer harbors, and we don't view this situation one where the market's demanding people come in overpay to attract the volume. Much of our conversations with these new homes' partners and other volume sources that SunPower has had historically, they're coming to us looking for the foundation that Sunrun has, a reliable business that knows how to predictably price, service and maintain and deliver for consumers and do so at a fair rate.

So we've definitely seen that take place. We are, however, investing in product expansion and not chasing volume specifically. And we don't anticipate that exercise. It consumes a lot of capital, but we do think it contributes towards that mid-teens double-digit year-over-year growth resuming in Q4.

Brian Lee

All right. Appreciate it. Best of luck.

Operator

Thank you. Our next question comes from the line of Julien Dumoulin Smith with Jefferies. Please proceed with your question.

Julien Dumoulin Smith

Hey, good afternoon, team. Thank you very much. Appreciate it. And nicely done indeed on the cash gen here. Maybe pick it up where Brian left off here if we can. Just on the full-year and just rolling forward here, I mean, cash gen looks very constructive. What does it reflect in terms of volumes looking in '25? You said, as you looked at the full year, obviously expecting solar volumes to decline, but seeing an inflection here to positive beginning in Q4, just how do you think about that volumetrically across the space as you look forward here, what's reflected?

And then related--well, actually, I'll let you run, and I'll follow up with a clarification.

Danny Abajian

Yeah. Hey, Julian. I'll give the short answer on volume as it relates to cash gen, which is, double-digit growth, I think we made the remark on the script. Getting to that level in Q4 and holding at that level beyond Q4 is the anticipation. That's in-line with the longer term view and objective of double-digit, like mid-teens industry growth potential as well.

Julien Dumoulin Smith

Can always try to ask for more granularity, right? If I can, just pressing on this a little further, right, so despite the eligibility on solar only systems for domestic content here, you're still raising storage guidance, right? I think that's an interesting dynamic here, by 10% to 20%. Is that a statement on California and NEM market specifically? Right, as you think about California being a big driver here nationally on volumes, is the fact that storage is doing relatively well a statement of what you guys specifically are seeing in California?

Mary Powell

It's a statement on what we specifically see provides incredible value for customers all across America, as well as for our shareholders. So we've made the move, Julien, into a multi-product company with our storage first strategy. We sell other products as well, but storage has really been a key focus of ours, not just because of the value it provides for shareholders, the value it provides for customers in terms of resilience, but also what we really continue to see is going to be a future unlock, which is the grid services value that we continue to talk about.

So it really allows Sunrun over time to be building a fleet of stored energy capacity that I think it's going to become increasingly valuable in the United States as utilities face not just rising cost challenges, but capacity challenges as well.

Julien Dumoulin Smith

Got it. All right, guys. Thank you very much.

Operator

Thank you. Our next question comes from the line of Moses Sutton with BNP Paribas. Please proceed with your questions.

Moses Sutton

Thanks for taking my questions. Congrats on seller updates. How do you think of competing for tax equity and transferability hybrid funds in the context of rising demand for such capital, particularly from your top competitor who is successfully pushing deeper into these markets, but possibly also from former loan providers and others trying to flood into this market?

Danny Abajian

Hey, Moses, it's Danny. We feel pretty well-positioned, I think in particular, given how many years we've been at it, right, the buyer universe, that's been pretty stable for us over many years. The ability to implement hybrid structures where we're combining the traditional buyer universe with a very rapidly expanding set of transferability buyers, many of whom are in the nine-figure zip code for individual check size in the transactions.

I think just given the momentum we've seen build over the year, we feel well, well positioned. We're well aware of the kind of the overall demand for tax equity, but I think it is being balanced for us with the radically expanding available supply that's coming in from the corporate buyer universe that is supplementing deal sizes in a very, very material way for us.

Ed Fenster

And Moses, this is Ed. I would say that the company, I think, has a fantastic reputation across all of our capital providers on the non-recourse side. But I think that is particularly acute with tax equity, who we've been working for so long and have done dozens of funds with multiple counterparties, both the company's performance, the lack of need to amend the transactions, the quality of the team. All those things, I think contribute to us being really on the top of the list of counterparties for those capital providers, and I think we feel very good about it.

Danny Abajian

Yeah. And one point just on top. The reliable flow nature of our business leads to very high rate of predictability for the person on the other side seeking tax credits and a tax planning exercise as well, and I think that's understood by the market.

