02-Nov-2017

NRG Energy, Inc. (NRG)

Q3 2017 Earnings Call

CORPORATE PARTICIPANTS

Kevin L. Cole
Senior Vice President, Investor Relations, NRG Energy, Inc.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

Kirkland B. Andrews
Executive Vice President and Chief Financial Officer, NRG Energy, Inc.

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

OTHER PARTICIPANTS

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Greg Gordon
Analyst, Evercore Group LLC

Abe C. Azar
Analyst, Deutsche Bank Securities, Inc.

Steve Fleishman
Analyst, Wolfe Research LLC

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Michael Lapides
Analyst, Goldman Sachs & Co. LLC

Ali Agha
Analyst, SunTrust Robinson Humphrey, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the NRG Energy Third Quarter 2017 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 conference call is being recorded.

I would now like to turn the conference over to Kevin Cole, Head of Investor Relations. Sir, you may begin.

Kevin L. Cole
Senior Vice President, Investor Relations, NRG Energy, Inc.

Thank you, Takia. Good morning, and welcome to NRG Energy's third quarter 2017 earnings call. This morning's call will be broadcast live over the phone and via webcast, which can be located in the Investors section of our website at www.nrg.com under Presentations & Webcasts. As this is the earnings call for NRG Energy, any statement made on this call that may 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 everyone to review the Safe Harbor in today's presentation as well as 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 reconciliations to the most directly comparable GAAP measures, please refer to today's presentation and press release.

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

Mauricio Gutierrez

President, Chief Executive Officer & Director, NRG Energy, Inc.

Thank you, Kevin, and good morning, everyone. I'm joined this morning by Kirk Andrews, our Chief Financial Officer. Also on the call and available for questions, we have Chris Moser, Head of Operations; and Elizabeth Killinger, Head of our Retail business.

I'd like to start the call by highlighting the three key messages for today's presentation on slide 4. First, we are on track to deliver on the Transformation Plan objectives we laid out earlier this year. For cost savings, we're actually ahead of our 2017 target through the third quarter of this year.

Second, today, we're initiating 2018 financial guidance, which I am pleased to confirm is in line with the targets provided in our Transformation Plan. Third, we are seeing a number of positive catalysts in our core markets from a recovery in ERCOT driven by asset retirements to multiple regulatory initiatives that highlight the urgency of reforming our power markets. This is certainly a time to be optimistic about competitive power.

Now turning to our Transformation Plan update on slide 5, we are making good progress across all areas. We are reaffirming our full cost savings on margin enhancement targets with a run rate of $855 million in recurring free cash flow accretion by 2020. Through the end of the third quarter, we have already realized $92 million in cost savings, which means we have achieved 142% of our target for 2017.

And as I told you previously, we were hard at work identifying cost savings starting early in the year. This focus on continuous improvement have led to a jump start on our plan and has enabled us to realize some of our anticipated 2018 cost savings in 2017.

In addition, we're currently putting in place the foundation needed to realize margin improvements starting next year. This includes everything from finalizing strategies for expanding and enhancing offerings for customers, to streamlining transactions, to enhancing our IT systems for more sophisticated customer analytics.

Our asset sales process remains on track. We are reaffirming our total proceeds target of up to $4 billion and we anticipate the vast majority of this process to be announced in 2017. With respect to our Renewables business and our interest in NRG Yield, while this is very much an ongoing process, what I can tell you is that we are currently anticipating a 100% sale of this platform.

We are pleased with the level of interest that our high-quality, unique assets and businesses have created from prospective buyers. These have allowed us to move to advance stages in multiple processes and we maintain the expectation of announcing significant transactions by the end of the year. But to be clear, and consistent with our objective to maximize shareholder value, we will not compromise value for time with any of these transactions.

On the capital allocation front, we remain focused on using excess cash to deleverage our business and position ourselves to take advantage of high-return opportunities in the future. Since our second quarter call, we have taken other $600 million of debt out of our capital structure, completing our 2017 capital allocation goal.

Turning now to our third quarter results on slide 6, we achieved $806 million of adjusted EBITDA for the quarter, which reflects the impacts of sustained mild weather in our core markets as well as Hurricane Harvey. As we have been tracking to the low end of the guidance coming into the summer, this results had led us to narrow and lower our full year adjusted EBITDA guidance to $2.4 billion to $2.5 billion.

I do want to take a moment, however, to acknowledge the strong results and outlook for our Retail business, which continues improving its operating efficiencies, and customer acquisition and retention, offsetting some of the impacts of summer weather. Despite the disappointing quarter in terms of weather and wholesale pricing opportunities, we have still made significant progress on executing many key priorities.

As we execute on our transformation, we have remained vigilant and focused on safety. For the quarter, we achieved a better than top decile safety performance with 118 out of 128 facilities operating without a single recordable injury. This result is a testament to the safety culture embraced by every one of my colleagues at NRG.

We also continue to execute on opportunities to quickly recycle capital through our partnership with NRG Yield, closing on a 38-megawatt solar portfolio for $71 million in cash proceeds and forming a new $50 million solar partnership. In addition, we are announcing today the offer of our 154-megawatt Buckthorn Solar assets to NRG Yield.

