05-May-2016

NRG Energy, Inc. (NRG)

Q1 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the First Quarter 2016 NRG Energy Earnings Conference Call. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will follow at that time. [Operator Instructions] As a reminder, this call maybe recorded.

I would now like to introduce your host for today's conference, Mr. Kevin Cole, Head of Investor Relations. Please go ahead, sir.

Kevin L. Cole
Senior Vice President-Investor Relations

Thank you, Christy. Good morning, and welcome to NRG Energy's first quarter 2016 earnings call. This morning's call is being broadcasted live over the phone and via the webcast, which can be located in the Investor section of our website at www.nrg.com under Presentations and Webcasts.

As this is an earnings call for NRG Energy, any statements made in this call that pertain to NRG Yield will be provided from the NRG perspective. Please note that today's discussion may contain forward-looking statements which are based on assumptions that we believe to be reasonable as of this date.

Actual results may differ materially. We urge everybody to review the Safe Harbor in today's presentation as well as the risk factors in our SEC filings. We undertake no obligation to update these statements as a result of future events, except as required by law.

In addition, we will refer to both GAAP and non-GAAP financial measures. For information regarding our non-GAAP financial measures and the reconciliations to the most directly comparable GAAP measures, please refer to today's press release and this presentation.

And now with that, I'll now turn the call over to Mauricio Gutierrez, NRG's President and Chief Executive Officer.

Mauricio Gutierrez

President, Chief Executive Officer & Director

Thank you, Kevin, and thank you, everyone for joining our call today. Joining me this morning is Kirk Andrews, our Chief Financial Officer. Also on the call and available for questions we have Elizabeth Killinger, Head of our Retail business and Chris Moser, Head of Operations.

We're off to a really good start for the year. Our financial performance was strong for the first quarter allowing us to reaffirm guidance for the full year. We're making significant progress in our priorities of reducing costs, replenishing capital, and deleveraging the business. And importantly, we're bringing certain people our platform with the conclusion of the GreenCo process.

So let me start with our first quarter results. NRG delivered $812 million of adjusted EBITDA under very challenging marketing conditions. We remained focused on our day-to-day operations, achieving top quartile safety performance, good availability across our generation fleet, and stable results from our retail business.

All of these, combined with our opportunity hedging program, mitigated the impact of the very weak wholesale prices that we experienced during the quarter. These results illustrate the strength of our platform and the unique value proposition that NRG offers.

We are making good progress in our commitment to deleveraging the business. We retired $229 million of NRG debt or approximately 30% of our 2016 targets. Not only are we on track with our original plans, we have expanded the total capital available for deleveraging to $1.3 billion after adding $253 million from our Midwest Generation capacity monetization financing, which Kirk will provide additional details on during his remarks.

Finally, this quarter, we're taking another important step forward in simplifying our business as we concluded, after much consideration, the GreenCo process. With the reintegration of business renewables last quarter and now the resolution for our Home Solar and EVgo businesses, which I will cover in more detail in a few slides, we have turned the page on this period of uncertainty and now are focused on executing our plan.

On our last call I spent some time talking about the merits of diversification as a necessary condition to succeed in the future of the competitive power industry. Today I want to expand on the multiple levers that NRG has to deliver value to our shareholders.

Now turning to slide 5, I have outlined the three key macro levers that describe the earnings potential of our business. Over the years we have successfully repositioned the company away from solely relying on energy margins to other more stable and predictable sources of revenue. So let me start with the first lever, which now represents two-thirds of our economic gross margin. This comes from parts of our business that are either not directly correlated to or that are countercyclical to the price of natural gas including our retail business, contracted generation and capacity payments.

This lever of our business provides a stable base of predictable and visible earnings potential, a quality that differentiates us from many others in our industry, and we do it at significant scale across all three areas. Keep in mind this base is also growing given market trends in renewables and contracted generation where our relationship with NRG Yield will continue to be a competitive advantage in the future.

Now let's talk about the second and third levers that comprise the other one-third of our economic gross margin which is directly tied to the price of gas and power. These portions' relative share has declined over the years given the prolonged weak commodity price environment. But we have deliberately maintained offset through fuel diversity, as I believe the current gas pricing environment is unsustainable in the medium to long run, and we want to be there with scale when the market recovers.

The second lever is what I refer to as the fuel spread. This is the traditional way we have made money selling coal, oil and uranium at gas prices. It is effectively a synthetic long gas position. For those of you who invest in the E&P sector, we are long roughly about three Bcf a day of gas, so for every $0.50 move in gas prices, our portfolio has the potential to flex up by $500 million in additional gross margin. Let me be clear. We're not gas agnostic and don't want to be gas agnostic, as we believe current prices are not sustainable.

The third lever is our power spread or heat rate exposure. As power markets tighten due to retirements or low growth, we maintain significant offset to increasing power prices, as we have the largest competitive power portfolio in the country with close to 50,000 megawatts of generation with both geographic and merit order diversification. So when people ask me why I'm convinced we have the right platform to be the leader in the competitive power space today and into the future, this is why.

Success in this industry is all about diversification of the business and core operational excellence. Our platform is designed to deliver results even in a difficult market, and given how unpredictable the markets can be having stability in our core platform is critical. At the same time, our leverage to any market recovery should be embraced not ignored because it is quite substantial. And when you couple these dynamics with our commitment to strengthening our balance sheet and streamlining our costs, I have no doubt that NRG is built to thrive under a variety of market conditions.

So moving onto the next slide I want to touch briefly on key developments across our markets. We are encouraged by recent actions from regulators in support of competitive markets. We are pleased that FERC has stepped in to effectively stop the out-of-market PPAs for AEP and FirstEnergy in Ohio. It is also encouraging that the U.S. Supreme Court decided to invalidate Maryland contract created for the sole purpose of suppressing capacity prices.

