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SolarCity Corporation (SCTY) Earnings Report: Q1 2016 Conference Call Transcript

The following SolarCity Corporation conference call took place on May 9, 2016, 05:00 PM ET. This is a transcript of that earnings call:

Company Participants

- Aaron Chew; SolarCity; Investor Relations
- Lyndon Rive; SolarCity; Co-Founder & CEO
- Tanguy Serra; SolarCity; President and CFO
- Peter Rive; SolarCity; Co-Founder & CTO

Other Participants

- Patrick Jobin; Credit Suisse; Analyst
- Krish Sankar; BoA Merrill Lynch; Analyst
- Philip Shen; ROTH Capital Partners; Analyst
- Brian Lee; Goldman Sachs; Analyst
- Colin Rusch; Oppenheimer & Co.; Analyst
- Julien Dumoulin-Smith; UBS; Analyst
- Ben Kallo; Robert W. Baird & Company, Inc.; Analyst
- Vishal Shah; Deutsche Bank; Analyst
- Gordon Johnson; Axiom Capital Management; Analyst
- Michael Morosi; Avondale Partners; Analyst
- Sven Eenmaa; Stifel Nicolaus; Analyst
- Sophie Karp; Guggenheim Partners; Analyst
- Edwin Mok; Needham & Company; Analyst
- Pavel Molchanov; Raymond James & Associates, Inc.; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Welcome to the SolarCity first-quarter 2016 earnings conference call.

Today's call is being recorded.

I would now like to turn the conference over to Mr. Aaron Chew, Vice President of Investor Relations. Please go ahead, sir.

Aaron Chew (Investor Relations):

Thank you. Good afternoon to all those joining us today for SolarCity's first-quarter 2016 earnings conference call.

Leading the presentation today will be a discussion from our Chief Executive Officer, Lyndon Rive; our President and Chief Financial Officer, Tanguy Serra; and our Chief Technology Officer, Peter Rive, after which point in time we will open up the call to questions.

As a reminder, today's discussion will contain forward-looking statements that involve our views as of

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today based on information currently available to us. Forward-looking statements should not be considered a guarantee of the future performance or results, and reflect information that may change over time.

Please refer to SolarCity's quarterly shareholder letter issued today and the slides accompanying this presentation, 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 statement.

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 definitions of these terms and required reconciliation between all GAAP and non-GAAP financial metrics included in the shareholder letter issued today and the slides accompanying this presentation, which are available on our Investor Relations website at investors.solarcity.com.

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

Lyndon Rive (Co-Founder & CEO):

Thanks, Aaron.

For the quarter, we installed 214 megawatts. That is dramatically above our forecast of 180 megawatts was what we forecasted during the last earning call. Tanguy will give an update on the big improvement there.

Let me jump into Q1 bookings. So, Q1 bookings came in a lot lower than expected. We had a bunch of headwinds that hit us all at the same time, and I would like to walk them through. So, for Nevada, we were expecting that grandfathering would be approved the beginning of February.

At the time, everybody was in favor of grandfathering. The Governor's office was in favor of it. The solar industry, the legislators, consumers, and as well as the utilities, were in favor of grandfathering. Now, that did not happen, and that actually had a spillover effect into other states. Customers were concerned about if they go solar, would they get grandfathering.

Now, this has actually been addressed. A lot of states have made it clear that [there's 28] grandfathering. And in Q2, we are not seeing this concern much at all.

We also had a bunch of pending regulatory items in California, Massachusetts and New Hampshire. These are all open items in Q1 that now have been resolved and actually look really good for the solar industry. We now have long-term visibility in those states. And, in fact, we have never had this type of long-term clarity for some time. So, though it was rocky in Q1, we now have that clarity.

We also increased pricing in January. And with the increase in pricing, it pulled in our sales cycle. So, typically, we have about a 15 to 20-day sales cycle for residential. With our customers knowing that we are going to increase in January, they came in and made the decision earlier. What that essentially allowed -- what happened to us, then, is that starting the year, essentially flushed our pipeline and now we have to build a new pipeline.

We also, halfway through the quarter, ended our MyPower product. We now redesigned it. It's a lot better, and a lot more simple product for a customer to understand. Previously, it was kind of a hybrid between a power purchase agreement and a loan. Now it is a fixed monthly payment. Customers like it a lot more.

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We just launched it. We launched it last week. And we are expecting to see a big demand for that.

We also have different financing terms. Previously, it was only 30-year financing. Now we have 20-year and 10-year financing. We are also seeing a big increase in demand for ownership, and we want to make sure we address that market. So we are quite optimistic about our loan product that we just launched.

And then, the 30% tax credit, that got extended for five years, which is a great win for the industry. But the effect of that is commercial customers who are under time pressure to make the decision in order to get the systems installed in 2016, they now have more time to make the decision, just going through the standard procurement process. So, we are seeing the bookings increase again in Q2, but we had a lull in Q1.

Because of all these headwinds, volume was low and that increased our customer acquisition costs. These have all been addressed. So these are all temporary affected us. We are starting to see customer acquisition costs come down quite dramatically in Q2. But it will take us about two quarters to get back to normalized customer acquisition levels.

So, because of the effect of Q1 bookings, we actually now need to re-guide on the year-end guidance. So, the previous guidance was 1,250 megawatts.

The new guidance is going to be 1,000 to 1,100 megawatts. This is because of Q1 bookings. And then, as well as we are timing our commercial installations closer to interconnection from the utility. We have seen now that after we install systems and the interconnection time lag may be three to six month afterwards, so we are actually timing it to match the interconnection timeframe.

For the quarter for 2Q before costing 185 megawatts installed. But, as mentioned, these headwinds, as I discussed that hit us in Q1, they are passed now. We are looking forward to seeing the effect of our consumer loan product. The -- this will also allow us to expand into new states. There are some states that do not allow us to offer a lease or PPA, and with this new consumer loan product, we will be able to offer a lease and PPA in those states.

And then in terms of regulation or policy, we now have better clarity than we have had -- (audio gap) right on time.

But I will hand it over to Tanguy.

Tanguy Serra (President and CFO):

Thanks, Lyndon.

We installed 214 megawatts in Q1. In the 214 megawatts, there is a 14-megawatt utility scale project that came in in the last two days of the quarter, which we were really expecting to come in the first few days of April. Crews outperformed and the weather cooperated.

But nevertheless, we came in nicely above our conservative projections on our residential installation, and commercial came in where we expected. The megawatts we deployed in Q1 had a value of $3.46 per watt, down slightly from the prior quarters on the back of lower [ESRIC] pricing, and an increase in the mix of commercial deployments. The piece I am the most excited about for this quarter is how much we monetize the $728 million of financing coming in in Q1. This was a massive accomplishment by our capital markets team, led by Rad Small.

At $3.12 per watt deployed in asset financing, it is a little bit above where we expect to be on a run rate basis, given we took our assets with no back leverage, down to 76 megawatts from 257 megawatts in Q4. Financing for us really is like working capital, and the 76 megawatts represents about a month of assets

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that are in the To Be Financed bucket.