Looking ahead to 2018, we are initiating adjusted EBITDA guidance of $2.8 billion to $3 billion. Kirk will provide more details later in the presentation, but, importantly, for the retained businesses, this guidance is in line with the targets provided in our Transformation Plan announcement this summer. This is despite removing several plants that were originally included in our 2018 Transformation Plan projections and lower than expected production from the oil field associated with our Petra Nova.

Now turning to slide 7 for a closer look at the key drivers this summer, we experienced very mild weather across the East and ERCOT, eliminating any opportunity for scarcity pricing. In Texas, we saw both a major hurricane and the coolest August since 2004 with cooling degree days 13% below normal. In the Northeast, cooling degree days were, on average, 8% below normal for July and August. This lack of weather resulted in very weak summer prices as you can see on the upper right-hand chart.

In ERCOT, real-time on-peak prices settled 43% below pre-summer expectations. But despite the absence of extreme weather this summer, ERCOT fundamentals remained strong. ERCOT's 2017 peak load of 69.5 gigawatts was up nearly 2% over the five-year average and came in just shy of the 2016 peak. In terms of total consumption, we were flat to 2016 levels despite having the coolest August in 14 years plus a major hurricane.

And while, for our business, we say summer 2017 weather was mild, for many living along the Gulf Coast, it was devastating. Hurricane Harvey was an unprecedented storm. It was the wettest storm to ever hit the Continental United States. In the face of this historic adversity, I could not be more proud of the way my colleagues responded.

Turning to slide 8, I want to take a moment to recognize the men and women of NRG who kept the lights on, supported each other and provided assistance to both our customers and impacted communities during a time of need. First and foremost, safety is always the primary concern and I am pleased to report we have no safety incidents at our plants or in our corporate offices during the storm.

But beyond safety, our employees showed great concern for their communities, engaging with first responders and community assistance programs to be on the ground, helping with services such as on-site emergency power supply. And Reliant, our flagship retail business in Texas, went above and beyond, demonstrating leadership by being the first retailer to offer customer relief programs.

We were as prepared as we could be for Hurricane Harvey. Our baseload generation maintained 80% availability during the worst of the storm, a testament to the resiliency and reliability of our portfolio. Today, we're back to 95% availability across all of our Gulf generation. Currently, only two of our plants are offline, and we're actively assessing impacts and determining our return to service strategy.

On the Retail side, at its peak, about 4% of our customers were without power and today, power has been restored to nearly all of our customers. Between our two businesses, we estimate the financial impacts of the storm and related weather to be about $40 million in 2017. As we continue to assess the situation, we will provide you with any necessary updates.

Once again, I want to express my deepest gratitude to everyone across the organization for their commitment to safety, their focus on building resilient operations, and their support for effective communities in the days and weeks following the storm.

Looking forward, we have many reasons to be excited about the markets, as outlined on slide 9. In ERCOT, the recently announced retirement of over 4 gigawatts of generating capacity puts further pressure on a market with already steady, strong fundamentals. For summer of 2018, these known retirements and asset delays alone will put ERCOT at the lowest reserve margin on record, which is expected to be somewhere between 10% and 11%. Other changes such as delay in new builds and new industrial demand could lower this number even further.

The tightening of the ERCOT market is something that we have been anticipating for quite some time. Just on our last earnings call, we were estimating reserve margins of close to 11%, which now has become a reality. We are encouraged to see that other generators in the market are being disciplined [audio gap] (13:39) uneconomic assets as we have done in the past.

And while news of these retirements during the past several weeks has increased power prices, it is important to note that these prices are still below what is needed to justify new build economics. Now while these retirements are important in improving market health, ERCOT must do more to strengthen markets and should recognize the locational value of power plants.

We have already provided a set of recommendations that would improve the pricing now for generators in locations where power is needed. Reliability and resiliency are important attributes to the grid and we will continue to work with ERCOT to ensure generators close to load centers are compensated for all the benefits they provide. Beyond these positive developments in the ERCOT market, we are seeing several other calls to action for market reform.

As the power grid continues to undergo significant change, low gas prices, renewable penetration, and attempts for out-of-market subsidy for uneconomic generation, regulatory bodies and other stakeholders are taking note. This has led to several significant potential catalysts. From the DOE stat report on competitive markets and NOPR, to PJM's proposed market reforms, I cannot recall another time where there has been such urgency and reach across ISOs to improve competitive energy markets.

We will continue our vocal advocacy against out-of-market subsidies for existing uneconomic generation and for market-based solutions that recognize all the services that generators provide: energy, capacity, reliability, and resiliency. And with that, I will turn things over to Kirk for a financial review.

Kirkland B. Andrews

Executive Vice President and Chief Financial Officer, NRG Energy, Inc.

Thank you, Mauricio, and good morning, everyone. Turning to the financial summary on slide 11, for the third quarter, NRG delivered $806 million in adjusted EBITDA and $599 million in consolidated free cash flow before growth.

Generation & Renewables contributed $265 million in adjusted EBITDA during the quarter while Retail and Yield delivered $276 million and $265 million respectively. Our results for the quarter reflect the impact of mild weather as well as Hurricane Harvey.