Moses Sutton

Yeah, I think it's very helpful. And I sure remember you out competing as far as SolarCity's days, so you've proven that. I guess one more separately. I noticed $220 million early repayment of pass-through financing. How is that reflected in cash gen? Was that swapped out new project debt? I know that was sort of a former kind of tax equity, but what's happening there with that $220 million?

Danny Abajian

Oh, are you referring to the repayment of--sorry, I missed part of the question. Is it the repayment of the tax equity financing obligation?

Moses Sutton

No, I noticed the early repayment of pass-through financing of $220 million. You had 20 last quarter also.

Danny Abajian

OK. Yeah, yeah. Yeah. That was an older style of tax equity fund that reached its buyout point. I think we've had a rolling amount of tax equity buyouts. I think this is no different. The tax equity fund buyout, the asset capital structure gets cleaned up eventually in connection with that. So, I think that's just kind of an ordinary course type of activity for us. These funds just reach kind of end of life in terms of the getting to the buyout point.

Moses Sutton

Right, right. Sorry, how was that paid? Was that reducing cash generation though?

Danny Abajian

It would have been paid with a concurrent debt financing of the assets in connection with the payout.

Moses Sutton

I'll take the rest offline. Thank you.

Operator

Thank you. Our next question comes from the line of Joseph Osha with Guggenheim Partners. Please proceed with your question.

Joseph Osha

Thank you, everybody. Following on Moses' question, insofar as the market for transferable credits is concerned, I'm wondering if you can give us some rough commentary on where those transactions are clearing in terms of pricing? And then I'm also curious as to whether there's any difference in the market, if you're looking at something that might be perceived as a little more aggressive, like stacking and energy communities, credit and a domestic content on top of the 30% or is everything kind of priced the same?

And then I'll just give you my follow up, which is super simple. I want to clarify on the cash generation for next year. Are you talking Q4 '24 to Q4 '25 for the $350 million to $600 million? I just want to make sure I'm thinking about the right comps. Thank you.

Danny Abajian

So taking the first part. So really, the primary pricing data point is the price per credit being paid. And I think that's been in a low 90s, expressed in cents per dollar of credit, in a low 90s range. I think that has moved incrementally, I think over the course of a year. Especially if we get late in the year, we could see pricing move up for those looking to fill out the year, and they're just kind of in a moment, more urgent demand. So we're seeing some of that activity now materialize in the back half of the year. Potentially, we'll see more of it.

Generally, the long-term expectation is that we see the price per credit incrementally pick up over time, both because the buyer universe expands, but then mature to the point where we're seeing repeat buying activity and it's that kind of reliability play where we could see the value differentiation or the ticking up in value come into play.

I think there will be monetization of retroactive credits, so pricing can be a little bit different depending on how far back we're reaching. And there's no distinction, because it's for dollar credit transferred, there isn't a distinction between the type of adder (ph) that's being paid for, if that's part of the question.

Joseph Osha

Yeah, that was my question. There's not any kind of perceived higher level of recapture if you're stacking multiple credits. People are just kind of paying what they're paying?

Danny Abajian

I think that's generally right. I mean, investors are doing their diligence and they're paying in consideration of their diligence. I think the prices reflect that. And then, Joe, can you remind me the second part, the follow up?

Joseph Osha

Yeah, it's just simple clarification, the '25 cash generation target. Can I think of that as where you exit '24 and then where you exit '25? I just want to make sure I understand.

Danny Abajian

That's more simply the cash generation in the year, so through all four quarters added up.

Joseph Osha

All right. So I want to make sure I'm clear. What does that imply for exiting '24 versus exiting '25? If I'm just comping like to like, what is that number then?

Danny Abajian

Right. So we have $50 million to $125 million for Q4 is the guidance. And if you simply annualize that by multiplying by four, that's $200 million to $500 million is the exit pace. And then for the full year, next year, it's $350 million to $600 million.

Joseph Osha

(Inaudible). Yeah. I guess--I'm sorry, I want to clarify this is. Are you saying that exiting 2025, the cash balance exiting the year should be between $350 million and $600 million higher than the cash balance exiting 2024?

Danny Abajian

That's correct.
Unrestricted.

Operator

Thank you. Our next question comes from the line of Andrew Percoco with Morgan Stanley. Please proceed with your question.

Andrew Percoco

Great. Good evening, everyone, and thanks for taking the question. I do want to ask another question on this cash generation here, just related to some of the ITC adders. I guess I just would have expected a slightly more meaningful jump in 2025 as you fully realize some of that domestic content adder. I believe that the top end of the $250 million to $500 million range that you provided for the fourth quarter this year contemplated like a 40% ITC. So if that goes to 45%, I guess I would have expected the top end of next year's to be slightly above where you're guiding. Is that just conservatism? And am I misreading some of your sensitivities? Would just love some additional color around how you're thinking about benefiting from some of those credits and whether or not there's potentially additional upside if you don't have to pass that through to the customer.