In PJM, the transition to the capacity performance product has brought higher capacity payments in exchange for higher performance commitments as we have pivoted our suite accordingly. Our program of transforming coal plants to gas was undertaken with an eye towards becoming a provider of reliability.

In Texas, we're optimistic in ERCOT as we see up to 9 gigawatts of coal generation at risk due to upcoming environmental regulations and continued strong growth. In addition, we expect market changes to ORDC with the purpose of increasing prices to better reflect scarcity conditions.

And in the West, while the Aliso Canyon issue will present reliability challenges for the California ISO over the next year, we do not expect this issue to have significant impact to our generation portfolio since most of our revenue in California is supported by PPAs and RA contracts.

Also our newest merchant plant, Sunrise, is supplied off the Kern River pipeline and thereof not impacted. We hope this becomes a catalyst to address gas power for the nation and fuel cost recovery issues that are much needed in California.

Turning to slide 7, let me now discuss the details around the conclusion of the GreenCo process that we started in September of last year. Last quarter, I explained that there were three objectives we sought to accomplish in this process, maintain our capability to take advantage of renewable trends at appropriate investment returns, incorporate all of our businesses into our financial results, and to minimize the use of the $125 million revolver.

Today I'm here to tell you we have met our objectives and have concluded the process. To do a quick recap, beginning last quarter we reintegrated business renewables, which allows us to maintain a strong position in the renewables market. This business is now fully integrated, and I will be updating you on its progress in the months to come.

Moving to residential solar, we undertook a comprehensive strategic review process over the past six months to determine the best course of action to realize value, minimize capital needs and, like business renewables, ensure we do not lose the ability to meet renewable energy demands across all types of customers. While our original goal was to secure permanent capital and deconsolidate the enterprise, we were not able to move forward in this direction in a way that met all our objectives.

Today we're announcing a change in our approach to residential solar that will allow us to meet them. First, we're both streamlining and simplifying the organization by significantly lowering the cost structure and focusing in markets where we have a competitive advantage. Residential solar will become a product in our retail offering, and we intend to fully integrate into our retail business by 2017.

Second, we are changing our business model to focus on origination, installation, and direct third-party sales which will allow us to simplify financial reporting by providing immediate revenue recognition. I am pleased to announce new partnerships with both Sunrun and Spruce Financial which will allow us to execute on this plan.

Our approach comes with significant changes in our overall organization, cost structure, and business model. This model allows us to maintain our 2016 financial guidance as we transition the business throughout the remainder of 2016 to be at least an EBITDA breakeven business by 2017.

While this is not a business you can expect to hear about each quarter, our strategy for this business is important to our organization, allowing us to maintain a viable yet right-sized structure so that when the ERCOT market economics are viable we can offer residential solar to our existing 3 million customers.

We have also concluded the strategic review process for our electric vehicle charging network or EVgo. I am announcing today the sale of a majority stake of this business to Vision Ridge Partners. NRG will receive total consideration of approximately $50 million with $19.5 million upfront available to NRG and $30 million remaining in the EVgo platform. In addition, NRG have some earn-out potential of up to $70 million through 2022.

Under this structure NRG will have – will not have any ongoing capital commitments to EVgo other than its obligations under the California settlement. With the closing of this transaction, EVgo results will no longer be consolidated into NRG financial statements. With the conclusion of the GreenCo process, the $125 million revolver is no longer necessary and will be eliminated as we move forward and execute on our new plans.

On slide 8 I want to provide you an update on the great progress we have made in streamlining our cost structure. We are on track to realize $250 million in recurring cost savings in overhead and O&M, and we have made significant progress in our new FORNRG program targets. This means that over the next two years we will have taken an impressive $400 million in total costs out of the system. Additionally, you will be able to track these costs in our disclosures to see our progress as we move through the subsequent quarters.

While I am very pleased with our efforts to date, I expect that we will be able to find even more opportunities to reduce our cost structure as we continue with our remaining asset sales, the integration of the residential solar business, and our push to find even more opportunities to streamline the organization.

So with that, I will turn it to Kirk for the financial review.

Kirkland B. Andrews

Chief Financial Officer & Executive Vice President

Thank you, Mauricio, and good morning, everyone. Beginning with the financial summary on slide 10, NRG delivered $812 million in adjusted EBITDA and $249 million in free cash flow before growth in the first quarter of 2016.

Having now concluded the GreenCo process, our financial results in our guidance now include both EVgo and the newly restructured residential solar within our corporate segment, which is part of the generation and renewable subset of our consolidated guidance. With all businesses now included, we are reaffirming our 2016 full-year guidance for adjusted EBITDA and free cash flow before growth.

During the quarter, we continued our deleveraging program and have now retired a total of $229 million of NRG corporate debt year-to-date through May 4, leading to an additional annualized cash interest savings of $16 million.

Finally, to update our progress in achieving our target of $1 billion in incremental consolidated available capital, which was announced on September 18th of last year, NRG has now completed a non-recourse monetization of future PJM capacity revenues from our Midwest Generation fleet for cash proceeds of $253 million. This transaction, which will be accounted for as a non-recourse debt financing with no impact on adjusted EBITDA, represents the final component of our plan to free up $1 billion of 2016 capital, leaving only the balance of our $500 million asset sale target. And we expect to complete this over the balance of this year.

Turning to slide 11, the Midwest Gen non-recourse capacity monetization proceeds of $253 million, increases our 2016 capital available for allocation by $210 million versus our prior expectation, as we reviewed during our year-end earnings call. The remaining $43 million in financing proceeds represents the acceleration of capacity revenues within 2016, which were already included in the NRG level of free cash flow before growth guidance midpoint, which was part of the $1.488 billion in 2016 capital available as shown in our year-end earnings materials.

Including the Midwest Gen proceeds, total 2016 capital available for allocation now stands at approximately $1.7 billion at the NRG level. We expect to allocate this incremental capital to further advance our deleveraging efforts or alternatively to repay our convertible preferred stock, which based on the conversion price relative to our current share price, presents a compelling potential opportunity.