In the latter case, the sustained heavy winds and lower temperatures led to below normal load for our Retail business. The resulting revenue impact, combined with losses experienced from unwinding hedges and depressed real-time prices, contributed to lower than expected retail results for the quarter.

Although our Houston base load assets weathered the storm admirably, our wholesale business was also impacted by outages and associated loss margin, resulting from flooding across the region, including in particular our Cottonwood facility, which has since returned to service.

Finally, our Boston Energy Trading and Marketing or BETM business, underperformed for the quarter, further contributing to results, which came in below expectations. Prior to the summer, although our Retail outlook had been trending above the range, our reduced expectations for wholesale more than offset this and, as I indicated in our second quarter call, our expectations for the balance of the year at that time placed us at the lower end of our consolidated guidance.

Now, factoring in the impact of the third quarter events I just reviewed, our outlook for 2017 is now approximately $115 million below the low end of our previous EBITDA guidance range. As a result, we are now reducing and narrowing our 2017 guidance to $2.4 billion to $2.5 billion in adjusted EBITDA. Our revised consolidated free cash flow guidance range is now $1.175 billion to $1. 275 billion while revised NRG level free cash flow guidance is now $755 million to $855 million.

We do not expect the contributing factors to our reduced guidance for 2017 to be recurring and they do not impact our outlook and guidance for 2018, which I'll review in a moment.

Immediately following the quarter end, we redeem the remaining balances of our 2018 and 2021 unsecured notes, further reducing corporate debt, extending our nearest maturity to 2022, and capturing nearly $50 million in incremental annual cash interest savings. These redemptions also represent the completion of our 2017 capital allocation plan and place us on track to achieving our leverage ratio target announced as part of the Transformation Plan.

Finally, on November 1, we closed on the sale to NRG Yield of a 38-megawatt portfolio of distributed and small utility scale solar assets which are not part of the ROFO agreement for $71 million, increasing 2017 capital available for allocation.

Turning next to 2018 guidance on slide 12, although as Mauricio indicated, we remain on track to announce most of our targeted divestitures by year-end, we will continue to include those assets and businesses in our consolidated results and guidance until that process concludes.

For 2018, we expect $2.8 billion to $2.9 billion in adjusted EBITDA with $950 million to $1.05 billion from Generation & Renewables, $900 million to $1 billion from Retail, which includes $30 million of margin improvements from the Transformation Plan, and $950 million from NRG Yield. Our 2018 consolidated free cash flow guidance is $1.55 billion to $1.75 billion, with $1.170 billion to $1.370 billion at the NRG level.

In order to provide a pro forma view of 2018, based on midpoint guidance and moving from left to right in the table, we deduct the 2018 impact to consolidated guidance associated with divestitures which is comprised of approximately $1.4 billion in EBITDA, $670 million in consolidated free cash flow, and $290 million in NRG-level free cash flow. These 2018 divestiture impact numbers differ slightly from those used in the pro forma walk we provided as part of the Transformation Plan, which were then based on 2017 numbers.

The final column provides an implied pro forma view of 2018 results based on midpoint guidance, and assuming asset sales including 100% of yield and renewables all take place as of January 1. On a pro forma basis, implied midpoint retained asset EBITDA is approximately $1.5 billion with nearly $1 billion of free cash flow.

These numbers also reflect the impact of our 2017 transformation targets, including achieving $500 million of cost savings, $30 million of margin improvement, and $85 million of additional working capital efficiency. Importantly, pro forma cash balances are also, of course, further improved by up to $4 billion in expected asset sale proceeds.

Beyond 2018, we expect nearly $300 million of additional upside from the full run rate of the Transformation Plan benefits as cost savings grow from $500 million in 2018 to the full $590 million by 2020 and margin improvements further expand from $30 million in 2018 to $215 million by 2020.

Turning to slide 13 for a brief update on 2017 NRG-level capital allocation with changes since the prior quarter highlighted in blue, our updated 2017 capital available for allocation of $1.3 billion now reflects the proceeds received from the closing of the 38-megawatt portfolio of distributed and small utility solar assets to NRG Yield as well as the $165 million reduction in the midpoint 2017 NRG-level free cash flow before growth guidance.

Turning to the GenOn settlement capital, as the GenOn noteholders on October 30 entered into and filed the consent agreement, extending the effective date milestones to as late as September 30, 2018, we now expect GenOn's to emerge from bankruptcy in 2018. However, we will continue to reserve for the GenOn settlement payment next year upon emergence. In parallel with the milestone extension, NRG and GenOn also reached agreement on a settlement term sheet in an effort to resolve certain open issues from the original RSA.

With our corporate debt reduction now complete, with the redemption of the 2018 and 2021 notes, we've revised the debt reduction up slightly to reflect the principal balance of the 2021 notes actually repaid versus the $200 million delevering placeholder in our previous disclosure and we expect approximately $70 million of excess capital at year-end 2017.

To complete the financial review, slide 14 provides an update on our corporate credit metrics for both 2017 and 2018. Based on our revised guidance for 2017, we expect a 2017 net-debt-to-EBITDA ratio of approximately 4.3 times.

