CORPORATE PARTICIPANTS

Chad Reed, Director, Investor Relations

John Stinebaugh, Chief Executive Officer

Matt Berger, Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Brian Lee, Goldman Sachs

Colin Rusch, Oppenheimer

Ben Kallo, Robert W. Baird & Co.

PRESENTATION

Operator

Good morning. My name is Julie and I will be your conference operator today. At this time I would like to welcome everyone to the TerraForm Power 2018 Third Quarter Results Webcast and Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press star then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key.

I would now like to turn the call over to Chad Reed, Director of Investor Relations. Chad, you may begin.

Chad Reed, Director, Investor Relations

Thank you, operator. Good morning, everyone, and thank you for joining us for our 2018 third quarter results conference call. I am joined today by John Stinebaugh, our Chief Executive Officer; Matt Berger, our outgoing Chief Financial Officer; and Michael Tebbutt, our incoming Chief Financial Officer.

Before we begin, I would like to remind you that a copy of our earnings release, supplemental information, and letter to shareholders can be found on our website. I also want to remind you that we may make forward-looking statements on this call. These forward-looking statements are subject to known and unknown risks and our actual results may differ materially. For more information you're encouraged to review the "Risk Factors" section in our SEC filings, which can be found on our website. In addition, we will refer to non-GAAP financial measures. For more information on a reconciliation of these non-GAAP financial measures to comparable GAAP measures, please refer to our earnings release and supplemental information.

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

John Stinebaugh, Chief Executive Officer

Thanks, Chad.

In the third quarter, TerraForm Power's results demonstrated the benefits of its diversified asset base. Strong wholesale power prices drove an increase in market revenues in Spain, which helped offset lower production from our North American wind fleet. Overall, our CAFD increased to $46 million from $19 million in the same period last year, primarily due to the contribution from our European platform.

Since the beginning of the year, we have made great strides in extracting additional cash flow from our existing assets. Once we fully implement our long-term service agreements with GE, we expect to deliver significant cost savings, improve the performance of our fleet to our long-term expectation, and further increase our wind output through deployment of GE's proprietary technology. Additionally, we are in the process of renegotiating the O&M contracts of Saeta's wind fleet and executing our performance improvement plan to increase productions of our solar fleet in North America.

As we look forward, we are turning our focus to deploying capital to grow our business. We have a portfolio of organic growth opportunities, including repowerings of selected wind assets, that we are continuing to progress. Additionally, we have ramped up our pipeline of add-on acquisitions, which will be an important driver of growth that leverages our business development and operational scale in North America and Europe.

With regard to operational updates, we are pleased to report that we completed the battery replacement project at our KWP II wind farm in Hawaii on budget and ahead schedule. We successfully commissioned the lithium ion batteries in October. In addition, we have been working diligently to implement the framework agreement with GE for turbine O&M and balance of plant services for our 1.6 gigawatt North American wind fleet. We are putting in place all of the project-level agreements, and we are completing necessary repair of wind turbine blades as well as other catch-up work from prior years in preparation for handover. In parallel, we are working to obtain lender and tax equity partner consents to change operators, and in certain situations, we are in negotiations with current service providers for early termination of our existing service contracts. We expect full implementation of the LTSAs within the first half of 2019. Finally, we recently launched a competitive process to reduce O&M costs and strengthen performance guarantees associated with Saeta's wind fleet. We expect to finalize this process in the fourth quarter of 2018 and enter into long-term service contracts to generate savings of at least 15% compared to existing costs.

We commenced our solar performance improvement plan this summer. After performing irradiation scans of our North American assets, we identified opportunities to increase production by at least 52 gigawatt hours to achieve our long-term average production. We are now working on business cases to quantify the required capital investment and the corresponding revenue increase that is achievable. Following an analysis of an initial subset of high-priority facilities, we have implemented remediation plans to restore 45 gigawatt hours of production, which we believe equates to $7.5 million in additional annual revenue. We will continue our business case analysis on the remaining assets, and we believe there is significant additional revenue upside. We expect to have the solar fleet performing at our LTA targets by the end of the first quarter of 2019.

In terms of growth initiatives, we have been pursuing a number of strategies to build our acquisition pipeline. We believe that there is a consolidation play in Spanish renewables, which is very fragmented with many assets owned by private, under-capitalized developers. We believe that we can acquire assets at prices that yield attractive returns and extract cost synergies by integrating these assets into our European platform. Following the recent election, we are evaluating a number of opportunities to invest in Mexican renewables. Particularly after the decision to cancel the new Mexico City airport, we believe there is greater uncertainty, which may translate into attractive risk-adjusted returns.