Furthermore, above and beyond the absolute dollar amount, I like where we are strategically on financing. We have monetized every piece of the value of a watt, with tax equity, residential and commercial asset debt, as well as [extra] financing. We tapped the bank markets and the securitization markets.

We also did a cash equity transaction at the beginning of Q2, and I will talk more about that later. But to summarize, we monetized $3.12 per watt deployed, or $728 million. And, as per usual, there is a memo that ties our audit plan statement explaining this number in detailed methodology.

Our bill costs continue to be best-in-class, under $2 a watt, the team led by Eric Rothenberg, who is doing a phenomenal job. Both our residential and commercial bill costs were flat in Q1 in spite of lower volume, which implies our variable costs continue to come down, and we are on track with our long-term install goals.

Lyndon talked a little bit about our sales in Q1 and part of the fixed costs were booked through yielding a higher than we would like customer acquisition costs of $0.97 per watt. Overhead is marginally up on an absolute dollar basis with some investments in policy and legal. But we feel good about where we are heading there.

Lastly, quick housekeeping note, we tweaked the methodology for capital unit costs. We added in the cancel costs as per the industry standard, but we took out the cost associated with managing the portfolio, which we are now reporting separately. And there's a full cost memo explaining the details as per usual on our website.

So as I mentioned, we've been doing a lot of work on our finance reporting in providing clarity to our business. [Regarding] showing our recurring cash flows from the generation of our portfolio. We generated $67 million of billings, paid for $14 million of maintenance costs, and as I mentioned, those costs were previously the unit costs, unit bill costs, we are taking them out and putting them in here now.

And we paid $21 million [tax] distributions, about $37 (inaudible), and we paid $14 million of interest on the asset financing, which leaves in Q1 $18 million of recurring cash flow to SolarCity.

Note that in Q1 that the cash flow from the portfolio was $27 million. That included one-off $10 million payment from MyPower customers paying down principal after their tax credit. We've gone back and checked on this historically and providing a memo on the website tying back to our financials.

When you put it all together, with the $768 million of cash we received from financing, the [$780 million] we spent to build the assets, pay for the overhead and the working capital. Our development companies roughly break even. But when you add in the $28 million of cash received from the portfolio, our solar business, our solar development business, generated $10 million of cash in Q1, even after paying for all the R&D (inaudible) our investment in Grid software that we have at SolarCity.

Cash flow positive for the solar business -- for the core solar business. Furthermore, we invested $42 million in our cell and module business, which continued success. And Pete will talk more about that. But overall, I am happy to have proven that our solar residential and commercial business can be cash flow positive and generate value contracted in [menial] cash flows above and beyond the cash.

As you might have seen, we executed cash equity trade over some of our assets. It's a great trade. We had a super high quality institutional investor diligence our assets and our processes, and we did a first of its kind trade for $227 million. There is a large class of investors that are looking for unlevered yield, and the secured new price has no reference for LIBOR and is [non-recourse to OC.

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If it is a clear floor on the value of our residential asset, at least $3.25 per watt of cash upfront and we still own some residual, and we own the 20 to 30-year residual customer relationship. I am happy to have proven out this alternative source of funding.

The thing that matters to us is keeping the customer relationship, and we offer grid services from those assets. We like the idea of leveraging in our recurring cash flows and redeploying that capital to dev co to continue lowering on costs and growing. This quarter, we also are disclosing our [ESHER] book.

This is cash flow from our assets on top of the recurring cash flow [retained] value. We generate roughly 282,000 SRECs in East Coast states, which we can monetize. And assuming on average $100 per megawatt hour, we generate another $30 million per year of cash, and the number is growing as we continue deploying assets.

The chart in the earnings deck provides explicitly contracted SRECs with investment grade offtakers that we have and the implied cash flows from those contracts. Retained value continues to grow on an unlevered basis, and given the finance of the assets and reducing the megawatts unfinanced as discussed at the beginning, the net retained value increased from [$1,963,000,000 to $1,994,000,000].

Our balance sheet continues to be healthy, and we are continuously moving assets from the -- in development from our revolver into our aggregation facilities and then to our long-term options, be it securitizations, times debt or cash equity. Opening new financing sources of takeout was an important strategic step for us.

It is important to understand that all of our debt pieces are specific assets yielding either recurring cashless or whether it is a clear financing takeout or vehicles that are tied to them, and that are engines that can deploy hundreds of megawatts has limited debt.

With that, let me pass it over to Pete to talk a bit more about the new products.

Peter Rive (Co-Founder & CTO):

Hi, everybody. Peter Rive, Chief Technology Officer. So the past couple of months, some great progress has been made towards the future vision for how rooftop solar can be compensated and integrated into utility operations. Specifically, a group of utilities and solar companies jointly proposed a long-term solution that supports net metering being in place until 2020, removes uncertainty for customers on grandfathering, and recognizes the value that solar provides the distribution system.

The post-2020 framework is basically to value these exported energy at the energy price plus the value to the distribution system plus the environmental benefits. This approach should work for us and is in line with our goal to include storage with most of our solar systems around that timeframe.

Additionally, a big part of the discussions we are having with regulators and utilities surround additional business model opportunities created by customer-sited energy resources. And to that end, we are excited about some product releases that address utility infrastructure needs, which is more than a $50 billion a year market.

We now provide products and services for firm generation as well as the transmission and distribution system, now seeing a 3X growth rate in this area. We have over 100 megawatt hours of storage under contract, and plan to complete one of the planet's largest firm and dispatchable solar systems in Hawaii this year. We are also engaged in several pilots with some of the largest investor-owned utilities to prove the benefits of our control systems within the distribution system.

Grid functions that have traditionally been performed through equipment like transformers and capacitor banks can now be performed by solar inverters, providing us with opportunities to extend our income

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streams beyond the sale of energy.

And with that update, I think that we are moving to questions and answers, I believe?

Aaron Chew (Investor Relations):

Operator, we will open up to Q&A, please.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions)

Patrick Jobin, Credit Suisse.

Patrick Jobin (Analyst - Credit Suisse):

Thanks for taking the questions. First question just about the cash equity financing, what is your outlook for that market or source of capital for remainder of the year? And then thanks for this disclosure. We are kind of backing into just over an 8% unlevered IRR. Is that about right? And then I have a few follow-ups. Thanks.

Tanguy Serra (President and CFO):

Hi, Patrick. Thanks, it's Tanguy. So look, we this -- the thing that is clear to us having done the work here is that this market is real, exists, and there is market participants that they are very, very active in it. They typically have had exposure to the residential and solar assets but invested in a number of different infrastructure classes.

So I think this market, as I discussed, is reasonably big. Since we announced this, we've had a number of inbounds. But, at this stage, we are not willing to make any commitments for the rest the year. But it's a -- it's clearly an asset class that has interest from some of the largest, most sophisticated institutional investors on the planet.

And then the specific terms of this specific agreement don't allow us to disclose the discount rate, but we have disclosed, I believe, enough information for you to do your work. And it's -- your number is probably right.

