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Q1 2020 TerraForm Power Inc Earnings Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Colin William Rusch *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*
Nelson Ng *RBC Capital Markets, Research Division - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the TerraForm Power 2020 First Quarter Results Webcast and Conference Call for investors and analysts. As a reminder, this conference is being recorded.

I would now like to turn the conference over to Sherif El-Azzazi, Head of Investor Relations. You may begin.

Sherif El-Azzazi ***TerraForm Power, Inc. - Head of IR***

Thank you, operator. Good morning, everyone, and thank you for joining us for TerraForm Power's

2020 first quarter results conference call and webcast. I'm joined today by John Stinebaugh, our Chief Executive Officer; and Michael Tebbutt, our Chief Financial Officer.

Before we begin, I'd like to remind you that a copy of our earnings release, supplemental information and letter to shareholders can be found on our website. Note also that we may make forward-looking statements on the call. These forward-looking statements are subject to known and unknown risks, and our actual results may differ materially. For more information, you're encouraged to review the Risk Factors section in our SEC filings, which can be found on our website, terraformpower.com.

In addition, we will refer to non-GAAP financial measures. For more information on a reconciliation of these non-GAAP measures to comparable GAAP measures, please refer to our earnings release and supplemental information.

With that, I'd now like to turn the call over to John.

John Marcus Stinebaugh ***TerraForm Power, Inc. - CEO***

Thanks, Sherif.

In the first quarter of 2020, TerraForm Power continued to execute its business plan of enhancing the cash flow from its existing asset base, investing in organic growth opportunities and strengthening its balance sheet. I'll briefly go through a few key highlights. We continue to make significant progress on the repowering of our 160-megawatt Cohocton and Steel Winds projects in New York. The projects were recently awarded REC contracts by NYSERDA for the 25% of incremental production resulting from the repowerings. These REC contracts have 20-year terms at attractive prices. We also made substantial progress on the related project agreements and are targeting executing a corporate PPA, the NYSERDA REC contracts, the turbine supply agreement with GE and tax equity agreements in the second quarter of 2020. We remain on track to commence construction in the first half of 2021. While we do not anticipate any delays due to supply chain issues resulting from COVID-19, we continue to actively monitor the situation.

Turning to operations. We have signed LTSA agreements for 540 megawatts of projects in our North American solar portfolio and transitioned operations of these projects to SMA. We have sent out consent packages to project lenders and tax equity investors for the remaining 450 megawatts of projects in our North American solar fleet. Upon receipt of these consents, we are targeting execution of the balance of the LTSAs and transfer of operations to SMA by the end of the third quarter of 2020. Our new O&M contracts are expected to reduce annualized costs by approximately $5 million and convey robust performance guarantees to our fleet.

With regards to the COVID-19 pandemic, we have taken important steps to ensure our employees and contractors are safe. At the end of March, we closed our New York City and Madrid offices and implemented our business continuity plan. Currently, the majority of our corporate and operations teams are working remotely with minimal disruption. Over the past weeks, we've engaged with O&M providers to ensure that they have appropriate business continuity plans in place to safeguard the health of our employees and contractors as well as to ensure our wind and solar plants continue to generate power. To date, we have not seen any material degradation in the performance of our assets as a result of the pandemic. However, in a number of our distributed generation solar sites, we experienced temporary inability to access sites due to limitations on nonessential work. In such instances, we worked with local authorities to clarify that these regulations did not apply to our assets, and we now have access to these assets. We continue to monitor this developing situation, and we will provide further updates as appropriate. All in all, we believe that TerraForm Power is positioned to ride out the COVID-19 pandemic given it's 95% of our revenues are under long-term contracts, over 90% of our PPA off-takers are either investment-grade rated or municipalities with investment-grade characteristics, our business is less labor-intensive than most other industries, and our assets are predominantly operational, which mitigates our exposure to supply chain disruptions.

