3Q 2024 Earnings Call
November 7, 2024
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

Q&A Participants

- Brian Lee - Goldman Sachs
- Julien Dumoulin-Smith - Jefferies
- Andrew Percoco - Morgan Stanley
- Kashy Harrison - Piper Sandler
- James West - Evercore ISI
- Praneeth Satish - Wells Fargo
- Philip Shen - Roth Capital Partners
- Dylan Nassano - Wolfe Research
- Andre Adams - Oppenheimer
- Maheep Mandloi - Mizuho Securities
- Mo Chen - Truist Securities

OPERATOR INSTRUCTIONS

Good afternoon and welcome to Sunrun's third quarter 2024 earnings conference call. 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.

PATRICK JOBIN

Thank you operator. Before we begin, please note that certain remarks we will make on this call constitute forward-looking statements. Although we believe these statements reflect our best judgment based on factors currently known to us, actual results may differ materially and adversely. Please refer to the Company's filings with the SEC for a more inclusive discussion of risks and other factors that may cause our actual results to differ from projections made in any forward-looking statements. Please also note these statements are being made as of today, and we disclaim any obligation to update or revise them.

On the call today are Mary Powell, Sunrun's CEO, Danny Abajian, Sunrun's CFO, and Paul Dickson, Sunrun's President and Chief Revenue Officer.

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. This was a strong quarter. Sunrun is becoming faster, better and stronger at everything we do, providing a differentiated customer experience and delivering value to the bottom line.

While public markets fret policy uncertainty and changes in the short-term, Sunrun is more confident than ever in our leadership position, differentiated offering, and our ability to generate enduring value. All Americans want reliable, affordable energy and that has not changed.

Our focus is yielding strong operating and financial results. In Q3, in addition to reaching the 1 million customer milestone, we again set new records for storage installations, net subscriber values, and delivered solid quarter-over-quarter growth for solar installations.

We delivered the second consecutive quarter of positive Cash Generation and are reiterating our strong Cash Generation outlook for the fourth quarter and for 2025.

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

Storage-first Strategy & Accelerating Innovation

One way we are executing this higher margin strategy is by leading with our storage offering, which increases the customer value proposition through enhanced resiliency and control, delivers a more sophisticated clean energy platform, and lays the foundation for future value creation from grid services.

We are blazing the trail to a storage-first future, with a nearly 50% share of all residential storage installations in America. In Q3, we installed storage on 60% of our new customers, nearly double the 33% attachment rate a year ago, and a six point increase from levels achieved in Q2. We installed 336 megawatt hours of storage in Q3, up 92% from a year ago, the most we have installed in any quarter. Our fleet of Networked Storage Capacity has reached 2.1 Gigawatt hours with 135,000 storage systems installed.

While still in the early stages of commercializing these important, dispatchable energy resources, we continue to advance programs that generate value for customers, the grid and Sunrun. We now have 16 grid service programs active across the country, with over 20,000 customers participating. These resources are being utilized by the grid and can replace several costly and polluting gas-fired peaker plants. Sunrun is leading in establishing a platform to turn homes and vehicles into smart controllable load that can be dispatched to, and improve, the electric grid.

Most recently we activated New York's largest residential power plant with the utility Orange and Rockland. This adds to our recently announced partnerships with Tesla Electric and Vistra to support the grid in Texas, as well as our other programs in California, Maryland, and Puerto Rico. Our customers are actively reducing the need to overinvest in costly centralized peaking power plants and associated infrastructure. Customers are also benefiting from direct payments for participating in these programs or, in some cases, receiving batteries at discounted prices when subscribing to our service. Sunrun is also earning

incremental revenue for enrolling storage systems in these programs. These incredibly reliable, clean energy resources, lower the cost of the grid for all users.

These same storage resources routinely provide financial value to customers by optimizing their use against far-too-complicated utility rate structures while also powering them through far-too-frequent grid outages. This hurricane season again showed the crippling effects of climate change on our country's aging infrastructure. I'm pleased to report, but not surprised at all, that our systems performed remarkably well as they are built to withstand these harsh events. Nearly 3,000 Sunrun storage customers powered through hurricanes Beryl, Helene, and Milton with 100,000 hours of critical backup power during and in the aftermath of these devastating storms. It is so inspiring to hear from many of our customers that while their local grid systems were down for multiple days, they were able to keep their homes powered, and in many instances, share some of that power with neighbors in need.

Lifetime Value Opportunities

A cornerstone of our strategy to increase our differentiation and augment our competitive advantage is to become a multi-product company that offers a suite of clean energy products to new and existing 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 products to our large base of customers for decades into the future.

We are demonstrating this potential by testing products through pilots and scaling them once success is proven. On slide 7 we highlight the various initiatives underway to learn from and inform our strategy to provide valuable services to existing customers.

One of the areas where we are seeing tremendous success is offering batteries to existing customers -- nearly 87% of our existing 1 million customer base today does not have a Sunrun storage system. We already have thousands of orders, which have been growing rapidly. One way we are selling the offering is through our Sunrun app. We are seeing tremendous interest from customers in signing up through the app, which positions us to fulfill quickly, simply, and at low cost.

