

SolarCity (SCTY)

INCREASE TARGET PRICE

Rating	OUTPERFORM* [V]
Price (24 Jul 14, US\$)	72.16
Target price (US\$)	(from 75.00) 93.00 ¹
52-week price range	86.14 - 28.63
Market cap. (US\$ m)	6,645.98
Enterprise value (US\$ m)	6,443.65

*Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.

¹Target price is for 12 months.

[V] = Stock considered volatile (see Disclosure Appendix).

Research Analysts

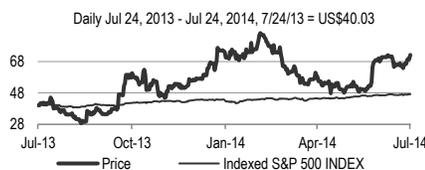
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Off to the Races: This Securitization Matters as Funding Machine Now Firmly in Place

- Positive implications of latest securitization as yield & spread declines while leverage increases, Increasing TP to \$93:** Today SolarCity priced a third Asset Backed Security (ABS), raising \$201.5m at a weighted yield of 4.32% on a portfolio of 118 MWs. All metrics improved from the prior securitizations – spread narrowed, yield declined, leverage increased, notes were added on top of fund investors (demonstrating ~100% funding potential through ABS & Tax Equity) and all disclosed portfolio characteristics (pricing, escalator, FICO scores, recovery rates etc) were healthy. On back of the increased confidence in obtaining low-cost financing, we increase our TP to \$93 (from \$75) and reiterate our Outperform rating. SCTY remains our preferred exposure to the distributed generation theme across our coverage.
- Yield declines and spread narrows even as leverage increases; all disclosed portfolio metrics remain healthy:** SolarCity raised \$201.5m in two tranches (\$160m and \$41.5m at 4.026% and 5.450% yields, respectively) with a weighted yield of 4.319%, a decline from the first two ABS raises done at 4.8% and 4.59%, respectively. Importantly, the spread above the 7-year swap continued to narrow, declining to 215 bps from 265 (ABS I) and 220 (ABS II), indicating continued appreciation of solar assets. The leverage ratio increased to 73% as \$1.71/watt was raised, an increase from the prior two securitizations. The only potential perceived negative we see is that the duration declined slightly (to 6.9 yrs) and the ABS is only partially amortizing, leaving a potential refinancing risk upon maturity (we note, however, that the near-term cash flow to SCTY is higher and the aggregate cash flow generated reduces the need for capital refinancing in future periods. See exhibit inside for the full comparison of the three securitizations to-date. *Continued inside...*

Share price performance



On 07/24/14 the S&P 500 INDEX closed at 1987.98

Quarterly EPS	Q1	Q2	Q3	Q4
2013A	-0.44	-0.54	-0.47	-0.46
2014E	-0.82	-1.05	-0.80	-0.90
2015E	-1.01	-0.58	-0.33	-0.64

Financial and valuation metrics

Year	12/13A	12/14E	12/15E	12/16E
EPS (CS adj.) (US\$)	-1.90	-3.58	-2.56	-0.44
Prev. EPS (US\$)	—	—	—	—
P/E (x)	-37.9	-20.2	-28.2	-163.0
P/E rel. (%)	-207.8	-119.7	-187.2	NM
Revenue (US\$ m)	163.8	330.1	590.3	947.4
EBITDA (US\$ m)	-107.9	-233.0	-56.1	238.3
OCFPS (US\$)	2.19	-1.51	1.10	5.20
P/OCF (x)	26.0	-47.9	65.8	13.9
EV/EBITDA (current)	-62.2	-28.8	-119.6	28.2
Net debt (US\$ m)	-48	-202	-655	-2,136
ROIC (%)	-16.03	-27.69	-12.03	5.04
Number of shares (m)	92.10	IC (current, US\$ m)	801.01	
BV/share (Next Qtr., US\$)	5.7	EV/IC (x)	7.3	
Net debt (Next Qtr., US\$ m)	-20.9	Dividend (current, US\$)	—	
Net debt/tot eq (Next Qtr., %)	-2.2	Dividend yield (%)	—	

Source: Company data, Credit Suisse estimates.

