SolarCity (SCTY) Earnings Report: Q3 2014 Conference Call Transcript

The following SolarCity conference call took place on November 5, 2014, 04:30 PM ET. This is a transcript of that earnings call:

Company Participants

- Aaron Chew; SolarCity; IR
- Lyndon Rive; SolarCity; CEO, Co-Founder
- Tanguy Serra; SolarCity; COO
- Brad Buss; SolarCity; CFO

Other Participants

- Patrick Jobin; Credit Suisse; Analyst
- Brian Lee; Goldman Sachs; Analyst
- Krish Sankar; Bank of America-Merrill Lynch; Analyst
- Paul Coster; JP Morgan; Analyst
- Ben Kallo; Robert W. Baird; Analyst
- Philip Shen; Roth Capital Partners; Analyst
- Josh Baribeau; Canaccord; Analyst
- Edwin Mok; Needham; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Greetings and welcome to the third quarter 2014 earnings conference call.

(Operator Instructions).

As a reminder, this conference is being recorded. I would now like to turn the conference over to your host, Mr. Aaron Chew, Vice President of Investor Relations. You may begin.

Aaron Chew (IR):

Thank you, and good afternoon to all those joining us today for SolarCity's third-quarter 2014 earnings conference call. Leading the presentation today will be a discussion from our Chief Executive Officer, Lyndon Rive and our Chief Operating Officer, Tanguy Serra, as well as some final earnings commentary from our new Chief Financial Officer, Brad Buss, after which point in time we will open it up to questions.

As a reminder, today's discussion will contain forward-looking statements that involve our views as of today, based on information currently available to us. Forward-looking statements should not be considered a guarantee of future performance or results, and reflect information that may change over time. Please refer to SolarCity's shareholder letter issued today as well as the slides accompanying this letter, as well as our periodic reports filed with the Securities and Exchange Commission for a discussion of forward-looking statements and the factors and risks that could cause our actual results to differ from our forward-looking statements. We do not undertake any obligation to publicly update or revise any forward-looking statements.

In addition, during the course of this call we will use a number of specially-defined terms relating to our business metrics and financial results, including non-GAAP financial metrics. We refer to the definitions of these terms and the required reconciliation between GAAP and non-GAAP financial metrics included in the shareholder letter today and slides accompanying this presentation which are available on our Investor Relations Web site at investors.SolarCity.com.

With that finally behind us, I would like to introduce SolarCity's Chief Executive Officer, Mr. Lyndon Rive.

Lyndon Rive (CEO, Co-Founder):

Thank you, Aaron. Q3 was a record quarter for the company. We booked 230 megawatts which is 150% increase from Q3 last year. We also installed 137 megawatts which is 77% increase from Q3 last year. Our residential installations increased by 100% though. The last three months have been amazing. We launched 4 new products. I'm super pleased with the entire team for all the hard work they did on launching these new products.

The first product we launched is MyPower. MyPower broadens the offering to our customers that want to own systems but they still receive the benefits of paying for power. Solar MyPower is unique as it pays off the loans with the energy the system produces. The other product we launched, two new products on the mounting hardware side, are ZS Peak and ZS Beam. ZS Peak allows us to provide more kilowatt hours per square foot and ZS Beam reduces our cost of installs for carports.

Finally, we're very happy to announce Solar Bonds. This is an additional source of capital, but more importantly, it will allow every American to participate in the energy transformation. When we normally raise capital, only institutional investors can participate, but now everybody can participate in the benefits of deploying clean energy. So as you can see, the last three months have been very, very busy.

Moving forward onto contracted payments, for the quarter we added over $800 million of nominal contracts and we now have over $4.1 billion of contracted payments coming to SolarCity . Our customer count continues to grow. We have over 168,000 customers, and we're well on our way to achieve our million customer goal by mid-2018. To achieve this, we only need to grow at 61% a year and historically we've always grown at 100% per year, so I'm feeling very confident about achieving our million customer goal come mid-2018.

Our market share continues to grow. With our vertical integrated model, it allows us to invest into our people and to our products. We have the best looking systems at the lowest cost. We've gone from 11% to 36% in less than three years. Our residential division is now larger than next 50 competitors combined.

I'm now going to now hand it over to Tanguy Serra, our COO.

Tanguy Serra (COO):

Thank you, Lyndon. Q3 was a great quarter for SolarCity with 137 megawatts deployed, of which 18 megawatts were commercial installs and 119 megawatts of residential installs, up 100% year on year. We are doubling our install capacity every year of already large numbers.

We've developed sophisticated compensation structures across the organization and infrastructure to grow our warehouse footprint and our fleet. This allows us to grow our capacity while reducing our costs at the same time. With a massive amount of proprietary, mobile accessible, Web based software to track the location of our assets and to stage (in our platform) customers. Which links our call centers and our operations centers including a number of predictive algorithms insuring no disruption in our supply chain. I truly believe we have cracked the code on growing residential solar while lowering costs at the same time.

We added six new warehouses in Q3 and will add another 14 in Q4, mainly on the east coast, in Arizona and in California, to satisfy the demand for our products. We cover 95% of the population in our core states within a 30-mile radius of our warehouses. We already cover 26% of the total population of the US.