Now I'll turn the call over to Michael to discuss our financial results and provide an update on liquidity.

Michael Tebbutt ***TerraForm Power, Inc. - CFO & CAO***

Thanks, John, and good morning, everyone.

I'd like to start by recapping our financial results. In the first quarter of 2020, TerraForm Power had a net loss attributable to Class A common stockholders, adjusted EBITDA and CAFD of $55 million, $180 million and $20 million, respectively. This represents an increase in net loss of $46 million, an increase in adjusted EBITDA of $2 million and a decrease in CAFD of $24 million compared to the same period in 2019.

Performance in the quarter was negatively impacted by a 36% decline in market prices in Spain as well as 6% lower wind generation in North America compared to the first quarter of 2019. Offsetting these factors were contributions from recent acquisitions as well as high SREC revenues. The lower market prices in Spain were in part caused by lower demand resulting from the economic slowdown caused by COVID-19 pandemic. We expect this decline in market prices in Spain to be mitigated through the price ban adjustment mechanism defined under the Spanish regulated revenue framework whereby any shortfall in the actual power price compared to the forecasted power price outside of the price band are recouped in future periods through an increase in the capacity payments that our assets receive. The lower wind generation in North America was mainly due to lower resource, especially in our Central and Northeast regions, as production guarantees in our GE O&M contracts largely offset availability that was below expectation.

Moving on to our liquidity. Despite the challenges COVID-19 posed to the capital markets during the first quarter, we were able to continue executing our plan to extend debt maturities and reduce financing costs. In March, we completed $246 million in project-level refinancing of one of our North American wind farms at a rate of 3.28%, which we expect to achieve interest savings of $2.5 million per annum. The senior note -- senior secured notes are fully amortizing with a final maturity in June 2037. At the end of the first quarter, our total corporate liquidity was $1.2 billion, inclusive of our $500 million sponsor line with -- credit agreement with Brookfield Asset Management.

I'll now turn the call back over to John.

John Marcus Stinebaugh ***TerraForm Power, Inc. - CEO***

In March, we entered into a definitive merger agreement with Brookfield Renewable to acquire all the outstanding shares of Class A common stock of TerraForm Power, other than the approximate 62% currently owned by Brookfield Renewable and its affiliates. Each share of Class A common stock of TerraForm Power will be acquired for consideration equivalent to 0.381 of a Brookfield Renewable unit. For each share of TerraForm Power's Class A common stock, shareholders will be entitled to receive at their election either Class A shares of Brookfield Renewable Corporation or limited partnership units of Brookfield Renewable. The Special Committee of the Board of Directors of TerraForm Power, comprised solely of non-executive independent directors, has unanimously recommended that TerraForm Power shareholders approve the transaction. The Special Committee believes the transaction is fair and in the best interest of TerraForm Power and its unaffiliated shareholders.

A preliminary version of Brookfield Renewables F-1 merger proxy was recently filed with the SEC. Once the merger proxy is finalized, the transaction is expected to be presented for approval of TerraForm Power shareholders representing a majority of the outstanding shares of TerraForm Power Class A common stock not owned by Brookfield Renewable and its affiliates. The transaction is subject to other customary closing conditions and is expected to close in the third quarter of 2020.

Now I'd like to discuss our outlook. When Brookfield became our sponsor in 2017, TerraForm Power owned 2,600 megawatts of wind and solar assets primarily in the United States. Since its assets have been largely neglected during its former sponsor's distress and bankruptcy, a major aspect of our business plan was to enhance the value of TerraForm Power to existing asset base and invest in organic growth opportunities within its portfolio. Over the past 3 years, we've made significant progress on executing this plan through cost reductions of approximately $30 million, signing O&M agreements that include robust production guarantees at LTA generation levels and progressing 2 important repowering projects. We have significantly increased the cash flow generating capacity of TerraForm Power and enhanced shareholder value.