Now I'll turn the call over to Matt to discuss our financial results and provide a quarterly update.

Matt Berger, Chief Financial Officer

In the third quarter our portfolio delivered adjusted EBITDA, net loss, and CAFD of $197 million, $19 million and $46 million, respectively. This represents an increase in adjusted EBITDA of $87 million, a decrease in net loss of $17 million, and an increase in CAFD of $27 million compared to the same period last year. The increase in our results primarily reflects full quarter contribution from the Saeta acquisition. Aside from this, savings in corporate interest expense resulting from our Q4 2017 refinancing initiatives were largely offset by lower wind incentive revenue in the Northeast, timing of incentive revenue invoicing, and the impact of ongoing maintenance to prepare the wind fleet for the LTSA implementation.

North American wind production was slightly higher than Q3 2017, though at levels significantly below our long-term averages. While poor wind resource, particularly in Hawaii and the Midwest, was the main driver, revenues were also impacted by greater than normal maintenance, which will be largely mitigated under the full implementation of our LTSAs with GE. Our European platform performed in line with expectations, with lower than expected solar resource offset by higher than expected market revenues due to wholesale electricity prices in Spain, which year-to-date have averaged 10% higher than prior year.

In the past few months, there were four hurricanes or tropical storms that impacted regions in which we own assets. In each instance, our emergency preparedness plans were in effect prior to the storms making landfall. The impact of these storms on our assets was minimal, and all of our assets were back online shortly after the storm events.

During this quarter, we made progress on the $350 million non-recourse debt financing plan for the Saeta acquisition. In September, we closed on the second project financing of certain of our unencumbered assets in the U.S., yielding net proceeds of $77 million. The financing is a fully amortizing structure with a final maturity of 14 years and a very attractive coupon of 4.64% that implies a spread over U.S. treasuries of 165 basis points.

In September, we closed a €50 million upfinancing of the Montegordo wind farm in Spain, yielding net proceeds of €12 million and optimizing the project's CAFD profile. The loan is fully amortizing with a final maturity of 12 years and a blended interest rate of approximately 4.2%. Additionally, we recently launched a financing of a portfolio of utility scale and distributed solar assets from which we are targeting to raise approximately $100 million, with an expected close in the fourth quarter. Over the next three months, we plan to launch the final project financing to raise the balance of the $350 million of proceeds. Once the financings are complete, TerraForm Power's liquidity will be restored to over $900 million, providing significant dry powder to invest in attractive opportunities that we find within the sector.

Finally, in early October, we made certain amendments to our existing $600 million revolver to bring pricing in-line with our Term Loan B. We extended the tenor two years to 2023, refreshed the $150 million accordion feature, and reduced commitment fees by 12.5 basis points and the drawn spread by 75 basis points. We also cancelled Saeta's €120 million revolving credit facility. Together, these actions are expected to yield approximately $3 million in annual savings on a run-rate basis.

John Stinebaugh, Chief Executive Officer

Now I'll take the call back over. Thanks, Matt.

Since it's the first full quarter of contribution from our European platform, we thought it would make sense to do a deep dive into the Spanish regulatory framework, which is expected to comprise approximately 34% of TerraForm Power's consolidated revenue, in order to demonstrate its resiliency. Under the Spanish regulatory framework, revenues have three components.

First there is the return on investments. All renewable power plants receive a monthly capacity payment. This capacity payment, when combined with margin from the market revenues forecasted by the regulator, is sized to allow the generator to earn the regulated rate of return on its deemed capital investment. The return on investment is recalculated every three years. Since the capacity payment is a fixed payment, it is very stable, with no volume or price risk. Historically, this revenue stream has comprised in the range of 65% of our regulated revenue.

Second, there is the return on operation. This is applicable only to concentrated solar power plants. This revenue stream consists of an additional payment for each megawatt hour produced to recover deemed operating costs that are in excess of market revenue forecasted by the regulator, such that the margin on forecasted market revenues is equal to zero. The return on operations is recalculated every three years. Aside from the volumetric risk associated with production, this revenue stream has no market price risk and has historically comprised less than 10% of our regulated revenue.

Lastly, there is the market revenue. Renewable power plants sell power into the wholesale market and receive the market-clearing price for all megawatt hours they produce. Although this revenue stream is subject to both volume and market price risk, its impact on overall revenues is mitigated by the reset on return on investment every three years. Market revenues historically comprise in the range of 25% of our regulated revenue, yet only 8% of TerraForm Power's consolidated revenue.