The dropdown of NRG's remaining stake in CVSR to NRG Yield continues to represent an additional opportunity to further supplement NRG level capital available, and we intend to offer this remaining stake to NRG Yield during the quarter.

Finally, liquidity stands at $1.9 billion as of March 31, which includes $589 million of cash at the NRG level, which has since been supplemented with the proceeds from the Midwest Gen capacity monetization, which closed just following the quarter end.

Finally, turning briefly to slide 12, our continued progress on deleveraging keeps us on track to bring our 2016 corporate debt-to-corporate EBITDA ratio below our target as we position NRG's balance sheet to maintain adherence to our 4.25 times target ratio even through a continued low commodity price cycle. And we will continue to update this analysis as our debt reduction program progresses.

And with that, I'll turn it back to Mauricio.

Mauricio Gutierrez
President, Chief Executive Officer & Director

Thank you, Kirk. And in closing, I wanted to remind everyone of our priorities in slide 14. This is the scorecard that I will share with you throughout the rest of the year. As you can see we have made considerable progress in just the first few months of the year. Addressing the general debt is among one of our highest priorities given both the overall debt levels and maturities in 2017 and 2018. We're actively evaluating alternatives to optimize the capital structure with a focus on maximizing value for all stakeholders. With this objective in mind, we expect to be engaging in discussions with general creditors as a part of this process in the near term. As we evaluate alternatives, we remain committed to our prudent balance sheet management principles including maintaining our target corporate credit metrics.

We remain focused on executing our current strategy. And with the reintegration of renewables, we're now in a position to reinvigorate the development pipeline and provide certainty to NRG Yield's growth potential. I believe we now have all the pieces to move forward and demonstrate the value of our integrated platform.

So with that, operator, we're ready to open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions]

Our first question is from Stephen Byrd of Morgan Stanley. Your line is open.

Stephen Calder Byrd
Morgan Stanley & Co. LLC

Q

Hi, good morning.

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Hey, good morning, Stephen.

Stephen Calder Byrd
Morgan Stanley & Co. LLC

Q

I wanted to just delve into the relationship with Sunrun and Spruce that you mentioned. Could you just walk through the roles of NRG and then your two partners just so I can understand better the nature of that relationship, what each party brings to the table, and what this business looks like for you going forward?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Sure Steve. I mean, I think the best way to think about it is we're going to be focused in the area that we believe we have a competitive advantage. That is in selling the system and installing the system. Once we do that, we have an agreement with Spruce and Sunrun to monetize these systems, to monetize these leases into their platform. So I mean it is a different way of – the way we have done it in the past. If you recall, we were – before we would drop it into Yield, but we would be – it would be consolidated NRG as a whole. Now basically the entire lease goes to our partners.

Stephen Calder Byrd
Morgan Stanley & Co. LLC

Q

Understood. So the assets won't go to NYLD, but – and your partners will monetize it. So would you receive effectively an upfront fee for the value you're creating by acquiring a customer or would there be an ongoing cash flow to you?

Kirkland B. Andrews
Chief Financial Officer & Executive Vice President

A

Steve, it's Kirk. The way to think about this is the cost of the system, which is normally in the traditional construct you think about the CapEx necessary to put a given system in place. The way to think about that in this construct is that is basically cost of goods sold. And the revenue is the price that Sunrun and Spruce pay us for that particular system.

So rather than you – than seeing proceeds come in in terms of a return of capital and CapEx go out in advance of that, that is now going to be revenue, which is what we will receive for lock, stock and barrel the entirety of system to Sunrun or Spruce. And then they'll also retain the ongoing obligation to manage and operate the system O&M and the like. And our – and what was formally our capital expenditures would be COGS. So think about it. We are migrating to a gross margin model rather than a gain on sale model, if you want to think about it that way.

Stephen Calder Byrd
Morgan Stanley & Co. LLC

Q

Yeah. Yeah. That's very clear. So Kirk, then every quarter as you get new customers and you sell those assets to Sunrun and Spruce and then that's revenue in terms of the proceeds you receive from them every quarter your operating costs, which used to be CapEx are truly COGS. That's clear. Okay.

And then I just wanted to shift over to, Mauricio, what you had said on GenOn at the end. I know we don't know – we can't predict what the outcome will be of those discussions, but is it a clear priority that if there were to be an outcome that that outcome needs effectively to be consistent with your overall credit metrics of NRG as a whole?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Absolutely, Stephen, and I've said that before. And I want to make sure that I'm clear. I mean, we have to maintain the credit metric targets that we have at NRG in – and adhere to that principle in any of the options that we are going to be evaluating. As I said, I would like to simplify the message in the spirit of that. We need to look at simplifying also the capital structure. We need to address GenOn for that reason and because of the near term maturities that we have, but we have to adhere to those prudent balance sheet management principles that we have.

Stephen Calder Byrd
Morgan Stanley & Co. LLC

Q

That's great. I'll get back in the queue. Thank you very much.

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Thank you, Stephen.

Operator: Thank you. Our next question is from Greg Gordon of Evercore ISI. Your line is open.

Greg Gordon
Evercore ISI

Q

Thanks. Can you guys hear me okay?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Yes, just fine.

Kirkland B. Andrews
Chief Financial Officer & Executive Vice President

A

Good morning, Greg

Greg Gordon
Evercore ISI

Q

Great. So just to beat a dead horse a little bit on the resolution of the process, it sounds like you've created a reasonable way of sort of keeping an option while stopping the losses. But there's probably a lot of investors who are hoping that there would be a clean break here. So can you just talk about the process and the market [indiscernible] (25:31) crossover in those assets and why the option, which frankly I think sounds like a good option, is the best thing that you could come up with?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Right. Greg, I mean, we actually went through a process that took a significant amount of time. During this time I think everybody knows that we knew that the conditions both in the capital markets and then through the beginning of the year were pretty challenging for both the residential solar business as a whole but also on the capital markets. So this was not the best time to be in the market. We knew that. That's why we were looking at selling a majority stake, not all of it, because we wanted to maintain the optionality on the Texas market where we think we have a significant asset in our customers to be able to offer them residential solar.