In order to grow the business, our mandate relative to other Brookfield-sponsored entities was to acquire operating wind and solar power assets in North America and Western Europe. In a little over 2 years, we invested $1.2 billion of equity to expand into Western Europe and an additional $440 million of equity to further grow our European business and build out our distributed generation business in the United States. Not only did these transactions increase the scale of our business to 4,200 megawatts, but we expect them to meet or exceed our return on equity target of 9% to 11%.

Since we've harvested most of the low-hanging fruit within our existing asset base, TerraForm Power is entering a new stage of its growth cycle in which we will have to deploy significantly more capital to continue achieving our distribution growth target of 5% to 8% per year. Furthermore, as a result of a substantial increase in institutional capital-seeking investments in operating wind and solar assets in developed markets, the ability to achieve its target returns has become more challenging. As such, the timing of our pending merger with Brookfield Renewable is opportune. Following the close of the transaction, our shareholders will own a significant stake in one of the largest publicly traded, globally diversified, multi-technology, pure-play renewable power platforms with total assets of approximately $50 billion and annual funds from operations of approximately $1 billion. In addition, shareholders will participate in a broader growth mandate that includes investments in high-growth countries such as Brazil, India and China as well as the opportunity to invest in higher-returning development projects through Brookfield Renewable's 13,000-megawatt development pipeline. This broader growth mandate should enable Brookfield Renewable to continue achieving its higher return on equity target of 12% to 15% and its distribution growth target of 5% to 9% annually.

Finally, shareholders will upgrade their investment to a BBB+ balance sheet with liquidity in excess of $3 billion, which is even more important in today's turbulent macroeconomic environment. For these reasons, we believe the merger is of great value for TerraForm Power shareholders, and we encourage you to vote in favor of the transaction at the upcoming shareholder meeting, details of which will be announced in due course.

This concludes my formal remarks, we'd be pleased to take questions at this time.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Colin Rusch from Oppenheimer.

Colin William Rusch ***Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst***

As we look out at your growth prospects and certainly, the Brookfield relationship enhances your position as an acquirer of assets. But as you survey the landscape, could you talk about the opportunities for acquisitions, distressed projects as well as the access to capital from the debt markets right now that you're seeing?

John Marcus Stinebaugh ***TerraForm Power, Inc. - CEO***

Sure. We do think that the market volatility caused by COVID-19 is going to potentially present some interesting opportunities. Initially, there was a significant trade-off in the public market certainly. Although many companies have largely rebounded, what we have seen is that there is uncertainty in terms of the cost of capital. And in particular, within the renewable power sector, the cost of tax equity is uncertain, so that's creating greater uncertainty from a developer perspective as to what their development margins are. And we think that all of this could potentially lead to some interesting opportunities for TerraForm as well as Brookfield Renewable. Generally, we still are very bullish about the continued build-out of renewables in all of our target markets. So we think that the trend is going to continue to be a very strong trend for the foreseeable future. And what we're excited about with the combination of Brookfield Renewable and TerraForm Power is the ability to have a broader growth mandate.

We are seeing right now that if you look at risk-adjusted returns, we think it's more attractive to invest at the development stage as opposed to the operating stage. There's a lot of capital looking to invest in operating projects, which has squeezed returns. But we think that you earn attractive risk-adjusted returns if you've got the development capability to invest in earlier stage in projects and capture premium returns that we think more than compensates for the risk. So that's one of the big opportunities that we're excited about from the combined platform.

Colin William Rusch ***Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst***

All right. And then just thinking about the tax equity market and some of the public reporting that's happened around the potential for changes to treasury guidelines and rules around tax equity and the potential for cash or the tax equity requirement, at least for a period of time, what's your best diligence and intelligence right now on what's happening with those provisions from the federal government?