You will hear a lot more about this multi-product strategy and our success providing additional products and services to customers in the quarters ahead.

Industry Leadership

I want to spend a minute on what we are seeing in recent industry data.

We don't manage to market share – we view our leading position in the industry as a natural long-term result of pursuing a customer-first, disciplined growth strategy. There have been periods with irrational competitive behavior – such as pricing and terms loan providers offered a few years ago, and more recently, pricing and terms being offered by certain financing-only new entrants – but our view is that fundamentals always prevail in the long-term. We lead with the best customer experience, underwrite healthy and financially sound business, and grow in a sustainable, strategic way.

The latest data from market research firms highlights that our strategy is indeed leading to strong growth. We have seen our share of residential solar installations nationwide pick up significantly in the last few quarters – from 13% in Q1 to 18% in Q3 – and our residential storage share has expanded to 49% in the US. I'm pleased to see these trends, but more pleased that we are doing it in a way that is generating cash and delighting our customers.

I also want to provide an update on the traction in our new homes business. This division is seeing tremendous growth. Sunrun is now working with 9 of the top 10 new home builders in California, and over half of the top 20 home builders in the US. In September, we signed a multi-year exclusive agreement with Toll Brothers in California.

While the new homes division currently represents less than 5% of our volumes, we expect it to grow at least 50% over the next year. Home builders appreciate our leading subscription offerings, service commitments, and long track record. Our offering can provide new home buyers with immediate value, savings on energy and resiliency from backup storage, without increasing the cost of purchasing the home.

Fundamental Demand Drivers

To sum it up, we are gaining share in a disciplined and sustainable way and are on track to accelerate our Cash Generation in the quarters ahead. Utility rates continue to rise and utility service reliability is deteriorating, while solar and storage equipment costs are declining. Customers remain eager to take control of their energy needs with affordable and resilient solutions to power their lives, the ultimate in independence.

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 energy independence and the desire to connect customers to the cleanest energy on earth.

Our leading direct-to-home sales team in Bakersfield and our top installation team in Oahu have delivered some incredible results this quarter on safety, quality, battery attachment rates and customer experience. Thank you so much for all that you do every day to make Sunrun the trusted and beloved clean energy partner for our valued customers. I want to make a specific shout-out to Sterling Hills for your great leadership and achievements at Sunrun. Thank you Sterling!

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

DANNY ABAJIAN

Thank you, Mary.

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

Turning first to the results for the quarter on slide 10.

Volumes

We have now installed over 135,000 solar and storage systems, with storage attachment rates reaching 60% of installations during the quarter. We expect storage attachment rates to remain around this level or slightly higher for the next few quarters. This higher mix of storage continues to drive Net Subscriber Values higher.

During the quarter, we installed 336 megawatt hours of storage capacity, well above the high-end of our guidance and an increase of 92% compared to the same quarter last year. Our total networked storage capacity is now approximately 2.1 gigawatt-hours.

In the third quarter, Solar Energy Capacity Installed was approximately 230 megawatts, at the high-end of our guidance of 220 to 230 megawatts.

Customer Additions were approximately 31,900, including approximately 30,300 Subscriber Additions. Our Subscription mix reached 96% of deployments in the period.

We ended Q3 with just over one million Customers and approximately 858,000 Subscribers representing 7.3 Gigawatts of Networked Solar Energy Capacity, a 13% 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 Q3, our Annual Recurring Revenue, or ARR, stood at over $1.5 billion, up 22% 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 11.

In Q3, Subscriber Value was approximately $51,200 and Creation Cost was approximately $36,600, delivering a Net Subscriber Value of $14,632. This strong result was from higher battery attachment rates, a higher average Investment Tax Credit level and sequential growth in volumes leading to improved fixed cost absorption.

Our Q3 Subscriber Value and Net Subscriber Value reflect a blended Investment Tax Credit of 37.7% which now includes all three ITC adders.

Total Value Generated, which is the Net Subscriber Value multiplied by the number of Subscriber Additions in the period, was $444 million in the third 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 7.1% in Q3. As a reminder, we have taken this approach historically to enable ease of comparison across periods and have not updated 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 7.1% discount rate, Net Subscriber Value was $10,744 and Total Value Generated was $326 million.

On slide 12 you can see our progress increasing Subscriber Value through higher-value mix and higher ITC levels, while keeping creation costs largely flat, generating expanded Net Subscriber Values. Efficiency improvements and hardware cost declines, coupled with our return to operating cost leverage from strong sequential volume growth, have largely offset the increased costs associated with higher storage attachment rates. We expect these trends will continue into Q4 and 2025.

Gross and Net Earning Assets

Turning now to Gross and Net Earning Assets and our balance sheet on slide 14.

Gross Earning Assets were $16.8 billion at the end of the third 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 $6.2 billion at the end of the third quarter, up $550 million from the prior quarter. Net Earning Assets is Gross Earning Assets, plus cash, less all debt. Net Earning Assets does not include inventory, other construction in progress assets or any net derivative assets related to interest rate hedges, 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.