I think when you couple that with this change in the business model where it's effectively we sell, install and flip to a third party, and importantly, refocusing the business where we actually have been successful in the past and reducing significantly the cost structure. We felt that that combination was the best path for maximizing value for this business. And I think we'll provide that over the next 12 months. We expect that business to be at least breakeven in 2017.

I've always looked at residential solar as another product in our retail offering. It makes a whole lot of sense if we already have that relationship with the residential customer and this is one of the products that they are asking for it that we provide it. And if we can provide it in a way that is cost effective and that we can create value, we should have it in our lineup of product offerings.

So I think the rationale is there. I think the appetite from customers for rooftop solar is there. We just needed to make pretty significant changes in the way we can structure the business model to ensure that it was, quite candidly, a profitable one. And I think that those are the steps that we have taken.

Greg Gordon
Evercore ISI

Q

Okay. So first of all, you're focusing on New Jersey, Massachusetts, New York. Those are states where you have a presence. So that means you're going to stop spending gobs of money on advertising and feet on the street to try to break into markets where you don't have a presence. Should I presume this also means that you're merging the business line into the core business and getting rid of duplicative overhead, marketing staff and other things like that and just making it sort of part of the product offering of the overall business as opposed to a separate freestanding business, and those are sort of the ways that you're reducing the cost profile?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Exactly. I mean not only we are reducing all the costs by not being in states or regions where we don't have a core advantage, but making it part now of our retail business or in the process of making it to our retail business, we will have significant synergies. Particularly in the marketing and selling, if we now have already a relationship with a customer that is buying system power, we will be using those same vehicles to offer now rooftop solar and potentially decrease the cost of selling that we had on a standalone basis.

So I mean, I think this way we create not only a lot of synergies by including in our retail business, but we also are being very disciplined in terms of the size and the scope of this business as we transition through this period, and importantly, maintain the option to, if this becomes viable in Texas, we can offer this to our 3 million customers because that to me is the prize. I mean, that is the goal.

Greg Gordon
Evercore ISI

Q

Great. One more question and then I'll go to the back of the queue as well. You made the decision to bring some cash flow forward by monetizing these capacity payments. I mean, theoretically cash in hand today is better than cash in hand a year or two from now, especially if you're in a position to aggressively de-lever the balance sheet. But Kirk, can you talk about what you're foregoing in the future to get that cash today? How much financing costs are you incurring? And do you see that as working given the market opportunities to retire debt? And where is your debt currently trading? Is it still at big discounts or has it accrued?

Kirkland B. Andrews
Chief Financial Officer & Executive Vice President

A

Sure. I'll try to cover all that, but if I miss a piece of your multi-part question you can remind me. But as to the Midwest Gen financing, to answer your question, is it worth it? Yes. As I think as we disclosed in the press release, certainly in the Q, a cost of just under 4.5%, and that is basically the way to think about the cost of financing.

The way that it works mechanically is you're basically monetizing today the discount and the implied cost from an interest rate standpoint is that kind of 4.5 type cost. Relative to the opportunities certainly that we have and even relative to what the path that we were on exploring previously, which is the term loan B market, we see that as at an attractive cost, as you well put it, to bring cash forward today to take advantage of opportunities and obviously get ahead in our deleveraging progress.

I mean, certainly we are focused on doing that, but we are cognizant of the fact that right-sizing the balance sheet is important today so that we can preserve flexibility for the company tomorrow. And this $250 million, net $210 million as I mentioned for 2016, is an important step in that direction for us.

As far as our overall debt is concerned, our long-term notes are still trading at a much smaller discount. They've accreted largely closer to par even on the long-dated maturities, which certainly from the standpoint of opportunistically purchasing debt at a discount makes it more expensive, but as you well know, we are a serial issuer or a serial roller of debt from a refinancing opportunity standpoint. So that certainly I feel a lot more comfortable with what that means.

In terms of the barometer and the confidence that the high yield market has and the quality of our credit, I think underpinned by what we're on the path to doing in driving those ratios down, and also giving us greater flexibility on the refinancing front. So in the total package, I like where we are today. I mean, I think we've probably have seen 350 basis points of rally on the long side just since our last earnings call.

Greg Gordon
Evercore ISI

Q

Great. Thanks, guys. I'll go to the back if I have more.

Kevin L. Cole
Senior Vice President-Investor Relations
A

Thank you, Greg.

Operator: Thank you. Our next question is from Angie Storozynski of Macquarie. Your line is open.

Angie Storozynski
Macquarie Capital (USA), Inc.
Q

Thank you. I actually have a question about your sensitivity to gas and heat rates. I think we've all struggled with trying to gauge what is the correlation between the heat rates and gas especially in Texas? And also how linear is this correlation with gas is especially for the GenOn portfolio, right? You're showing a movement of $0.50 in gas, and I'm basically trying to understand how you are showing that sensitivity because a $0.50 move in gas presumably has little effect at all on GenOn's assets.

Mauricio Gutierrez
President, Chief Executive Officer & Director
A

Angie, I'm assuming that you're talking about the slide 5 where I put the sensitivities...

Angie Storozynski
Macquarie Capital (USA), Inc.
Q

Yes.

Mauricio Gutierrez
President, Chief Executive Officer & Director
A

...for the entire portfolio?

Angie Storozynski
Macquarie Capital (USA), Inc.
Q

Yeah.