John Marcus Stinebaugh ***TerraForm Power, Inc. - CEO***

It's hard to say. Certainly, if you look at the financial crisis, there was the cash in lieu of production tax credits, the cash grants that were offered. And I think part of the reason for that is there was a lot of uncertainty regarding the tax appetite of a number of the investors in tax equity. And as a consequence, I think that's certainly one of the things that's being discussed right now as an incentive to help continue the sponsorship in support of renewables during this crisis. So it's something I know it's certainly on the drawing board, and it's being advocated by a number of the lobbyists that support the industry. We view that to be a positive. We like being able to utilize the cash grant, have more simplified capital structures that where you don't necessarily need to incorporate tax equity into your capital structure. But we're -- with the strong relationships we have with banks, even if tax equity continues to be a important form of financing, we've got access because of the strong relationships in the Brookfield group to tax equity, and I think we'll be able to continue using that as an important financing tool.

Operator

Our next question comes from the line of Nelson Ng from RBC Capital Markets.

Nelson Ng ***RBC Capital Markets, Research Division - Analyst***

Great. My first question relates to the draft merger proxy. Do you think it will be finalized this quarter? Or do you expect a few extra turns on the documents kind of implying for a Q3 date for finalizing the documents?

John Marcus Stinebaugh ***TerraForm Power, Inc. - CEO***

Yes. It's a tough one, Nelson. On the one hand, it is a pretty complex document because not only do you have the merger, but there is BEPC, the C corp equivalent that the SEC has to review as well. So as a consequence of that, we do think there's going to be questions that we receive by the SEC that we'll have to address before we can finalize the proxy. It's hard to say to what extent working remotely is going to affect schedule and whatnot. But I think we generally think that probably 60 days after filing it, we should be in a position to finalize it as a rough estimate. So we filed it end of April, so 60 days would kind of push a -- with the wait time for shareholder vote to a close, it would be sometime mid-second quarter, which -- sorry, mid-third quarter, which we still think is our best estimate.

Nelson Ng ***RBC Capital Markets, Research Division - Analyst***

Okay. And then my next question relates to the New York wind repowering projects. So I think you said the repowering would start next year. Is the completion date also in 2021? Or would that drag into 2022?

John Marcus Stinebaugh ***TerraForm Power, Inc. - CEO***

The completion date is 2021. So we've got basically a schedule that we're negotiating with GE that it'd be basically beginning of the fourth quarter that we would anticipate completing both Cohocton as well as Steel Winds, which then provides a good probably 6 to 8 weeks of cushion in order to make sure that turbines are online by the end of '21 to qualify for the 80% PTCs.

Nelson Ng ***RBC Capital Markets, Research Division - Analyst***

Okay. And then is there -- like in terms of the U.S. charger's potential 1-year extension, is there any potential upside for getting 100% of the PTC qualification rather than 80%?

John Marcus Stinebaugh ***TerraForm Power, Inc. - CEO***

I don't think so. Because in order to access the 80% PTCs, we've been working with GE to purchase turbines that have been warehoused at that level. So where we are in terms of finalizing our turbine supply agreement, tax equity agreements and all that -- the other project documents, we're well down the path. So our focus is on basically get our documents executed, maintain the schedule that we're on for the 80% PTC turbines, and our economics have always been predicated on the 80% PTC turbines.

Nelson Ng ***RBC Capital Markets, Research Division - Analyst***

Got it. And then just one last question. In terms of interest expense on the regulated wind and solar segment, I think there was a material increase from $15 million to $21 million during the quarter. Does that include some onetime costs? Or is it purely due to the recent tuck-in acquisition?

Michael Tebbutt ***TerraForm Power, Inc. - CFO & CAO***

Nelson, it's Michael. It's predominantly related to the acquisition that we've completed end of December and in February.

Operator

(Operator Instructions) At this time, I'm showing no further questions. I would like to turn the call back over to Sherif El-Azzazi for closing remarks.

Sherif El-Azzazi ***TerraForm Power, Inc. - Head of IR***

Thank you, operator. Thank you, everyone, for joining us today. This concludes our call.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.