Every three years, the regulated components of revenue are reset in order to mitigate the overall variability of revenues. Based on market conditions, the regulator updates its market price forecast. Since the combination of margin from market revenues forecasted by the regulator and the regulated components of revenue are sized to equal the regulated return, the return on investment and return on operations are reset accordingly. Furthermore, to the extent that the wholesale market price is greater or less than a price band centered around the market price forecasted by the regulator during the preceding three years, the difference in revenues, assuming average generation by the regulator during the preceding three years, I'm sorry, the difference in average generation accumulates in a tracking account. The return on investment is either increased or decreased in order to amortize the balance of the tracking account over the remaining regulatory life of the assets. Over time, this adjustment dampens the impact of wholesale price variability.

Every six years, the regulated rate of return may be reset to a level that allows generators to earn a fair rate of return in light of market conditions. The regulator may take factors such as interest rates, the equity market premium, and others into account when making its recommendation, and any change to the regulated rate of return must be proposed by the Spanish Government and approved by a decree of parliament. To the extent there is no decree of parliament, the regulated rate of return will remain unchanged. In early November, after receiving input from stakeholders, the regulator made a final non-binding recommendation to reset the regulated rate of return to 7.09% from the current 7.4%. Based on this recommendation and other considerations, parliament may decide to change the regulated rate.

With the acquisition of Saeta, TerraForm Power has further solidified its cash flow, with over 95% of its revenue either under long-term contract or benefiting from the regulatory framework. Approximately 38% of TerraForm Power's revenue is generated from wind assets, 29% from solar assets, and 34% from wind and solar assets under the Spanish regulatory framework. In addition to the geographic diversity across North America and Europe, capacity payments account for over 20% of our revenues.

With regard to relevant regulatory updates, in September, California enacted legislation that establishes a framework for the California Public Utilities Commission to decide the amount of wildfire-related liability that utilities can pass on to ratepayers. While the legislation establishes a cap on utility shareholder exposure to wildfire losses under most circumstances, it provides that utilities can still be held accountable for a fire if its infrastructure is substantially involved in the accident. While the legislation was considered unbalanced to be a credit positive for California utilities, all three rating agencies have recently downgraded PG&E, the California utility with the greatest wildfire potential liability. In total, 12% of our megawatts under long-term contracts have counterparties that are California utilities. But with less than 1% of our megawatts and projected revenue contracted with PG&E, TerraForm Power's exposure to this potential credit risk is minimal.

In early October, the Spanish Government suspended the 7% generation tax through Q1 2019, subject to parliamentary approval. The intent of the action is to reduce wholesale market prices and, as a result, rates that residential customers pay for power. Since the generation tax is a significant component of the generators' cost structure, policy makers expect that this will reduce their bidding price in the wholesale market. Furthermore, the suspension of the generation tax will be combined with reductions in the regulated components of revenue by a commensurate amount. Thus, the value of the generation tax will be passed on to ratepayers and will have a neutral impact on our regulated assets over the long term.

Moving to the macroeconomic outlook, with strong consumer sentiment and greater than expected increases in corporate profits, U.S. economic growth continues to be robust. GDP growth was 3.5% for the third quarter and expectations are for growth of 3.1% for the year. With the U.S. unemployment rate at its lowest level in nearly 50 years, many analysts expect long-anticipated wage increases to put upward pressure on inflation. In light of recent economic data, the U.S. Fed has indicated that it will likely continue raising interest rates. In October, the 10-year reached the yield of nearly 3.2%, triggering increased volatility in the equity market.

In Europe, economic growth has stabilized, with third quarter GDP growth up 1.7% and expectations for the full year hovering around 2%; however, in Spain and Portugal, GDP growth rates remain above the European average. Emerging inflationary pressures driven by falling unemployment, wage growth, and higher oil prices have pushed the ECB to taper its quantitative easing program, with the goal of ending it entirely by the end of 2018. Nonetheless, interest rates in Europe remain exceedingly low with the 10-year bund hovering just below 0.5%.

Overall, we believe that TerraForm Power is well positioned to execute its business plan across a range of economic outcomes. Over 85% of our debt is fixed rate with no material maturities in the next four years, insulating our cash flow from rising rates. Our objective is to grow our dividend by 5% to 8% per year. In our five-year plan, we seek to accomplish this through cost savings, improved performance of our assets, and a modest amount of investment in growth. With our current dividend yield plus our targeted growth, we believe we can deliver a total return that is attractive to investors, even in a rising interest rate environment. Over the past months we have been working hard to build up our business development pipeline. For all add-on acquisitions, we will remain disciplined and seek to achieve our targeted returns on equity. To the extent we pursue any larger-scale acquisitions we will use our five-year business plan as the yardstick to measure accretion.

