08-Nov-2024

NRG Energy, Inc. (NRG)

Q3 2024 Earnings Call

CORPORATE PARTICIPANTS

Kevin L. Cole
Senior Vice President, Corporate Finance-Treasury & Investor Relations, NRG Energy, Inc.

Lawrence Stephen Coben
Chair, President & Chief Executive Officer, NRG Energy, Inc.

Rasesh Patel
President-NRG Consumer, NRG Energy, Inc.

Bruce Chung
Executive Vice President & Chief Financial Officer, NRG Energy, Inc.

Robert J. Gaudette
Executive Vice President-NRG Business, NRG Energy, Inc.

OTHER PARTICIPANTS

Shahriar Pourreza
Analyst, Guggenheim Partners

Julien Dumoulin-Smith
Analyst, Jefferies LLC

Angie Storozynski
Analyst, Seaport Global Securities LLC

Michael P. Sullivan
Analyst, Wolfe Research LLC

David Arcaro
Analyst, Morgan Stanley & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day. Thank you for standing by. Welcome to NRG Energy Third Quarter 2024 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please note that today's conference is being recorded.

I will now hand the conference over to your speaker host, Kevin Cole, Head of Treasury and Investor Relations. Please go ahead.

Kevin L. Cole

Senior Vice President, Corporate Finance-Treasury & Investor Relations, NRG Energy, Inc.

Thank you. Good morning and welcome to NRG Energy's third quarter 2024 earnings call. This morning's call will be 45 minutes in length and is being 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.

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 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 reconciliations to the most directly comparable GAAP measures, please refer to today's presentation.

And with that, I'll now turn the call over to Larry Coben, NRG's Chair and CEO.

Lawrence Stephen Coben

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

Thank you, Kevin, and good morning, everyone. I'm joined today by Bruce Chung, our CFO; and Rasesh Patel, Head of NRG Consumer, who will share an exciting update on our Virtual Power Plant initiative. Other members of our management team are also on the call and available to answer questions.

Let's start with today's three key messages as shown on slide 4. First, our strong performance this year led us to raise our 2024 financial guidance by $175 million in late September, the second consecutive year we have surpassed our original earnings target. Today, we're reaffirming this elevated outlook for 2024 and initiating strong guidance for 2025.

Second, we're excited to announce a strategic partnership with Renew Home and Google, supported by Google's AI platform to accelerate our Virtual Power Plant efforts. This partnership strengthens our ability to meet evolving customer needs and marks the beginnings of our effort to scale VPP.

Finally, we're enhancing our guidance framework by introducing adjusted EPS. We're also presenting a multiyear outlook supported by a new organic growth program and highlighting additional opportunities to exceed those targets and drive further shareholder value.

On slide 5, let's review our 2024 performance and 2025 guidance. Our year-to-date results and increased guidance are driven by strong plant operations, effective supply risk management throughout the summer, margin growth across all of our business segments, and continued success in Smart Home. These results underscore the strength of our business model and position us exceptionally well for the future.

I'd also like to note that in response to investor feedback, we are now including all amortization costs related to Vivint Smart Home and Retail Home Energy in the depreciation and amortization line of the income statement. Bruce will provide more details and clear disclosures on this change, which is noncash and has no impact on our cash flow metrics or adjusted EPS. This update enhances transparency and simplifies financial reporting and modeling for our shareholders.

We're initiating 2025 guidance, now including adjusted EPS alongside our usual metrics of adjusted EBITDA and free cash flow before growth. For 2025, we expect adjusted EPS of $7.25, adjusted EBITDA of $3.85 billion, and free cash flow before growth of $2.1 billion. This reflects a 14% increase in adjusted EPS from our raised 2024 guidance and a 28% increase from our initial 2024 guidance.

Our 2025 guidance incorporates the achievement of our key 2023 Investor Day commitments, reaching $550 million in run rate synergies, achieving investment-grade credit metrics, and delivering 15% free cash flow before growth per share growth. This achievement is significant as our June 2023 projection of 15% to 20% free cash flow before growth per share growth was based on a 2025 share price of $46 or less than half today's trading price. Through operational improvement and excellence, accelerated growth and synergy achievement, we have stayed on and achieved this target.

Today, we are also announcing that we are increasing our share repurchase authorization by an additional $1 billion. In short, 2024 has been an outstanding year, and 2025 will be even better. Market conditions are highly favorable, our operations remain superb, and our outlook has never been stronger. It's an exciting time to be part of NRG.

On slide 6, with the introduction of adjusted EPS, we're presenting our multiyear growth outlook, targeting at least a 10% CAGR through 2029 based on our raised 2024 guidance. Starting from our original 2024 guidance, this raise would approach 13%, reflecting the extraordinary operations and opportunities in our business.

To provide a clear view of our EPS drivers, we've divided this outlook into two categories, organic business earnings growth and capital allocation. The business earnings portion only incorporates the organic growth plans of our core businesses with no value added for such opportunities as the tightening of the Texas power market or data centers. I will return to these additional opportunities shortly.

Our long term outlook includes an annualized $750 million in adjusted EBITDA organic growth through 2029, largely driven by our consumer businesses. Key drivers include customer growth in Smart Home, initiatives to increase Home Energy wallet share, and advancements in our Virtual Power Plant. We're also strategically expanding our Commercial and Industrial Energy services footprint. In terms of capital allocation, we plan to return $8.8 billion to shareholders with $7.1 billion dedicated to share repurchases.