Turning to 2018, and taking into account our implied midpoint pro forma EBITDA post asset sales, which includes, again, the benefit of both cost savings and margin enhancements, and taking into account the $640 million of additional debt reduction due to divestitures, which was previously disclosed as part of the Transformation Plan, places us on track to achieve our net-debt-to-EBITDA target ratio of three times with significant surplus capital for allocation from asset sale proceeds.

And with that, I'll turn it back to Mauricio for his closing remarks.

Mauricio Gutierrez

President, Chief Executive Officer & Director, NRG Energy, Inc.

Thank you, Kirk. Turning to slide 16, I want to provide a few closing thoughts on our 2017 priorities. We have made significant progress across all the goals we set for the organization. We remain focused on delivering results and executing on the Transformation Plan.

We have exceeded our 2017 targeted cost savings and continued to reduce our debt profile in order to achieve our corporate credit metrics. As we continue to work diligently through the asset sales process, I look forward to providing you with further detail on sale announcements upon reaching agreement.

We also continue to make good progress on GenOn. We have worked with GenOn to resolve open issues in the restructuring support agreement, which were detailed in the summary term sheet filed in our 8-K this week.

This includes items such as the timing and nature of transition services, the treatment of NRG's Canal 3 project, and other post employment benefit obligations. We stake these terms will be finalizing the plan confirmation on November 13 and will set the path forward for GenOn's emergence from bankruptcy.

On a final note, I promise all of you that we would provide a more robust plan and opportunity for strategic discussion through an Analyst Day. We are planning to hold our Analyst Day in March of 2018, where we will provide you with an update on our transformation plan progress, updated financials, as well as details around the strategic direction of our business.

So with that, I want to thank you for your time today and your interest in NRG and with that, Takeisha, we are now open – we're now ready to open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Julien Dumoulin-Smith of Bank of America Merrill Lynch. Your line is now open.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Q

Hey, good morning.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Good morning, Julien.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Q

So perhaps a quick first question, follows up a little bit on what you just alluded to in your closing remarks there, but can you elaborate a little bit? I suppose the last time you all spoke, you talked about potentially getting some data points on asset sales, potentially before this call. I wanted to perhaps delve into a little bit more in light of the hurricane, realizing that now you've disclosed that Cottonwood was actually out during the quarter.

Was that part of the delay potentially here? I mean, obviously some of your peers may have seen delays in their own closing of sales processes as well. Can you comment on that as well as the timeline for bringing back Greens Bayuo and Gregory and how that might be complicating the process still?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Yes. Well, Julien. First of all, welcome back. It's good to talk to you again. And I mean, we only disclose on the asset sale process, the sale of our Renewables business. We didn't provide any additional details on the conventional assets. So with that in mind, what I can tell you is that some of the businesses that we have, which are very high-quality businesses are large and complex and that takes time in terms of due diligence.

And as you alluded to, Hurricane Harvey impacted some of the activities and due diligence events that we were planning. So without providing you any more information, all I can tell you is that, yes, Hurricane Harvey impacted some of the processes, but I'm still confident that we will be able to announce something by the end of the year in the vast majority of our processes.

With respect to the two plans that you alluded, I mean, right now, we are evaluating our return to service strategy and as you can tell, there has been significant changes in the ERCOT market due to the retirement. So I think that has – we're taking that into consideration as we look at the economics of our power plants, particularly those two power plants.

Was there – I think that was it, right, Julien? I want to make sure that I got.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch
Q

No, no, absolutely. Thank you. And then maybe let me just ask you this real quickly as a quick follow-up here. Can you elaborate a little bit on your retail efforts? I mean, obviously, they're pretty meaningful improvement in margin that you've talked about at least the last time. Can you elaborate a little bit on where you stand against that, both in terms of the portion of new versus existing customers in that $215 million you initially articulated?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.
A

Yes, and I think it's important for us to remind everybody that the margin enhancement target starts in earnest in 2018 so we don't have a specific goal in 2017. But having said that, we're getting ready. The team is not waiting for 2018. We're making really good progress in assessing and evaluating our platform from the IT infrastructure to data analytics. What I will tell you is that we're focusing on a couple of things specifically. One is looking at the effectiveness of our sales channels and increasing that effectiveness. We're advancing some of the secondary products that we have and getting ready to provide that to our customers.

We have now initiated our digital transformation to provide additional and more seamless customer experience. We are further integrating our Generation and our Retail business and while I am very pleased with that integration, I think we're now going into the next phase of integration. All of these efforts, as you can appreciate, are interconnected. So we are strengthening the IT platform, the analytics platform to make sure that, while these efforts are going in parallel, the information now travels faster and better throughout the entire retail business.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch
Q

And you can't say which portion is new versus existing though, right, within that?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.
A

Well, most of – a lot of these are new and/or improving what already exist. As I think as I said before, I am very proud of the Retail business that we have and the strong brand recognition that we enjoy particularly in Texas, but we did a very comprehensive review. We had an opportunity not only to look at the cost structure of Retail, but also the competitiveness of our Retail business even outside of power – retail power. And these are the best practices that now are making its way. So right now, we're in the process of evaluating, planning, assessing, getting ready for implementation, which as I said, will happen in earnest in 2018.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch
Q

Thank you all so much. Good luck.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.
A

Thank you, Julien, good to have you back.