Our commercial megawatts came in below our internal forecast. One of the main reasons for this is that we have a series of commercial projects, about 10 megawatts developer, with whom we are having issues. We were expecting 3 megawatts in Q3 and about 7 megawatts in Q4. Based on where we stand today, I don't see those systems getting installed this year.

We're on track to install 179 megawatts to 194 megawatts in Q4. The range is wide given the weather and the holiday season for inspections and the potential for commercial jobs slipping in Q1. But we don't see any significant operational constraints that we control outside of (inaudible). This implies a full year number of 505 to 520 megawatts, which is still almost doubling year on year, but 10 megawatts shy of where we wanted to end given the commercial job I mentioned earlier. Importantly, we expect to enter 2015 on track to deploy 920 megawatts to a full gigawatt in 2015.

The R&D team at Zep is continuing to innovate. After having given up a significant competitive advantage in residential installs, Jack Weiss and his team are turning their minds into the commercial space, have come up with innovative structures for flat roofs, for carports, consistent with our principals of optimizing every piece of the process from parts to labor for the overall benefit of the customer. Both ZS Peak and ZS Beam allow for significantly faster install times, reducing labor costs while increasing the production in kilowatt hours and ultimately revenue available per square foot of liner or roof.

Silevo continues to perform according to plan. The unique architecture of the cell is allowing (James Cho) and his team to continue having breakthroughs which we're excited about and hope to be able to talk about in the near future. The building in New York is on schedule and we expect to be producing modules in 2016 and ramp up to full capacity in 2017.

As I mentioned, in Q3 we saw 100% growth in residential installs, so growing our capacity and our infrastructure and a continued investment in R&D. Despite that, we have continued reducing unit costs significantly, taking another $0.13 out of the cost structure and getting us under $2 a watt, fully loaded costs. We've taken out $0.13 a watt on a unit basis in one quarter out of our cost structure, massive achievement.

The vast majority of these costs are fundamental productivity improvements for which I'm incredibly proud of the men and women at SolarCity . Our sales and our operations group work as one team and we're all focused on the build cost of our assets. I'm particularly focused on our installation costs as at scale overhead will not be significant. And the number one reason for not going solar is people don't know about it. As solar becomes like other basic services, insurance or cell phones, the cost of acquisition will fall as we have seen in those industries.

I should mention our quality and safety are at all-time highs, proving our best in class productivity and cost structures, quality and safety do truly go together. We have seen other industries also.

Page 12 has a chart I'm particularly happy with. Over the last 8 quarters, we have continually been taking out costs. We IPO'd a cost structure of $3.93 a watt. We have taken our total costs down to $2.90 a watt. This is all the cash out, including all the sales costs, all the overhead, all of our R&D, the infrastructure growth, the government affairs team, legal, et cetera, et cetera. All in costs, under $3.00 a watt at $2.90 a watt currently right now.

Take out $4 per watt or 25% of our total cost structure, a third of the install cost in under two years while doubling and installing half a gigawatt. Summarized in a couple of PowerPoint slides, the massive amount of work and the sacrifice 7,500 SolarCity employees have done over the last 8 quarters. I'm incredibly grateful to everyone wearing the SolarCity logo on their shirt today.

Last quarter we set ourselves a goal of $1.90 a watt installed cost by 2017. In light of our recent performance, we are ready to reach this number, but we also want to communicate conservative goal of an all-in cost of $2.50 a watt. As you can see, this assumes marginal reduction costs of acquisition overhead. Jonathan

Beamer and the entire marketing and sales organizations are all over transforming how solar is sold at significantly lower cost and we hope to be able to update this number as our efforts kick in.

Lastly I'm about to pass the floor over to the only person who is more allergic to overhead than I am, my partner and SolarCity CFO, Brad Buss. Brad, over to you.

Brad Buss (CFO):

Thanks, Tanguy. You're a cost animal and as a CFO I really appreciate that. Hi, everybody. I'm very excited to join the team. This is a fascinating company at a fascinating time and sure makes my time in semiconductors look much slower than what it really was. I'm very excited to be here working with the team on costs, returns, and more importantly, driving a long term value creation. I see that as very heavily in our cards and one of the main reasons why I joined.

So one of the first questions I get from people is, what happens to the business post the planned ITC step-down in 2017? My answer is, it's really business as usual. Pete and Lyndon have built this company from day one on driving to a cost structure that is very profitable. And more importantly in a non-incentivized world. As Tanguy has shown you, we have a strong cost discipline which I'm very grateful for as a CFO. And our target of $2.50 in 2017 will allow us to drive very healthy profits and return through the long run with NPVs greater than $1 per watt. In addition, I think the competition will struggle to be anywhere near this cost target. And more importantly, this overhang that many of you get hung up on will be gone and you'll be able to model the business long term with even greater confidence.

As well, any extension or any other incentive would only be upside to the model and we will take that if and when that comes. Retained value is a very strong indicator for the long term value that we're creating and it really isn't apparent from reading our financial statements. The Q3 increase in retained value grew 104% year over year and we ended the quarter with a cumulative value of $2.2 million. The quarterly increases will continue to grow materially each quarter as the law of large numbers and rapid growth work in concert. Go do the math like I did before I joined for the next three to five years and I think your jaw will drop regardless of the assumptions that you will use.