Looking at potential opportunities to significantly exceed this outlook, we have not factored in any rise in Texas power prices, which we've held at $47 through 2029 despite expected market tightening from growing demand. We have provided growth sensitivities for your additional visibility into our gearing and to allow our investors to reflect on and sensitize their expectations.

Our projections also include (sic) [exclude] contributions from our 21-site development portfolio and two shovel-ready Texas brownfield projects that were not selected for the Texas Energy Fund. Each of these represents additional upside to our baseline growth expectations. I'll explore these elements in greater depth over the next two slides. Our long-term outlook emphasizes the strength of our platform and shows that we're well positioned to capture emerging opportunities in our sector.

Moving to slide 7, let's break down our $750 million growth plan, driven by disciplined investments and high-value initiatives. Our growth is expected in each of our primary businesses, around 30% from Home Energy, 50% from Smart Home, and 20% from Commercial and Industrial Energy.

In Home Energy, we're focused on leveraging our strong Texas market share to expand wallet with our customers. We have been testing a Home Essentials bundle that provides energy customers added value while increasing margin and retention, and the results have been very encouraging. This initiative also enhances our ability to scale our Virtual Power Plant offering. We will provide details of these initiatives later on in the presentation.

For Smart Home, growth is driven primarily by continued customer base expansion, which we have a strong record of achieving historically. We will also attract a broader segment of customers through new and less expensive bundles.

In Commercial and Industrial Energy and NRG Business, we're enhancing our platform by incorporating AI into both sales and customer care, which will increase speed, improve service quality, and reduce costs. We're also expanding in our existing markets by offering advanced products such as load management and reduced carbon options. Additionally, we're broadening our highly successful strategic client services for both electric and natural gas customers, resulting in incrementally higher unit margins.

To meet our $750 million annualized EBITDA target, we plan to invest up to $1.6 billion over the next five years. That's the total investment, implying return on investments approaching 50%. We expect these initiatives to convert to free cash flow before growth at a rate of approximately 90%. These initiatives align with our 80:20 capital allocation framework, reinforcing our commitment to you of disciplined, high-return growth. I'm very confident that we will meet and lightly exceed these base targets. I look forward to keeping you updated on our progress.

Now let's look at some of our other opportunities on slide 8. On the left, we show our 2025 Texas generation open gross margin sensitivity to various around-the-clock power price scenarios. This analysis assumes stable natural gas prices and normal weather conditions. For further details on multiple hedging scenarios, please refer to the appendix.

This highlights the substantial value potential of our Texas generation under different price scenarios. As markets tighten due to rising demand, previously uneconomic generation can become not only economic, but highly profitable. The table also highlights the asymmetrical nature of our gearing to power price fluctuations.

Texas remains the country's most attractive power market, drawing major demand growth. For instance, the largest Houston transmission company recently reported an 8-gigawatt queue of data center demand, a 700% increase from pre-summer levels. By comparison, Northern Virginia, the largest US data center market, has a total installed capacity of around half that. This demonstrates the kind of structural load growth in Texas that could drive significant value beyond our base case.

On the right, we feature our portfolio of 21 development sites and current or former power plants, all located in competitive markets. These sites offer desirable attributes and key infrastructure, making them ideal for projects that prioritize speed to market. In Texas, we also continue to evaluate the best use for our two shovel-ready brownfield projects that total 1.1 gigawatts in capacity. Since they were not selected under the Texas Energy Fund's one asset per developer allocation, we have the flexibility to explore other value-enhancing options for these projects, such as directing them to hyperscalers. Together, these opportunities represent two of the many high-quality, tangible paths to creating additional value well beyond our baseline expectations.

On slide 9, we outline what this means for the substantial cash generation we anticipate in the coming years. Our capital allocation plan balances disciplined growth with substantial capital returns to drive sustained value well into the future. Our growth initiatives exceed our hurdle rates, and we invest only where we see exceptional value. Importantly, these investments also exceed the implied return of repurchasing our own stock, which currently trades at a low teens free cash flow yield. That is an extraordinary value, in my view.

With that, let me turn it over to Rasesh Patel, the Head of NRG Consumer, who'll provide an exciting update on our Virtual Power Plant initiatives.

Rasesh Patel

President-NRG Consumer, NRG Energy, Inc.

Thank you, Larry. Turning to slide 10, I am thrilled to announce our strategic partnership with Renew Home and Google to develop a 1-gigawatt residential Virtual Power Plant for VPP in Texas. This partnership brings together leaders across the energy and consumer technology industries to develop an innovative energy management solution for NRG and our customers. Our intention is to combine NRG's consumer reach and supply management expertise with Renew Home's residential demand response capabilities and Google's advanced AI technology. This will enable us to deploy smart thermostats and other devices that will allow our customers to optimize their energy use and save money while enhancing the stability and flexibility of our supply strategy and the Texas grid.

On slide 11, you will find the key components of our partnership. We will develop a compelling, personalized energy management platform that provides near real-time dispatch capacity at a fraction of the cost of a generation plant. Renew Home will provide the demand response capabilities and will fund a significant portion of customer acquisition costs, minimizing NRG's capital outlay. This collaboration also positions NRG as the partner for all new Google Nest VPP enrollments in Texas. NRG will manage the customer relationship, experience, and dispatch of VPP events.