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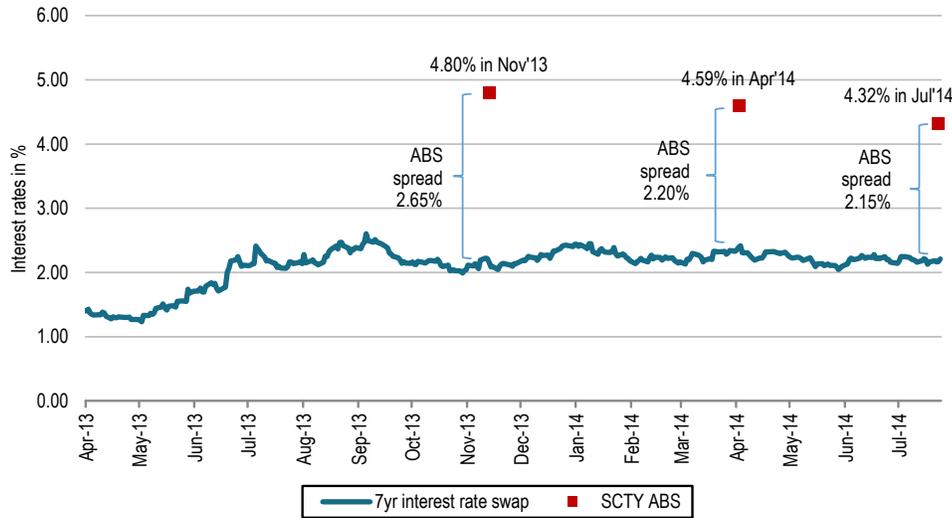
- **Funding machine in place – ABS raising \$1.71/watt in addition to Tax Equity:** SCTY was able to raise \$1.71/watt on top of tax equity (typically \$1.8-\$2.2/watt), indicating at a minimum SolarCity is now able to raise ~\$3.5/watt, covering all of the cash flow needs to grow rapidly (most recent all-in cost, including capitalized and opex, was ~\$3.23/watt). This leverage ratio of 73% is an increase from 62% and 66% for ABS I and II, respectively. With both tax equity and securitization, SolarCity should be able to grow rapidly without having to raise dilutive capital through convertibles or secondary equity issuances to fund the core business. The expansion to upstream manufacturing with Silevo could require this – but would be separate from funding the core business growth. Raising ~\$1.71/watt is also a positive development as it indicates SolarCity can utilize securitization after the ITC declines to 10% in 2017 when higher-cost tax equity will fund a smaller portion of initial capital outlay.
- **Raising target price to \$93 (from \$75) as confidence in funding ability increases:** We increase our Target Price to \$93 (29% upside) based on our DCF framework as we lower our execution discount rate to 12% (from 15%) given the increased confidence the low-cost funding mechanism is in place. We continue to see a ~\$170/share blue sky scenario (stable value/watt, 8x TV multiple) and \$33/share downside case which reflects only three years of operations. While the valuation framework is unique given challenges with GAAP, we believe the closest metric to P/E is the retained value created in a period to current equity value, which at 13x today, a significant discount to the market, is not reflective of the disruptive above-market growth potential.
- **Catalysts:** (1) Q2 earnings (August 7th) where bookings/deployments and value per watt will be disclosed along with potentially outlining an updated cost reduction roadmap or targets, (2) closing of Silevo acquisition & solidifying net capex plans over the next few months, (3) resolution of the Arizona property tax dispute (timing uncertain), and (4) evolution of California Net Metering 2.0 constructs (likely mid-2015, deadline of YE2015). The ongoing US/China trade dispute will garner headlines (announcement expected on the preliminary anti-dumping duty on Taiwan cells Friday afternoon) but we believe SolarCity is relatively immune as solar module supply has been secured at reasonable rates and modules are available for late 2014 and into 2015 at comparable price (~\$0.75) without exposure to trade outcomes.

Exhibit 1: ABS Pricing Summary & Portfolio Characteristics

	Series I 2013-1	Series II 2014-1	Series III 2014-2
1 Note Principle (\$millions)	\$54.425	\$ 70.2	\$ 201.5
2 Tranch A	na	na	\$ 160.0
3 Tranch B	na	na	\$ 41.5
4 Preliminary Rating from S&P per report	BBB+	BBB+	BBB+/BB-
5 Pricing Date	13-Nov-13	3-Apr-14	24-Jul-14
6 Maturity Date	Dec 2026	April 2022	July 2022
7 Maturity/Duration (Years)	13	8	6.89
8 Yield (weighted)	4.80%	4.59%	4.319%
9 Tranch A	na	na	4.026%
10 Tranch B	na	na	5.450%
11 7-year swap rate (%)	2.15	2.40	2.17
12 Spread over 7-year Swaps (weighted rate), bps	265	220	215
13 No. of PV systems	5,033	6,596	15,915
14 Aggregate PV system size (MW DC)	44	47	118
15 ABS Proceeds Raised per Watt (\$/w)	\$ 1.24	\$ 1.49	\$ 1.71
16 ADSAB (Aggregate discounted solar asset balance, \$million)	\$ 87.80	\$ 106.17	\$ 276.00
17 Offering amount to discounted asset value	62.0%	66.1%	73.0%
18 Weighted average customer agreement initial term (months)	223	237	240
19 Range of customer agreement initial terms (months)	120-240	168-240	156-240
20 Weighted average customer agreement remaining initial term (months)	201	225	233
21 Range of customer agreement remaining initial terms (months)	78-238	120-239	148-240
22 Weighted average customer agreement seasoning (months)	22	12	7
23 Range of customer agreement seasoning (months)	1-63	1-60	0-19
24 Weighted average price per kWh (\$)	0.15	0.15	0.15
25 Weighted average customer price escalator (%)	2.07	1.58	1.61
26 Percentage of ADSAB related to residential customers (%)	71	87	86
27 Weighted average FICO score (residential customer)	762	767	763