Finally, the Board of Directors of TerraForm Power is pleased to announce the appointment of Michael Tebbutt as Chief Financial Officer effective this coming Monday. Michael is a chartered accountant and first joined Brookfield in 2011. He’s held a series of senior finance positions within the group, previously serving as CFO of Brookfield Property’s U.S. retail business and Brookfield Infrastructure’s Asia Pacific operations. Michael succeeds Matt Berger, who is rejoining Brookfield Property Group. So, I’m sure Matt is disappointed, but this will be his last conference call. From all of us at TerraForm Power, we want to thank Matt for all his hard work and contributions over the past year.

As always, we are grateful for your continued support and look forward to updating you on our progress in the coming quarters. This concludes our formal remarks. Thank you for joining us this morning and we’d be pleased to take questions.

QUESTION AND ANSWER SESSION

Operator

At this time, if you would like to ask a question, please press star then one on your touchtone phone. Again, that’s star and then one.

Your first question comes from Brian Lee from Goldman Sachs. Please go ahead, your line is open.

Brian Lee, Goldman Sachs

Hey, guys. Good morning. Thanks for taking the questions.

Just, first off, on the payout ratio for 2018, how should we think about the right range for this year? I know you’ve talked about 80% to 85% being the target and due to the first three quarters of this year you’re sort of running at about 100% and you’d need about $60 million to $70 million of CAFD in 4Q to get to that 80% to 85% ratio. So just can you sort of frame how you’re thinking about it for this year and whether or not that’s sort of changing here in the near term?

Matt Berger, Chief Financial Officer

Sure. So, your math is just generally accurate, although I'd say for the third quarter our dividend in relation to our CAFD numbers, it's closer to the upper end of our range than 100%, although earlier in the year your numbers are correct. The 80% to 85% is a target and this year, as we've disclosed in previous calls, resource and availability has been something that we're working to, resource has been something that we've been dealing with and availability is something we've been working to improve, which, through our solar improvement plan and the GE LTSA, we think we'll make great strides toward improving our availability and increasing our revenues going forward. So, I wouldn't take too much from this particular year as the year of transition and I'd say coming into 2019 the expectation would be we'd probably be, again, adjusting for normal resource, we would be toward the lower end of that range on a go-forward basis.

Brian Lee, Goldman Sachs

Okay. No, that's helpful. I appreciate that. And then just second question is related to that. I know you had the sort of 10%, 11% shortfall versus the LTA this quarter. Can you help us frame how much of that, I know you mentioned resource was the majority of it, but how much of that was really resource versus some company-specific items? And then, as you look into the early part of 4Q, have you seen the resource improving off the trends you saw through 3Q? Maybe if you could just give us a bit of a flavor around what's happening there from a fleet perspective. Thanks.

Matt Berger, Chief Financial Officer

So, I'll answer the first part of the question. The majority of the shortfall is resource for sure. Some of it is related to downtime and maintenance and repairs as we were preparing the fleet for the LTSA. And I think the impact of the storms is relatively minimal from a revenue standpoint and really, when we talk about the impact of the storms being minimal, the primary thing we're talking about is the condition of the assets being in good shape and back on line. But, to answer your question, majority is resource. I guess, as it pertains to the fourth quarter, we don't tend to think about it in terms of quarter-over-quarter variation. We believe in our long-term averages and we've published those and believe they'll be delivered over time. And also, with the GE contract, a lot of the resource variability and availability variability we've seen this year is mitigated.

John Stinebaugh, Chief Executive Officer

But through October we've seen resource that has been below LTA as well.

Brian Lee, Goldman Sachs

Okay. I appreciate the color, guys. Thanks.

Operator

Your next question comes from Colin Rusch with Oppenheimer. Please go ahead, your line is open.

Colin Rusch, Oppenheimer

Thanks so much. Guys, you've done a lot of work around some of the larger systems in portfolio. When you do think you'll start turning your attention to the distributed assets and leverage that you have on that footprint at this point?

John Stinebaugh, Chief Executive Officer

Colin, it's John. That's definitely a priority for 2019. One of the things we're doing right now is, as part of the solar performance improvement plan, the IR scans that we've done and the remediation plans, that includes the solar utility assets as well as the distributed assets, so we're basically taking a look at opportunity to improve performance from the entire solar fleet.