As illustrated in the VPP capital efficiency metrics at the bottom left of the slide, this is an economically attractive approach to supplementing our generation portfolio. The upfront investment is roughly 1/10 of a new peaker plant, while delivering an IRR greater than 50%, which is significantly higher than traditional alternatives. On the right-hand side of the page, you can see our plan to scale this program with the goal of reaching 650 megawatts of dispatchable capacity by 2030 and 1 gigawatt by 2035.

Now let's turn to slide 12, where we outline our strategy for bringing the Virtual Power Plant program to market with an exciting new offering. To accelerate our VPP efforts in Texas, we're introducing the Home Essentials bundle, which includes the Vivint Smart Thermostat, doorbell camera, and professional installation, all provided at no cost to customers enrolled in the VPP plan as long as they remain an NRG Energy customer. Should they choose to leave, they can continue to receive the Smart Home services for a monthly fee of $14.99, allowing customers to continue enjoying the benefits of Smart Home while protecting our investment and their experience.

We have tested this new value proposition with select energy customers in Texas, and the results have been very encouraging. In our pilot, we're seeing strong adoption of this offer and a step change in customer engagement with the average household using our Smart Home app more than 160 times per month. Moreover, 20% of these customers have opted to purchase additional Smart Home products and services that generate incremental recurring revenue.

Over time, we see this bundle becoming a powerful entry point that will deliver enhanced value to customers, build scale for VPP, and encourage customers to explore a broader suite of Smart Home services. We are leveraging our strong market share in Texas to expand our share of wallet with customers with Renew Home co-funding up to $150 of customer acquisition costs through our VPP partnership.

This go-to-market strategy focuses on making smart energy solutions accessible, valuable, and deeply engaging. We're meeting our customers where they are, the solutions that empower them to take control of their home and energy experiences while strengthening their relationship with NRG. We will make home-based essentials broadly available in Texas spring 2025.

Moving to slide 13, let's take a closer look at how our Virtual Power Plant generates value and delivers strong economics through two distinct value streams: consumer and supply. On the consumer side, where we retain 100% of the economic benefits. We expect margin uplift and increased tenure for customers adopting the home based essentials bundle, as well as incremental recurring revenue from customers opting for additional Smart Home services.

The Home Energy industry, relative to other consumer services, has elevated customer churn, and we expect this initiative to improve customer retention due to the enhanced value, engagement, and savings from this integrated offering.

On the supply side, where we retain over half the economic benefit, we've provided an illustrative breakdown that shows how VPP creates margin opportunity based on the number of events per summer and the implied in-the-money power price. Beyond direct value, this asset also provides critical risk mitigation, allowing us to dispatch the VPP to further stabilize our supply portfolio during periods of volatility. At scale, we're a 650-megawatt VPP. We anticipate approximately $110 million in annual recurring margin for NRG, $80 million from consumer value and $30 million from supply value.

Looking ahead to a 1-gigawatt VPP, we project the total annual incremental margin to exceed $160 million, making VPP a highly profitable and flexible asset that strengthens both our financial and operational resilience. If Texas supply becomes more constrained in the coming years, as many expect, the value to NRG and our customers will only increase.

I look forward to keeping you updated on our progress as we execute this plan. With that, I will turn it over to Bruce to provide the financial review.

Bruce Chung

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

Thank you, Rasesh. Before I discuss our third quarter results, I'd like to provide a few updates on our key financial performance and valuation metrics. As you can see on the slide, we are introducing adjusted net income and adjusted earnings per share as part of our reporting framework. These metrics offer additional context for NRG's profitability and growth, capturing both underlying business growth driven by investments into our platform, as well as the impact of our robust capital allocation program.

For 2024, we are on track to deliver $1.3 billion of adjusted net income, equivalent to $6.35 per share of adjusted EPS. The midpoint of our raised adjusted EPS guidance represents a 12% increase over the midpoint of our original guidance, reflecting the strong business performance.

We are pleased to provide these additional tools for investors to use in their evaluation of the investment merits of NRG. We believe these new metrics, coupled with our preexisting metrics such as free cash flow before growth per share, will continue to shine a spotlight on NRG's attractive valuation. We will continue to provide adjusted EBITDA and free cash flow before growth alongside these two new disclosures for the foreseeable future.

Going forward and including today's third quarter results, adjusted EBITDA has been updated to recast all amortization of capitalized customer acquisition costs from SG&A and cost of operations into the depreciation and amortization line item. This change addresses a point of common confusion that investors have given us direct feedback on. This is part of our ongoing commitment to provide better visibility into our businesses and simplify the modeling process. More details are available in our 10-Q, as well as in the Reg G tables appended to this presentation and this morning's press release.

As you can see on the right-hand side of the slide, this change results in an upward adjustment to the midpoint of our 2024 guidance by $130 million from $3.56 billion to $3.73 billion. We have accordingly recast adjusted EBITDA for historical periods to conform with this methodology and to allow for direct comparison of our results across reporting periods. This is simply a geography change of noncash items and therefore has no impact on any of our reported free cash flow before growth or adjusted EPS metrics and outlook.

Turning to slide 16, NRG delivered another strong quarter of financial and operational performance with adjusted EBITDA of $1.055 billion, an increase of $68 million over the third quarter of the prior year. Texas delivered $584 million of adjusted EBITDA for the quarter, $32 million higher than Q3 of 2023. When adjusted for asset sales executed in 2023, our outperformance was approximately $80 million. This improvement reflects the strength and resilience of our integrated platform.

Unlike last year, Texas was marked by a lack of power price volatility and generally lower pricing despite warm temperatures. Our integrated supply strategy and the ability to turn off units during periods of low pricing enabled us to maximize margins as we served our retail load. The ability to cycle our plants on and off as part of our overall supply strategy is what gives us confidence in delivering consistent financial results through a variety of market conditions.