The recent run-up in Treasury yields is a strong reminder of the value of our prudent risk management approach. 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.

Capital Markets & Capital Runway

Turning to our capital markets activities.

As of today, closed transactions and executed term sheets provide us with expected tax equity capacity to fund approximately 272 megawatts of projects for Subscribers beyond what was deployed through the third quarter.

We also have over $900 million in unused commitments available in our non-recourse senior revolving warehouse loan. This unused amount would fund approximately 318 megawatts of projects for Subscribers. In July, we expanded our warehouse loan by $280 million to $2.6 billion in commitments, matching the growing scale of the business. Our strong debt capital runway allows us to be selective in timing term-out transactions.

Since the start of the year we have closed four ABS transactions, including three that were publicly marketed. Sunrun's industry-leading performance as an originator and servicer of residential solar assets continues to provide deep access to attractively priced capital.

In September we closed a $365 million securitization of residential solar and battery systems. The oversubscribed transaction was structured with two separate classes of publicly-placed A+ rated notes. The weighted average spread was 235 basis points and the weighted average yield was 5.87%. The initial balance of the Class A notes represents a 73.8% advance rate. The credit spread was 30 basis points higher than our last transaction, and in-line with the overall credit spread environment. Similar to prior transactions, we raised additional subordinated non-recourse debt financing which increased the cumulative advance rate to above 80%.

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 is intended to avoid the use of parent recourse capital to fund our recurring origination activity.

Balance Sheet, Cash Generation & Capital Allocation

Cash Generation was $2.5 million in Q3, consistent with our guidance of positive Cash Generation. Timing of tax credit realization will continue to play a factor in Cash Generation timing as the transferability market grows and matures. The terms of each sale vary depending on the buyer's tax return timing, with some resulting in faster payments but at lower prices, and some with higher pricing but slower payments. Our approach is to optimize first for the best value realization for Sunrun, instead of the fastest payment timing. We executed transactions according to this principle, which delayed Cash Generation from Q3 to future periods.

We expect as the number of participants in the tax credit transfer market increases there will be more predictability in timing, and we will create financing solutions that efficiently bridge this working capital investment, accelerating our realization of cash proceeds over the coming quarters.

We have a strong balance sheet with no near-term corporate debt maturities, we have extended our recourse working capital facility maturity to March 2027, and as of today, we have already reduced parent debt by over $100 million since March.

We ended the quarter with over $1 billion in total Cash. Total Cash declined $32 million from the prior quarter, as we consumed $46 million in Cash to repurchase $50 million of our 2026 convertible notes at a discount. We had $133 million of these notes outstanding as of the end of the quarter. We have continued to repurchase this debt into Q4 and currently have $83 million in principal outstanding as of today.

In Q3, of the $143 million increase to our Restricted Cash balance, $133 million relates to establishing a reserve account to repurchase the remainder of our 2026 convertible notes. Establishing this reserve provided us the ability to extend the maturity of our recourse working capital facility to March 2027.

We addressed all of our corporate debt maturities very early in the year. We have no parent capital needs at this time.

Outlook

Turning now to our outlook on slides 17 and 18.

The underpenetrated nature of our industry 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 our mix of higher-value products and by keeping our costs low.

Storage Capacity Installed is expected to be in a range of 320 to 350 megawatt-hours in Q4. This represents 52% growth year-over-year at the midpoint. This implies over 1.1 gigawatt-hours of capacity added in 2024, an increase to our prior guidance, and 100% growth at the midpoint.

Solar Energy Capacity Installed is expected to be in a range between 240 and 250 megawatts in Q4. At the midpoint, this represents 8% growth compared to the prior year and 7% sequential growth from Q3. This level represents a decline of 17% for the full year, which we believe represents substantial market share gains. We expect year-over-year growth to remain positive in 2025.

Given our emphasis on more valuable product mix, higher ITC levels through optimization of adders, and cost efficiencies, we expect our Net Subscriber Values will increase in Q4 compared to Q3 levels.

We are reiterating our Cash Generation outlook. We expect Cash Generation to be $50 to $125 million next quarter. Because of the discrete large capital transactions inherent to our business, where we ultimately land within this range will depend on project finance transaction timing in Q4.

We continue to expect Cash Generation to be $350 to $600 million in 2025. On slide 18, we have outlined assumptions and sensitivities related to key variables that would affect our achievement. We expect a 45% weighted average ITC level in 2025, and further underpinning our guidance are assumptions of 7.5% average cost of project-level capital, battery attachment rates around 60%, and slight improvements to the timing of tax credit transfers as that market further matures. We expect solar install volumes to grow next year closer to our long-term outlook of 10% to 15%, but our focus will be on margins and Cash Generation as opposed to specific volume attainment.

As we increase our Cash Generation, we will continue to allocate excess unrestricted cash to reduce parent recourse debt and are committed to a capital allocation strategy beyond this initial de-leveraging period that drives significant shareholder value.