Patrick Jobin (Analyst - Credit Suisse):

Okay, and then my second question, I guess it's a two-part question, relates to the cost structure. Just when we think about putting fewer volumes through the system here in 2016, given the bookings challenges in Q1, how should we think about cadence of total cost structure through the end of the year, where you think you can end the year?

And then the related question, I guess, relates to mix. How sizable would the C&I mix be in the volume guidance now? And what, if any, volumes are you including with the utilities, scale, solar and storage? Thanks.

Tanguy Serra (President and CFO):

So the -- Pete mentioned there is a project in Kauai that he took scale that we would be building out. That one is clearly in the guidance. The rest of the mix is roughly the same mix as historically, call it 80/20, residential/commercial. We continue on that mix. Does that answer your question?

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Lyndon Rive (Co-Founder & CEO):

And then the cost question, the equipment costs we have clear --

Tanguy Serra (President and CFO):

We variable-ize significantly the install cost structure, so that number is going to continue to come down on a like-for-like basis. So, residential assets are going to continue getting built for less. There are some procurements benefits that are going to ripple through. Cost of panels are going to quickly to decline as well as cost converters. So those numbers are going to keep coming down.

And then, Lyndon had some comments around the cost of acquisition --.

Lyndon Rive (Co-Founder & CEO):

Yes, the cost of acquisition will come down quite dramatically in Q2. But it will probably take about two quarters or so before we get to normalized acquisition levels that we have seen in the past.

Peter Rive (Co-Founder & CTO):

And also, I think they were -- on the utility-scale question, like we are carving out a pretty special niche here, and a differentiated type of generator when you combine solar and battery. So it's not like a typical utility scale solar economics.

Like with Kauai as an example, it is about $0.14 a kilowatt hour PPA, and it is a very different type of PPA and that it is combined with a battery in the energy is available at night. But the same is also true with the project that we are finishing installing right now in Connecticut. It's a combination of a power purchase agreement with a capacity agreement.

So the majority of the utility scale business that we are pursuing is this kind of hybrid between solar economics and battery economics. But it's not like we are signing up $0.03, $0.04 a kilowatt hour utility scale projects or anything like that.

Patrick Jobin (Analyst - Credit Suisse):

Thank you.

Operator:

Krish Sankar, Bank of America Merrill Lynch.

Krish Sankar (Analyst - BoA Merrill Lynch):

Thanks for taking my question. I had a few of them. First one, Lyndon, a high-level question. If I look at it over the next last couple of years, it has been a lot of moving parts. You guys wanted to retain assets now. The focus is shifting a little bit. We are willing to sell maybe for price discounting, whatever it is, you change focus from growth to cost reduction. So my big picture, first question is what exactly is the business model of SolarCity? And I had a couple of follow-ups.

Lyndon Rive (Co-Founder & CEO):

So the business model of SolarCity is to provide energy at a lower cost than you can get it today from fossil fuel. And then long-term, our goal is to transform energy infrastructure to a renewable energy infrastructure. In doing this, there are many different products that customers want. Some customers prefer a power purchase agreement, some customers prefer leases, and we have seen a growing demand for customers wanting to own the equipment. And that is where we have solar loans.

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But to answer your question -- I think there was another question on volume and cost optimization. Yes, we have reduced volume and we are focusing on cost optimization for this year.

Krish Sankar (Analyst - BoA Merrill Lynch):

All right. Did you guys quantify what exactly would be the cost exiting calendar 2016?

Lyndon Rive (Co-Founder & CEO):

No, we haven't given a forecast for 2016. We have given a forecast for the end of 2017 of [225].

Krish Sankar (Analyst - BoA Merrill Lynch):

But that is still on target?

Lyndon Rive (Co-Founder & CEO):

Yes, we still feel good about that.

Krish Sankar (Analyst - BoA Merrill Lynch):

All right, and then another follow-up is, it looks like you need 60% of your install is weighted in the second half of the year to meet the [32] gigawatt target. So I am curious what gives you the confidence you can hit that, and what are the key factors that will be the key drivers for you to hit the [32] gigawatts this year?

Lyndon Rive (Co-Founder & CEO):

Yes. So we feel very confident about our gigawatts. Now the key thing there is based on the state policies, the [WC] right now, is that we actually have tremendous clarity in all our primary states. So, if something happens to one of the primary states, feel good about the gigawatts. The getting to [1.1], that also then we need to see improvement in conversion rate from the loan product, and I am optimistic about the loan product. But I feel very confident about the 1 gigawatts and depending on how the loan product goes, will get us potentially to 1.1 gigawatts or over.

Krish Sankar (Analyst - BoA Merrill Lynch):

Got it, thank you.

Operator:

Philip Shen, ROTH Capital Partners.

Philip Shen (Analyst - ROTH Capital Partners):

Thank you for taking my questions. Just as a quick follow-up on MyPower, can you talk about -- can you just give us a bigger overview of the product? Specifically, do you have a partner on the solar loan product? Do you have a source of capital that you have already designated and identified for that product specifically? And then getting back to mix, can you help us understand on the annual guidance how much might be MyPower?

Tanguy Serra (President and CFO):

Sure. So the -- so in terms of the partner, for essentially the relaunch of MyPower we are actually not going to be calling it MyPower. It is just a little confusing in the name. It's going to be a solar loan. It's a

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little more straightforward. But essentially, it is MyPower 2.0.

The products, the fixed monthly payment to the customer, the -- out of the gates we are going to be partnering with multiple financial partners to provide it, to actually review it as a cash sale. We will be selling it and then somebody else will be financing it. So that is the current plan for the loan product.

In terms of mix, it is hard to forecast. Historically, our out of the gates, MyPower was run 20% range. Then it started winding down to around 12%, 15%, depending on the state. But I am optimistic about it. We have seen a trend towards consumers wanting to own it, and if you can provide financing costs, it makes it very affordable. We think the ownership model will take some share of our business.

Philip Shen (Analyst - ROTH Capital Partners):

Lyndon, can you share any of the names of the financial partners by chance?

Lyndon Rive (Co-Founder & CEO):

Not at this stage.

Philip Shen (Analyst - ROTH Capital Partners):

Okay, one more if I may, and I will jump back in the queue. With the cash equity deal in place, can you talk to us about how you view ABS versus cash equity, how you might toggle between the two? What might we see next? Should we expect to see a cash equity deal next or an ABS ahead of that, since the debt markets are incrementally improving since early this year?

And then additionally, can you talk us through potentially the eventual tax implications of the cash equity deal? So, given the fact that much of the depreciation is passed on to tax equity investors, what are the potential tax implications from the cash equity financing? Thanks.

Tanguy Serra (President and CFO):

Thanks, Philip, it's Tanguy. So first question on securitization versus cash equity, the way our business works is in developed assets and pipeline is financed by the revolver. We then take that out with the tax equity and the aggregate facility. And then, we have got time and what we really want to do is optimize around that. So there's a number of markets that can take out and put permanent capital in these assets.