Danny Abajian

Hey, Andrew. Yeah. So based on the implied volume growth we expect to see next year, the volume mix and the amount of adders, the $350 million to $600 million implies a high single digits to slightly north of 10% type of free cash flow margin, if you will. So just taking free cash flow against all the proceeds raised from financing in the business as the indexing, which we view as an appropriate level of target margin for the business next year, especially as we figure out how to market by market, go to market with the adders, especially the domestic content piece.

In areas where we have lower battery adoption, there might be some pricing benefits, accruing to the consumer as opposed to us. All things considered, as we wash that through, that's 6% to 10% level of net

margin, even through consideration for working capital as we resume growth, we feel like it's an appropriate target area to expect.

Andrew Percoco

Understood. OK. That's helpful. And then maybe just switching gears, coming back to the battery storage part of your business for a second. Maybe, can you just elaborate, obviously, California, very, very strong battery storage market under NEM3. Can you just give us any data points or anecdotes in terms of what you're seeing on attach rates outside of California? You mentioned Texas already, but maybe just compare and contrast where you are on battery attach rates in some of those markets today versus 2023 or 2022. That'd be helpful. Thank you.

Paul Dickson

Yeah. I think overall, we see consumers in every market expressing interest in batteries, but we really have pockets that have far stronger battery attach rates. So inside Hawaii and Puerto Rico, obviously, we have nearly 100% or 100% battery attached. California as a backup storage is well under the 80%. Texas has been trending up really steeply, as we've talked about in the past. So for us, a heavy focus, as Mary kind of alluded to this being a core strategy for us, is opening up additional markets. And across the east coast, you see a lot of markets that have relatively low penetration today but have really attractive consumer value props.

The grid deeply needs it. We see a lot of future opportunity because of it. Our sell people are eager to sell it. So as we work with policy, the different cities, the utilities, and a good market strategy, that's kind of where additional growth would come. But nationwide, I would say strong demand for it and pockets that we've cracked the code on and other markets that are emerging.

Mary Powell

Yeah, and I would also just build on that by saying we see just really significant potential in our retrofit program, going back to our existing customer base. So again, we expect to see real growth there as well.

Operator

Thank you. Our next question comes from the line of Kashy Harrison with Piper Sandler. Please proceed with your question.

Kashy Harrison

Good afternoon, and thanks for taking the question, and congrats on the cash gen. So my first question goes back to the commentary surrounding irrational pricing. If we take that comment, and then we combine that with the fact that the OEMs will have domestic content available for pretty much everyone, what gives you guys the confidence that competition won't just end up eliminating the excess benefit of the higher ITC, and that you guys can in fact retain the value?

What makes you think that the cost of the lease across the board doesn't just come down and really, it benefits the customer, but you and your peers end up in a relatively similar cash position as this year?

Paul Dickson

Yeah. Great question. So I think today we're proving that out in the reality that we're generating cash, we have differential price points and returns than our competition. And we see a large component of the market is out there selling and offering higher rates to sell dealers than we do. And we still have the volume and the growth and the kind of pricing power that we have. And as we see more competitors struggle and go out, we see consumers get more thoughtful around selecting who they go solar with on merits other than just the price they're paying.

We also think that complication is our competitive advantage. And so as markets get more complicated, have different rate structures and require batteries and other considerations to deliver a complete

consumer value prop, we view that as absolutely our advantage and anticipate more markets becoming more complicated and us being able to price differentially as a result.

Ed Fenster

And as Danny mentioned, some pass-through to the customer is considered--

Mary Powell

Yeah. I mean, for sure, in how we built our guidance. We built in the assumption that some would flow through to benefit customers, without a doubt. But yeah, for sure. And we are, just building on what Paul said, that is something we are definitely seeing that I think is more recent, which is--and probably the most recent disruption with SunPower will drive this home even further, where customers are looking harder at servicing. They're looking harder at the long-term relationship, where again, Sunrun just has a very, very strong story to tell.

Kashy Harrison

Got it. I appreciate the color there from everyone. And then my follow up question, maybe a little bit more theoretical, might be a little bit tricky to answer, or more difficult to answer, but let's say rates decline faster than the market currently anticipates, faster than what's implied in yield curves, just due to a more significant deterioration in the economy. Do you have any historical reference for how project financing spreads could trend? I'm basically trying to understand if you get lower benchmarks, but they're offset entirely by higher credit spreads, or if you think that would potentially be a net benefit to you, or if it's just too difficult to answer until you go ahead and do a deal under that scenario? Thank you.