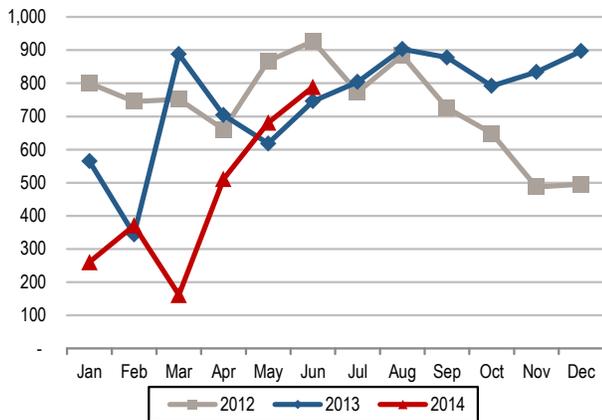
Source: Credit Suisse estimates, S&P Preliminary Presale Documents

Exhibit 2: Spread Narrowing to 215bps on top of 7-year swap



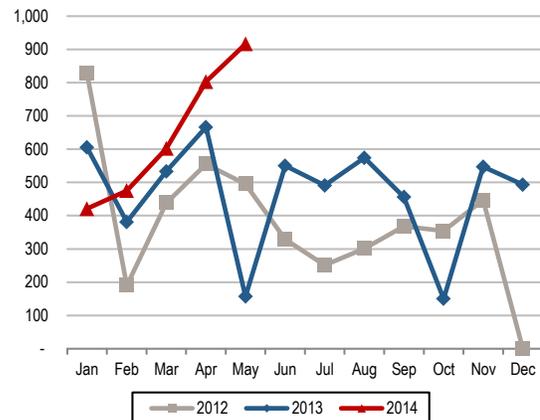
Source: BLOOMBERG, Thomson Reuters, Company data, Credit Suisse estimates

Exhibit 3: Arizona Permit Trends: Strong Q2 Activity, with Sequential Increases in April, May and June



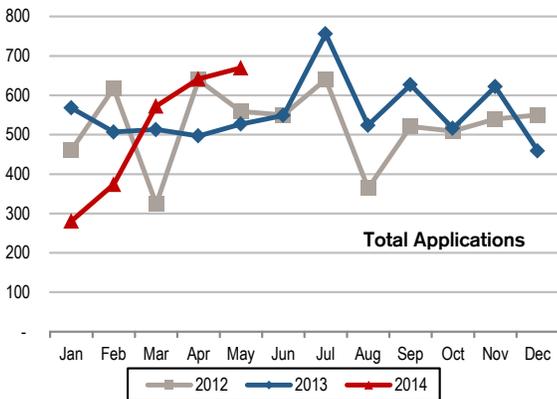
Source: APS, arizonagoessolar.org
Note: Residential & Non-residential

Exhibit 4: Colorado Solar Permits Increasing



Source: Xcel Energy
Note: for small customers <10kW

Exhibit 5: New Jersey Applications also increasing y/y and sequentially



Source: Source: NJ Clean Energy
Note: majority is residential application

Companies Mentioned (Price as of 24-Jul-2014)

SolarCity (SCTY.OQ, \$72.16, OUTPERFORM[V], TP \$93.0)

Disclosure Appendix

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3-Year Price and Rating History for SolarCity (SCTY.OQ)

SCTY.OQ	Closing Price	Target Price	
Date	(US\$)	(US\$)	Rating
13-Dec-12	11.79		R
07-Jan-13	15.97	22.00	O *
14-May-13	31.44	28.00	N
14-Jun-13	36.29	52.00	O
18-Jun-13	36.47		R
25-Jul-13	40.09		*
27-Oct-13	58.03	52.00	O
28-Oct-13	56.98	75.00	

* Asterisk signifies initiation or assumption of coverage.



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Restricted	3%	

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Price Target: (12 months) for SolarCity (SCTY.OQ)

Method: We are using a discounted cash flow framework to value SCTY and arrive at our \$93 price target. Our key assumptions include a 12% discount rate with 86% megawatt growth in 2014, 66% growth in 2015, 45% in 2016, and 15% long-term with incremental retained value per watt, net of operating expenses, increasing to \$1.43 by 2016 and declining to \$0.95 following the reduction in the Investment Tax Credit reduction in 2017.

Risk: Risks to our price target of \$93 for SCTY include: increased competition, regulatory changes for net metered energy and utility rates, interest rates, energy rates, solar panel prices, and IRS and US treasury department investigations.

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When you purchase non-listed Japanese fixed income securities (Japanese government bonds, Japanese municipal bonds, Japanese government guaranteed bonds, Japanese corporate bonds) from CS as a seller, you will be requested to pay the purchase price only.