So the securitization market I have always liked. We clear north of $3 a watt in the securitization context, and a significant portion of the backend. So we like that market a lot. Again, the key here is clearing our costs. Once we clear our costs, then it is a liquidity decision as opposed to a penultimate decision.

The cash equity market is -- we believe in price best-in-class, first of its class -- kind security. That is a market that is going to continue to be available. More players are entering this particular market. And, over time, we think the cost of that is going to be coming down.

And then there is the bank debt market. I don't think you should discount the bank debt market. The bank debt market is attractive and there's a number of banks that are looking for really elongated paper at -- with super high-quality assets in US dollars. And the thing I would say above and beyond anything else is that the quality of our reporting, the quality of our data, the quality of our process, the auditability of everything from our people in China that are looking at our supplier's factories, down to our O&M business and the way we accept assets or fleet is truly phenomenal.

And so we are able to access both capital that other players might not be. So, I felt about all those different sectors.

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I don't want to predict what we are going to do next. I think the beauty of having a number of choices is that we are not overly reliant on any given market. And I think that's really important as we think about capital structure here. So, on the tax (technical difficulty) -- does that -- so does that make sense, Phil? Do you need any other clarifications there?

Philip Shen (Analyst - ROTH Capital Partners):

No, that makes sense. And if you can talk about the tax impact, especially on the pretax MPV, that would be fantastic, thanks.

Tanguy Serra (President and CFO):

Sure. So the -- I don't want to spend too technical here, but the investment is structured as a combination of debt and a piece of preferred. And so, as a consequence, it is financing and the -- there is no tax implication for us upfront.

Philip Shen (Analyst - ROTH Capital Partners):

Okay, thanks, Tanguy and Lyndon. I will jump back in the queue.

Tanguy Serra (President and CFO):

Thanks, Phil.

Operator:

Brian Lee, Goldman Sachs .

Brian Lee (Analyst - Goldman Sachs):

Thanks for taking the questions. I had two of them. Maybe the easy one to start off. I think in the recent past, you guys had talked about, I think, about $2.8 billion to $3 billion of capital in total needing to hit the operational plan for 2016. Now with the new target in place, can you update us as to what that number would be?

And then as a follow-up to that, how much you have already secured, maybe a quick rundown on tax equity to date, DES, and any other forms of capital you would count towards that to 2016 funding target? And then I had a third question.

Tanguy Serra (President and CFO):

Sure. Hey, Brian, it's Tanguy. So the round numbers, right? About a gigawatt of volume and roughly on average [$2.7 billion, $2.8 billion] cost structure, and about $2.8 billion total, so that's the rough breakdown of the assets of the capital that we need for refinancing purposes. Over the last four months, we have raised $1.1 billion and o we are well on track to be able to raise that capital.

The one thing that with the cash equity I think is interesting to note is that, as a consequence of the cash equity, we actually paid down some of our aggregation facilities, freeing up more capacity from there. So that's the beauty of being in a model where you are recycling capital, which is you're able to use capital more than once. And so with that, right now we have got $714 million of available project financing capacity, which includes just under $500 million of tax equity, as you can see on page 9.

Brian Lee (Analyst - Goldman Sachs):

Okay, thank you. That's helpful. The second question was just around the -- I guess maybe the philosophy around growth here. This is the third year in a row you have lowered the volume target. I don't think

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there has been once where there was a financing issue at play, at least per your guys' commentary as to what might have driven the need to adjust volume targets over the past couple of years.

So given how important that part of the equation is to you guys funding the business, wondering I guess at a high level what the thought process is around maybe completely slowing down customer adds to the point where maybe the cumulative cash from the installed base starts to offset some of the growth OpEx, and you can self-fund to some degree. And so basically targeting absolute volumes not to grow each year, which doesn't translate well right now. -- it appears, based on the market's reaction.

But, just maybe start focusing on net customer adds, even if lower each year, the targeted better cash flow and profitability profile. So, just be curious to hear your thoughts on transitioning to something like that?

Lyndon Rive (Co-Founder & CEO):

Sure. Let me just address the [refi] costs for this year. So the original plan was 1,250 megawatts. The adjustment for that is nothing at all to do with anything relating to financing. It is purely just because of the essentially multiple headwinds that hit us in Q1.

If it wasn't for that, we would probably -- the guidance would stay as is or pretty close to where it is right now. The -- everything just happening all in one quarter was just too much to recover from and still keep on track for the rest of the year. We have already seen big improvements in Q2, and it should get everything back to normalized levels again in Q3.

In terms of growth, we are very excited about a lot of the innovation that we are doing here. And although we are seeing about 20% growth this year, I don't want to forecast for 2017, but once the business starts generating cash, the goal would be to go back into growth mode again.

Operator:

Colin Rusch, Oppenheimer.

Colin Rusch (Analyst - Oppenheimer & Co.):

Can you talk a little bit about the cost trajectory to date, just in terms of your construction costs? Obviously not coming down quite as much as we would have expected. Can you talk a little bit about what's going on internally with that? And how we should see that move forward? And I know you have talked about it a little bit, but just specifically what areas you are going to get the cost out of?

Tanguy Serra (President and CFO):

Thanks Colin, Tanguy. Absolutely. So just to be clear, the Q1 costs on the install panel are a combination --

Colin Rusch (Analyst - Oppenheimer & Co.):

Yes, yes. I am just talking about the construction costs. I am fully aware of the amortization over the number of megawatts.

Tanguy Serra (President and CFO):

Agreed. So, the Q1 costs was $1.98 in Q1; (technical difficulty) [$1.92] in 4Q. So (technical difficulty) make sure we are clear on is that this is a blend of residential costs and commercial costs. Our residential costs are lower than our commercial build costs. And both residential and commercial were flat to down on a like-for-like basis between 4Q and Q1, but the mix affect of deployed assets in 1Q skewed up the cost per

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watt of residential -- of the blend, sorry.

But the thing to note is that both residential and commercial are separately on a downward trajectory. So that -- nothing has changed there. That has been true as long as I've been here, I think historically forever.

Peter Rive (Co-Founder & CTO):

Yes, and a couple of things on what we are seeing that will help reduce costs as we have seen the ISP of module prices decline. We are seeing the same happening with inverters. And then there is a couple of pretty big breakthroughs in the mountain harbor on the residential side as well as on the commercial side that will further drive down costs and give us a lot of confidence for our long-term cost targets.

Colin Rusch (Analyst - Oppenheimer & Co.):

Okay, great. And then as you look at the variety of the ways that you can monetize these assets, how much lead-time do you need for decision-making purposes from looking at what's going on in the market to deciding which route you are going to go, and to the point that you monetize and actually price these things? And how much flexibility do you have in terms of switching from one strategy to another with a given portfolio?

Tanguy Serra (President and CFO):

Well, so, the key here is having tax equity funds that are fully deployed with all the assets billing. Once you have got a -- because that creates a very, very neat series of assets within the cash flows that are very discreet and eminently financeable. So, just for the sake of argument, typically you would raise the tax equity in a given quarter, deploy it, and install it in the next, and then have everybody -- all the customers in the underlying assets reach permission to operate into being able to be billing in the fourth quarter.