So just some housekeeping on the financials. We had a lot of stuff going on in Q3 and I just want to highlight some of it just to put it in perspective. So on the convert, we issued 500 million of convertible notes at a fixed rate of 1.625%. The conversion price is $83.53 and we also purchased a cap call, which is the first time it's been done here at SolarCity , in a separate transaction. That will end up raising our net as converted price upon expiration to $126.08. Obviously a very bullish sign of what we expect for the future. I'd be disappointed if we don't go north of that by that timeframe.

The green shoe was exercised in October for $66 million and again, we have the same cap call on that piece. Silevo closed in late September and there's a lot of accounting that goes with that. We issued 2.28 million of shares and there was a lot of balance sheet impact that you can see in our 10-Q that will come out tomorrow. Overall the integration has gone very well. We're focused on bringing Buffalo up and introducing new products and driving our costs down.

As you'll see, our GAAP net loss was smaller than expected due to tight OpEx controls and also due to the one time noncash benefit in the tax line related to our Silevo acquisition where we released a portion of our valuation allowance. In addition, we ended the quarter with GAAP earnings per share, yes I said earnings, due to a higher share of the loss being absorbed by our non-controlling interest under the HLBV accounting rules. I don't expect that to continue on an ongoing basis. As you know, it varies wildly and will fluctuate and we're not guiding for that for Q4.

Solar Bonds I'll discuss a little more later, but there's no impact to Q3 since we launched in October. Basically the same thing for MyPower. I'll cover that as well, but there's really nothing of any material amount that was in the Q3 numbers.

So as you see, we've moved our earnings release to a shareholder letter concept. It's our first attempt to try to describe our business model and results in an easier fashion. Since quite frankly the GAAP accounting doesn't fully reflect our business and the value that we're creating, the team here is very focused on providing more details. I think you'll see continual changes over the next few quarters and if you have any suggestions or ideas, please reach out.

If you go through our GAAP statement of operations, a couple of things I'd like to point out. The operating lease revenue increased 110% year on year. Gross margin was 51% and that included $2 million of intangibles. If you exclude the intangibles, we had really an operating gross margin of about 55%.

The vast majority of the operating expenses which totaled $100 million were incurred to add the additional $804 million of contracted payments as we discussed earlier, very good leverage on each dollar invested. Also in our Q3 OpEx, we had $60.5 million of noncash expenses associated with stock based comp as well as some intangible amortization and we also had a benefit of $6 million from the receipt of some certain insurance proceeds.

On the balance sheet if you look at the cash end of it, you'll see cash and you'll also see investments for the first time. That totaled $733 million. A lot of ins and outs. We obviously have the convert, as I talked about, that after the cap call netted us about $431 million. We had tax equity proceeds of $223 million, ABS proceeds of $196 million, and we put out $137 million in various debt payments. We also invested $343 million into new solar system assets. So again, you'll see a lot more detail and explanations in the 10-Q.

Overall I would just say I think our finances are in very good shape. I don't see the need to do any type of equity raises any time soon. We're adding new global banking partners and I think long term you're going to see us continue to focus on dropping our cost of capital.

Solar Bonds, very excited to see that product and be part of that. Our plan is to broaden our pool of solar ambassadors, allow retail investors to achieve better than market returns which are quite frankly pathetic right now, as well as participate in the distributed generation revolution. We rolled it out as a soft launch. It's exceeded our early expectations and we've had page views of over 100,000 and we've signed up bondholders in every state in the country. We will begin the first wave of marketing next week, post this earnings. And due to the fact that we have an open registration, there's not a lot of details we can provide at this time. Please go see the Web site for more details.

MyPower, a very popular question lately and as Lyndon said, it's an extremely important product for us. I mean the most important thing is it expands the available market. For us we're now able to capture homeowners that want to own versus lease. It's being very well received across all markets and it's also the first product that doesn't require financing through tax equity funds and also allows us to have the homeowner under contract for 30 years versus the standard 20-year contract plus the 10-year renewals. All very positive from a financial perspective.

The introductory rate is 5% and we'll go down to 4.5% if you sign up for ACH. We plan on evaluating the rate periodically and we'll adjust it as necessary. In the end, the incremental retained value we're creating with this product, as well as adding new customers, is very healthy for the long term returns of the company.

I'll now finish up with some guidance. For Q4 2014 we're expecting megawatts deployed of 179 to 194 driven mostly by residential. This will yield you 505 megawatts to 525 megawatts for the year and obviously excludes the commercial job that went sideways as Tanguy described. Operating lease and solar energy systems revenue of $47 million to $52 million. Remember we get a little bit of Q4 weather seasonality that impacts that number and the same for the gross margin. I would see solar systems sales of $20 million to $24 million driven mostly by commercial. The operating lease gross margins, again, 35% to 40%, impacted by the weather seasonality and a tick up in intangibles from Silevo. If you adjust the intangibles, you'll see operating lease gross margins of 45% to 50%.

Operating expenses of $118 million to $128 million, up from Q3 really due to just hires that we're doing in the sales end of things to drive the future growth. And remember, included in that we have $22 million to $28 million of noncash expenses related to stock based comp and intangibles. And if you roll that all together, I would expect a non-GAAP loss per share of $1.25 to $1.35. And again, that's doesn't include any assumptions for HLBV due to the inability to forecast that.