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

Greg Gordon
Analyst, Evercore Group LLC
Q

Thanks. Good morning.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.
A

Good morning, Greg.

Greg Gordon
Analyst, Evercore Group LLC
Q

So I think the – just talking about the quarter a little bit, I think we understood what the hurricane and weather impacts were going to be in the quarter, and are more or less in line with – had guesstimated that the impact would be around $50 million to $75 million, which you guys came in at $65 million on that front, but can you explain what happened with Boston Energy? And should we be concerned about that going forward or is that business not expected to be a contributor in your pro forma EBITDA guidance?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.
A

Yes. Kirk?

Kirkland B. Andrews
Executive Vice President and Chief Financial Officer, NRG Energy, Inc.
A

In terms of – just to put it in perspective, so year-over-year, I think for the full year, at BETM, we had about $38 million in 2016. We're certainly below that in terms of 2017. Obviously, a trading business is impacted by movements in the market prices, [audio gap] (33:08) natural gas with power. And obviously, some of the movements that took place, in particular around some of the impacts of Hurricane Harvey, impacted the trading positions there or some of the positions that were taken. We do not expect significant contribution from BETM on an ongoing basis, moving forward. We're not significantly reliant on that in our 2018 guidance.

Greg Gordon
Analyst, Evercore Group LLC
Q

Okay, great. And then you have modified your language around the asset sales. I think Julien went over some of that, but you're now no longer assuming that a 50% sale of NRG Yield is in the realm of the possible. I apologize if you discussed this earlier, I was multitasking, but what's changed in the process to get you so confident that you'll now be exiting 100% of the business?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.
A

Greg, no, that's a good observation and as I said, I mean, it varies material developments in the sales process. My commitment to you was to communicate that and as we are advancing through the sales process of the Renewables business, in ASCOM, clear to us that the most likely outcome will be the 100% sale of our Renewables business. And that's why I think that's the modification that we want to, or the update that we wanted to give to the market. So when you think about now, the range that we provided, we are looking now at the up to $4 billion and 100% sale of our Renewables business, which I am very confident that will happen by the end of the year and we'll be able to announce something.

Greg Gordon
Analyst, Evercore Group LLC

Q

Great. And then in terms of the outlook, you're on credit watch for upgrade at Moody's and I know your bonds have responded extremely favorably to that. Are there now opportunities for potential accretive refinancings that weren't necessarily in the base case cash flow forecast that you laid out in the Transformation Plan? And also, should we assume that you're hopefully not building in any point of view on whether PJM price reform will happen or whether we'll have a return of volatility? In your outlook, you're just simply using the current curves?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Yes. Greg, that is correct. We don't assume any potential upside. The guidance that we provide to you is based on the forward markets. Now, with respect to be financings, Kirk, the refinancing opportunities.

Kirkland B. Andrews
Executive Vice President and Chief Financial Officer, NRG Energy, Inc.

A

Greg, I would say your observation and intuition are directionally correct. We are always mindful in monitoring the trading levels on bonds in the high-yield market. And clearly, we've seen a rally there where I think most of the yields on our bonds, A, they're trading at a premium, which means they're trading inside the nominal coupons, in almost every case. In fact, I think in every case, all the way out to the longest maturity inside six, which is really sort of an attractive long-term rate for unsecured financing at that credit level.

So we will certainly continue to monitor that. We have some near-term callable debt. So I think our approach to the leverage side of the balance sheet is going to be a balance of obviously, first and foremost, maintaining that three times net-debt-to-EBITDA ratio, but in the process, I'm a big believer in, obviously, interest savings on accretive or NTV positive basis in addition to maturity extension. So I think you'd see us looking at that pretty closely. I think at or around the bond levels are trading right now, especially on the longest dated maturities, which is the best barometer or we can refinance on a long-term rate.

We are at or even slightly ahead of what would be an implied accretive transaction. So I think that is certainly not beyond the realm of possibility and we'll continue to monitor that closely to sort of blend in that opportunistic refinancing and maturity extension, which is driving those balance sheet ratios to where we want them to be.

Greg Gordon
Analyst, Evercore Group LLC

Q

Fantastic. Thank you, guys.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Thank you, Greg.

Operator: Thank you. Our next question comes from the line of Abe Azar with Deutsche Bank. Your line is now open.

Abe C. Azar
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Good morning.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Good morning, Abe.

Abe C. Azar
Analyst, Deutsche Bank Securities, Inc.

Q

With your pro forma credit metrics on slide 18 showing close to one times net-debt-to-EBITDA, do you have any further thoughts on what you might do with excess balance sheet capacity?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Yes, Abe. So I mean the first thing, as you can appreciate is executing on the Transformation Plan to provide the flexibility, the capital flexibility, the financial flexibility that we have and really to have enhanced excess capital. We have laid out our priorities. We're going to follow very disciplined our capital allocation priorities and to remind everybody, first and foremost, is to ensure the safe and reliable operations of our Generation and Retail business.