Mauricio Gutierrez
President, Chief Executive Officer & Director
A

Let me just – I mean, this is the entire portfolio, not just coal and nuclear, which have been our traditional disclosures. But I guess in the spirit of providing more visibility and clarity to the sensitivity on commodities, I included the gas and oil portfolio as well in this sensitivity chart.

So the way to think about my remarks of moving the value of the portfolio by $0.50, $0.5 billion is on an open basis. And this is based on economic generation that we can see today at current markets. So as you can appreciate that economic generation, as commodity prices move, that will increase and your sensitivity to the same $0.50 move will be greater. This sensitivity basically reflects the economic generation that is exposed at current market. So I don't know if that at least provides some clarity in terms of what this number is.

Now, in terms of the GenOn, I would say that it's pretty sensitive to increases in natural gas. I'm not sure I...

Angie Storozynski
Macquarie Capital (USA), Inc.
Q

Well, I understand, but I'm just trying to say a $0.50 increase in natural gas for GenOn doesn't necessarily mean that a number of those plants are now becoming economic, right? And yet a $1 increase in gas would make a number of GenOn assets economic. So I'm basically trying to see how to capture that sensitivity, right, which is clearly accelerating as gas prices rise.

Mauricio Gutierrez
President, Chief Executive Officer & Director
A

Right. No. That's fair. The only thing that I would say is, as you recall in particular on the GenOn complex, but this is in general to both portfolios for GenOn and EME, we already went through a pretty comprehensive asset optimization process where we converted some of these coal plants that were very sensitive to energy prices to natural gas, in effect pivoting the revenue driver from energy margins to capacity margins.

So I would say that some of that is already captured in the GenOn complex. I don't know if that was part of your comment that, perhaps, the GenOn complex is not as sensitized to natural gas because of those fuel conversions, but $0.50 makes some difference. I mean, it is not – you will be, I guess, adding economic generation as prices increase. But from current levels where we are, clearly, it's not as significant as it would be in a different market scenario.

Angie Storozynski
Macquarie Capital (USA), Inc.
Q

And how about now the link between gas prices and heat rates? I'm particularly struggling how to call it in Texas. So you're showing the movement in gas by $0.50 and one heat rate. Can you tell us what's the correlation between these two in Texas and PJM or across the portfolio?

Mauricio Gutierrez
President, Chief Executive Officer & Director
A

Look, I mean, I think for simplicity we have provided this as a linear sensitivity. So $0.50 move on gas, half a heat rate move on power, I mean, clearly, when gas prices increase, heat rates tend to be compressed because you want to keep [indiscernible] (37:20) content. And the reverse happens when gas prices decrease.

We have not provided that comprehensive correlation just – I guess, just for simplicity. Not that we don't have it, because that's the way we actually model our portfolio when we account internally for different changes in commodity prices. But for these type of disclosures we are trying to make it linear and something simple that people can just have a rule of thumb.

Angie Storozynski
Macquarie Capital (USA), Inc.
Q

Okay. Thank you.

Operator: Thank you. Our next question is from Steve Fleishman of Wolfe Research. Your line is open.

Steve Fleishman
Wolfe Research LLC
Q

Yeah. Hi, good morning.

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Hi, Steve.

Steve Fleishman
Wolfe Research LLC

Q

Hey, Mauricio, a couple clarifications. On the EME money forwarding, are you going to have to put money back into Edison Mission, Midwest Gen in 2018, 2019?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

I am sorry, Steve. Are you saying environment – some sort of environmental CapEx or asset optimization? What...

Steve Fleishman
Wolfe Research LLC

Q

No. I'm sorry. The forwarding of the hedge value, the capacity value, excuse me.

Kirkland B. Andrews
Chief Financial Officer & Executive Vice President

A

Not necessarily putting money in, but as I said before, it is literally a shift forward. So one of the points I wanted to make clear is because of the accounting convention behind how this particular capacity monetization is treated, it is treated as a financing which is why the EBITDA or capacity revenue component of our revenue line is unchanged. But the overall cash flow effect is we're getting those proceeds today. We'll have the capacity revenues tomorrow, but we will have an offset or principal and interest payments that is associated with the payments, if you will, to be third party.

But there isn't an injection of cash per se. It's just that the capacity revenues serve to pay the financing cost principal and interest, at least directionally, or the way that is going to play out in the financials as we go forward, if that makes sense.

Steve Fleishman
Wolfe Research LLC

Q

Okay. But just then from a cash flow standpoint in 2018, 2019 I assume you lose that cash at...

Kirkland B. Andrews
Chief Financial Officer & Executive Vice President

A

Yes.

Steve Fleishman
Wolfe Research LLC

Q

...EME.

Kirkland B. Andrews
Chief Financial Officer & Executive Vice President

A

The direct answer is yes. You're pulling the cash forward today which means it won't be there tomorrow.

Steve Fleishman
Wolfe Research LLC

Q

Okay. Okay. And then just on the thinking on GenOn, so the support payments which I think are part of your NRG EBITDA, in the event that we go to the scenario where you do have to kind it let it go, can you cut cost significantly to kind of offset the loss to that revenue?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Yes, Steve. I mean, I think the rule of thumb is that it's about 50% of the cost that we...

Kirkland B. Andrews
Chief Financial Officer & Executive Vice President

A

It is a significant portion of that number overall. I mean, as you recall, you go back and look at our overall corporate G&A before GenOn and after GenOn, the costs associated with managing that overall portfolio and providing those services is a significant portion of that shared services payment as we move forward. So there is an offsetting reduction in cost if you, just for academic purposes, imagine that shared service payment away. It isn't an absolute.

Steve Fleishman
Wolfe Research LLC

Q

Okay. Great. Thank you.

Operator: Thank you. Our next question is from Praful Mehta of Citigroup. Your line is open.

Praful Mehta
Citigroup Global Markets, Inc. (Broker)

Q

Thanks so much. Hi, guys.

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Good morning, Praful.

