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Hannon Armstrong Sustainable Infrastructure Capital, Inc. (HASI)

Q2 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and welcome to Hannon Armstrong's Conference Call on its Q2 2016 Financial Results. Management will be utilizing a slide presentation for this call, which is available now for download on their Investor Relations page at investors.hannonarmstrong.com. Today's call is being recorded and we have allocated 30 minutes for prepared remarks and Q&A. All participants will be in a listen-only mode. [Operator Instructions]

At this time, I would like to turn the conference call over to Amanda Cimaglia, Investor Relations Director for the company.

Amanda Cimaglia
Director, Investor Relations & Corporate Communications

Thank you, operator. Good afternoon, everyone, and welcome. Earlier this afternoon, Hannon Armstrong distributed a press release detailing its quarterly results, a copy of which is available on our website. This conference call is being webcast live on the Investor Relations page of our website where a replay will be available later today.

On today's call, we have Jeffrey Eckel, our President and CEO; and Brendan Herron, our CFO. We will discuss non-GAAP financial measures on this call. A reconciliation of GAAP to non-GAAP financial measures is provided in our posted earnings release and slide deck.

I would like to remind you that some of the comments made on today's call are forward-looking statements and within the meaning of Section 27A of the Securities Act of 1933 as amended and Section 21E of the Securities and Exchange Act of 1934 as amended. The company claims the protections of the Safe Harbor for forward-looking statements contained in such sections.

The forward-looking statements made in this call are subject to the risks and uncertainties described in the Risk Factors section of the company's Form 10-K and other filings with the SEC. Actual results may differ materially from those described during the call. In addition, all forward-looking statements are made as of today and the company does not undertake any responsibility to update any forward-looking statements based on new circumstances or revised expectations.

With that, I'd like to turn the call over to Jeff who will begin on slide three. Jeff?

Jeffrey W. Eckel

Chairman, President & Chief Executive Officer

Thanks, Amanda, and good afternoon to the investors and analysts dialing in. We know many of you will be anxious to jump from our call, which we hope will be boring to get on the Tesla call at 5:30, so we will endeavor to keep it short and simple today. Today, we are announcing core earnings for the quarter of $0.32 per share, a 23% increase from Q2 of last year. For the quarter, we closed $257 million of transactions, down from $350 million in the second quarter of last year. However, we remain ahead of last year's pace for the first half of this year.

Our balance sheet remains strong with a completion of our $91 million follow-on equity offering in June, our leverage at 1.7 to 1, and our fixed rate debt at 70%. We expect to remain on track for 2016 annual earnings, consistent with prior guidance, but the second half of the year should benefit less from fee income, as Brendan will address more completely, while we work to build the balance sheet according to our business model. As you know, we generate our dividend, currently 5.4% annually, by investing in a diversified portfolio of efficiency wind and solar assets, assets that we believe constitute the future of energy investing.

Turning to page four, we've now been public for three years and have produced a total shareholder return of over 125% in that period, which is supportive of our investment thesis. We believe we will earn better risk-adjusted returns by investing on the right side of the climate change line and by making those investments in the senior or preferred equity positions of the capital stack.

Let me detail that thesis a bit more. By investing on the right side of the climate change line, we mean our investments will be in assets that are neutral to negative on incremental greenhouse gas emissions. We believe that in a world increasingly defined by carbon, we don't sacrifice returns to have positive environmental impact, but rather we will expect to have better results than if we ignore carbon in our investment decisions.

As we have done for years, we analyze each investment for its greenhouse gas impact. And in Q2, the aggregate investments reduced greenhouse gases by 81,000 metric tons, equivalent to approximately 40,000 metric tons of coal. Turning to page five, our pipeline remains at more than $2.5 billion for the next 12 months. With that said, we believe the new-build utility scale wind and solar markets, as reported by others, are softer in 2016 for many clients. And we're reminded of the value of having multiple markets and platforms available for Hannon Armstrong to originate new transactions.

The forward-looking yield on our portfolio stayed at 6.3%, as it was last quarter. And we continue to use our diversified pipeline to help us build a portfolio with the best risk-adjusted yields. We continue to see variations in originations quarter-to-quarter and believe no one quarter represents a trend, either good or bad, and think we should be judged by the annual results. In summary, we had a strong quarter. Our investment thesis is solid and our markets are growing.