So that's the timeline. So the assets go from the revolver and then ultimately to the aggregation facility. And then at that point, executing whether it is on a bank debt transaction, a securitization or cash equity trade, in weeks, not -- sort of -- call it two months, 60 days, 90 days, to get a trade done along those lines. Depending on market conditions, the securitization might go faster. This cash equity trade we did, we did it in that sort of timeframe, and this was a market that did not exist, where we had to write the docs from scratch. So that gives you a sense of the speed at which we can execute here.

Colin Rusch (Analyst - Oppenheimer & Co.):

Okay, great. I will take the rest of the off-line. Thanks a lot, guys.

Operator:

Julien Dumoulin-Smith, UBS.

Julien Dumoulin-Smith (Analyst - UBS):

So just following up a little bit on that cash flow breakeven commentary in bringing the business back in line there, when do you think you'll get there such that you will begin focusing on growth again? I just want to kind of reframe the story.

And then secondly, you talk about normalizing your cost structure. I would just be curious -- you are indeed reiterating your cost targets for 2017, correct? I just want to make sure I have this correct that you will get to that level at that point in time?

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Lyndon Rive (Co-Founder & CEO):

We won't get to 2017 cost dollars in the next two quarters, so that is not the add counts -- the --

Julien Dumoulin-Smith (Analyst - UBS):

Right, but you are on target for 2017, in 2017?

Lyndon Rive (Co-Founder & CEO):

Yes, yes. We still feel very good about our on target for [225] at the end of 2017. So we still feel good about the goal. So, but in terms of your growth question, we are working hard towards being cash flow positive in Q4. And at that point in time, we are going to be looking at, as you know, the market conditions, the cash generation of the business, and then decide if we want to go back into growth mode.

Julien Dumoulin-Smith (Analyst - UBS):

And can you define the cash flow target a little bit more, just what that means?

Lyndon Rive (Co-Founder & CEO):

Cash is coming in the business is more than the cash going out of the business.

Peter Rive (Co-Founder & CTO):

The difference in cash position between two periods being higher.

Lyndon Rive (Co-Founder & CEO):

Yes, and not counting any diluted equity rate.

Tanguy Serra (President and CFO):

Julien, just one comment, just to be clear, in Q1 -- so we actually achieved that target on just the solar business. We actually cleared $10 million and some retained value. On a cash basis, we cleared $10 million. And then invested $42 million into our southern module business, where we are building a best-in-class asset. So that feels pretty good.

Julien Dumoulin-Smith (Analyst - UBS):

Got it. So just to be clear, though, about like hitting the dev co cash, you hit it for this quarter outside of the -- obviously the cell module?

Peter Rive (Co-Founder & CTO):

That's right.

Tanguy Serra (President and CFO):

And so the goal here is that, to Lyn's point, to make the cellular module bar on slide 12 go to the other side of the chart that says unequivocal that we are generating cash even after having paid (technical difficulty).

Julien Dumoulin-Smith (Analyst - UBS):

Okay. Fair enough, guys. Thank you.

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Operator:

Ben Kallo, Baird.

Ben Kallo (Analyst - Robert W. Baird & Company, Inc.):

Hey, Lyndon, Peter, Aaron and Tanguy, thank you for taking my question. Krish's at mother Merrill, I think his question was very good. What is SolarCity, if we take a step back? And I think the market thinks that the residential business in the US is not a good business. And so can you just explain why it is a good return on invested capital right now for you guys?

There's a lot of math being done around some of these asset sales and people worry about capital. And just talk us through what you're thinking, what the business looks like in five years. And if the return on invested capital is different than the market that you are losing money on these deals with cash equity. Thank you, that's it.

Lyndon Rive (Co-Founder & CEO):

Yes. Let me address that head on, because this is one I really don't agree with. So, let's just take a step back. So here are the economics, right? On a -- and we have been extremely transparent on where all the numbers come from, all sides of our GAAP financials, they're all on the financials. So there is no debate about these numbers.

So, we can build these assets -- 2015 we built these assets for about $2.70 per watt. So that is about [$1.90] of construction costs, some COA, and then some overhead. But we are building them for [$2.70] a watt.

As Lyndon said, in Q1, our sales could be higher-than-expected, but overall our buildings were out [$2.70] a watt. Now, in that [$2.70] a watt, as Pete said, the cost of panels, the cost of inverters, is clearly going to continue coming down. So it is a cost per watt that is declining. There is clearly three years of regulatory runway here, as established, as Peter and Lyndon talked about. So what that gives us is that the topline economics are not going to change too much over the next three years.

When you combine all that with an exquisite cash trade, with a leading (inaudible) investor, we are clearing at least $3.25 a watt for a portfolio that is somewhat -- reasonably representative, but arguably with a little bit less California than our current mix, we are clearing at least $3.25. So the worst-case scenario we are clearing $3.25, less [$2.70], and you are clearing $0.50 a watt on the resi asset.

Now that is a margin concept. The return capital concept is what is does it take to grow? And this is a key point, which is when we grow, we add warehouses, we add trucks, we had qualified installers. But there is no capital costs associated with growing that. And as you've seen, we have disclosed our specific CapEx for our solar business, our solar development business, which is in the single-digit millions of dollars a quarter.

So the idea that the residential business does not clear super attractive return capital, is just wrong. And happy to spend more time on that --

Ben Kallo (Analyst - Robert W. Baird & Company, Inc.):

Are you taking share?

Tanguy Serra (President and CFO):

I'm sorry?

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Ben Kallo (Analyst - Robert W. Baird & Company, Inc.):

Are you taking share? (multiple speakers) Market share. How is that changing? And why?

Tanguy Serra (President and CFO):

So, as a percentage of installs, the Q1 numbers are not out yet to the best of my knowledge. I saw Vivid came out before this call, I haven't gone -- time to go through the numbers. But it feels like we are doing pretty good in the market, yes.

Peter Rive (Co-Founder & CTO):

I think like in Q4, it went up from Q3. I have not seen the Q1 numbers yet, but it is probably going to be like in the kind of mid-30s, I would guess, and somewhere in there. I don't think that there is a reduction in our share of installations or anything.

Lyndon Rive (Co-Founder & CEO):

Yes, and it was with the new loan product and I think it should accelerate.

Tanguy Serra (President and CFO):

Does that answer your question? It is really important to me that we all agree that this return on capital concept is measuring the difference in margin over the ability to grow. On that basis, we are absolutely a great business.

Ben Kallo (Analyst - Robert W. Baird & Company, Inc.):

And so, what is the difference between you and number two, three, and actually number 10? And how has the market changed with size and scale? Because if you guys -- if capital is constrained, then doesn't everyone else have that issue and then needs to be able to take share? Or am I wrong?

Tanguy Serra (President and CFO):

So, capital is not a constraint. Let's really address that. It has not been a constraint. It is not our current constraint, and it's not capital. This is high quality assets and people want to finance this asset.