As Tanguy discussed, our 2015 megawatts deployed have bene adjusted up to 920 to a gigawatt with very high confidence. In summary, I'm very excited to be here. It's an amazing company at the start of an amazing journey. I've been very impressed with the financial discipline. I love the market leadership. And more importantly, we're just in the infancy of a long ride. So if you take a look at the retained value that we're talking about and look at growth rates in the future, it's pretty amazing. So all I'd say is buckle up, it's going to be an amazing ride. And we'll now turn it open to questions.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions). Patrick Jobin, Credit Suisse.

Patrick Jobin (Analyst - Credit Suisse):

Good afternoon, guys, and nice work on reducing that all in cost number. So a few quick questions for me. First, it seems like backlog is building a little bit. I guess, Tanguy, how are you thinking about installation capacity today to get to that Q4 number? How you're alleviating that? Then I have a follow on. Thanks,

Lyndon Rive (CEO, Co-Founder):

This is Lyndon. So the -- there's no real constraints in the operations. So if you look at the bookings that we had in Q2, it was 218 or so. That's now getting installed, a majority of that's getting installed now in late Q3 and Q4. We do have some commercial projects that push out, and then we also have, in the net bookings of the last quarters, there are some cancellations. And those cancellations get netted out in the next quarter's bookings. So currently the only constraint is Massachusetts, right, Tanguy?

Tanguy Serra (COO):

Correct. That's exactly right. We've cracked the code on how to grow here and so we're growing to make sure that we bring installers on time, to make sure that we develop the megawatts that they can build. The only place which is hard is Massachusetts where the licensing requirements there are somewhat annoying and difficult to deal with. But everywhere else is in great shape.

Lyndon Rive (CEO, Co-Founder):

Then our install timeframes for the average -- so the median is about 85 days right now?

Tanguy Serra (COO):

75.

Lyndon Rive (CEO, Co-Founder):

75. And then the average is about --

Tanguy Serra (COO):

On average it takes us 75 days to install across the company and that includes some of the longer timelines in Mass as well as some of the Nevada jobs where they were sold before the install, the program opened up. So there's some natural sort of timelines there. But overall, we're in great shape.

Patrick Jobin (Analyst - Credit Suisse):

Got it, makes sense. Then just a question when I think about profit margins on new contracts. So I guess certainly retained value will become a little bit more complicated with the loan product.

But if I look at Q3, I'm calculating an incremental retained value per watt of about $1.72 versus last quarter's $2. I just want to better understand what drove that decline. And then bigger picture, how you're thinking about I guess NPV per watt for loan versus lease and what your expectations are for mix. Thanks.

Aaron Chew (IR):

Hey, Patrick, it's Aaron. I'll tackle the first and let Lyndon tackle the second one. So on the implied derived incremental retained value, really three things there. One is a little bit lower resi-commercial mix. A little bit, not a huge factor. But the bigger driver actually was that the commercial incremental was just below the low end of our historical range just because of some specific -- the economics of some specific projects signed that quarter.

Also, resi was down a little bit, but still I'd say in the $1.80, $1.90 range, reflecting, as we have discussed a little bit in the past, the new California pricing strategy.

Lyndon Rive (CEO, Co-Founder):

A little bit of add on to there is, hopefully I've been consistent on every earnings call, the incremental unit is not the unit that one should be looking at. One should be looking at the total retained value. Because what's important is how many dollars are we collecting? On the dollars per watt, I don't think that's the metric. If you had the choice of deploying 2x the megawatts, but at a 20% less retained number, it would be wise to do that.

Then on MyPower, out of the gate it's been received quite well. This is a total guess, this is not a forecast at all, it's just an expectation, what I think will happen. I'd say probably mid to late next year, Q2 to Q3, we'll be at a run rate, not for the year, but at a run rate at about call it 40% to 50% of our residential business. So we like it. We think it's going to be a great product for us to launch.

On the interest rates, as Brad mentioned, we have essentially an introductory interest rate of 4.5%. We'll continue evaluating that and it's a very high probability we'll increase that we just don't know exactly when. Do we increase it in Q1 or Q2. But that's roughly the timeframe that we're looking at.

Operator:

Brian Lee, Goldman Sachs .

Brian Lee (Analyst - Goldman Sachs):

Hey, guys, thanks for taking the questions. Maybe to follow up on those comments, Lyndon, on MyPower specifically, I was wondering, can you give us any better sense from a logging perspective where you think it adds the most potential to be additive in the next 12 months? So are there states that you now target that you haven't before and what are those? And then in the states you're in already, where do you see most upside from MyPower and what are some of the dynamics that might be driving that in those locations?

Lyndon Rive (CEO, Co-Founder):

In terms of new state expansion, it's very hard to move the needle. At the size that we are right now, no new state can move the needle within a one year period. It's going to be very hard to do that. It takes -- every other state is doubling so you start off with a small foundation in a new state, it takes a few years for that to really impact the business.

So if you were to look at MyPower and actually look at the impact to the business, it will be what's in our existing states. And out of that I'd say the popular states will be Arizona and California would probably be the two most popular states, then Colorado.

Brian Lee (Analyst - Goldman Sachs):

Okay, fair enough. And then just a follow-up question would be on the competitive landscape. I know there seems to be some growing concerns here in the market that pricing is potentially getting more competitive, maybe some chatter around aggressive pricing tactics by some of your peers.

And so as the market starts to consolidate, which it seems like it is if you look at the market share stats, just wondering how you're expecting pricing to trend from here and whether or not this fixed pricing strategy that you recently introduced allows you to raise prices along with utilities I guess over the next 12 months if that's the trend as it has been in states like California.

