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NRG Energy, Inc. (NRG)

Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the NRG Energy, Inc.'s Fourth Quarter 2023 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 be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, 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 fourth quarter and full year 2023 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 upon 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'll 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 Interim President and CEO.

Lawrence Stephen Coben

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

Thank you, Kevin. Good morning, everyone, and thank you for your interest in NRG. I'm Larry Coben, and I am the Chairman, Interim President and CEO. I'm joined this morning by Bruce Chung, our Chief Financial Officer, and we also have members of the management team on the call and available for questions. While I have been CEO for 3 months, I have been Chairman for 7 and on the board for 20 years. I have never been more excited about NRG as a company than I am today.

Let's begin with the NRG value proposition on slide 4. We are the trusted partner to almost 8 million residential customers, earned every day through unique and differentiated offerings that simplify and improve our customers' lives. We have 5.9 million energy and 2 million Smart Home customers, and that is the second largest C&I energy and natural gas retail portfolio in the country. We have taken the necessary steps to position NRG to win the energy transition at the convergence of energy and technology in the home and grid with the evolution of smart devices and generative AI data centers.

We generate significant excess cash well beyond our current business needs, resulting in financial flexibility to return significant capital to our shareholders while maintaining a strong balance sheet. Our business and financial outlook has never been stronger, and I've never been more excited about the future of the company than I am today.

Turning to slide 5, first, in 2023, we delivered record free cash flow before growth and near record adjusted EBITDA. We exceeded our Investor Day outlook and our previously increased 2023 guidance ranges. This is the direct result of the strategic initiatives and actions we've taken in recent years to strengthen and stabilize our business. Our outlook continues to get better and better, and today, we are reaffirming our 2024 financial guidance ranges.

Next, we made significant progress advancing our long-term energy transition and electrification strategy. We have line of sight to achieving our current $550 million by 2025, and we are now turning our attention to the next phase of our growth. Lastly, we continue to execute our disciplined capital allocation strategy, which involves both a strong balance sheet and returning significant capital to you, our shareholders.

Turning to slide 6, we delivered $844 million of adjusted EBITDA for the fourth quarter, 82% higher than the prior year. This brings our full year results to $3.282 billion of adjusted EBITDA, 76% higher than last year, primarily driven by improved operational performance of our integrated energy platform and the addition of our Smart Home business.

Our 2023 adjusted EBITDA was $152 million above our original guidance midpoint and at the high-end of our adjusted guidance, while free cash flow before growth came in above the high-end of our increased guidance range at $1.92 billion or $185 million above our original guidance midpoint. This resulted in $9.25 of free cash flow before growth per share in 2023, well ahead of the $8.50 target provided at our June Investor Day. Bruce will provide more detail shortly. But again, this performance is the direct result of our strategic initiatives and actions taken to strengthen and grow our business, and I note that these took place even with share purchases occurring at higher levels than projected on Investor Day.

Turning to our 2023 scorecard, we delivered across our strategic priorities. As you know, safety is our top priority, and I'm pleased to share that we achieved top decile safety performance through a year with many distractions. I'd like to thank all of our employees for their focus and dedication and hard work to making this happen, as well as to making our financial results happen. Next, we made progress in our continuous improvement goals for cost excellence. We completed the $300 million Direct Energy synergy program announced earlier in the year, and we quickly turned our attention to identify and execute our previously announced next phase of cost initiatives, $250 million by the end of 2025.

Turning to growth, our success in achieving the $9.25 of free cash flow before growth per share versus our $8.50 target was primarily driven by faster execution of our growth plan. We are incredibly pleased with the results of our Smart Home acquisition and believe our current growth plan is just the beginning. We are only starting to scratch the surface. Lastly, on capital allocation, we executed over $1.5 billion in debt paydown and returned another $1.5 billion to shareholders.

Turning to slide 7, we'll take a look at our 2024 outlook. Today, we are reaffirming our 2024 financial guidance ranges in our Investor Day 15% to 20% growth strategic roadmap. We are well-positioned across each of our businesses to deliver on our commitments. In consumer energy, we expect the momentum gained in 2023 to continue into 2024, with volume, margins and earnings growing across residential and small commercial, as well as commercial and industrial customer segments. This success will be driven by our diverse and efficient marketing and sales engines, our leading care and retention capabilities, and our best-in-class innovative digital experience.

We are also seizing numerous opportunities as they arise or as we create them. An exciting example is Lubbock, Texas, a market of just over 100,000 customers that opened in early January, with 65% of customers having already made their electricity provider choice. So far, we are exceeding expectations for our success and winning customers and look forward to bringing our innovative offerings and experiences to that market.