Our East, West, and Services segments also demonstrated improved year-over-year outperformance. Adjusted EBITDA for the quarter was $214 million, representing an $18 million increase from the prior year. This improvement was primarily driven by lower power and natural gas supply costs, resulting in margin expansion and an increase in average customer counts of 7%.

Finally, our Smart Home segment delivered $257 million of adjusted EBITDA for the quarter, an $18 million increase from the prior year. This was driven by mid single-digit growth in our subscriber count and continued net service margin expansion of 6%, reflecting the embedded operating leverage of the business as the subscriber base continues to grow.

As you can see on the table, we have added disclosures for adjusted net income and adjusted EPS. For the third quarter, NRG produced $393 million of adjusted net income, equivalent to $1.90 of earnings per share. This represents a 21% increase over Q3 2023 results, primarily driven by higher gross margin and share repurchases. Free cash flow before growth for the quarter was $815 million, a $460 million increase over Q3 2023. This reflects higher gross margin, favorable working capital, and lower CapEx given the completion of the Parish restoration work in 2023.

Lastly, we are reaffirming our revised 2024 financial guidance and have provided our guidance ranges across all the key reporting metrics, including adjusted net income and adjusted EPS.

Turning to 2024 capital allocation on slide 17, we continue to deliver on our capital allocation priorities. There are only a few minor changes to the capital allocation waterfall from our second quarter earnings call. On our last earnings call, we announced an agreement to sell our Airtron HVAC business. That transaction closed in late September. As a result, we are updating the net cash proceeds from the Airtron sale to approximately $425 million.

We are also increasing free cash flow before growth by $100 million. For liability management preferred dividends, we reduced our 2024 allocation to $420 million from $602 million. Our aggressive debt reduction over the past few years, coupled with improved financial performance, will result in achieving our target credit metrics by the end of 2024, a full year earlier than originally intended. As a result, we have reduced the amount of liability management we had intended to pursue in 2024 and have reallocated that cash to our remaining unallocated CAFA.

We have increased our share repurchase total from $825 million to $925 million, which reflects the increase in our 2024 FCFbG guidance. Through October 31, we completed $544 million of repurchases, and we expect to complete the remaining repurchases by year end. Inclusive of our year-to-date activity, we have executed over $3.8 billion in share repurchases at an average price of around $50 since 2019, representing nearly 30% of our shares outstanding.

In our other investments, we have allocated $122 million for other growth, including updated spend associated with our ERCOT new build project.

Finally, we expect to end 2024 with approximately $605 million of unallocated capital, which we have rolled into 2025 for application towards continued share buyback programs.

Turning to the next slide, we are excited to introduce our financial guidance for 2025. We are guiding 2025 full year adjusted EBITDA to a range of $3.725 billion to $3.975 billion, representing a midpoint of $3.85 billion or an 8% increase from our original 2024 guidance midpoint. As you can see from the chart at the bottom, this is driven by the completion of our previously announced growth and cost synergy programs, margin expansion from higher power prices, and partly offset by the lost EBITDA from the sale of Airtron.

We are also guiding 2025 full year free cash flow before growth to a range of $1.975 billion to $2.225 billion, representing a midpoint of $2.1 billion, also an 8% increase over the midpoint of our original 2024 guidance. In addition to adjusted EBITDA and free cash flow before growth, we are initiating guidance for adjusted net income and adjusted earnings per share. For full year 2025, we are initiating guidance on adjusted net income to a range of $1.33 billion to $1.53 billion, representing a midpoint of $1.43 billion and a range of $6.75 to $7.75 for adjusted EPS, representing a midpoint of $7.25 per share.

Moving to the next slide, we are providing a five-year road map with the major drivers of our adjusted EPS and free cash flow before growth investment outlook on a per-share basis. As you can see on the slide, we are targeting long-term adjusted EPS and FCFbG per share growth of greater than 10%. These growth rates are pegged against our recently increased 2024 guidance. More modeling disclosures can be found in the appendix of today's presentation.

Our five-year outlook is underpinned by visible organic growth, resulting in $750 million of incremental run rate adjusted EBITDA and a robust capital return program of nearly $9 billion over the 2025 to 2029 period. I'd also highlight that this five-year outlook assumes flat power pricing and does not include any of the additional upside opportunities Larry touched on earlier.

As you can see on the slide, our organic growth plan and share repurchases comprise nearly $4 of EPS growth and nearly $6.50 of FCFbG per share growth. Offsetting this growth is an increase in taxes as available tax credits expire in 2025 and as NRG continues to generate strong earnings that utilize its NOL balance.

In addition to taxes, we are projecting the impact of higher interest costs on earnings and free cash flow growth as maturing low-cost debt is refinanced at higher rates.

Turning to 2025 capital allocation on the next slide and starting on the left side of the chart, we are showing approximately $2.7 billion of cash available for allocation, which includes the carryover amount from 2024. As I have already noted, we will achieve our target credit metrics earlier than originally forecasted. And as such, our liability management program in 2025 will be comprised of selling the convertible note hedge and preferred stock dividends.

As you can see, the primary focus of our 2025 capital allocation activity will continue to be share repurchases, with $1.36 billion planned for 2025. Together with the planned 8% increase in the common dividend to $1.76 per share, our total return of capital is currently expected to be about 85% of CAFA after liability management and integration costs.