Danny Abajian

That's a great question. And prior to assuming the role, I like Capital Markets. And we've seen this play out through cycles and different points and cycles. You might, and I suspect what we're seeing right now in capital markets transactions, when there's an immediate and sudden change in base rates, you might see a little bit of credit spread impact.

Those can be relatively short lived. We go through a period of, price reset, price discovery. We've seen it happen over the last couple of years, even, where spreads have momentarily moved and in subsequent transactions they've come back down. So we've planned for all of that. I think we're taking both sides of the equation, looking at base rates and planning appropriately and conservatively for credit spreads as we plan out the cash generation of the business.

As far as the approach, when base rates fall, monthly and even weekly, we hedge the base rate--we lock in the base rate environment we're in, or that weaker month, depending on the lifecycle of where the asset is relative to install, and we effectively protect that rate until the asset is installed and turned out. So we've been quite--as you can imagine, we've been active at that very recently with the pullback in rates and the seven-year treasury indexes are borrowing costs and that's down quite a bit, ahead of the any decision by the Fed to start reducing short term rates. So we're already benefiting from that.

On the credit spread environment, we'll be very thoughtful about how we approach markets. So in the past where we've seen momentary short-lived rises in credit spreads, rather than doing non-callable transactions in the capital markets, we might turn out in the commercial bank market, which has refinancing flexibility for a future point when credit spreads come back down. So we've got a well scripted playbook for out of experience in playing that through different points in the cycle.

Operator

Thank you. Our next question comes from the line of James West with Evercore ISI, please proceed with your question.

James West

Hey everyone, I wanted to just quickly ask about the current pricing environment. Mary, I know you mentioned it was getting--your competition that had been a little sloppy, was getting better. I'd love if I get some more context on this. Are these larger competitors? Are these smaller competitors? Are these competitors that are slowly going out of business? I mean, what's changing in the overall pricing environment and how is it helping to get better?

Mary Powell

Yeah, so thanks for the question. I view it more as we were giving you an update versus a seismic shift. So there has been, I would say, since the Inflation Reduction Act, there has been, particularly in the financing only space with the rapid move to third-party owned model versus loan, there's been a lot of entrance into the space. I view it more as we were giving an update. We are definitely glad to see what we thought would happen, which is some maturation as entrants learn that this is a very, very different space than loan or cash.

But Paul, do you want to add any specific color relative to his questions?

Paul Dickson

Yeah. I think the only thing I would add to that is when a new financial entrant comes in, and there's been a pretty big handful of them with small individual scale, but several of them, they come in with low controls, attractive pricing, and trying to buy up and grow market share.

And as them and their financers learn more about owning 25-year assets, tax credits, and the things that, to use Danny's terminal, the well scripted playbook that we've built over nearly two decades. As they learn those things, they are repricing and implementing a lot of the controls that we already have in place, bringing it closer to a level playing field. And as that happens, volume migrates back to us. And so we have not seen and don't see these groups scaling, but it's more the quantity of them out in the marketplace with transferability tax credits making it more readily available.

James West

OK. Got it. That makes sense. Thanks for the help, guys.

Operator

Thank you. Our next question comes from the line of Philip Shen with Roth Capital Partners. Please proceed with your question.

Robert Freeman

Hi, this is Robert on Phil's line. Thank you for taking my question. First question is just for the inverter battery procurement strategy for domestic content. Second is how you're thinking about originations over the next 12 months and leveraging tax equity versus tax credit transferability. Philosophically, how are you making the decision between tax credit transfers and tax equity? To what degree does tax credit transfer improve the GAAP financials and then which is more expensive between tax equity and tax credit transfers? I know you kind of touched on that a bit earlier. If you could provide any additional color, that would be helpful.

Danny Abajian

Yeah. Yeah. I think, on the first part of the question, we think that we'll get--implied in the 45% weighted average ITC level guided for next year, is the vast majority of our systems qualifying, whether they are storage or solar only. In the case of solar only, it's a combination of components, including the inverter, the racking. We called out, gave a shout out to SnapNrack on the call. There is domestic content qualification contribution from that business that will primarily benefit solar only. On the battery side, we have been using batteries that have been manufactured in the US. I think there's good line of sight industry wide on batteries as well.