Now, I'll turn it over to Brendan to detail our financial performance.

J. Brendan Herron

Chief Financial Officer & Executive Vice President

Thanks, Jeff. You will note in the press release and in the Q when it's filed that we have modified our presentation of the income statement to calculate a total return number for the quarter. We did this, because various third-party reports had conflicting information on total revenue. And we wanted a consistent calculation that all sources could use. We've also eliminated the net interest margin calculation.

As you may be aware, the interest expense includes the interest on our nonrecourse loans for our equity method investments, but does not include the earnings on those investments. Year-to-date interest expense for those loans is approximately $7 million or 32% of interest expense. Thus, any interest margin that was being calculated using this data was not a meaningful presentation and we have discontinued the calculation.

Turning to the presentation, you'll see that we're now showing core – or now showing GAAP earnings and a reconciliation to our core earnings in response to the new SEC guidance on non-GAAP measures. For the quarter, we generated GAAP interest income, rental income, and income from equity method investments, which we've labeled investments income, of $17 million for the quarter, an increase from approximately $11 million this quarter last year as a result of growth in the portfolio from $1.1 billion to $1.4 billion.

Included in this increase is approximately $1.4 million of equity method income, resulting from some of our preferred return projects, where we're investing on the sponsor side, which reduces some of the HLBV allocation issues we see when we invest alongside the tax equity investors. When combined with the core equity adjustments, we have recognized a total return of $13.6 million on our equity method investments year-to-date, up from $6 million this time last year.

This increase over last year is a result of an approximate doubling of our equity method investments. And we have received approximately $30 million of cash from these investments this year. We also generate gain on sale and fee income, which we've labeled other investment revenue, of $5.8 million, up from $2.4 million in this quarter last year. For the six months, we've generated $11.6 million of this other investment revenue versus $5.5 million in the same period last year.

Since we've been public, we have averaged approximately $3.4 million of other investment revenue a quarter. So the past two quarters have clearly been larger. We make the decision on what to securitize or monetize based on a number of factors, including the state of the equity market, the size of the transaction, the value we achieve from the securitization versus the value of holding on the balance sheet for the long-term and interest rate and portfolio management considerations.

As we've said, the classic transaction we would securitize would be a large long-dated fixed rate federal energy efficiency contract. One of the strengths we have in our business model is the ability to use securitizations to reduce our exposure to raising capital in volatile or difficult markets. If you remember, back in the first several months of the year, equity markets were very volatile. During this time, we had several transactions that fit the classic model and decided to securitize them to limit our equity exposure.

Thus, we securitized approximately 60% of the transactions in the first half of the year, up from a more typical 25% to 30%. We would expect that the second half of the year will likely be equal to or lower than our quarterly average. Interest expense grew to $11 million from $6 million last year. As you can see from the press release, our overall debt balance grew by approximately $150 million. And we were at 70% fixed rate debt at the end of the quarter as compared to 42% this time last year.

Comp in general and administrative expenses grew by $2.5 million due to higher staffing costs and higher professional fees. The staffing cost includes additional head count up to approximately 35 people from 30 at this time last year, as well as reflecting compensation increase and bonus accrual. The professional fees were in part due to this being the first year the auditors will have to report on SOX due to the growth in our market cap.

In total, we have $3.7 million or $0.09 per share of GAAP income, a significant increase from the $0.04 in the same quarter last year. After adding in the core adjustments, primarily the equity method adjustment and non-cash stock comp, we had $12.7 million of core earnings or $0.32 a share as compared to $8.1 million or $0.26 a share last year, a 23% increase on a per share basis.

Turning to slide seven, our focus on high credit quality assets is reflected in our portfolio, which, excluding equity method investments, consist of 42% of our assets in government obligors and 56% investment grade commercial transactions with only 2% of our assets or $17 million not considered investment grade.

Our portfolio is widely diversified with over 115 projects at an average outstanding balance of approximately $12 million per project. Our exposure to projects other than our residential solar portfolio that involve yieldcos is under 10%. And we do not expect any negative impact from the SunEdison bankruptcy.

Turning to slide eight, we want to focus on the balance sheet. Presently, 62% of our assets are fixed rate debt investments with the remaining consisting of floating rate debt, equity method, and real estate. As we've discussed, new assets are originated at current rates, which, in fact, is similar to a bond ladder.