Lyndon Rive (CEO, Co-Founder):

Yes, so two things on that. So we essentially have two competitors. You have your current cost of retail energy which is Competitor A which to us is the number one competitor. And then you have solar competitors. So in terms of the Competitor A, the current energy provider, their costs continue to go up and our fixed pricing should be able to go up.

But then you have to match it up against competition. And our current cost is lower than our competitors by a healthy margin. We're also the only company to have successfully securitized our assets, so our cost of capital is also better. So they are pricing -- they're doing it purely for market gain not because it's going to add initial volume, or initial NPV for them. So we would have to react to it. Now the benefit is, we have the lowest cost structure.

But I don't see us moving it. The early indication is I think we're going to hold tight at $0.15 in California and then we've launched our fixed pricing in all the utilities that we're in. And I haven't got -- it hasn't yet needed to move it and the market is pricing very similar to one another. So I think we'll hold next year.

Brian Lee (Analyst - Goldman Sachs):

Okay, thanks for the color.

Operator:

Krish Sankar, BofA Merrill Lynch.

Krish Sankar (Analyst - Bank of America-Merrill Lynch):

Hi, thanks for taking my question. I have a couple of them and I do apologize for the background noise. First is, do you guys right now have the personnel to do a gigawatt for next year? And along those same lines, is the plan to grow the business with minimal backlog or do you want to grow backlog as you start going into 2015? I also have a follow up.

Tanguy Serra (COO):

I'll take the first piece. So the answer is no, we don't have the personnel currently. And I would separate that out by two buckets. It would be sales and install personnel versus the overhead personnel. Sales and install personnel by definition, you want to make sure that you're matching onboarding people and megawatts to be deployed to insure that you've got a cost structure that makes sense.

So what we have though, however, and this is probably the most important point, which is we've got the infrastructure, the recruiting teams to be able to onboard that personnel. So from an overhead perspective, the answer is yes. From a variable cost perspective the answer is no. But we feel very good that we've got the (inaudible) to be able to onboard those people. That's the first part of the question.

Lyndon Rive (CEO, Co-Founder):

Let me answer that. Aaron, just remind me again, what was the megawatts installed in Q1?

Aaron Chew (IR):

82.

Lyndon Rive (CEO, Co-Founder):

82. So we installed 82 megawatts in Q1, so within 3 quarters, we're now planning 190. So it is clear that the company knows how to scale.

Brad Buss (CFO):

Yes, and guys, just from a financial perspective, it's very impressing what the team -- they have a copy paste ability, they have fantastic tools upfront from a booking and where the market is going. And they know where they want to go and where they need to be and then they're able to just recruit, copy, paste, drop in, right ahead of time. So we don't need to build up a bunch of costs that are stuck there for a while. And it's operated very, very well so far, so I have 100% confidence on the ability to scale from a deployment perspective.

Tanguy Serra (COO):

Then the other question is no, I mean I think it's just a better customer experience. If you're able to get a sale or sign up for solar, get a site survey within 5 days, very quickly get a design turnaround, within 24 hours. And then as soon as your permit in your local jurisdiction allows you to get, get it installed on your roof. I just think it's a much, much better customer experience. And I think that's ultimately what matters here is the customer experience. Then if we can combine an awesome customer experience with best in class cost structures and continue to scale, that feels pretty good to me.

Krish Sankar (Analyst - Bank of America-Merrill Lynch):

Got it. Thank you, that's helpful.

Lyndon Rive (CEO, Co-Founder):

One other point on that. I'm not sure you know this, we actually increased our forecast for next year. We took up the bottom end from 900 to 920.

Krish Sankar (Analyst - Bank of America-Merrill Lynch):

Right. Thanks for that. And just as a follow-up, is any of the MyPower expectations rolled into your one gigawatt forecast for next year, or would MyPower be additive to the forecast? Thank you.

Lyndon Rive (CEO, Co-Founder):

No it's included in the one gigawatt.

Operator:

Vishal Shah, Deutsche Bank.

Unidentified Participant:

Hi, this is Jeremiah on the line for Vishal. Thanks for the question. I just wanted to delve a little deeper into the cost structure here. You guys have made some good progress there and the 2017 goal doesn't seem that far off. So how conservative is that? And how much is that sort of a function of the scale in the back half of the year?

Tanguy Serra (COO):

I think you answered your own question.

Lyndon Rive (CEO, Co-Founder):

In all seriousness, we were going back and forth, do we even forecast the $2.50. One of the concerns of forecasting the $2.50 was we feel very comfortable we will exceed that number. So do we forecast that, do we want to give a more aggressive number? So we feel that it would be more appropriate for us to forecast the $2.50. You can do the math on it. With a 10% ITC, we create a buck of value for every system we deploy.

Assuming our million customer goal, we'll be at around a 2 gigawatts run rate, that's $2 billion of incremental value every single year if we stay flat. So that's kind of the message that we wanted to convey. And then you can play around with assumptions, okay, is it $2.50, or do we come in at $2.30, you can play with your own assumptions there. As we get better at our sales and marketing, get more leverage through OpEx, and reduce our overall costs, we'll update that number.

Brad Buss (CFO):

And just another tidbit, the entire company is very heavily on performance bonuses up to and including the stock. And Tanguy and I are very aligned in that perspective on driving costs down.