Peter Rive (Co-Founder & CTO):

I've got massive respect for our competitors. But the one thing I would say is that our key clear differentiators are cost structure. Our cost structure is better than everybody else's, and we are ultimately selling with the commodity electrics. We are clearly in a better place there.

The other big differentiator I think is all the investment that we're making under Pete's leadership on the grid services, the agreement that has come up with between us and some of our peers, one of the Eastern states, in the state of New York, I think it's a blueprint for how the industry is going to go from forward.

So, we've got clear technological leadership. We own our Mountain Harbor investing around the, a clear availability of capital, and we are ultimately building what is our best in class power plants for the lowest cost. That feels like pretty strong differentiators.

Lyndon Rive (Co-Founder & CEO):

Yes, and Tanguy mentioned this, but our debt product itself on launching hardware allows us to still foster less disruption for the customer with -- but at the same time, it just looks better than any other system out there, so, historically, it's just a better looking system than any of our competitors.

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Ben Kallo (Analyst - Robert W. Baird & Company, Inc.):

So, I -- Lyndon, I think we should focus on that more going forward than tax equity flips and depreciation, accelerated depreciation over five years. I am not telling you how to run your business, but Wall Street thinks it's way too complicated and we need to get back to brass tacks of what you guys do, and that is just my two cents there.

Lyndon Rive (Co-Founder & CEO):

Hey, that is great feedback. I think we will maybe have a little more in-depth product review the next time. I think that's great feedback. We are investing a lot here and we have massive differentiation.

Ben Kallo (Analyst - Robert W. Baird & Company, Inc.):

Thank you, guys.

Operator:

Vishal Shah, Deutsche Bank.

Vishal Shah (Analyst - Deutsche Bank):

Thanks for taking my question. You mentioned your customer acquisition costs will come back in the next two quarters. Where do you think costs will be in Q3, Q4 timeframe? And then is the second half mix going to be more skewed towards commercial, given that you are sort of pushing some of the installations to closer to those interconnection time frames? And does that impact your project value or economics in the second half?

Tanguy Serra (President and CFO):

So in terms of customer acquisition costs, I expect it to come roughly 20%-ish down this next quarter and then the following quarter back to normalized acquisition levels. In terms of commercial mix, roughly it is going to be about 20%. So I don't expect too much change in the total value of megawatts deploy.

Vishal Shah (Analyst - Deutsche Bank):

Okay, great. And then can you just talk about whether you are raising PPA rates in other markets outside of California, and how that is impacting just the customer behavior? It looks like the world financing environment, while it is good, it is slightly, in terms of costs, it is worse than what you were previously expecting. So does that translate into higher rates in industry overall?

Tanguy Serra (President and CFO):

Yes, I would say the biggest impact in a pricing increase was the flushing of the pipeline and accelerating customers from January to December. So, starting the year with essentially no pipeline was the biggest impact in terms of the pricing increase. We increased slightly, so it's about [$0.005] to $0.01 per kilowatt hour depending on the market, so it's a small increase. But that does make a difference in a dollars per watt basis.

We don't see this as a reason for losing business, at least we don't see yet. And we actually see a lot of our competitors actually needing to increase their pricing too -- in fact, we have actually started to increase our commercial pricing as well.

Vishal Shah (Analyst - Deutsche Bank):

Okay, great, thank you.

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Operator:

Gordon Johnson, Axiom Capital Management.

Gordon Johnson (Analyst - Axiom Capital Management):

Thanks for taking my question. So I guess first with respect to the cash equity deal, I guess with respect to the cash equity portion, the $345 million, is that cash that is available to invest immediately in growth and debt repayment?

And then in addition and with respect to that deal, will you guys continue to recognize revenue and other financials on the projects -- or the project cash flows that were sold to John Hancock? Then I have a follow-up.

Tanguy Serra (President and CFO):

Yes, and not quite sure I am following the number. So, the cash equity trade that we announced was $227 million of cash in. With that, we repaid in part the aggregation facilities and so -- of $151 million, and the rest was cash that we cleared for the Company. And so that is cash sitting on our balance sheet right now.

Gordon Johnson (Analyst - Axiom Capital Management):

Right, but is that cash -- sorry, is that cash associated with the tax equity -- is that cash that you have available in your coffers to immediately extend to apply to growth and debt repayment? Or is that cash already accounted for? Is a portion of that cash already accounted for?

Tanguy Serra (President and CFO):

The cash is fungible, so when we execute a trade, cash came in. We repaid a part -- $151 million of aggregation facilities and the rest was cash that was absolutely available on our cash balance on a daily cash balance, yes.

Gordon Johnson (Analyst - Axiom Capital Management):

Okay, and then are you guys going to recognize the revenues and other financials associated with the projects -- the project cash flows you sold? Will you still recognize those revenues in your income statement, even though the cash associated with those revenues is being paid to John Hancock?

Tanguy Serra (President and CFO):

So, just to be clear, the trade is that there is -- John Hancock takes about 95% of the cash flows, but we retain a portion of them. And so yes, absolutely, we will continue recurring that that way.

Gordon Johnson (Analyst - Axiom Capital Management):

Okay, so you will recognize 100% of revenues. And then with respect to your guidance to be cash flow positive this year, I just want to be clear here. So you are saying you're going to be cash flow positive including financing, so debt raises and potential equity raises as well as module manufacturing investment. So you are not seeing you are going to be cash flow positive from an operating cash flow perspective or a free cash flow perspective. You are saying you are going to be cash flow positive from the perspective of including financings you may do as well as excluding any module manufacturing investment. Am I thinking about that correctly?

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Lyndon Rive (Co-Founder & CEO):

We will be cash flow positive, but that does not include -- that includes all the financing for the assets -- it includes for the quarter for the cost of the manufacturing. But if there was a dilutive round, it would not include any of that. So it is only focused on all cash generated from financing the assets.

Gordon Johnson (Analyst - Axiom Capital Management):

Okay, okay. And then lastly, I noticed last quarter -- or not last quarter but the quarter before, you guided your Q4 cost to $245 million to $260 million. And it actually came in at $227 million, the GAAP OpEx. So is the higher cost this quarter a potential spillover from delayed cost recognition in Q4? And how should we think about that transitioning through, I guess, the rest of the year? Thanks for the questions, guys.

Lyndon Rive (Co-Founder & CEO):

I didn't follow that last question. $240 million? What's the question?

Gordon Johnson (Analyst - Axiom Capital Management):

Yes. So the GAAP OpEx guidance for Q4, operating expense guidance was $245 million to $260 million. The number actually came in at $227 million. So we thought that your cost could be slightly higher this year as there was some delayed cost recognition from Q4 to Q1 -- not this year, I'm sorry. This Q1, the first quarter of 2016, it looks like your cost was higher. I wanted to know if the cost is going to remain at that level or we should see some work down of that going forward?