Second is the credit metrics and, as Kirk pointed out, I mean we have a pretty good line of sight with asset sales in 2018 to achieve it. Then, you have the – any growth opportunities and we have laid out the financial guidelines to invest this 12% to 15% return and five-year payback. And then final is returning capital to shareholders and these two I see them interrelated.

They have to be benchmarked in an absolute and on a relative basis. But what I will tell you is right now, I cannot think of any more compelling investment than our own stock, given the Transformation Plan that we have laid out. But, again, I think is – we need to go through our priorities first and foremost, is have the capital, then get to our credit metrics and then we can start talking about allocating capital.

Abe C. Azar
Analyst, Deutsche Bank Securities, Inc.

Q

Great. And then with the way your PJM portfolio has transformed mostly into a capacity play, do you see material potential benefit if PJM changes the inflexible pricing rule?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Absolutely. I mean, we, particularly around the [indiscernible] (39:25) area, we have a lot of base load generation, coal base load generation. If PJM moves forward to improve their price formation and acknowledge that, you have inflexible units that auto set their marginal price during off-peak hours. This will have a positive impact on prices, which will have a positive impact particularly on that part of our portfolio.

Keep in mind that the rest is around low pockets, so the location of that is very important, around New York City, Southwest Connecticut. So I'm very comfortable with the portfolio that we have right now at PJM and the potential positive impact that these reforms can have on it.

Abe C. Azar
Analyst, Deutsche Bank Securities, Inc.

Q

Right. And then, is there any color you can provide on what the type of buyer for the NRG Yield and the Renewables stake could look like? Is the outlook in transaction yesterday, is that a model for what you guys could do on NRG Yield or is that too different?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Well, I hope that you appreciate that we're in very advance stages in many of our process including the Renewables. So I don't think it will be prudent at this late stage in the game to provide you any additional information that could potentially compromised the sales process.

So I promise you that, as soon as we have more information to share with you, we will do it in a very promptly manner, but first and foremost is to make sure that these processes run its course as smooth and as good as we can possibly make it.

Abe C. Azar
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Good luck.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Thank you.

Operator: Thank you. Our next question comes from the line of Steve Fleishman of Wolf research. Your line is now open.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Yeah. Hi. Good morning, everyone.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Good morning, Steve.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Hey, Mauricio. So I just want to tie in some of the updated – the 2018 guidance to your kind of Transformation Plan announcements. So, if you look at the post asset sales of the $1.5 billion EBITDA you're giving, and then if you add in the full run rate to 2020 on the cost of the margin enhancement, I'm getting more like $1.770 billion or something, and I think you had said $1.845 billion. So I think, first, is that correct? And secondly, I think you mentioned Petra Nova maybe is a little lighter. So just is there a little bit of changes in some of the components there?

Kirkland B. Andrews
Executive Vice President and Chief Financial Officer, NRG Energy, Inc.

A

Steve, it's Kirk. The high level answer is no. We are still on track, as I said, to hit that target by the time we get out to 2020. And obviously, I think directionally, just focusing on the mid-point, you're correct, but a few things are true. One, in 2018, as Mauricio mentioned, there's a few assets still offline, remains to be seen what we do with those, and we mentioned in particular, Greens Bayou and Gregory.

In addition, our Encina plant, which we don't have a contract for yet for capacity in 2018, so we basically have no contribution there, I think there is reason to be optimistic to see that come back online. But more importantly, as you move from 2018 and beyond, Petra Nova is still not a significant contributor in 2018, but as that ramps up, we still expect that to contribute to at least more meaningfully on a relative basis, albeit governed by what Mauricio indicated was lower volumes.

More importantly, the Carlsbad Energy Center project, which still has actually a slight negative EBITDA contribution in 2018 as we complete that project, as we move into 2019 and beyond, you've got a pretty significant contribution there from that particular asset, in order of magnitude, to give you a sense, $80 million to $90 million of EBITDA run-rate basis points once you want to get beyond 2018.

So that's the reason, sort of looking for that $1.845 billion as a target for full Transformation Plan and full achievement of some of those assets in Carlsbad still coming online.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Okay, great. And then secondly, just maybe high level, Mauricio, assuming that ERCOT is going to be a much stronger market in 2018 than we thought, can you just give us your thought of the NRG Texas portfolio both Wholesale, Retail, and how much of that benefit do you capture given that you're both long and short? How should we think about that?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Yes. Well, first, let me address the Generation business and our portfolio is very close to low pockets around the Houston area. So either way they carry some inherent locational value that we have been very vocal toward that they need to recognize.

As heat rates increase, we benefit both from our base load generation and our peaking generation. If you look at the hedges, the hedge disclosures that we have put in the appendix, we have now pivoted to where we're significantly open in 2019 and beyond and that has been on purpose.

We were expecting a tightening in the market. We've been talking about asset retirements. We've been talking about the load growth that we have seen and the potential delays of new generation. So we actually have positioned the portfolio very favorably to benefit from these strong fundamentals that we're seeing.