On the debt side, we're at approximately 70% of the debt at fixed rates and our leverage is 1.71 to 1 against our 2.5 to 1 leverage target, down from 2.3 to 1 last quarter as a result of the equity raise at the end of June. Given the timing of the offering in late June, we will see dilution from the offering in the second half until we're able to rebuild leverage through new investments. We have discussed that given continued, low short-term rates, we continue to focus on maintaining our fixed rate debt to be 50% to 70% fixed rates.

As of June 30, 2016, we estimated a 25 basis point increase in LIBOR would increase quarterly interest expense by approximately $200,000 or less than $0.01 a share, certainly a manageable number. Just a quick update, we sold approximately $1 million under the ATM, which we put in place last quarter, which is consistent with our expectation that it is not expected to be a primary source of equity.

I will now turn it back to Jeff who will wrap up the presentation.

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

Thanks, Brendan. Turning to slide 10, to close, we continue to execute on our business plan and continue to produce for our shareholders. Our long-term cash flows from the senior slice of capital provides a stable dividend, delivering an attractive and growing dividend yield. Our portfolio is continuing to diversify. I think Brendan mentioned 115 individual assets with respect to the number of transactions, customer segments and technologies.

And, again, we pride ourselves on good governance and alignment of managers of the business with the owners of the business, you, the shareholders. Again, it is an honor to work with my colleagues at Hannon Armstrong and I thank them publicly for another outstanding quarter as we continued to invest in the future of energy.

We appreciate you listening to our update. We'll now open the call for a few questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instruction] And we'll take our first question from Carter Driscoll with FBR.

Carter Driscoll
FBR Capital Markets & Co.

Q

Hey, guys. How are you?

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Hi, Carter.

Carter Driscoll
FBR Capital Markets & Co.

Q

Just a quick question. So you talked about doing a lot more securitizations the first half of the year. Kind of at what point or maybe you could kind of characterize the transition or you think it's kind of stabilized? Obviously you tapped the equity markets late June. And how you see that maybe being more stable in the second half of the year and how that maybe does or doesn't play into your forward yield potentially in the second half of the year, maybe potentially creeping up after flat lining q-over-q?

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Yes. Carter, this is Jeff. I think as we've done in the past, when we raised equity, it's because we need it. And we're going to be able to put it to work. So, the first half of the year, it was a little dicey in the equity markets. It certainly has been more stable. And we expect to get back to plan and start building the balance sheet up to the targets.

Carter Driscoll
FBR Capital Markets & Co.

Q

Is it possible – obviously your leverage ratio just as a point estimate fell sequentially. Is it reasonable to assume you're trying to get back to where you were last quarter by year-end? Would that be a reasonable target?

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Yes. I think so.

Carter Driscoll
FBR Capital Markets & Co.

Q

Okay. All right. I know you guys want to keep it short. I'll get back in the queue and take them offline.

Operator: And we'll take our next question from Charles Nabhan with Wells Fargo.

Charles Nabhan
Wells Fargo Securities LLC

Q

Hi, guys. Wanted to get some commentary around the pipeline. It looks like it's shifted towards solar and wind projects away from energy efficiency. So I was hoping you could just give some color on what you're seeing across those markets and talk about what prompted the shift in the pipeline?

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Thanks, Chuck. The pipeline last quarter was dominated by efficiency, which was probably more related to our surprise at the year-end extension of the tax credits than any real pure measure of the market. We've adjusted now to the fortunate reality of having five-year visibility on tax credits. And it's not that efficiency is falling. It's just that now we're seeing solar and wind transactions that we hadn't seen. Now the one point we made is some of the utility scale solar and wind transactions we expect to be back-end loaded in 2016 and 2017. It's been pretty light for the solar guys, particularly utility scale. Residential, commercial and industrial still seems to have good prospects.

Charles Nabhan
Wells Fargo Securities LLC

Q

Okay. And as a follow-up, it looks like the balance – the equity method – the equity balance increased by about 10% or $30 million this quarter. Is that attributable to adjustments in the current investments going into the quarter or where there any new equity method investments this quarter?

J. Brendan Herron
Chief Financial Officer & Executive Vice President

A

Yes. There was a new equity method investment of about $40 million this quarter, Chuck.