Importantly, for those keeping a scorecard, we are on track to significantly exceed the original return of capital commitments shared as part of our 2023 Investor Day with more than $4.5 billion to be returned from 2023 through 2025. Given our outstanding performance relative to the 2023 Investor Day plan, our board of directors approved an increase in total authorization for repurchases from $2.7 billion to $3.7 billion. As of October 31, approximately $2 billion is remaining under the total authorization inclusive of this increase.

In 2025, we have allocated $165 million to other investments, which includes continued progress on our ERCOT new build program and investment in near-term actionable initiatives related to our long-term organic growth plan.

Finally, we are showing $235 million of unallocated capital, which we will allocate over the course of 2025.

With that, I'll turn it back to you, Larry.

Lawrence Stephen Coben

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

Thank you, Bruce. Turning to slide 22, we've provided you today a detailed view of our compelling five-year financial outlook, enhanced with additional disclosures for clearer insights into our earnings and growth trajectory. Our plan is simple, transparent, and backed by durable recurring cash flows and a strong balance sheet. We're confident in achieving our long term targets of at least 10% growth in adjusted EPS and free cash flow before growth per share with numerous opportunities to significantly exceed these goals.

In closing, on slide 23, 2024 has been another year of strong execution where we have delivered financial, operation, and capital allocation results, well ahead of guidance and expectations. I'm exceptionally proud of the work of our 18,000 employees across all of our organization who have driven these results. I'm deeply committed to driving NRG forward, to creating additional significant shareholder value. We are seeing a long-term step change improvement in fundamentals across our platform. You can expect a continued and remaining heightened focus on operational excellence, prudent growth, and being good stewards of our investors' capital.

I have never been more excited about the potential of NRG than I am today. Thank you for your time and continued interest.

Operator, we're now ready to open line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question coming from the line of Shar Pourreza from Guggenheim Partners. Your line is now open.

Shahriar Pourreza
Analyst, Guggenheim Partners
Q

Hey, guys. Good morning.

Lawrence Stephen Coben
Chair, President & Chief Executive Officer, NRG Energy, Inc.
A

Good morning, Shar. How are you?

Shahriar Pourreza
Analyst, Guggenheim Partners
Q

All right. Quite an update, Larry. Quite an update. Let me just start just – I want to touch on the process around the sites. I mean, some of your peers this week mentioned portfolio approaches to hyperscaler deals. You have the ability to provide a degree of additionality with the gas units. Is it still your plan to sort of update the Street in January? And how are you seeing – are you seeing more interest in one region versus the other? Thanks.

Lawrence Stephen Coben
Chair, President & Chief Executive Officer, NRG Energy, Inc.
A

Yes and yes. No. Sorry, Shar.

Shahriar Pourreza
Analyst, Guggenheim Partners
Q

Happened to me before, by the way.

Lawrence Stephen Coben
Chair, President & Chief Executive Officer, NRG Energy, Inc.
A

It worked.

Shahriar Pourreza
Analyst, Guggenheim Partners
Q

I got [ph] Tom Kai'd (00:35:45) for the first time. There we go.

Lawrence Stephen Coben
Chair, President & Chief Executive Officer, NRG Energy, Inc.
A

No. We are – Shar, we are going to provide an update, as we said, by the fourth quarter call. And we're seeing a lot of interest across our sites, both in PJM and in Texas, both in portfolio approaches and in individual approaches.

Look, I think it's a very complex process, rapidly changing. People are – we're still figuring out exactly what it is that we want. And I think by stepping back as we did and now diving back in, we're really in a position to optimize the value of what we have. So, still super excited. We've done a lot of more site analysis, as you can see in the appendix here. And we look forward to updating you when that time comes.

Shahriar Pourreza
Analyst, Guggenheim Partners

Q

Got it. And then as we get more disclosures, you plan on layering in the optionality into the numbers through time, or how do we get an update?

Lawrence Stephen Coben
Chair, President & Chief Executive Officer, NRG Energy, Inc.

A

Yeah. I mean, I think – as we know what the numbers are, we will layer them in now. Remember how we talked about before, some of this may be things that we never, ever disclosed because someone comes to us and they want an extra 1,000 megs of something, and then we decide we're going to build the plant. And some hyperscalers may or may not want those two events tied together. So, one of the ways that you may see that we're doing this is, all of a sudden raising our estimates, raising our CAGR, all of those kind of things rather than one-off announcements. Could go either way, but that's where you'll see it.

Shahriar Pourreza
Analyst, Guggenheim Partners

Q

All right. Perfect. And then just lastly, coming back to sort of the identified growth component of the plan, appreciate obviously the breakdowns between the segments through 2029. Some of these are obviously familiar to investors like the C&I margin, customer accounts, but some aren't. Where do you see kind of the most room for variability within these three verticals? And any color on cost to achieve? Appreciate it, guys.

Lawrence Stephen Coben
Chair, President & Chief Executive Officer, NRG Energy, Inc.

A

Sure. Look, I think we've put out a plan that we're really excited to and feeling really good about signing up for. And I think we see bias to the upside across all of these things. I mean, if there's a world recession or something, are people going to move less and maybe purchase less energy or fewer smart home? Anything is possible. Same in the industrial sector. But we feel really good, Shar, about what we've signed up here for. And to achieve this $750 million of annualized EBITDA over the next five years, we're going to invest $1.6 billion in total. So, that's the cost to achieve.