Praful Mehta
Citigroup Global Markets, Inc. (Broker)

Q

Hi. So Mauricio, you made the point on natural gas prices and the fact that you're long natural gas, which makes sense. Just wanted to understand how you look at retail when you talk about it because you mentioned retailer is countercyclical, which we all understand it is. So when you look at EBITDA sensitivities to natural gas prices, how do you fit in retail and the sensitivity of retail being countercyclical to that EBITDA sensitivity?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

All right. I mean, we have said in the past that in a rising natural gas price environment which theoretically will also increase in power prices, our retail business will contract in their margin. But that will be more than offset on the pickup that we will get on the generation side.

So when we think about that integrated platform, we have actually smoothed some of the peaks and valleys by putting it together, particularly in Texas, which is important because of the market construct. The energy-only type of market construct that is the way I described it is feast or famine. I mean, it is almost a digital market. It is prices are very low or prices are very high.

So we feel very comfortable with our value proposition. And we feel very comfortable that if gas prices rise the impact or the negative impact that has in retail is more than offset by a significant multiple on the generation side.

Praful Mehta
Citigroup Global Markets, Inc. (Broker) Q

Got you. That's simple. But any order of magnitude impact on the retail versus the wholesale?

Mauricio Gutierrez
President, Chief Executive Officer & Director A

I don't think we – I mean, we've provided a band of our retail business in the past, but I don't believe we have provided a sensitivity to a percentage move in natural gas or power prices. But I mean that is something that we could potentially look at in the future. And I'm making a note of that.

Praful Mehta
Citigroup Global Markets, Inc. (Broker) Q

Okay. Great. That would be very helpful. And just quickly, secondly, I was looking at your hedge disclosure on slide 24.

Mauricio Gutierrez
President, Chief Executive Officer & Director A

Yes.

Praful Mehta
Citigroup Global Markets, Inc. (Broker) Q

And the Texas and South Central seems to have a weighted average hedge price that looked to have dropped for 2017 by about $5 a megawatt hour, and just wanted to ensure I understand what's driving that?

Mauricio Gutierrez
President, Chief Executive Officer & Director A

Yes. Look, I mean, what we did is we layered in additional hedges for 2017. I mean, if you look at the hedge percentages from the last quarter to this quarter, I think we increased by I want to say 25% to 30% our total hedge price. And I think that is the effect of just increasing our percentage hedge at some lower prices which reflect current market. And I mean we did it in the back of the recent rally that we have seen in the natural gas market.

As I have said, I continue to be bullish in 2017, but we need to be prudent in terms of our hedge profile for a potential extension of this trough in the commodity cycle. But as we have been in the past we're very opportunistic, and we felt that with this recent move it was a good time to layer in additional hedges. Now, I think that pertains only to our coal and nuclear fleet. It does not have our gas portfolio reflected in this.

Chris, do you have any additional comments?

Chris Moser
Senior Vice President, Commercial Operations, NRG Energy, Inc.

A

No. I think that's true. I think that's a factor of some of the heat rate moves we've seen on the expansion and how you calculate gas sales when you translate them into heat rate. Sometimes you get a bit of a funny move like that. As you can see the average equivalent natural gas price is decent right there at $3.52, so I think it's an artifact of some moving around on the heat rate side.

Praful Mehta
Citigroup Global Markets, Inc. (Broker)

Q

Got you. Thank you, guys. I will get back in the queue.

Operator: Thank you. Our next question is from Michael Lapides of Goldman Sachs. Your line is open.

Michael Lapides
Goldman Sachs & Co.

Q

Hey, guys, two questions for you and congrats on a good start to the year.

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Hey, Michael.

Michael Lapides
Goldman Sachs & Co.

Q

Just looking at some of the detail you provide on the Texas market in your market outlook, I'm kind of at slide 21 and beyond. Just curious, the units you view at risk, what do you think the catalyst is? What you think the timeframe is for when the owners of some of those units have to start making decisions about when to retire? Is there a forcing function or could this kind of drag out longer than people expect?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Look, I mean, I will give you two cents on it before I pass it on to Chris, but clearly the current commodity or power price environment is already a pretty good catalyst for starting that conversation. And we announced at the beginning of this year that we were going to – our intentions to retire one of our units because of the absolute lack of scarcity pricing and the failure of ORDC to provide the right price signal in what we consider the tightest market in the country.

So I would say that you have different catalysts right now brewing. The first one is this very low power price environment in Texas. The second one is the regional case regulations and then the one-hour SO_2 requirements. So when you put those three together, I think this is what we tried to show in this slide, which units are exposed to either one, two or all three. And I think that will inform the decision of asset owners in terms of the economic viability of their units.

But Chris, I mean, do you have...

Chris Moser
Senior Vice President, Commercial Operations, NRG Energy, Inc.

A

Well, yeah. I don't know that I have a lot to add to that. I mean, I think as you're sitting there and you're thinking, God, I have to put new scrubbers on Big Brown and Monticello. And then, oh, we still haven't seen exactly what the damage is from those in terms of we haven't yet seen the final one-hour SO2 impact. I think that combination has got to be daunting.

Michael Lapides
Goldman Sachs & Co.

Q

What's the timeline? When do plants have to comply with both those?

Chris Moser
Senior Vice President, Commercial Operations, NRG Energy, Inc.

A

Well, regional haze is going to be later 2019, 2020 and the one-hour SO2 I don't have a good answer for you on because I think it's still being baked.

Michael Lapides
Goldman Sachs & Co.

Q

Got it. And when you think about nuclear plants in Texas, I mean, we're seeing retirements of nuclear plants in some of the markets that have capacity payments. Can you talk about whether South Texas project is generating free cash flow and whether you think nuclear plants are facing some of the same challenges in Texas that we're seeing elsewhere in the country?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Yes, Michael. I mean, I think all the traditional baseload generation is facing some challenges at $2 gas prices. I think from our perspective, and we don't provide specific information on a plant by plant basis, but what I will tell you is in Texas we actually have a higher threshold than if we were a standalone generator. And the reason why is of our integrated model. So we actually achieve significant amount of synergies and value by pointing generation to retail. We avoid collateral charges. We avoid friction costs. So we have this higher threshold when it comes to evaluating the economic viability of the plant.