Charles Nabhan
Wells Fargo Securities LLC

Q

Okay.

J. Brendan Herron
Chief Financial Officer & Executive Vice President

A

And you'll see it in the Q. It was an equity method investment in a distributed set of commercial, industrial and a little bit of residential solar.

Charles Nabhan
Wells Fargo Securities LLC

Q

Okay. Great. And if I could sneak one more quick modeling question in. Given the increase in the head count and the ongoing SOX compliance, is it fair to assume that the G&A expense line we're seeing this quarter is a fair run rate going forward?

J. Brendan Herron
Chief Financial Officer & Executive Vice President

A

I think I would use an average of the last two quarters.

Charles Nabhan
Wells Fargo Securities LLC

Q

Okay. Great. Thanks for the color, guys. I appreciate it.

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Thanks, Chuck.

Operator: We'll take our next question from [ph] David Carter (17:33) with Robert W. Baird.

Benjamin Joseph Kallo
Robert W. Baird & Co., Inc. (Broker)

Q

Hey, guys. This is Ben Kallo. How are you?

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Hi, Ben.

Benjamin Joseph Kallo
Robert W. Baird & Co., Inc. (Broker)

Q

Nice quarter. Could you guys talk a little bit about, I guess, you're getting close to $1 billion market cap. You've come a long successful way the past couple years. How has competition changed or origination and how you find opportunities? I guess last thing, also last question as you step forward into some of the renewables, which I guess would carry higher returns, how are you managing that? The head count question is interesting because I think you probably added two people. But just as you get bigger, what's changed and has the competition changed at all?

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Good question. I think our market cap is largely irrelevant to the competitive landscape. We continue to focus on efficiency wind and solar and trying to do as many programmatic transactions with the leading players as possible. And if we get to be $2 billion or $3 billion, I don't really expect to see that that strategy change much.

I think there's two countervailing competitive trends in the market you've got that we certainly see but are hard to sort out what the net impact is. You've got the exit of yieldcos as buyers in a lot of these transactions. But you also have a lot of institutional investors going down market a bit. I mentioned I think in the last call John Hancock doing a residential solar transaction that was a great deal for them and SolarCity, but was surprising for us to see that.

So, I think, there's always competition. I don't think it has anything to do with our market cap. And in terms of managing the assets, we have added more on the asset management and technical side. We've brought in an old colleague of mine, George Emsurak, who is really on point for our wind and solar investment. He has built wind farms and solar farms and ex-Bechtel engineer and a really good person to help us manage these assets. And I think it gives us a capability to talk to the clients at a technical level and an engineering level that we probably hadn't had until George came on board.

Benjamin Joseph Kallo
Robert W. Baird & Co., Inc. (Broker)

Q

I guess just two quick follow-ups. A quick kind of say in regards Brendan what kind of financing opportunities are open to you with your line of credit? Where it is? Is there something that you want to change about that or are you comfortable with that? And then I guess a follow-up for you, Jeff. There's been a little bit of headlines up on the PACE side. Any movement there or kind of it's still early phase? Thanks, guys.

J. Brendan Herron
Chief Financial Officer & Executive Vice President

A

Ben, I think, on the finance plan, we've been working to kind of continue to reduce cost and increase the number of lenders. And we continue to do that. We have ongoing discussions with a wide variety of lenders. We've brought new lenders in over the last 12 – a significant number of new lenders in over the last 12 months and continue to talk to new people and continue to find people that are interested in playing in various parts of our capital stack on the debt side. So we think that market is robust right now and we continue to have those discussions and look for new opportunities both with existing lenders and new lenders.

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

And you, of course, will get me Googling PACE headlines with your question. But we continue to develop our PACE business. We think it is a very interesting market. It's still early days in PACE, but we're starting to see some uptake of the product and find the delivery mechanism that allows us to scale it. So we're still quite optimistic about the PACE business.

Operator: And we'll take our next question from Noah Kaye with Oppenheimer.

Noah Kaye
Oppenheimer & Co., Inc. (Broker)

Q

Thanks very much. So just a question for you, first of all, about the state of capital flows in the market. We've actually seen the [ph] triple B (22:30) yields continue to kind of come down over the course of the year. But you guys continue to do great job in maintaining and growing your yield. How much of that is a shift in the portfolio? And how much of that is continuing to occupy this niche? And, I guess, the implied question. Are any of the asset classes that you're investing in under any yield pressure right now with more folks looking for yield, given extremely low base interest rates?