Unidentified Participant:

Great, that's helpful. And then also, on the commercial side, given the issues that you had in the quarter and sort of the commentary around that, would there have been any change to the traditional 80/20 mix of residential versus commercial? Or are you sticking to that?

Lyndon Rive (CEO, Co-Founder):

For now we're still sticking to that. We're still investing into commercial. Some of these slips are bound to happen when you deal with commercial. But no, we're still sticking to 80/20.

Operator:

Paul Coster, JP Morgan.

Paul Coster (Analyst - JP Morgan):

Thank you. A couple of quick questions. First off, there's clearly a little bit of a supply constraint in the panels coming out of China, at least near yearend. Is that in any way a constraint at the end of this year or the beginning of 2015? Then I have a quick follow up.

Tanguy Serra (COO):

No, so our scale -- we're the perfect business for these businesses. If you think about the Chinese panel manufacturers, they don't obviously have massive output. And what they really care about is a consistent throughput that they can put into us. And our resi business in particular is literally a weekly demand and so we're able to absorb on a weekly basis the amount that comes out. So we're typically a first choice for a number of these panels and we've had no issues there.

Paul Coster (Analyst - JP Morgan):

Good. Then if you deliver on these costs and your customer targets, gigawatt targets, then obviously this is going to be producing a huge amount of free cash flow after 2017. And I'm just wondering, you must be a bit frustrated by the fact that the stock is trading at a discount to the retained value. So is it possible for you soon to articulate a dividend kind of strategy, albeit forward dated, and start to sort of have a target dividend expressed so that people can start looking at this from a free cash flow or dividend perspective?

Brad Buss (CFO):

Yes, hi, this is Brad. I don't think you're going to see a dividend in the cards anytime soon. I mean if you really look at it, every dollar we generate, plus taking advantage of a low cost of capital, that as I mentioned I think will only get better going forward, we plan on reinvesting every nickel with as much leverage as is rational for a long time. I think what you're hitting on, though, is if you look at kind of the power business so to speak, all that future retained value, levered, unlevered, and the cash flow and margins that could come with that, that is one of the big areas that we're spending a lot of time working on internally to help provide more information and that I think we will be setting longer term targets associated with that. But I don't want anyone thinking there will be a cash dividend, because as far as I can see, if something dramatically changes, we can be investing in this market for eternity.

Lyndon Rive (CEO, Co-Founder):

Even at our million customer goal, we still only have a 2.5% penetration just in the markets that we serve today. So the best use of our cash is to reinvest.

Brad Buss (CFO):

Yes. I mean we'll go international, we'll go to other states, we'll add additional service offerings into our model. If you really look at it, we're evolving into really a consumer oriented internet/energy provider/financial institution. So I don't think there's going to be any limit on the number of things that we can add to provide greater returns than a dividend. And being 50 years old, I do appreciate dividends, but I think I would look for it in a different area.

Operator:

Ben Kallo, Robert W. Baird.

Ben Kallo (Analyst - Robert W. Baird):

Hey, guys, thanks for taking my question. Just looking at the tax equity capacity, 150 megawatts, could you just talk through that and how comfortable you feel? It looks like it's less than a quarter ahead, so what's changed there? And then I have a follow up.

Brad Buss (CFO):

This is Brad. I think we're fully booked up for the end of the year. I mean that is definitely a different animal. I think the thing that I've been very positive on is obviously with us being the market dominated - the market driver in this area, we're seeing more and more appetite for this asset class. We're seeing a lot of movement out of the bigger utility deals and I think even wind as this asset class becomes more mature.

So Yes, I don't think it's something we're ever going to have a full year in advance, but we spend a lot of time on it, we have a lot of interest from all the major banking, insurance institutions, as well as a lot of the major corporations that obviously have big tax appetites and only continue to grow.

Lyndon Rive (CEO, Co-Founder):

Yes, the goal of course is to increase that backlog. But what we find is that when we raise the capital, the investors want us to deploy the capital. Investors -- if we sit on the capital for a long time, they don't like that. They like coming back for repeats and continual repeats. So expect probably a quarter for now if Brad can change some stuff there.

Brad Buss (CFO):

Yes, and again, I'm trying to evolve the whole financing to the company to what I call the financing factory. Because we really are like a factory. We're adding tens of thousands of customers, very repeatable, very consistent assets. And we're trying to evolve all the financing to try to stay on that factory-like concept and be very repeatable, somewhat standard terms.

The nice thing is, we can give a lot of the big corporations -- they weren't that excited at seeing $25 million or $50 million because it's a lot of work to do a deal. But now with our size and the dollars, we can be giving hundreds of millions to a corporation which gets them very excited and then they can see that we can continue to give that over a long term basis. And that gets them very excited. So that's kind of the big focus for 2015.

Ben Kallo (Analyst - Robert W. Baird):

Okay, and then if I can, just two quick ones. NPV a watt for MyPower and then I think there is a little bit of -- concern, I don't know, may be too strong of a word, about deployments as I look out to next year saying you're going to do 800 or so megawatts of residential and your run rate of just over 100. Could you tell us about how you did in October since that's passed?

Lyndon Rive (CEO, Co-Founder):

No, we don't want to break out on months, so we're sticking to -- we feel very confident about the 800, but we don't want to break out the months.