But again, I don't think we can make a decision of retiring a plant based on one month or three months of very low commodity prices which, to be fair, we have very effectively mitigated with our hedging philosophy and strategy. What we need to do is we need to look at it in the context of all the dynamics in that market. What are the prospects for each of those plants, and what exactly is what that plant provides to the system that eventually will be captured in the prices? So that's I guess where I see that.

What I will tell you is that we have an absolute commitment to operate plants that are economic. We have, I think, a pretty good track record in terms of retiring plants where the system doesn't need them in the past, for over the last 10 years. And even since the beginning of this year we have retired close to a gigawatt of generation in western New York and Texas because the market just doesn't support it and because we felt that the economic prospects in those particular markets were not going to support it. But I think investors should rest assured that we will make the right economic decision. But we need to make sure that we go beyond the next month and we look at the prospects going forward.

Michael Lapides
Goldman Sachs & Co.

Q

Got it. Thanks, Mauricio, much appreciated.

Operator: Thank you. Our next question is from Julien Dumoulin-Smith of UBS. Your line is open.

Julien Dumoulin-Smith
UBS Securities LLC

Q

Hey good morning.

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Hi. Good morning, Julien.

Julien Dumoulin-Smith
UBS Securities LLC

Q

So a couple of little questions, little details here on the resi solar piece, just going back to that, how many megawatts do you expect you will be able to monetize annually as far as a run rate? And then secondly on the EVgo piece can you comment real quickly, what's the California payout still due? I imagined – I think it says you retain that piece?

Kirkland B. Andrews
Chief Financial Officer & Executive Vice President

A

Sure. Julien, it's Kirk. I'll answer the EVgo piece of that. We've probably got over the next four years about – the good rule of thumb on the California settlement, think about that order of magnitude about $20 million a year over the next four years. It bumps around, but that's sort of a good averaging. And then we'd be completed in terms of our obligations in California under that settlement.

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

And Julien, I mean, I think what you should be looking at on the home solar business is we're actually looking at the last six months of operation. We don't have any grand aspirations in terms of the total sales and installations that we want to have for the year. We're calibrating that to the historical levels.

I feel very strongly that our plan needed to be a plan that it was achievable. I'm not going to provide you specific numbers, but what I will tell you is that I feel very comfortable hitting those targets. And I think with the agreements that we have with our partners we're going to be able to effectively implement this new business model. So I think that's what I'm comfortable disclosing to you, Julien, today.

Julien Dumoulin-Smith
UBS Securities LLC

Q

Well, wait, sorry. Just to be clear you're comfortable hitting which target?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

No. What I'm comfortable is on the financial numbers that I provided. I don't want to go into specific systems that we're going to be deploying. What I said is that this business is going to be at least break even by 2017, and that in 2016 the negative EBITDA that I have disclosed is mostly coming from this first six months of operation while we were running this business. I mean, going forward I think that turns into a breakeven value proposition. But I don't want to provide right now specifics in terms of megawatts deployed or systems installed. I feel that the financial disclosures that we're providing will be sufficient going forward.

Julien Dumoulin-Smith
UBS Securities LLC
Q

Got it. And just turning to the PJM auction coming up here, I've just got to ask. You put it 140 to 160 as analyst expectations, but what are your expectations? And then specifically within that what are you thinking about demand response, the RICE regulations, and new supply entry?

Mauricio Gutierrez
President, Chief Executive Officer & Director
A

Chris, any comments on the BRA?

Chris Moser
Senior Vice President, Commercial Operations, NRG Energy, Inc.
A

Yeah. I mean, back on page 22 we discussed it a little bit. I mean, we've seen some pretty decent numbers out of capacity markets in general across the board there at $7 [ph] NE Pool (54:43). We like – obviously the last BRA in the 200s for areas where we have a lot of generation were fantastic results. And then the New York May spot market has been – was a great trend there in the face of a lowered load forecast.

We see a lower load forecast for the CP auction as well. So it's probably down year-on-year. So that's why we threw the analyst expectations on. I'm not going to throw a number, our own internal number out there, but look, I think it's reasonable to think it's going to be down some or moderate a little bit from the numbers we saw last time just because of the changes in load forecast.

And then you're right to point out, I think there are some pretty big wildcards out there in terms of, hey, what does FirstEnergy do? What does AEP do? And what kind of impact is the RICE NESHAP going to have on those? And those are a bit of wildcards out there that could swing that one. Well, I think that those swing it directionally upwards compared to where it otherwise would be if you start pulling out some of the DR based on auto DR. And then also if you look at FirstEnergy and AEP decide they're going to retire those units and don't want capacity obligations because they're concerned about whether or not this end run, this most recent end run they're trying around FERC works or not.

I think there that 6,000 megawatts of stuff that's up in the air, which arguably could have a bullish piece on it. Will that be enough to offset the load change that they've had in the load forecast? That remains to be seen.

Julien Dumoulin-Smith
UBS Securities LLC
Q

But I don't hear you emphasizing new supply or a big swing in demand response, right?

Chris Moser
Senior Vice President, Commercial Operations, NRG Energy, Inc.
A

Sorry, Julien, say it again?

Julien Dumoulin-Smith
UBS Securities LLC
Q

I don't hear you emphasizing a big move in new supply or demand response participation.

Chris Moser
Senior Vice President, Commercial Operations, NRG Energy, Inc.
A

Well, I think on the demand response side this is kind of the last hurrah for a base – for the base capacity product. So we'll see what happens on that side, but I – yeah. I don't think there's big swings either way on those two points.