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Yes, a good question. I think you mentioned a niche. We really look at it as four or five niches that we're investing in. And that is a good defense against competitive pressures. That said, we don't defy gravity on interest rates or spreads. It's our job to continue to find the places where we can add value and it's not too crowded. So I mean the numbers are what they are, but I think we're doing a good job of keeping the margins where we want them to be.

Noah Kaye
Oppenheimer & Co., Inc. (Broker)

Q

And you mentioned a hire in the asset management side. Certainly, I mean, the mix of assets continues as the previous caller said to shift a little bit towards renewable. As you put more capital into solar and wind and let's take wind specifically, how comfortable are you in terms of your visibility on kind of the cadence of returns of these assets on a quarterly basis, given some fluctuations or does your positioning in the capital stack make you slightly immune to those kinds of fluctuation output considerations?

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

I think it's the latter question. We are senior. There is generally some preferred flip. And then the accounting is also very supportive of a more levelized earnings stream. Brendan mentioned, what, $30 million of cash and $13 million of earnings. You can be a lot of variation in the $30 million of cash and it doesn't really affect our $13 million of revenue recognition. And just a question on the asset management. We've always done asset management. We just outsourced it to George and his business and now we've brought him on not all the asset management, but the technical aspects of solar and wind projects and we just brought him on board. It's not like we are building an engineering company or anything. His name is George.

J. Brendan Herron
Chief Financial Officer & Executive Vice President

A

And he's been on – it's not a new hire. He's been with us since the beginning of the year. The other comment to Jeff's point is we do structure these projects. So we have preference in cash flows and thus we avoid – we don't absorb that variability that you may see if you were a sponsor.

Noah Kaye
Oppenheimer & Co., Inc. (Broker)

Q

Okay. Thank you so much.

Operator: We'll take our next question from Michael Morosi with Avondale Partners.

Michael Morosi
Avondale Partners LLC

Q

Hi, guys. Thanks for taking the question. Just building on your preference position within these projects and to the extent that the market cap is rising and the stock is performing and there might be new investors interested in the name. Could you just take a step back and just talk conceptually about where you think Hannon's dividend yield and risk profile should slot longer-term relative to other assets in the market, relative to yieldcos, relative to utilities, and just the broader investment universe?

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Sure. And we took out the slide and spared everybody the slide of why we invest where we do. But it's one of my favorites. We're generally senior in the waterfall to sponsor equity in solar and wind. I think we are senior. So we think we should price beneath the yieldco type, IPP type investors just on that basis. And we think all of those are generally senior to the utility equity investors. And that the source of our revenue are operating costs for a regulated utility that come out before the debt and the preferred and the common gets felt, so – or it gets paid. So we like being senior in the cash flows. We wouldn't mind being in the equity, if we thought the returns were there, but the returns are kind of thin and in most equity projects as people chase yield. So I think senior is a nice place for us to be.

Michael Morosi
Avondale Partners LLC

Q

Great. Thanks a lot.

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Thank you.

Operator: We'll take our next question from Jeff Osborne with Cowen & Company.

Jeffrey Osborne
Cowen & Co. LLC

Q

Hey. Good afternoon, guys. Congratulations on the strong results. A couple questions on my end. I think Brendan, if I heard you right, you said you made an equity method investment in residential solar, just given the challenges that that sector has had in terms of net metering roles. Can you just discuss what exposure you would have to what you bought and potential role changes in the state or jurisdiction that you have the asset?

J. Brendan Herron
Chief Financial Officer & Executive Vice President

A

Yes. So it was a distributed portfolio that had some residential, mostly C&I.

Jeffrey Osborne
Cowen & Co. LLC

Q

Okay. And then how do we think about, Jeff or Brendan, on the pipeline for wind and solar? I think a lot of the third-party forecasters have pushed out some of the utility projects that they thought would happen in 2016 into 2017. If I heard you right, you mentioned that both years will be back-end loaded. And certainly this year, the industry for solar is back-end loaded as is wind based on the installation data, but, I guess, just how do we think about 2017? And then if you have land ownership in a project that maybe was pushed out from this year to next, are you still being paid on that? Whether the project moved forward or not? Just trying to understand some of the dynamics for the couple gigawatts of utility scale that has pushed to the right.