Shahriar Pourreza
Analyst, Guggenheim Partners

Q

Perfect. I appreciate it, guys. Congrats on the results, and it's good to see that Bruce was busy. Appreciate it.

Lawrence Stephen Coben
Chair, President & Chief Executive Officer, NRG Energy, Inc.

A

Well, once a year, whether he needs to or not, Shar. Thank you, Shar.

Operator: Thank you. And our next question coming from the line of Julien Dumoulin-Smith with Jefferies. Your line is open.

Julien Dumoulin-Smith
Analyst, Jefferies LLC

Q

Hey, Larry, team. Good morning, guys. Nice to chat. Just following up a little bit on...

Lawrence Stephen Coben A
Chair, President & Chief Executive Officer, NRG Energy, Inc.

Hi, Julien. How are you?

Julien Dumoulin-Smith Q
Analyst, Jefferies LLC

Hey. Good, good, good. Pleasure, guys. Nicely done. Maybe just following up a little bit on what Shar pegged you on first here. Let me needle you a further on this in terms of just the update timeline, and, more specifically, what that could look like if you think about what to set expectations around should we say January or otherwise here, right? Is it principally – are your efforts geared principally towards this additionality and leveraging those two additional sites? Or are you still thinking – it seemed earlier that you're principally focused on the Midwest portfolio, the site value there. We've seen a lot of excitement in the Midwest. Is that more where we should be thinking about? Again, I know there's 20-plus sites here.

Lawrence Stephen Coben A
Chair, President & Chief Executive Officer, NRG Energy, Inc.

I think it's both.

Julien Dumoulin-Smith Q
Analyst, Jefferies LLC

You tell me where – what permutation is that?

Lawrence Stephen Coben A
Chair, President & Chief Executive Officer, NRG Energy, Inc.

Julien, I think it's both. I mean, I think what's happened is, we were obviously still – we're laser-focused on the 21 sites, and we remain so. But when the TEF decided that they were only going to give one loan per customer as they did, that – we felt for us that opened up the additionality potential for those two shovel-ready projects.

And so we've kind of just put them into the mix post the TEF announcement, which was around the end of August, you'll recall. And there's, I think, a fair amount of interest because, as you know – I think you've written about, additionality is going to be critical going forward to the development of these kind of sites, and to have shovel-ready additionality is rare.

Julien Dumoulin-Smith Q
Analyst, Jefferies LLC

Right. Yeah. Indeed. And actually, just to clarify that even, with respect to TEF, would you expect TEF Part II here to include those sites here? I mean, is sort of the idea to double dip, if you will, between TEF and additionality next year potentially with the customers?

Lawrence Stephen Coben A
Chair, President & Chief Executive Officer, NRG Energy, Inc.

You know, they haven't put out any guidance at all about TEF II. We don't know if it's going to occur, so we're going to push forward right now as if there is no TEF II for those projects. But if that shows up, obviously, that's one option that we will consider. I don't know that you'll be able to double-dip. We'll have to wait and see what the rules are. But we don't need to double-dip to make those very attractive to somebody who's looking for additionality.

Julien Dumoulin-Smith Q
Analyst, Jefferies LLC

Yeah. Okay. Excellent. Thank you. And VPP, out of that $1.6 billion, I think, how much does it cost you to do the VPP? I think you said $100 a kilowatt. So, it's like $65 million for the 650 kilowatt?

Rasesh Patel A
President-NRG Consumer, NRG Energy, Inc.

Yeah. Julien, if – one of the unique things about VPP is, we don't have to wait to get the benefit. As we acquire customers and put the assets to work, we actually start to realize the value. And so think of it as we ramp up investment, and it stays below $50 million for us because we start to gain, gain, you know, benefits from the deployed assets.

Julien Dumoulin-Smith Q
Analyst, Jefferies LLC

All right. Excellent, guys. Thank you so much. All the best.

Lawrence Stephen Coben A
Chair, President & Chief Executive Officer, NRG Energy, Inc.

Thanks, Julien. Talk to you later.

Operator: Thank you. And our next question coming from the line of Angie Storozynski with Seaport. Your line is now open.

Angie Storozynski Q
Analyst, Seaport Global Securities LLC

Thank you. It's kind of funny that all these questions are focused on what else you have to say and even though the entire call was filled with announcements.

Lawrence Stephen Coben A
Chair, President & Chief Executive Officer, NRG Energy, Inc.

Well said, Angie.

Angie Storozynski Q
Analyst, Seaport Global Securities LLC

The bar is set really high, I guess. No. So, my question is about the VPP, Virtual Power Plant. So, we're seeing some cooling off in, like, battery investments in Texas, right? I mean, there is this realization that existing batteries are starting to cannibalize on peak power prices, and that eats into the other pricing arbitrage that these batteries rely on. And so why shouldn't the same be true for the VPP? And I understand that the biggest component of the profitability of this business is basically customer retention, so the energy component is relatively small. But why shouldn't that be true that, in a sense, the curve gets sort of flatter and your ability to actually capture this additional energy benefit is lower?

Robert J. Gaudette
Executive Vice President-NRG Business, NRG Energy, Inc.
A

Hey, Angie. It's Rob, and great observation. What I would tell you or remind you is, because we serve consumer energy customers, we're always building our portfolio, and we're including that component that I've called insurance, right, the options on the back end. What VPP does is it self-provides that, right? So, as we think about the customer, and as we think about how we insure against an extreme event, the beauty of VPP is it is the perfect hedge for that kind of exposure.