On the Retail side, while you are correct in the short term, in terms of some of our customers and the shore position, keep in mind that we don't necessarily manage a shore position in Retail. For any [indiscernible] (45:39) that we have, we have Generation. We back to back it. It's about retail margins.

We don't speculate the commodity market with our Retail business. As you move out when you have on price load but expected load, we have the opportunity to pass whatever is that cost and the prices to customers just like any other retailer do so we don't necessarily harm our competitiveness in the market.

We just reflect the supply cost inherent in the market. Now obviously, there is a – we've always say that these two businesses move countercyclical that's why they're so complementary and you see commodity prices rise, we would expect some pressure on the Retail. But it is more than offset by the gains that you have on the Generation business.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Great. Thank you.

Operator: Thank you. Our next question comes from the line of Shahriar Pourreza with Guggenheim Partners. Your line is now open.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Q

Good morning guys.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Good morning, Shah.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Q

Most of my questions were answered at this point, but let me just on Texas and ERCOT. I mean, obviously, you've highlighted some big moves from some of the coal -retirements your peers had. So as you're sort of finalizing your asset sales by year-end, what are your thoughts on how you're thinking about selling parts of Texas especially given this call option you have on coal retirement and market tightening?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Yes. Well, right now, we're very comfortable with our Texas portfolio, and given the Retail business that we have and we're always looking at balancing our Generation and Retail. We're trying to move out now in the Northeast and the transformation plan has actually accelerated that rebalancing. But in Texas, we are very comfortable. You look at the peak load that we have on our Retail business, you look at our capacity and when you peel the onion a little bit, one layer more, we have base load generation at peak. And base load generation allows us to have a lot of the credit synergies that we look for when you put these two businesses together.

Our peaking facility provides us the flexibility to manage peak loads. So far, the load following or the mid-merit, we've been able to buy that from the market at very attractive economics. Right now, we are very comfortable with acquisition. We have no – but if that changes, we will start looking at mid-merit. But what I can tell you is for now and the next couple of years, I am just very comfortable the way we have positioned our Retail and our Generation business in Texas, base load peaking and then going to market for mid-merit.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Q

That's helpful. And then just on your margin enhancement, it's good to see that it's underway. That's obviously one of the tougher drivers for investors to kind of model. I know it's early, but are you seeing any kind of opportunities in this stage to potentially accelerate ahead of some of your preliminary expectations similar to some of your cost cuts?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc. A

Yes. So what we have done is really, we're trying to have it in a jump start on our margin enhancement and while the margin target's starting 2018, all the work that needs to be done behind the scenes is already happening in earnest in 2017. So getting ready, our platform, our IT platform, our high grading our analytics, evaluating the – and increasing the effectiveness of our sales channels, looking at secondary products like natural gas and security and investing in the digital transformation that it's going to make it much easier for customers to interact and engage with us.

I mean, all of those things are happening right now, but these are the foundation to have a very successful effort in 2018, when we start capitalizing and monetizing in these investments. So I don't want to leave you with the impression that somehow we're waiting, the team is waiting for 2018 just because that's where we have the target. I mean, everybody's right now focused on building the platform so we hit 2018 running.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC Q

That's helpful. Thanks again.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc. A

Thank you, Shah.

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

Michael Lapides
Analyst, Goldman Sachs & Co. LLC Q

Hey guys. Couple of questions, one on Texas. Saw that you hedged a lot of 2018; also saw that you didn't really hedge that much more of 2019. Just curious, is that a market and fundamentals view, meaning that you still think there's dramatic upside left into 2019? Or is that a liquidity where you wanted to hedge it, but you couldn't actually get it done?

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

Hey, Michael, Chris here. That has more to do with making sure that our Retail side is flat against expected load and et cetera, so we make sure that they're covered up and since most of the expected retail load is kind of front-loaded, that's probably what you're seeing in the chart.

Michael Lapides
Analyst, Goldman Sachs & Co. LLC Q

Got it. The other question, just thinking about the conventional generation portfolio, if you had to look at the assets post the GenOn separation that you'll own in PJM New York, New England, which of those markets do you feel stronger about, meaning where you think you'll get good returns, good cash flow out? Which of those three markets are you more concerned about kind of the direction of the market to own conventional generation?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.
A

Yes. So we have been very optimistic about PJM. The introduction of capacity and then the capacity performance, the attribute that highlights their reliability component of the grid, now the conversation around resiliency and just the market structure and the leadership in PJM to support competitive markets is – we're very optimistic about that. But as you think about our generation portfolio in the Northeast, now with position in PJM and particularly in comment, which has been a premium location, New York City and Southwest Connecticut.

And with the objective of balancing our Generation and Retail business, I mean, we are trying to – we are focused on perfecting the integrated platform. A lot of the generation is going to be driven by our retail needs and how we grow retail and a lot of our retail is going to be driven by where we have generation. So we are right now, in the process of balancing the portfolio. As even without the GenOn assets and some of the conventional asset sales, we're still long generation in PJM. I mean, we have a ways to go before we have a balanced portfolio like we have in Texas so we have a lot of room to grow in Retail. But just in terms of market structure, I would put PJM number one, I think New England number two and New York number three, if I had to force rank them.