On the second part, on the mix of financing, I think we'll definitely see a mix of both, and we'll even see participation of traditional tax equity players in a hybrid format where it does look like a tax equity fund and a large portion of the credits would be transferred out. And the traditional participant will be also active in brokering the transfer out of the fund.

So we'll expect a good deal of that hybrid format, and we'll probably see a mix of an arrangement of parties by us in structures where each participant takes a different part of the value stream and we're participating out the transfer of credits. I think it'll be more often than not that there's a tax credit transfer involved in a transaction.

What that does is, it takes the size we would have had in a bilateral transaction with a traditional player and allows us to raise single tax equity funds of much greater size. I think that's a key benefit for us as we consider the number of deals we have to do throughout the course of the year.

Robert Freeman

Great. Thanks much. I'll pass it on.

Operator

Thank you. Our next question comes from the line of Maheep Mandloi with Mizuho. Please proceed with your question.

Maheep Mandloi

Hey, good evening. Thanks for taking the questions here. Firstly, just on the storage growth here, could you just help us understand whether it's driven by attach rate growth or are you seeing larger system sizes, maybe more backup instead of shift batteries in California? And then I had a follow up on cash generation. Thanks.

Mary Powell

I mean, we're definitely seeing that it's driven by a higher attachment rate, as we've talked about, as well as the fact that many customers want now whole home backup. So we're seeing more and more customers with the desire for multiple batteries. So again, two. In some cases, three. Sometimes that is tied to a larger solar system size as well, depending on the individual customer, but for sure, that is a big part of what is driving the storage attachment rate and the growth. It's both the attachment rate and the number of products per customer.

Maheep Mandloi

Gotcha. And then just on cash generation for next year, any just early thoughts on the cadence there? Was the Q4 run rate, is it more linear or some seasonality? I think in the past you said Q1 weaker, but any thoughts? Appreciate it. Thanks.

Danny Abajian

I think other than to expect normal seasonality. Q1, we get volume decline. We start to see that pick-up in Q2, more materially in Q3. And that has a core--historically, if you look at our cash generation, obviously adjusted for one-time, extraordinary items, especially this year, you will see that sort of shape of cash generation. I think that will continue, but we'll get more specific as we go.

Maheep Mandloi

OK. Thank you.

Operator

Thank you. Our next question comes from the line of Dylan Nassano with Wolfe Research. Please proceed with your question.

Dylan Nassano

Hey, good afternoon, everyone. Thanks for fitting me in. Just going back to the questions on domestic content and the qualifying equipment. How much do you plan to shift the current equipment mix as it stands now to potentially realize more adders in the back half of this year? And then just to follow up is how permanent could those changes be? Would you kind of revert back to the prior mix at some point? Thank you.

Paul Dickson

Yeah, I think the current products that we have in inventory are set, established and flowing out into installs currently, are domestic content qualifying, so that is and has been underway.

Dylan Nassano

OK. Thanks. That's it for me.

Operator

Thank you. Our next question comes from the line of Colin Rusch with Oppenheimer. Please proceed with your question.

Colin Rusch

Thanks so much, guys. Can you talk about how much market risk you're taking on pricing with these aggregated capacity portfolios? And secondly, are you seeing any uptick from potential utility partners to start new programs, especially given what's going on with interconnection queues?

Mary Powell

Could you repeat the beginning of the question? I'm not sure I followed it. Are you talking about the virtual power plants?

Colin Rusch

Yeah, with the VPPs, how much market risk are you taking on the pricing and how should we think about that flowing through the model as we go through the balance of this year and into next year?

Mary Powell

We're not taking market risk with the pricing. So all of the virtual power plants projects that we're actively engaging in are positive for customers and positive for Sunrun. And again, the value of what we're doing is not just the initial inherent value for customers and for Sunrun, but is really, again, as you mentioned, I think in the second part of your question, so much tied to the future potential value as, again, we're seeing it play out all over the country. More acutely in some parts of the country than others, but where utilities really don't have the capacity to meet the electrification demand, combined with weather events that are happening, combined with, of course, the highly talked about publicized AI load growth demand. So we see that our resources are going to continue to have increased economic value in the coming three to five years.

Colin Rusch

Thanks so much.

Operator

Thank you. That concludes the time that has been allocated for Q&A. You may now disconnect.

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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; the Company's financing activities and expectations to refinance, amend, and/or extend any financing facilities; 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, including contract renewal and repowering programs; anticipated demand, market acceptance, and market adoption of the Company's offerings, including new products, services, and technologies; the Company's strategy to be a storage-first company; the ability to increase margins based on a shift in product focus; 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 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.