Tanguy Serra (President and CFO):

So the -- in Q4, as we talked about last time around, we are reducing the marketing spend in Q4. And so, as a consequence, those costs came down a little bit on a cash OpEx basis. In the -- but those costs are not linked to Q1. So in Q1, the run rate we are at right now is going to stay roughly where it is with increased volume, as Lyndon mentioned. So our unit costs will come down.

Gordon Johnson (Analyst - Axiom Capital Management):

Okay. Thanks again, guys.

Tanguy Serra (President and CFO):

Thank you.

Operator:

Michael Morosi, Avondale Partners.

Michael Morosi (Analyst - Avondale Partners):

First off, on the utility services segment, longer-term, how much of a factor do you think this could play in the overall business in terms of leveraging costs over a larger installed base? And also from a more strategic standpoint, as the business becomes more ownership agnostic, whether it is loan products, presumably that means that the business is increasingly agnostic with respect to whether utilities ultimately own these assets as well. So, how does this segment kind of position SolarCity for those longer-term market developments?

Peter Rive (Co-Founder & CTO):

Yes. So, and I think that if I look at the next decade, I would be surprised if we weren't deriving, call it,

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15% to 30% of our revenues from utilities. I think that you end up in a situation where you have an energy contract with the customer and you know how other assets finance them may change, and it seems to get a lot of airplay. But like the payments to us come in part from utility and in part from the customer.

But the value proposition to the customer is still cheaper, cleaner and probably more reliable energy. So again, I just see that, in the long run, 2020 and beyond, the way that the grid is basically designed, and maintained, is fundamentally different, and utilities don't necessarily have to look only to capital expenses in order to be able to meet the grid needs but it can look to these customer cited resources for a lot of these benefits.

Lyndon Rive (Co-Founder & CEO):

I mean, looking at that timeframe, to me there is no doubt that all systems that we will be deploying at that time will have storage combined with smart inverters. And when you have that, you can provide all the good services you need to the utility, the idea that we will be investing into big power plants and at that time hardly got it.

And we have an asset that can generate energy at the pace where it is needed, and you will be able to store it, and you will be able to provide services to the grid. That is a far better way of building out the grid. And leveraging existing equipment that we will be deploying anyway. So this is just over and above the equipment -- services over above the equipment we are deploying anyway.

Peter Rive (Co-Founder & CTO):

In terms of utility ownership of behind the meter generation, I just think that it's -- and I think this is shared with economists and many regulators that extending the utility as a monopoly position should be avoided as much as it can be. I think that people are more looking towards ways to kind of innovate within the utility sector.

And so, a couple of interesting ideas are being advanced in terms of being able to give the utilities the ability to earn income off services they can procure from a Company like SolarCity rather than necessarily only earning income off of capital expenses or equipment that they own.

Lyndon Rive (Co-Founder & CEO):

Yes, if that utility once to get into this business, I actually -- I am very encouraged by it. I want utilities to get into this business. If they want to get directly into the same business, they should, just not under the regulated divisions Pete mentioned. It should be under a different part of the Company which doesn't have the protection of all the ratepayers.

They can go through the same process, make the same investment decisions that we have to make. But I think in the long run, it would just be more simplistic to partner in that area.

Michael Morosi (Analyst - Avondale Partners):

That's great. And then with respect to the asset monetizations, one of the bigger question marks around the Company and the value that the Company creates is how to value the renewal period. Public equity investors have apparently always very heavily discounted it, or at least in recent quarters, they have.

The ABS market does not attribute much value to it or any value, yet the cash the equity deal with Hancock didn't really -- it was a 20-year term. So what can you do to prove out that renewal value or to maybe even change -- innovate around contract structures and maybe even extend contract terms, as there is more of a track record with the technology in the field and people get more comfortable around the longer-term production profile?

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Is there any opportunity to kind of partially prove out that renewal period by actually making it not a renewal period, and instead, making it a longer contracted period?

Tanguy Serra (President and CFO):

Well, I think the longer contracted period for the customer would not necessarily be a little (technical difficulty). I don't think that we necessarily want to try to increase the contract term. And I don't -- I can't immediately think of some way to prove out exactly what will happen 20 years from now. But I think that I can just extrapolate as to what the value of the energy will be.

And then also just think about what additional technology can be deployed alongside that, that would be particularly appealing to the customer? So, being able to, 20 years from now, retrofit the system with the technology that can allow them to participate in this kind of grid services economy, or being able to add a battery to add additional reliability, as well as additional income streams.

I think what gives me great comfort in renewals is the ability to supplement the product that they have was something that will be even more appealing to them at the point, combined with the fact that fundamentally, the value of the energy is expected to be quite a bit lower than what they are paying the facility.

Lyndon Rive (Co-Founder & CEO):

Yes. I mean, the asset life for this is 35, 40 years. The direct warranty is 25 years. So, there is tremendous value past the renewal period.

Peter Rive (Co-Founder & CTO):

And also, just the value of the relationship with their customer, I think, is a little less tangible, but it is present, and not just the customer, but the relationship that we have with the home, seeing as the customer may sell it -- will likely sell their home during that period. So, and that is not as tangible, but I think in my opinion, anyway, is incredibly valuable.

Michael Morosi (Analyst - Avondale Partners):

All right, thanks a lot, guys.

Operator:

Sven Eenmaa, Stifel.

Sven Eenmaa (Analyst - Stifel Nicolaus):

Thanks for taking my questions. First I wanted to ask in terms of the Hancock type of asset monetization transactions, if you think of the megawatts deploying in the years -- during the year, like how big part of the mix you will expect to finance those type of transactions going forward?

Tanguy Serra (President and CFO):

Appreciate the question. Thanks. So we -- I think it really will depend on where the financing markets are. So in a vibrant securitization market, you might want to do more in the securitization markets. But this creates another significant opportunity.

It also depends on -- this is a way to clear more liquidity upfront than we would on a securitization. It also depends on specific liquidity across the business at that moment in time. So, I don't want to give a mixed forecast basis. I would expect we would do all of our assets over time, go either into bank debt,

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securitization, or cash equity, and a nice, healthy mix of all three over the cycle, but any given period, I don't know.

Sven Eenmaa (Analyst - Stifel Nicolaus):

Got it. Second question I wanted to ask, in terms of you mentioned the combination of the cost structure on the utility projects you are doing, consisting of traditional utility scale plus storage. How should we think that is impacting your kind of cost curve here as you go through the rest of the year? I mean your high-dollar-90's in the current quarter. As the mix increases, what is the implications here?

Peter Rive (Co-Founder & CTO):

I think that in subsequent quarters, we will be providing you a better framework to understand the costs and the profit associated with solar plus battery systems. So it is unfortunate at this point in time I don't think we can break it out or give you a good indication. But I think that, generally speaking, we will be able to give you a good framework to understand what the solar costs are, and then separately, what is the cost of storage.

Sven Eenmaa (Analyst - Stifel Nicolaus):

The last question I want to ask, in terms of -- and I apologize if you mentioned it already, but if I look at your first-quarter bookings and sequential kind of 25% growth commentary here, what will be the catalyst here on bookings to drive you guys into that gigawatt level for -- or 1.1 gigawatt for the year to be able to meet that target?