But the next thing that we're going to do is we're going to begin looking at opportunities to repower, expand, deploy more significant capital into the solar assets in order to drive incremental revenues and earn attractive returns. So, as part of that, a big focus will be on the distributed assets where we have got captive customers, we're currently providing a discount to the retail tariffs for their behind-the-meter utility bills, and we think that there is opportunity to, whether it be expand the systems, in some case replace panels to panels that have got greater energy density. In certain circumstances, depending on what the tariff structures look like, there may be opportunity to deploy batteries, but that's a big part of a business plan that we're looking to put in place where the first part is to identify the opportunity and then begin executing that. So, that's a big initiative we're going to be working on in the first half of 2019.

Colin Rusch, Oppenheimer

Great. And then, as you think about entering into Mexico, just in terms of service footprint, I mean are you looking at one-off assets or are you looking at more of a platform play as you evaluate those opportunities?

John Stinebaugh, Chief Executive Officer

The couple of opportunities we're looking at right now, they are portfolios of assets, so we will get some scale, but we think that we can pretty readily plug that into our North American platform. I think to the extent we do an acquisition, we'll have a force on the ground in Mexico to address some of the local issues, and certainly the operations of the plant will be done locally. But in terms of the asset management and the oversight, that will be done through our North American platform.

Colin Rusch, Oppenheimer

Appreciate it. Thanks, guys.

Operator

Again, if you would like to ask a question, please press star one on your telephone keypad.

Your next question comes from Ben Kallo with Baird. Please go ahead, your line is open.

Ben Kallo, Robert W. Baird & Co.

Hi. Good morning. Thanks for taking my question. I just want to kind of gauge the temperature of the competition out there for assets, and I think we've talked before about your pipeline having some differentiation to be able to find undervalued assets. I kind of want to get an update on that, what you see in the marketplace and the competitiveness in the U.S. and other parts of the world.

Operator

Ladies and gentlemen, please stand by; we're experiencing technical difficulties. Thank you.

You have a question from Brian Lee with Goldman Sachs. Brian, your line is open.

Brian Lee, Goldman Sachs

Hey, guys. I know we're having technical difficulties but maybe I'll just ask Ben's question so we can get the answer. What's the environment like competition-wise for assets? If you can maybe give some commentary around what you're seeing out there for demand, supply, and then maybe valuations. Thanks.

John Stinebaugh, Chief Executive Officer

Sure. There is a lot of transaction activity going on right now. It's really driven by, with the substantial build out of wind and solar in North America as well as Europe, a lot of build out is been done by private developers, and they're looking to recycle assets once they're notice to proceed or commercial operations, and that's fueling a lot of M&A activity. What we're seeing generally is there's also a lot of capital on the sidelines, particularly when you start to look at clean assets in auction processes. So, in auction processes, typically you're going to see, I would say, acquisitions of solar assets, levered returns in the 7% to 8% range, wind assets in the 8% to 9% range. And that would be for the United States.

In Europe we're seeing, in the markets we're focusing on, Spain, where rates of return are a few hundred basis points higher than that, so pretty attractive from a risk-adjusted return standpoint. Against that backdrop, what we're looking to do is, we typically don't participate in that many auction processes and we will look for situations where we think we've got an angle or, alternatively, we'll leverage our business development footprint to try to originate deals that are off market, like the Saeta transaction. So, we typically will look at situations that are more complex, whether it be take-privates, recapitalizations, more structured transactions, things of that nature, and we're trying to get a couple of hundred basis points of alpha regarding what we could get in a typical auction situation, and our business development pipeline reflects those kinds of opportunities.

Right now I'd say we're looking at a number of things, as I mentioned in the letter, in Spain as well as in Mexico, and we are seeing some opportunities in North America where development is becoming quite a bit more capital intensive as people need to fund interconnection deposits as well as PPA deposits. So, that wait stage aspect of development has become quite a bit more capital intensive and we're looking for ways to leverage our balance sheet, help bridge that gap in exchange for being able to buy assets at more attractive valuations. But, all in all, we think our business development pipeline is starting to firm up pretty nicely.

Operator

Again, if you would like to ask a question, please press star one on your telephone keypad.

We have reached the end of our Q&A session. I will now turn the call back over to Chad for closing remarks.

Chad Reed, Director, Investor Relations

Thank you, operator. That concludes our call for today.

Operator

Thank you for your participation and you may now disconnect.