Ben Kallo (Analyst - Robert W. Baird):

Okay, got it. Then the incremental, the NPV per watt for MyPower?

Brad Buss (CFO):

I think it's a little early right now. We got -- I think we'd like to get a good quarter under our belt with the business to see what state and what it's coming at and then we'll give you some more color in the next quarter. Again, like I said earlier, it's a very healthy NPV and I would take MyPower projects all day long.

Ben Kallo (Analyst - Robert W. Baird):

Thank you very much, guys. Congratulations.

Lyndon Rive (CEO, Co-Founder):

Just one point on the 800 megawatts, Tanguy just mentioned this, is if you use Q4 as the proxy, you can do the math.

Tanguy Serra (COO):

Can't give out October. If you use the quarterly guidance for Q4, break out the residential there and multiply by 4, we're in pretty good shape.

Ben Kallo (Analyst - Robert W. Baird):

Got it, thanks.

Brad Buss (CFO):

I'll be disappointed if Tanguy doesn't hit that number.

Operator:

Philip Shen, Roth Capital Partners.

Philip Shen (Analyst - Roth Capital Partners):

Hey, guys, thanks for taking my questions. I was wondering if you can articulate your strategy and technology behind expanding your Web presence? Perhaps help us understand what the potential impact is to your cost structure and what the timing of that might be?

Tanguy Serra (COO):

Sure. So the Web presence, there's two aspects to it There is the sort of presale or preinstall and post in the installation period. And those are two discrete periods. The online presale piece I think is critical. As we think about cell phones, insurance, or Uber or other consumer services where you can sign up, I think that Web experience, whether it's mobile or on a desktop, I think is very, very important. Just ease of making it simple and frictionless to be able to sign up for a service. That is -- there's a number of great applications out there and I think we're going to have a phenomenal product, totally frictionless online sales which we're incredibly excited about. As you can imagine the cost of acquisition through that channel becomes very, very attractive. That's one piece of it.

And the second piece of it obviously is, post the sale, once the customer is in that period between the sale and the install, where we're going to work in the background, but where nothing happens, for me I think the best proxy there is the Amazon , Chevrons where you know exactly where your package is. Or the Domino's pizza where, again, same thing, you see exactly who's having your pizza and who's doing with what. I think giving customers that experience of just showing where they are in the process I think is incredibly powerful. In terms of costs, think of one, a significant benefit in cost of acquisition. Secondly, a significant benefit on time between sale and install and just getting customers more informed. And then also some marginal costs on our increased throughput. But the key one is on cost of acquisition.

Brad Buss (CFO):

Yes, I think -- I don't think you're going to see any major step up in OpEx for it. We have the team, we have the engineers in place, and I think you'll be pleasantly surprised where we end up relatively soon. And if you haven't had a chance to go through the process online, go do it. It's pretty amazing. And it's only going to get exponentially better as Tanguy said. We expect to have a very large percent of our business done through the Web over the next few years.

Philip Shen (Analyst - Roth Capital Partners):

Great. What kind of mix could we actually see?

Lyndon Rive (CEO, Co-Founder):

Web versus direct sales? Is that --

Philip Shen (Analyst - Roth Capital Partners):

What kind of mix of Web and direct sales?

Lyndon Rive (CEO, Co-Founder):

It's just too early for us to forecast that now.

Philip Shen (Analyst - Roth Capital Partners):

Okay. As a quick follow up to a prior answer or question, you guys talked about your blended turnaround times of being 75 days. What do you guys expect going forward? How low could it go? I think in the past you guys have said the theoretical limit might be 45 days. What are you seeing now and what's the timing of those reductions?

Tanguy Serra (COO):

Yes, I think it depends by state. So in California we're obviously significantly faster than the 75. I think we're below theoretical limits which suggest the theoretical limit is lower than that number. The theoretic limit is 24 or 48 hours turnaround, so the customer signs up, site survey that afternoon or next morning, design overnight, and then in some jurisdictions, whether it is an online or over the counter permitting process, you can get the install in that afternoon or the next day. That's the theoretical, like that's the true theoretical limit which is very, very fast. For that to happen obviously there's a significant amount of work that the jurisdictions need to do in allowing residential installer to be either over the counter or online process which we're big fans of and we're supporting that.

Lyndon Rive (CEO, Co-Founder):

And California has actually made big movements there.

Tanguy Serra (COO):

And we're incredibly good in the state of California for the movement they've done, phenomenal work by including our (inaudible) teams. So that would be a theoretical limit. And candidly that's where we'd like to get to over a long period of time. I don't think we're going to get there anytime soon, but over a long period of time. Right now we're at 75. As I said California is lower and I expect depending on the mix of the states, that number to hover around 60 to 75, hopefully below that. But that's kind of the range which we're expecting to hover around.

Operator:

Josh Baribeau, Canaccord.

Josh Baribeau (Analyst - Canaccord):

Hi, thanks. Do you guys feel like you've had to walk away from some sales given the fixed pricing in California?

Lyndon Rive (CEO, Co-Founder):

No. We are -- well let me repeat that. So fixed pricing does have a production minimum in it. In other words, if your house has really bad shading and it cannot accommodate the fixed pricing, we'll give the customer two choices. Either don't go solar or increase the pricing. So in that case we would be no different than if we had our previous pricing strategy before.