With that, let me turn it back to Mary.

MARY POWELL

Thanks, Danny.

I so appreciate the work of the entire Sunrun team, committed to providing customers with a greater sense of independence, stability and security in their own homes, while producing value for our shareholders at the same time, a winning combination.

Operator, let's open the line for questions.

Operator

Thank you. And at this time, we'll conduct our question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. We ask participants to limit themselves to one question and one follow-up question. A confirmation tone will indicate your line is in the question queue. You may also 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.

And our first question comes from Brian Lee with Goldman Sachs. Please state your question.

Brian Lee

Hey, everyone. Good afternoon. Thanks for taking the questions. I guess first one, just appreciate all the guidance metrics here. And you're reintegrating the $350 million to $360 million of cash generation in 2025, obviously closing on financing, the ITC adders. It was--you've kind of laid out the path to get to that cash generation target for next year.

But the big question, I guess, on investors' minds is just how de-risked is that, given especially the election outcome we had a couple days ago. Can you speak to that in any sort of with quantitative, qualitative color, the term sheets? Do you have a percentage committed, et cetera? Just how do you think about the implications of the election outcome for some of the key moving pieces of that cash generation target for next year, especially the ITC-related ones? And then I have a follow-up.

Mary Powell
So hey, Brian. This is Mary. Good to hear from you. Yeah, so at a high level, Brian, we see an outright repeal of the IRA as highly unlikely. Americans want affordable, reliable energy. The Inflation Reduction Act targeted loss of investments in red states, very concentrated in Republican areas. So it was no surprise in August of this year to see 18 Republican representatives in Congress write a letter to support a more surgical approach to look at the IRA.

So as we move forward and as we think about the ITC, I think, again, it's important to remember that the ITC under the former Trump presidency actually came up for expiration, and it was extended. So one of the things that is really important to remember in the context of the work we do in the residential solar and storage space is that it really is the area of energy that holds so strongly across party lines.

So I think that then leads to support in a more general way across party lines. So--and then there are some technical--as I think about cash generation for next year, there's also just some technicalities in place that would make it very, very hard, even in surgical changes, for them to happen rapidly. So certainly as we think about next year, we feel very strong about our cash generation guide.

But, Danny, let me turn to you to answer some of Brian's more specific questions.

Danny Abajian
Sure. Hey, Brian. I'll add my qualitative on the capital side. As far as on the flow basis, what's being funded today is funding against all three adders through all of our funds, and we believe our investors view that as very secure. As we go into next year, what's underpinning the cash generation guidance is a 45 percent weighted average ITC level that is about 9 points of domestic content, roughly. There is some plus or minus there, but roughly 9 percent with the balance being energy communities in low income.

And as we've documented our funds, whatever qualifies gets funded against, and we've been working in order here. As we mentioned in the past, we've got low-income energy communities previously. And through the quarter, we started to get increasing amounts of approvals for domestic content across a number of funds, even some of which go back to last year.

Brian Lee
Awesome. Appreciate all that color. Maybe just a quick follow-up, hopefully a quick one for Danny. The (inaudible) asset level cost of capital, you showed 7.1 percent this quarter, and that's kind of encouraging, given it's been 7.5 percent, 7.6 percent consistently for close to a year. I know you have the caveat in that same slide saying based on what October rates are, it would be right back at 7.5 percent. But can you kind of speak to the change you saw in the quarter?

Was it a unique transaction, or are you just seeing better cost of capital over that three-month period? And then, I know the slide assuming 7.5 percent is still the base case for your 2025 assumptions. But what do you think the path is from here? It seems like that's a conservative view but would appreciate any thoughts, just given the performance you saw in the quarter being below the 7.5 percent base assumption to begin with. Thanks.

Danny Abajian
Great. Yeah, yeah, I would say we saw a declining base rate environment through the quarter that inflected in September. So as we average that period with the 235 spread on our term-out transaction, and what we're seeing on subordinated debt, that was the 7.1 percent. As we look at it today, assuming we

hold the credit spread constant, today mark to market is about--it's probably spot on with 7.5 percent today, even through the Fed rate move.

So the Fed has been easing, base rates have moved up a bit, perhaps on expectations for what's going to happen on both the monetary and fiscal side, with even more clarity over the last few days with the election. And we think largely that's repriced through the system. We have an outlook for 7.5 percent.

The credit spread environment, as we noted, is up slightly deal over deal. I think we're still in a normal range for what we've seen on transactions. Participation remains good. And as we've noted also in the past, participation for us can be--over time, deal by deal can be privately placed through big private debt funds publicly marketed such as the last one, which had good participation. So the spread environment we also can see fluctuate but today we see at 235 basis points, up a bit but still in kind of a normal historical range.

Operator
Thank you. Our next question comes from Julien Dumoulin-Smith with Jefferies. Please state your question.

Julien Dumoulin-Smith
Hey, good afternoon, team. Thank you guys very much, appreciate it. Just with respect to the debt principle pay down here, just how would you expect to show this, going forward? Obviously, you did a nice proactive pay down below par here, $50 million, ultimately showing slightly better than zero cash obviously in terms of the cash gen.