Lyndon Rive (Co-Founder & CEO):

So I don't understand the question. You say what caused us to --?

Sven Eenmaa (Analyst - Stifel Nicolaus):

What would be the catalyst to increase bookings going forward?

Lyndon Rive (Co-Founder & CEO):

Right. So the solar loan would be a good example of this.

Peter Rive (Co-Founder & CTO):

So the regulatory issues have all been resolved, at least most of them have. That's a big item. Q1 had many decisions that have been made. California made its decision, Massachusetts made its decision. New Hampshire made its decision. So that is all now been addressed. The solar loan product, there is a growing demand for customers who want to own new equipment, so we think that will have an impact. Seasonality kicks in, so now we are entering into the summer -- and then we are also going to be expanding into new states, so those are other areas that will help us with the additional bookings.

Sven Eenmaa (Analyst - Stifel Nicolaus):

Got it, thanks a lot.

Operator:

Sophie Karp, Guggenheim.

Sophie Karp (Analyst - Guggenheim Partners):

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Thank you for taking my question, guys. I just wanted to get your perspective on how much leverage do you think is appropriate for these assets? And your funding mix has both quite a bit, is more debt-financed in this quarter, less tax equities. So, what do you kind of see as a normalized level in terms of whether or not you want to choose that the cash flow or debt to EBITDA for this assets within the Powercore? Thank you.

Tanguy Serra (President and CFO):

Yes, I think it is more percentage of PV6 -- to take it how the securitization markets look at it, so you look at the post-tax equity cash flows, you discount that back at 6%, that gives you a dollar number. And then the securitization market, we'll say anywhere between 70% and 80% of that number would be available for a securitization principle. Then there are some DSER rations around that, but that is kind of the metric to look at.

Sophie Karp (Analyst - Guggenheim Partners):

Thank you. And then just as a follow-up on the mix, I guess I just want to make sure I understood you correctly. I think you said that going forward you expect to have 80% residential, 20% C&I. But this quarter in particularly saw a higher percentage of the C&I. Is that right?

Tanguy Serra (President and CFO):

That's right, yes.

Sophie Karp (Analyst - Guggenheim Partners):

Okay. Thank you. I will go back in the queue.

Operator:

Edwin Mok, Needham & Company.

Edwin Mok (Analyst - Needham & Company):

Thanks for taking my question. So I just want to quickly revisit kind of your OpEx or your cash OpEx. I think this quarter you said because of the low booking volume, your OpEx (inaudible) and expect to come back in the second quarter as your booking accelerates rate. Just how do you think on overall OpEx for the Company?

I think previously you guys talked about that number likely to continue growing on a sequential and year-over-year basis. Just want to kind of get a sense where do you think OpEx or cash OpEx would be for the Company, let's say by towards the second half of the year? And -- or are we kind of at the level that you think you're already good enough to ramp up your booking levels and therefore can keep it at this level? Any kind of guidance on that?

Tanguy Serra (President and CFO):

So we really think about the cost on a unit basis, and so that is why we disclose the cost memo, which really ties all of our OpEx numbers to a per-unit basis. So the parts of the OpEx are including in overhead and the cost of sales. We expect the overhead piece on an absolute dollar basis to be roughly flat and we expect the sales and marketing piece to reflect, as Lyndon said, a decline in a per-unit basis in Q2 and Q3.

Edwin Mok (Analyst - Needham & Company):

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I see. And beyond this year, right, as you look longer-term, do you think -- let's say you continue to grow and you increase your size of your installations per year, do you see a need to grow that? Or -- I wouldn't think that as you build out your regions, you can kind of -- basically, start in those regions and still can't get more leverage of your sales team. Do you not see that or can you give us some color on that?

Lyndon Rive (Co-Founder & CEO):

Yes, so you definitely need to continue to invest in sales and marketing. We saw that when we slowed down our performance marketing, so all the advertising in November/December, it generates less leads. So you do need to continue investing into sales and marketing.

We are looking at different sales channels to continue reducing our acquisition costs. When we look at different acquisition costs, some of the sales channels is actually quite low. So we will be scaling those out more aggressively. So, but you will still continue investment in sales and marketing. I don't see that changing. Even in states like California, we still only have, call it 3%, 4% penetration. So we need to continue to advertise.

Operator:

Pavel Molchanov, Raymond James.

Pavel Molchanov (Analyst - Raymond James & Associates, Inc.):

You mentioned at the beginning that the regulatory climate is the best in years, as you put it, or in a long time. What are the remaining question marks in -- at the state level that you have yet to get clarity on and that you expect to be resolved by the end of the year?

Lyndon Rive (Co-Founder & CEO):

So the -- I'd say the biggest open item right now is Arizona. I don't expect we will get clarity the end of the year; probably get clarity Q1 next year, maybe a little later than Q1 next year. But Arizona I would say is the biggest unanswered state. But for the rest of the states, clarity looks really good.

Peter Rive (Co-Founder & CTO):

I think that like traditionally when people have talked about clarity, and the way we talked about it, it has been a strong focus on net metering. But there's a lot of distributed resource plans that are currently being evaluated in California, New York and other places, where like the utility business model and the way that utilities can be compensated is changing.

So there's a lot of interesting stuff happening in New York and California this year that we are watching very closely. In California, we have good net metering runway, but there's a lot of stuff going on as to how utilities in California can include the benefits of these customer-sited resources in the distribution system. So, there's a lot of stuff happening there that hopefully will create the environment for us to be able to see greater incomes from our solar systems.

Lyndon Rive (Co-Founder & CEO):

Yes, and actually expected to get clarity for Nevada in the February-ish legislation. The legislators definitely want to do the right thing. 17,000 people are treated really unfairly and so now the legislators want to look at addressing that. And I know that the state wants to see solar come back. The community definitely wants this to come back, so that's another area that I think where we will see more clarity around the February/March timeframe.

Pavel Molchanov (Analyst - Raymond James & Associates, Inc.):

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And then just a small kind of technical question. You introduce the new line item on the revenue statement, operating lease prepayments and upfront incentives. What is that going to correlate with? In other words, is that tied to your cash sales or the megawatts installed? What's the connection there?

Tanguy Serra (President and CFO):

Yes, thanks. So what we'll try to do is really break down in the financials the -- there is total revenue from periodic billings. So that ties to the amount of megawatts that we have under management and the irradiance, and the dollars coming in associated with those PPAs, leases and longer contracts. We then have revenue from operating lease prepayments and operating incentives, so this would be correlated to the one-off dollars coming in from specific one-off programs. And so that will correlate to megawatts installed or deployed. Deployed would probably be a better metric.

Pavel Molchanov (Analyst - Raymond James & Associates, Inc.):

Okay, appreciate it.

Operator:

Thank you. And ladies and gentlemen, that does conclude today's conference. Thank you again for your participation. You may now disconnect.

Lyndon Rive (Co-Founder & CEO):

Thank you so much. Have a good day.

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