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer — A

So if it's a land deal and we own the land then the project has closed and is generating profits. So we're not speculating on pure development land deals.

J. Brendan Herron
Chief Financial Officer & Executive Vice President — A

Or is at least in construction.

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer — A

Yes or in construction, correct. So any push out wouldn't affect our land. The utility scale is just one market that where the new-build utility scale, solar and wind markets are just one market. We continue to look at tax equity tails and see how we can participate in those. And those are legacy projects that may have been built seven years, eight years, nine years ago and really unaffected by that. And that's why I made the comment I'm glad we've got multiple markets, because some of these markets will not be as productive in any one period as you might like them to be. So it's good to have some other options like PACE and efficiency and distributed solar.

Jeffrey Osborne
Cowen & Co. LLC — Q

Got it. And then the last question I had just, Jeff, on the energy efficiency side just as you have conversations with your partners like Johnson Controls and others, how are they feeling or what are they relaying to you in terms of the pipeline of projects for the rest of this year as we head into 2017 post-election, things like that? Are you still feeling comfortable with the pace of growth, in particular, with your exposure to the government vertical?

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer — A

Well, first, I never feel comfortable, Jeff, so I'm a constant worrier. So I won't say I feel comfortable about anything, but never have. But yes, I think the federal and the state and local market is continuing to be a good source of business for us. State and local is going to be completely unaffected by an election. I don't see really the federal market being affected by an election either way. The infrastructure continues to depreciate. The needs continue to change and the economics continue to be very sound. If those elements are there, a fair share of business will be generated.

Jeffrey Osborne
Cowen & Co. LLC — Q

Perfect. I appreciate it. Thanks so much.

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Thank you, Jeff.

Operator: And we'll take our final question today from Philip Shen with ROTH Capital Partners.

Philip Lee-Wei Shen
ROTH Capital Partners LLC

Q

Hey, guys. Thanks for taking my questions.

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Hi, Phil.

Philip Lee-Wei Shen
ROTH Capital Partners LLC

Q

I've been bouncing around between calls, so apologies if this has been asked. With the expected growth in energy efficiency, solar, wind over the next few years, what are your expectations for maybe pushing transaction volumes meaningfully beyond $1 billion perhaps in 2017? How real is that possibility and what would it take to get there?

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

I think we've talked before about the hazards of accelerated growth. If we just do our business model of $1 billion, $700 million a year going on the balance sheet in two years, three years, four years, five years, it becomes a sizable company. I think if we see opportunities, I think, the first order of business for us is to optimize the risk-adjusted returns, not necessarily grow. That said, we're not going to be sticks in the mud if there really are significant increases in the market opportunity. But those are good problems to manage to. I think we're going to stick to the netting and stick to the model.

Philip Lee-Wei Shen
ROTH Capital Partners LLC

Q

Great. Thanks, Jeff. As for my follow-up, can you talk about OpEx and the trends that you see there? I mean, do you see any reason to take operating expenses up meaningfully in the near-term? If not, how do you see them trending in Q3 and Q4?

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Now that I've mentioned George so much, I think, he is going to ask for a raise, but what do you think generally, Brendan?

J. Brendan Herron
Chief Financial Officer & Executive Vice President

A

So, I think, generally, I'd say if you take the first two quarters as an average and run that out for the rest of the year, I think, you're in the right ballpark on a core basis. For operating expenses, we are going to have some – we're seeing some higher costs because of SOX and some other things. But I think we're at $9.3 million through the first two quarters. So I think if you take after the second half, you'd be in the right relative range, Phil.

Philip Lee-Wei Shen
ROTH Capital Partners LLC

Q

Great. Thanks, Brendan. Thank you, Jeff.

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

A

Thank you.

Operator: And this will conclude today's question-and-answer session. I would now like to turn the call back over to Jeff Eckel for any additional or closing remarks.

Jeffrey W. Eckel
Chairman, President & Chief Executive Officer

Thanks so much, everybody, and good questions. And we'll go get back to work and try to produce a good Q3. Thanks so much.

Operator: And that does conclude today's conference. Thank you for your participation. And you may now disconnect.