But that's obviously inclusive of some debt pay down. Just how would you expect to kind of talk to the cash generation next year? Shall we kind of expect that some of the cash is proactively used for debt pay down, for instance the payoff remaining 83 as you start to execute against your range for 2025 that you just reiterated?

Danny Abajian
Yeah, I would characterize it as kind of strong focus on debt pay down. What we've demonstrated so far is the continued pay down of the convert. I think what you'll start to see is start paying down our corporate revolver as well. I think we like the combination of debt pay down, getting to lower leverage levels, replenishing capacity, and prioritizing stronger balance sheet as we go through this period of time. So I'd say it would be substantial. And we'll start to involve more and more. And over time, the majority of the debt pay down will be more geared towards the recourse revolver that we have outstanding.

Julien Dumoulin-Smith
Got it. And then just, how is the market shaping up right now from a competitive perspective? I mean, you took out some of the run rate language in the slides here about cash gen beyond 2025. How do you think about just the competitive backdrop or any other thoughts about that positioning here and obviously reiterated to your 2025 cash gen targets?

Paul Dickson
Yeah, I don't think anything in terms of cash gen targets beyond 2025 has materially changed. I think we're bullish and optimistic. The competitive landscape has had a bit of evolution. We've actually seen some of the people we've mentioned on previous calls as having--we've categorized as irrational pricing, essentially offering pay and cost in excess of the total proceeds you can raise against the assets. And that's before consideration of G&A or any cost for servicing those assets.

And we've seen correction in some of those partners who have been out in the market for a year-plus. We like new entrants in the space, but we've actually seen the replacement of those people with new entrants bringing even more aggressive pay into the market. And as Mary mentioned, despite that, we are out there playing dollar for dollar to try to win business.

We have a very like thoughtful and programmatic approach to deliver differentiated value to our customers, and we're picking up market share doing that. But we do continue to see that aggressive pricing structure to attract market volume. And I think there will be quick corrections for these players as they learn a better understanding of the economics of solar.

Operator
Our next question comes from Andrew Percoco with Morgan Stanley. Please state your question.

Andrew Percoco
Hey, good evening, guys. Thanks for taking the question. I did want to come back to the election point for a second, and just a slightly different question on that end, in terms of like how you guys are managing tariff risk. I know obviously you're buying batteries and inverters and racking equipment in the U.S. to hit that domestic content. But how are you thinking about panel supply in the context of potentially higher tariffs, either universally or directly on China? How are you dealing, and how are you diversifying your supply chain with this current backdrop?

Danny Abajian
Yeah, I mean, generally, like just as a reminder, module costs are less than 10 percent of our cost stack. So any impacts we think will also be a very small percentage of our total cost stack. We've seen--we've had diversity of supplier base that's not just modules. That's across inverters, batteries. And supply chain is already diverse. I think there's also the angle with domestic content.

As we see more of that transition to U.S.-made, that will also be part of the mix that can be higher cost but also delivers yet more value against the cost differential through the ITC adder.
So generally, we feel well-positioned. As a reminder, the industry is already burdened somewhat by tariffs. And I think we've been able to manage through it.

Andrew Percoco
Understood. That's helpful context. And then coming back to the IRA, I know it's not your base case that you again any repeal, but are you expecting any impacts to the health, the ABS markets, or tax equity agreements, just given the uncertainty around IRA repeal? Or are you expecting any kind of change in behavior from some of your counterparties there as you move into 2025?

Danny Abajian
Yeah, again, like I answered before, what's going into service that is qualified is clear at the moment. To the extent we're playing out scenarios on adders, I think there is a built-in experience in the industry on how to deal with times when there is something in the tax code, like even considering the corporate income tax rate, just to throw that one in there, there was a period not too long ago where that was in flux, right?

So I think there's experience on our side and amongst all the counterparties. To the extent we're looking at IRA or what happens with the current tax provisions, how they get extended, how they might change, there will be a period where we'll have to be more thoughtful about how to deal with that transaction. As I say, we have a lot of built-in experience doing that from cycles in the past.

Andrew Percoco
Thank you.

Operator
Our next question comes from Kashy Harrison with Piper Sandler. Please go ahead.

Kashy Harrison
Good afternoon, and thanks for taking my question. And no surprise, it's an election one as well. So, Mary, you're 100 percent correct that a wholesale repeal is extremely unlikely. But the prevailing thought is that the Republicans will look toward the IRA to at least partially offset the cost of extending the original tax cuts. Because they want to at least minimize the impacts of the deficit.

And so, even if the IRA doesn't completely go away, there's certainly the potential for tweaks. And obviously, no one knows what's going to happen, what that looks like, and what that's going to look like at this point. And so my question is what is the appetite for structurally revisiting the business structure to be capable to generate meaningful cash at a lower ITC, maybe 30 percent, just in case perhaps the adders go away?