Julien Dumoulin-Smith
UBS Securities LLC
Q

Got it. Thank you.

Operator: Thank you. We have time for one more question. Our next question is from the line of Jonathan Arnold of Deutsche Bank. Your line is open.

Jonathan Philip Arnold
Deutsche Bank Securities, Inc.
Q

Good morning, guys.

Mauricio Gutierrez
President, Chief Executive Officer & Director
A

Hi, Jonathan.

Jonathan Philip Arnold
Deutsche Bank Securities, Inc.
Q

Mauricio, you mentioned at one point that you are going to start looking for incremental savings. And just when we benchmark your SG&A against some of your peers, obviously, you are a bigger company, but it does seem still to be a much more scaled number than maybe others have. Can you give us some insight into what you see as the factors there and what sort of areas you might be looking at as you try to drive further cost savings? Is it a presentational issue?

Mauricio Gutierrez
President, Chief Executive Officer & Director
A

Right, Jonathan. No. I mean, what I said in the past is that I think it's not a fair comparison to put us against some of our generator peers because they don't have the scale of our retail platform and our retail business. So I mean, I think on our generation platform, I will put it vis-à-vis anybody in our space, but you need to take into consideration that we have a retail platform that I don't believe anybody else on our sector has. What we have done today and what I tried to articulate today is really to give you a comprehensive look at the entire cost structure that we have, one that you can actually reconcile with our financials and that you can hold us accountable going forward.

We have identified and either executed or are in execution close to $400 million of cost reductions that I feel we all feel very comfortable that are very achievable. And we're making significant progress. I think there are more opportunities as we integrate some of the businesses, specifically residential solar into the platform, but I expect that we will be looking at other areas. We now have a comprehensive continuous improvement program that over the years have been very effective under FORNRG umbrella, and we are extending that, expanding that to the entire organization.

So we are reinvigorating that initiative. It is now company-wide, and I expect that we will come with additional savings under that framework going forward, and as we start identifying them I will provide that additional detail. But I'm just excited about where we are in terms of our cost reduction program. We have made significant progress and I think we run a very – we're going to be running a very efficient organization here. That is my goal, and again, I mean I think when it comes to comparisons you need to make sure that you compare apples to apples.

Jonathan Philip Arnold
Deutsche Bank Securities, Inc.

Q

No. That is fair, but do you think that this sort of next round you're alluding to is something in 2016 or is that more longer term?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

No. I think it would be in 2016. I mean, we are in the process right now. I mean, I announced today the reintegration of residential solar. We have identified, as I said, significant cost savings. I think as it fully integrates with retail I am sure that there will be more. And we're looking across other areas in the organization. So I mean this is an area of focus and to be candid, I mean, it is a reflection and it has to be an – it is an imperative in this commodity cycle. So we are looking across not just overhead but also operations, O&M, and that is an area of focus as we're seeing changes in dispatch profiles and changes in terms of how our units get compensated specifically moving from energy-driven margins to capacity-driven margins. So I mean, everything is on the table. And I think, as I said, I mean, it is an imperative in this current commodity market environment.

Jonathan Philip Arnold
Deutsche Bank Securities, Inc.

Q

And maybe I'd just make one quick one on if you do move into Texas with the home solar business, is it agreed that that will be with the same partners under the same model or is that TBD?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

I think that's a TBD. Right now the partners were focused in the three Northeast markets. And I can't comment right now in Texas, but I think it's a TBD.

Jonathan Philip Arnold
Deutsche Bank Securities, Inc.

Q

So the deal you have with Sunrun and Spruce is specific to the three markets we've talked about today then?

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

I think what I will say is that's where we're focusing right now, and our partners will support us on those three markets.

Jonathan Philip Arnold
Deutsche Bank Securities, Inc.

Q

Great. All right. Well, thank you guys.

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Thank you.

Operator: Thank you. Our last question is from Brian Chin of Bank of America Merrill Lynch. Your line is open.

Brian J. Chin
Bank of America Merrill Lynch

Q

Hi. Thanks and good morning.

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

Hey, good morning, Brian.

Brian J. Chin
Bank of America Merrill Lynch

Q

So just going back to the Midwest Gen capacity, I get that you're just swapping out for a lower cost of capital, but what I'm wondering is that $253 million, does that cover the entirety of the Midwest Gen capacity? Is there an ability to upsize that to a larger number Why or why wouldn't you potentially upsize that lower cost of capital financing?

Kirkland B. Andrews
Chief Financial Officer & Executive Vice President

A

Brian, it's Kirk. What I would tell you is, no, it doesn't include all of it. The order of magnitude is a little less than half. There may be an incremental opportunity to do so, but that number provides us the amount of capital we thought was prudent right now given the opportunities we see on the deleveraging front. But again, so it's a little less than half of the total amount of capacity, so think about maybe 1,500 megawatts a year through the 2016-2017, 2017-2018, 2018-2019 timeframe.

Brian J. Chin
Bank of America Merrill Lynch

Q

Got it. And then could you conceivably expand that for any of your assets in PJM East or potentially in California under resource adequacy constructs?

Kirkland B. Andrews
Chief Financial Officer & Executive Vice President

A

I can't really comment too much on California. I think that's a little bit more complex, but the answer on the PJM East front is yes. Added complexity there is – obviously, a lot of those assets are in the GenOn complex, but it's certainly not impossible where that's concerned. And then I think going back to Midwest Gen, certainly that's an opportunity that we'd revisit post the completion of the next round of auctions there in PJM.

Brian J. Chin
Bank of America Merrill Lynch

Q

Appreciate it. Thanks for squeezing me in.

Kirkland B. Andrews
Chief Financial Officer & Executive Vice President

A

You bet.

Mauricio Gutierrez
President, Chief Executive Officer & Director

A

No problem, Brian.

Operator: Thank you. And that does conclude our Q&A session for today. Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program. You may all disconnect. Everyone have a great day.