So, when I look out the curve and as we're building the portfolio over time, what VPP does is it helps me manage the risks of a consumer energy business without having to go to a third party or dropping a lot of money to build massive peakers to meet that same obligation. So, I feel really good about the economics that we've got here. And as far as the long-term perspective, this is absolutely the best tool to manage the risk of a home-based energy book. Does that help?

Angie Storozynski
Analyst, Seaport Global Securities LLC
Q

Okay. So, basically it still is the most cost effective way to hedge against spikes and super peaks, right? I mean...

Robert J. Gaudette
Executive Vice President-NRG Business, NRG Energy, Inc.
A

Absolutely.

Angie Storozynski
Analyst, Seaport Global Securities LLC
Q

...not that we've seen it. And that's -my other question is that, we – I mean, we keep hearing those incredible announcements. Almost hard to even believe that they can be said with a straight face, right? 80 gigs of load in Texas from Oncor. I mean – and yet the curve is just not reacting at all. It's almost as if – and, again, could it be that this load is not going to impact 2028 or even 2029? And that's why we're not seeing any response? Or how can you actually reconcile the lack of response in forward power curves in Texas?

Robert J. Gaudette
Executive Vice President-NRG Business, NRG Energy, Inc.
A

Yeah. So, I look at both of those things. And what I would tell you is that, I am with you. I don't believe that the curve reflects the load that we expect or the supply/demand picture that we would expect in the future. As far as how we think about it and whether or not it's going to show up, I believe that the load is coming, I don't know if it's 80 gigs and, honestly, we don't need 80 gigs. But part of the curve, remember, and the reaction inside of pricing, is pretty shortsighted viewing or just looking a little bit into history. This summer was a little less warm than last year. We didn't have any real price formation like we did last year. And then everybody kind of lost sight of what could happen.

If you look into the future and you think about, okay, well, if you just – you add a little bit of incremental load into the ERCOT market, you have a real opportunity giving a renewables profile and, call it, just abnormal weather to really get price formation. And then everybody will be excited again, and the curves will go to the moon, and we'll be managing through it. It's – you've seen this before. We've all seen it. I just don't think that these curves in 2028, 2029, and beyond reflect reality.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Okay. And just the last question. So, maybe actually to both Bruce and Larry. So, is there a free cash flow yield that – below which you think that the share buybacks are just not unwarranted and there is some other way of capital return or maybe M&A or some other strategy change.

Lawrence Stephen Coben
Chair, President & Chief Executive Officer, NRG Energy, Inc.

A

Angie, there is one, but I don't think we're anywhere close to it. I mean, we're still in the double digits. So, when we get to the mid single digits, maybe we can have that kind of a look-again, depending on what the opportunities in the world looks like. But right now, given the undervaluation of the stock, it's still a pretty high hurdle rate for us. But we all look forward to the day, and I'm sure you do, too, that when the stock is trading so high that that becomes a real question for us.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Yes. To infinity and beyond. Okay. Thank you.

Lawrence Stephen Coben
Chair, President & Chief Executive Officer, NRG Energy, Inc.

A

To infinity and beyond. Thank you, Angie.

Operator: Thank you. And our next question coming from the line of Michael Sullivan with Wolfe Research. You line is now open.

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

Hey. Good morning.

Lawrence Stephen Coben
Chair, President & Chief Executive Officer, NRG Energy, Inc.

A

Good morning. How are you?

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

Good. Good. Good. Congrats on all the announcements here. Just – I know – so you gave this 10%-plus and said it can vary year-to-year. But just to clarify, does that mean you can go below it? Below 10% in some years? Or it's just going to be 10% or better in every year? And how much better can vary?

Bruce Chung
Executive Vice President & Chief Financial Officer, NRG Energy, Inc.

A

Yeah. I mean, Mike, I think the reality is, there are going to be – there may be some years where it might go below. There might be some years where it's going to go above. But generally speaking, on a long-term basis, we visibility around that plus 10% over the long term.

Michael P. Sullivan
Analyst, Wolfe Research LLC
Q

Okay. And just specifically on that, so if we go to slide 19 with the tax impact, does that all fall away in 2026? Should we think of, like, 2026 as being a lower year, and then you kind of catch back up again in the [ph] outlook (00:48:41) or...

Bruce Chung
Executive Vice President & Chief Financial Officer, NRG Energy, Inc.
A

I mean, there is – yeah. I mean, there is an incremental increase in the tax rate after 2025 because of expiring tax credits. I think the way that we think about that growth is, to the extent that there is a drag as a result of an incrementally higher tax rate, we probably see some business performance and business growth offsetting that drag.

Michael P. Sullivan
Analyst, Wolfe Research LLC
Q

Okay. Okay. Great. And then, yes, the VPP announcement, good to see there. And maybe just – is it fair to kind of bifurcate it as you broke out the $80 million component as being kind of more stable, and then locked in? And then that $30 million component, it looks like it would have been a lot better in 2023 if you get a summer like that. And then if we got this summer, maybe wouldn't have been around that level. Is that fair?

Rasesh Patel
President-NRG Consumer, NRG Energy, Inc.
A

Hey. Michael, this is Rasesh. Yeah. That's – it's a good way to think about it. The customer value is going to be stable and very sustainable. The supply value, which Rob can add a little more color on, that can be significantly higher in years of tighter markets. And so I think that's the right way to think about it.

Rob, would you add anything?