Mary Powell

Yeah. I mean, I guess I will make some opening comments, and then I'll ask Paul to talk a little bit more about our specific revenue strategies we look at. But from a broader picture perspective, like yes, you're right, like there's always--I would say I've been in the energy business over a couple decades. Like there's always tweaks. So I would say from a policy perspective, having tweaks is kind of something that we've certainly always had and I think can adjust to, for sure. The other things is they take time, which means that you certainly have time. You see things coming, and you can alter.

And again, this business and Sunrun have used the last couple years as an example to emerge in a much stronger position. And so that's sort of how we look at any changes that we see coming down the pike, is how do we look at those, and how do we think of it in our very margin-focused, disciplined way? And we really, again, are managing costs in a, I would say, maniacal way. We're really focused on making sure we're operating really efficiently and effective because that always gives you maximum flexibility.

So with that, Paul, why don't give you some more specifics.

Paul Dickson
I think I'd really start by just saying as we all know, equity markets don't respond well to uncertainty. So when you look at the facts, there's always risk in rebates and incentives. And in Trump's previous presidency, he actually had the opportunity not to extend the ITC because it did come up for renewal. And he opted to elect it. The ITC has existed for decades. And we're optimistic and confident around that.

That said, the way the ITC and the adders work in our business is it does enable market expansion, it enables route expansion, and it enables us to reach customers that we otherwise couldn't. And so in the event of contraction in that, we would react like we have regularly and consistently do in our business to adjustments and rebates and incentives.

That said, we feel like we're significantly more (inaudible) and de-risked relative to others, given our focus and strategy is less around chasing and offering a savings product to consumers, and we've invested heavily around building out our consumer offering to be more focused around functionality and service and resiliency. And so, we think we would see far less contraction than our competitors were that to happen.

Kashy Harrison
Got it. Appreciate the thoughts from both of you. And then, my follow-up question is maybe for Danny. I think you referenced the 10 percent to 15 percent megawatt growth year, but then you also said, look, it's really about cash generation, not growth.

That said, if I just think about normal quarterly seasonality over the course of a typical year, you combine that with your 250 megawatt exit rate, and then the fact that you also have like pretty easy comps in the first half of next year, it would suggest your starting point is quite a bit of upside to that 10 percent to 15 percent range.

And so is the 250 megawatt exit rate--is there something unusual about that activity level? Or is the thought that if you guys are running ahead (inaudible) pull back and focus on cash? I'm just trying to think about that growth rate relative to your baseline levels in 4Q.

Danny Abajian
Yeah, I think the best metric to look at, because we've had irregular year-on-year comps and because we've now gotten through three quarters of sequential increase, and we've returned closer to levels we saw prior to the NEM change in California, the year-on-year growth rate indicated for exiting this year is about 7 percent or 8 percent. I think it's 7 percent or 8 percent sequential and 7 percent or 8 percent year-on-year, however you look at that.

And that's trended towards a double-digit number and we think will hold that sort of pace. Now we'll, of course, have some of the, again, year-on-year comp irregularity, to a much lesser degree. But if we roll back like Q1 over Q1, last Q1 we were still in recovery, but we think double-digits area is achievable for the business. And we'll manage seasonality, working our way to balance seasonality, so we can really put the focus on volume in relation to fixed cost structure, fixed cost absorption.

And as we've been getting the volumes up, it's really seeing the cost efficiency return to the business, where we've been delighted to see what we thought would happen finally happen. And you can see that

through the metrics of creation cost of different elements to creation cost, how we've been able to get the battery attach rate higher, increase customer value but keep the cost relatively flat.

And actually, I think we had three consecutive quarters of creation cost decline. So on a unit basis, we're trending where we want to be through volume. Volume in itself is not the primary objective. It's the unit margin extension, which we expect to hold.

Operator
Our next question comes from James West with Evercore ISI. Please go ahead.

James West
Hey, thanks. Good afternoon, everyone. Mary, curious about the--and I won't ask about the election. I think we've kind of killed that one. So let me ask about your virtual power plants. You added several this quarter. I think that's a big, growing opportunity for you guys. What's the impediment to growth there? Is it utilities? Is it--I guess, how do you think about the impediment to growth, if there is one?

Mary Powell
Yeah, thanks for the question. I am, as you know, very excited about the development and the leading position Sunrun has around monetizing the value of these assets to help the grid and help customers. And it certainly contributes to the bottom line of Sunrun. It is really--it is all about having it continue to catch an edge in the context of the regulatory and utility environment.

So I've always felt for so many years, going back to when I was a utility CEO for over a decade, that we were going to be in the situation that we're finding ourselves in today, right, which is as people electrify their homes, as they electrify their transportation, and now we have the pressures of AI, the grid simply can't add resources or manage resources fast and effectively. And what we're finding is, again, these resources that we have are proving to be very valuable for the grid and really helping to sustain it as it's adjusting to these increased capacity demands.