But we actually think it's going to help us as it brings total transparency. Neighbors tell neighbors, hey, how much are you paying? I'm paying $0.15. Great, I'm going to get $0.15, too. So that's simplistic in the referral and in that sales process. So we definitely haven't walked away from any customers that we wouldn't have walked away before on the previous pricing.

Josh Baribeau (Analyst - Canaccord):

Gotcha. And then maybe as sort of a follow up to that, as more of this business becomes Web based, are you at all concerned that there's going to be too much transparency and maybe even the potential for additional price competition between your peers?

Lyndon Rive (CEO, Co-Founder):

Let me walk you through a little history on the solar industry. When I got into the solar business, everything was a very, very complicated sale. Then we looked at the sales process and said clearly we can deliver more value in the proposal, really expand the customers, the investment they're making and the savings that they're getting. So then we transformed it from selling equipment to selling energy.

Then it was, okay, can you sell this over the phone? And everybody thought that's impossible to sell this over the phone. Now in hindsight, everybody sells through the phone, it's super easy to sell over the phone. I think the next step is going to be selling it over the Web. It will take some time to crack that nut, but the number one -- I want full transparency. I think the pricing is important.

Today all our competitors know our pricing, we know all our competitors' pricing. The pricing is roughly the same. We have the lowest unit cost, so if we do need to react, we will. I don't think we will need to react next year, but I do think the transparency of selling on the Web will be good.

We'll also be adding additional services. We're adding storage, we're going to have new software applications that we're going to announce that will differentiate us in the market. And actually give a tool to our customers that no one else in the industry has. But that announcement won't be coming out for some time. Stay tuned on that one.

Josh Baribeau (Analyst - Canaccord):

Okay, thanks. I'll pass it on.

Operator:

Edwin Mok, Needham & Company.

Edwin Mok (Analyst - Needham):

Hi, thanks for taking my questions. So first one, just revisit the commercial -- I think you mentioned on the call that some of the pricing may have came in at low end or below the low end of historical range. Just want to know, is that -- are you guys seeing pricing pressure in the marketplace? And I guess did you book more projects at a lower price point that caused some pressure on your retained value for the quarter? Or incremental retained value for the quarter?

Aaron Chew (IR):

Edwin, this is Aaron. I think you're just mentioning -- you're referring to the comment I made about incremental value. It's nothing market driven, it's just keep in mind commercial is very lumpy and a lot of small -- or I should say a small amount of large projects. So it just really had to do with a couple projects. It's nothing market related.

Lyndon Rive (CEO, Co-Founder):

Yes, just to add to that, we have had good growth of our commercial bookings on the east coast which is the cost per kilowatt hour is lower, but you have a big S rack that you need to include as well. So that's the differentiation between the two. So the cost per kilowatt hour which is (inaudible) and retained value. And it's just because of the volatility on that.

So when you're booking commercial, that has a lower kilowatt hour rate, it kind of -- and this is where Aaron mentioned that the commercial bookings, the retained value on that is on the low end, that's because we're not including the S racks. You've got to include the S racks when you look at the total retained value, but S racks is not in our retained value formula.

Edwin Mok (Analyst - Needham):

Actually that explanation is very, very helpful. Thanks for explaining that. And then just on MyPower quickly, I know you guys don't want to give out -- you want to wait a little bit before you give out kind of how retained value will affect MyPower. Maybe help us out a little on the cost side. Does MyPower help you in any way, shape or form in terms of costs? Maybe lower cost per average customer or something? And how does it affect your way of selling your solar product?

Lyndon Rive (CEO, Co-Founder):

Yes, in terms of -- for now we're just kind of in the same costs. If you look at the slides that Brad went through, we're essentially selling the system, depending on the state, between $4.35 to $5.60. Our cost is $2.90. So you can just kind of -- all in cost is that and we're financing that to 4.5%. So I mean that to me is the most simplistic way to look at MyPower. It's costing us roughly $3, we're selling it roughly $5. Great, we're making $2 and we're financing that over 4.5% over 30 years.

Brad Buss (CFO):

And the other big impact is the cost of capital is vastly different since we don't have to deal with tax equity. I have a fund group the size of Rhode Island managing tax equity. I don't have pressure on those administrative costs.

And again, the other big question is going to be, does the homeowner actually take the dollars he receives from the credit and give it to us to pay down the rate? I mean that's going to have a big impact on what retained value really is.

So if you assume 100% due, you get one number. If you get some mix of it, it jumps dramatically. So I think we really have to see what the behavior is going to be before we see. In the end though, I think we're splitting hairs. When you look at the growth and where we're going and whether it's MyPower or whatever other products, on a gigawatt, it's not like it's billions of dollars. It's $100 million or $200 million maybe, delta. It all becomes a rounding error a couple of years from now.

Edwin Mok (Analyst - Needham):

Okay, great. That's all I have. Thank you.

Brad Buss (CFO):

My pleasure. Feel free to sign up on line.

Operator:

There are no further questions. At this time I'd like to turn the call back over to management for any closing remarks.

Lyndon Rive (CEO, Co-Founder):

Thank you, everybody, for your time today. It's been an amazing quarter, launching four incredible products, the hard work the entire team has done. And look forward to speaking to you again next quarter. Have a good day.

Operator:

This concludes today's teleconference. Thank you for your participation. You may disconnect your lines at this time.