Robert J. Gaudette
Executive Vice President-NRG Business, NRG Energy, Inc.
A

Yeah. So, the thing I would have you think about from the supply perspective, remember that we're using this in lieu of some form of insurance, right? So, the values on the page represent what it would cost me, right? The – on the top part of the slide, this is what we would have – this is what we save by not having to go and replace this with a heat rate call option or something like that. The representation down at the bottom, where we talk about the different years.

So, in 2023, the value of that insurance would have been considerably more valuable than, say, this year where we didn't have any real price formation. But when you think about it long term with NRG and how we build it in the portfolio, I'm going to buy that insurance regardless. So, I'm building the book 12 to 18 months out. We're putting in the insurance to protect our business. And so we're going to capture the values up at the top, and then the representation at the bottom is just the value that that protected me from, right?

So, I bought the insurance in 2023. It was really valuable. I bought insurance this year, and I didn't need it. That's the examples at the bottom. So, the value that we see around VPP is consistent year – every year, regardless of the circumstances because I'm going to buy that insurance to protect the portfolio anyway. Does that make sense?

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

It does. Thanks, Rob. That's really helpful.

Robert J. Gaudette
Executive Vice President-NRG Business, NRG Energy, Inc.

A

Yeah.

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

Okay. And last one, just to round it out there, too. I mean, it's pretty sizable. Can you maybe just give us a sense of, are there any competitors out there or other people looking to do this? Or how big does that VPP market get in Texas overall, outside of what you were doing?

Rasesh Patel
President-NRG Consumer, NRG Energy, Inc.

A

Hey. That's – it's a great question. And one of the reasons I think NRG is so uniquely positioned is, we have a scaled customer base. We have the supply management expertise. And now, partnering with Renew Home and Google, we're partnered with the largest demand response platform in North America. The partnership also gives us exclusivity to all new Nest thermostat enrollments into demand response in Texas. And to give you context around that, there are already 1 million Nest thermostats deployed in ERCOT, almost 300,000 of which are overlapped with the NRG customer base. And so this is a very unique opportunity for NRG.

And, two, everything that we've outlined today is showing you the thermostat opportunity. But we will be working with our partners to tie in batteries, electric vehicles, other things onto the platform where we can leverage already deployed resources into this platform. And so, Michael, I think it'd be very hard for anybody else to replicate this at scale.

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

Okay. Awesome. Thank you so much.

Operator: Thank you. And our final question comes from the line of David Arcaro with Morgan Stanley. Your line is now open.

David Arcaro
Analyst, Morgan Stanley & Co. LLC

Q

Hey. Thanks so much. Good morning.

Lawrence Stephen Coben
Chair, President & Chief Executive Officer, NRG Energy, Inc.

A

Hi, David. How are you?

David Arcaro
Analyst, Morgan Stanley & Co. LLC

Q

Good. Good. Hey, I was wondering if there's any organic growth kind of opportunity at the retail energy business that could be potential upside from here. How is that incorporated in there? I mean, I – it seems we're seeing pretty good residential growth in Texas over time, plus all of the C&I growth potential from new data center load. Didn't really see that maybe clearly called out as one of the components of the EBITDA growth opportunities. So, wondering how you're thinking about that.

Rasesh Patel A
President-NRG Consumer, NRG Energy, Inc.

Yeah. It's a great question. The way I would really think about this is, we have very strong market share on the residential energy side in Texas, right? Nearly 40% share of the market. And so the larger opportunity we see is, how do we leverage that household relationship to actually expand share of wallet with customers? And through the launch of Home Base Essentials, we're giving our existing scaled customer base a lot of incremental value. And in the trial that we've seen over the summer where we've provided customers this new bundle, 20% of them have already bought incremental Smart Home services from us, and that's very attractive.

So, I would just characterize that as, there will be opportunity, obviously, with modest household growth, but the larger opportunity for NRG is to expand the share of wallet, leveraging the near 40% market share we have in Home Energy.

David Arcaro Q
Analyst, Morgan Stanley & Co. LLC

Yeah. Got you. Absolutely. Makes sense. And maybe on that data center side, is there growth coming to your service territory that would boost the Commercial and Industrial side of the business in terms of retail contract opportunities and retail growth? Are you seeing data centers show up in that – in the retail business coming – come to you with a multiyear energy contract and opportunities?

Robert J. Gaudette A
Executive Vice President-NRG Business, NRG Energy, Inc.

The short answer is yes. We are definitely seeing data centers coming with long-term contract requirements. And then the way to think about how it affects the rest of the C&I marketplace is that in a market where there's growing tightness and there's competition for those megawatts, I've said it before and we talked about it, there's a flight to quality that occurs amongst large industrials and commercial customers where they want additional service. They want skilled operators on the other side of their contracts. And so we see an uplift into our opportunity set as we see this trend continue in ERCOT and honestly in PJM.

David Arcaro Q
Analyst, Morgan Stanley & Co. LLC

Got it. Okay. Great. Thanks so much.

Robert J. Gaudette A
Executive Vice President-NRG Business, NRG Energy, Inc.

Yes, sir.

Lawrence Stephen Coben A
Chair, President & Chief Executive Officer, NRG Energy, Inc.

Thanks, David.

Operator: Thank you. And I'm showing no further questions in the queue at this time. I will now turn the call back over to Mr. Larry Coben for any closing remarks.

Lawrence Stephen Coben

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

I want to thank you, all, for your interest in NRG. As you can tell from our releases, our slides, and our presentation, we are all super excited about our business. And we look forward to keeping you up to date on it going forward. Have a great day, and have a great weekend.

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