So I think we're just going to continue to see this trend grow. I was really encouraged just in every venue I'm in, every conference I go to, it is certainly becoming something that was talked about, I would say more on the fringes, to something that is being discussed in a much more mainstream way. So I feel very positive about that. And we are, of course, scaling at an incredible pace. We hit a really strong record in terms of 60 percent of our installations now have storage. And that just positions someone really, really well to benefit--to create benefit for our shareholders and our customers as we help out the grid.

James West
Maybe a quick follow-up for me on the data center AI theme. What do you see is the opportunity set for Sunrun there?

Mary Powell
Very much an extension of the same. So what you're finding is that, again, there are challenges in so many parts of the country to meet the demand. And what you're also finding is that in many cases, a lot of the developers do want clean energy alternatives. So certainly, there's always more than one solution, but Sunrun's assets could play a very important role in contributing to solutions to the AI demands that are happening. So as I think was reported, we're in NDAs with a couple of AI developers along those lines.

So one of the things I love, again, about our resources, as somebody who ran a fully integrated utility, where we had generation assets, we had transmission distribution, the whole supply requirement, one of the things I really like about the storage and solar assets, the residential solar and storage assets, are they are--I would stack them up against a (inaudible) plant any day of the week as being more reliable.

Because you're aggregating so many different touchpoints. So let's just say a couple don't come online, it makes no difference in the overall value that you can supply to the grid. So again, I think this is going to continue to be a very valuable resource. I know so many regulators think so. Regulators are a big part of why you're seeing increased demand for these types of virtual power plants and grid services programs.

Operator
Our next question comes from Praneeth Satish with Wells Fargo. Please state your question.

Praneeth Satish
Thanks. Good evening. Maybe switching gears a bit here, obviously projecting a lot of growth in the new homes market. Maybe if you could just help us understand better the unit economics there. I assume you've got some benefits from kind of streamlining the customer acquisition cost. But there's probably also revenue shares and maybe a longer cash conversion cycle. So I guess how does the cash generation economics compare in that channel versus your typical residential solar sale?

Paul Dickson
Yeah, just really simply, as Mary mentioned I believe in her script, about 5 percent of our business today we see tremendous growth opportunities in that route. And as you mentioned, kind of across-the-board, it's a more efficient model in terms of economics. So you have single permitting, you have a one-to-many kind of customer acquisition model, and then it's an efficient route. And so we would anticipate improved margins as that becomes--and scales to the more meaningful part of our business.

Praneeth Satish
Got it. And not withstanding the elections, but just as it relates to the ITC and domestic content, maybe specifically on domestic content, can you walk through kind of your framework for how you go about deciding whether to keep that or share that? It sounds like you're going to look at it market by market, customer by customer. But I guess what kind of signals or competitive dynamics would lean you one way or another?

Danny Abajian
Yeah, I would say (inaudible) versus shares, not like the decision framework we've been applying. It's more of a margin target setting exercise. So that results in implicitly some amount accruing out to the customer or being retained. And it depends on the value of the market, our relative positioning in the market, the product category, whether it's a higher-value or lower-value product, mainly being driven by whether or not there is a storage attachment to it.

So we're looking at a variety of factors and solving to attractive and good margin profiles for us and a good value prop to the customer and a good competitive position within that particular space. So it's a pretty granular exercise.

Operator
Our next question comes from Philip Shen with Roth Capital Partners. Please state your question.

Philip Shen
Thanks for taking the questions. First one is a follow-up on your 10 percent to 15 percent growth for solar installs next year. I was wondering if you might be able to share the regional breakdown that you expect in 2015, sorry, 2025, so for example, California versus the Northeast, Puerto Rico, Southwest, et cetera? Thanks.

Danny Abajian
Yeah, I think we've had--so California, we've had a good track record in California for many years. It's been our biggest market. We think it will continue to be, of course. And then I think we've shared in the past as well, like the return of volume in California and its growth rate recently has been outpacing everywhere else. We see strong spots--continue to see strong spots in the Northeast, Illinois, and the Midwest. Puerto Rico is a good market where resiliency is a big driver. I'd say those are the major ones. Texas is also with a high battery attachment rate, so Texas has converted to much higher value recently as well. And we think that will accelerate with the domestic content angle as well.

Philip Shen
Danny, any chance you can quantify some of those regions? So California is a strong spot outpacing everywhere. Are we talking about 25 percent growth next year?

Danny Abajian
We haven't broken out kind of market-specific year-on-year growth rates. I'd say California has been as much as half of our business. That probably sells to more like a third immediately after NEM, the NEM change, and that's been coming back up. But we don't have specific market year-on-year growth rates to share at the moment.

Philip Shen
Thanks, Danny. And in terms of my follow-up, we've read a lot about the long lead times for Powerwall 3. Our sense is the big customers, such as yourselves, have no issues with securing Powerwall 3s. But on the margin, the smaller dealers and through distributions are having challenges. Do you anticipate any issues at all? Or do you guys expect to continue to get strong and reliable Powerwall 3 supply in 2025? Thanks.