Michael Lapides
Analyst, Goldman Sachs & Co. LLC
Q

Got it. Thank you. Last question, just coming back to Texas a little bit, with the big move in on-peak prices after recent coal plant retirement announcements, is that move enough to bring coal plants back into free cash flow breakeven? Or when you look at the market today with the big move in prices, are coal plants in the market still struggling to have cash flow breakeven?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.
A

Well, I think it's very plant-dependent. I don't think you can paint with a broad brush and just say coal plants generic, how is their economics? I mean, it has to do with where they are located in the grid, what type of coal they burn, what is their environmental profile? Do they have environmental controls already in place or not? What are the rules that are coming down the pipe? So I don't think you can make a blank statement like that.

What I have said in the past is our coal generation in Texas, I feel very comfortable with it given the size, the coal that they burn, which is PRB and the location in the grid and the environmental controls that they have. I mean, we feel very comfortable where they are right now. Clearly, the expected retirements that we've been talking for a while were announced. That has an impact on prices. But as I said, an impact, but it's not enough to bring – to justify new build economics.

So if ERCOT falls below the target reserve margins, I think more needs to be done in the market to incentivize new generation to come back, but that's how I think about our coal portfolio under these economics. I mean, somebody else is, I think, you can clearly see that these were uneconomic plans that were difficult to justify and we're just encouraged that they're behaving – they're taking uneconomic generation out of market and behaving rationally.

Michael Lapides
Analyst, Goldman Sachs & Co. LLC
Q

Got it. Thanks, Mauricio, much appreciated.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Thank you, Michael.

Operator: Thank you. We have time for one more question. Our final question comes from the line of Ali Agha with SunTrust. Your line is now open.

Ali Agha
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thank you, good morning.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Good morning, Ali.

Ali Agha
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Morming. Mauricio, a couple of questions on the 2018 guidance. First off, when I look at your retail guidance for 2018 and as you pointed out, there's a very small component of margin enhancement, I believe only $22 million or so. So if I exclude that, the underlying retail EBITDA for 2018 is probably the highest that I've ever seen, certainly in the last five years maybe longer. What's causing that number to be so high in 2018?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Yes. So the 2018 numbers, remember, are impacted by our cost savings and that we have significant – the cost savings initiative on our Transformation Plan is really at ease. That's when you see the bulk of it.

Ali Agha
Analyst, SunTrust Robinson Humphrey, Inc.

Q

So Retail is not just margin enhancement? A lot of the cost savings are flowing through the Retail segment as well?

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

A

Correct. I mean, you have the $30 million margin enhancement that Kirk already alluded to, and then you have the cost savings that had been laid out in the Transformation Plan and that we are well ahead of 2017, so that's the combination of the two.

Ali Agha
Analyst, SunTrust Robinson Humphrey, Inc.

Q

I see, and then – but on a full NRG level basis, when I look at the midpoint of your 2018 guidance, and I compare it to the midpoint of your revised 2017 guidance, if I exclude the cost saving pick up, the numbers are almost flat. Given the capacity margin, revenue increase, you're seeing 2018 over 2017, I'm just wondering why that would be the case?

Kirkland B. Andrews
Executive Vice President and Chief Financial Officer, NRG Energy, Inc.
A

Yeah, Ali, it's Kirk. There's some puts and takes, I mean that was in – when I responded with Steve on the call earlier, with Gregory, which is certainly a part and brings value et cetera in 2017 that currently, we have zero EBITDA for those two plants, that are currently offline as well as the Encino plant not having any at least EBITDA baked into our guidance on the base that we don't currently have a capacity contract there.

So there's a little bit of non-same-store on that basis between 2017 and 2018 where that's concerned. So some of that contributes to that. So basically, as we said all along, in 2017, even in the period of time when we were looking at our midpoint guidance, we talked about being sort of setting the baseline, if you will, which is why we anchored that and look forward.

So we've never looked at the 2017 to 2018 numbers as a hockey stick, but there are some market recoveries. There's certainly the cost improvement that contribute to that, and then as I said before, there's a few elements namely around the plant side where we don't have the same contribution on an EBITDA basis. So it's a combination of those elements.

Ali Agha
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Got it. Last question. Big picture-wise, as you're looking at – as you said, fairly advanced sale processes across the board, the mix of buyers both strategic and financial, is it more financial? Just a sense of who is out there generally.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.
A

No, Ali, I mean, I think on the outset, we provided some color on that. We wanted to put businesses that were very attractive, that were very high quality assets, that were unique and so attract the vast majority of the assets of the prospective buyers.

So you know, given where we are on the processes, under late stage on many of the processes. I don't think it's prudent for me to even provide any color on the type of buyers that are in the process.

What I will tell you is that they were a very wide array of – we really attracted a number, a very wide array of buyers in the process, but that's as much as I can disclose for you, Ali, at this point.

Ali Agha
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Understood. Thank you.

Mauricio Gutierrez
President, Chief Executive Officer & Director, NRG Energy, Inc.

Thank you. And thank you, all of you for your interest in NRG and I look forward to talking to you when we have more information about the asset sales process. Thank you.

Operator: Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect. Everyone, have a great day.