Paul Dickson
Yeah, great question. We've experienced very much the opposite. We view Tesla as a really key and strategic partner for us and believe, based off the way we're being treated by them with supply and the partnership, that we're a very strategic partner for them as well. So we don't have supply chain shortages with Powerwall 3s at this time and don't foresee them in our forecast.

That said, there are a lot of new, exciting battery technologies that are coming online, and if we focus on virtual power plants and functionality for customers in the connected home, knowing that space and understanding the technologies that are available there is paramount for us. And so in Q1, we'll be launching some new battery hardware that we're excited about but continue to be focused on building and maintaining our strong partnership with Powerwall 3 and Tesla.

Operator
Our next question comes from Dylan Nassano with Wolfe Research. Please state your question.

Dylan Nassano
Yeah. Hey, everyone. Good afternoon. Thanks for taking my question. Just wanted to go back to the domestic content qualification of 19 percent that you had in the quarter. Could you guys give an idea of what that could be in 4Q and just kind of give us a sense of what's the lowest hanging fruit to kind of get that number up higher the next couple quarters?

Danny Abajian
Yeah. I think there's a gradual pickup through Q4 and Q1. We'll see a meaningful pickup. I think that will go by early next year up to a qualification rate of around 90 percent, perhaps even higher. That's being driven by, initially more quickly probably on the battery side, on solar-only installs.

We have a combination of equipment getting us above the 40 percent threshold. We're cycling into that, so that's a meaningful area of pickup we'll continue to see. So I'd say that the relative pickup from here on out is more on the solar-only side that the storage side, but both are--we're starting from a low number and going to a very high one, so both are picking up very meaningfully.

Dylan Nassano
Got it. Okay. That's helpful. Thank you. Then my follow-up. I just wanted to ask on grid services. So I understand that I guess the lifetime value of grid services is something like $2,000 per customer. I think you have 20,000 customers enrolled right now. Can you just give us an idea of what's kind of the current actual revenues that you're getting from grid services? Is it something that should kind of be aligned with that $2,000 lifetime value?

Danny Abajian
Yeah. So the $2,000 lifetime value is expressed on a PV basis. And what's in that is an assumption for a few hundred dollars per year per customer. And I think we're generally seeing a pickup that's like kind of in line with that assumption.

Operator
Our next question comes from Colin Rusch with Oppenheimer. Please state your question.

Andre Adams
Hi, there. This is Andre Adams on for Colin. Are you starting to see any increase in labor availability, and how shall we think about construction cost trends, going forward?

Paul Dickson
Yeah, we're not. Kind of across-the-board, we're seeing strong demand in growth across our go-to-market goals as well as in our operation business and supply chain.

Andre Adams
All right. Thank you. And for the follow-up, just from a permitting perspective, you've spoken about automated permitting as a possibility for some geographies. Are you seeing any meaningful trends in permitting that could have material impact on your sales cycle or . . .

Paul Dickson
Yeah, we are actually seeing nice progress on that. And kind of across the business, we're looking for ways to automate more and more. In our sales, for example, as Mary mentioned, we're growing and selling more of our retrofit batteries. And rather than doing that through traditional routes, in our customer app, we're pushing out leads and had thousands of responses at far higher and faster conversion rates. And so, technology and implementing that across sales and operations is very improved for us.

Operator
Thank you. Our next question comes from Maheep Mandloi with Mizuho. Please state your question.

Maheep Mandloi
Hey. Thanks for taking the question, and (inaudible) most on the election and other topics over here. But maybe just one on the Safe Harbor process here. In the past, when tax rates were sunsetting, we saw a two-year Safe Harbor, giving you ample time to buy (inaudible) and keep the credits. Is there any guidelines or any clarity on that under the new tax rates on the IRA?

Danny Abajian
Yeah, there's a four-year period in the--to the extent we use Safe Harbor, we've had strategies in the past. To the extent they're valuable through available financing sources and things we've done in the past, I think we've got a good developed playbook there, as well. I think our guidance considers all the possibilities.

Maheet Mandloi
Got it. Appreciate it. That's all. Thank you.

Operator
Our next question comes from Jordan Levy with Truist Securities. Please state your question.

Mo Chen
Hey, thanks. This is Mo Chen on for Jordan. I just have a quick one about your new home segment. Can you talk about the profitability margin profile of this segment compared to your traditional subscription models? And how shall we think about blend of the margins as this segment becomes a larger part of the mix? Thanks.

Danny Abajian
Yeah. So I think, as Paul shared, there's good cost efficiency on the business, on the sales costs, the efficiency on permitting he noted. What you also get relative to a retrofit on average, a likely smaller system size with cost efficiency. On a margin percentage basis, they're similar to the relative product.

Like in California, for example, it will compare well to a retrofit product that we'd otherwise do. So it is--a majority of California, it is a high-value market. It has a similar margin profile. And the individual homes might be smaller, but the batches of units come in larger quantity, which is a strong offset when you consider the aggregate volume.

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, growth of certain divisions, 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, regulation and policy on the solar industry and our business; the potential impacts of future tax legislation, specifically related to changes in tax credits applicable to the solar industry; 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.