We also continue to see momentum with community choice programs as a way for customers to experience the benefits of electricity competition in markets that don't have favorable political and regulatory sentiment that would allow customers to have the ability to freely choose their electricity providers. Next, our diversified supply strategy manages our retail exposure in multiple scenarios to include events like the extreme summer of 2023 and Winter Storm Heather this past January, while at the same time handling the mild weather that we have seen most of this winter.

Our targeted investments for reliability and flexibility across our fleet led to material improvements in the performance of our generation when we needed it, and we expect to realize continued improvements. We continue to evaluate various ways to enhance our supply strategy. We have three brownfield sites ready to go in Texas with dispatch flexibility, and we are considering additional storage options for the portfolio, primarily through longer term structured transactions rather than outright ownership.

And finally, the Smart Home business delivered a strong year, driving impressive top and bottom line growth. Recurring revenue and margin per customer increased through selling more products and services while simultaneously reducing net service cost per customer. We will continue to drive toward the horizontal expansion of our 8 million customers' wallets. Our customer retention is the best in the industry with an average customer life in the Smart Home business of nine years, driven by unmatched customer engagement and world-class product performance and reliability. We continue to focus on integrating Smart Home and energy and achieving the initiatives we have previously communicated to you.

Turning to slide 8 for a closer look at growth and cost initiatives, in 2023, we advanced our energy transition, electrification and continuous improvement strategy and delivered $138 million of incremental earnings, which was more than twice our original $65 million target. We exceeded our goals for both growth and cost savings, resulting in more than $100 million of growth in our core businesses and sales channel optimization, and more than $35 million in cost savings. This outperformance was primarily the result of realizing synergies faster than originally anticipated. And today, we are reaffirming the full plan target of $550 million of growth and cost initiatives by the end of 2025.

Outside of this $550 million program, we have also identified additional attractive initiatives that are in early development, leveraging the significant value creation opportunity from the convergence of energy and technology in the home and the grid. First is, for example, Virtual Power Plant or VPP, where we are uniquely positioned, given our customer scale and reach, our data science proficiency and decades of commercial and market experience.

Importantly, VPP will increase in value as the grid tightens, and our integrated energy business will allow us to monetize this value without requiring regulatory change. Second, on data centers and AI, today, we are one of the largest competitive providers of power to the hyperscalers and other data center managers, and we have been in direct conversations with several of these customers about using more load. We see this as a significant opportunity for NRG and for competitive markets more broadly.

Finally, we continue to evaluate strategic dispatchable new build with 1.5 gigawatts of brownfield projects in Texas ready to go. As you may know, in November, Texas voters approved the Texas Energy Fund, which provides support for new dispatchable generation. We expect the rules for that to be adopted early this year, with applications beginning mid-year. We anticipate providing an update on these projects over the coming months.

With that, I'd like to turn it over to our Chief Financial Officer, Bruce Chung, for a financial review.

Bruce Chung

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

Thank you, Larry. Moving to slide 10, for 2023, NRG produced adjusted EBITDA of $3.282 billion, exceeding our original guidance and at the high-end of our upward revised guidance range, and free cash flow before growth of $1.925 billion, exceeding the high-end of our upward revised guidance range. Our 2023 free cash flow before growth and adjusted EBITDA represent the highest and second highest respectively in NRG's history.

This strong financial performance is a direct result of excellent execution across our businesses and made possible by the continued focus and effort from each of our employees in a year full of potential distractions. Our 2023 adjusted EBITDA improved by $1.4 billion as compared to 2022, driven by strong performance in our Texas region, the addition of the Vivint Smart Home business, and execution of our growth and cost efficiency plans.

Taking a closer look at the drivers within our segments and beginning with Texas, our full year adjusted EBITDA increased by $806 million over 2022. This was driven by higher revenue rates coupled with lower supply costs. Our diversified supply strategy worked as designed throughout a volatile year, lowering our supply costs during the mild start to the year and providing stable pricing through the summer's extreme heat.

As we discussed throughout 2023, the margin expansion we saw across both our residential and C&I energy businesses was produced through a combination of careful revenue rate management and providing our customers with differentiated products that address their needs for affordability, comfort and peace of mind. We believe this margin expansion will be durable over the foreseeable future, and this view is reflected in our 2024 guidance. In addition to improved margins, our residential energy business delivered strong customer retention of nearly 80%, while maintaining average customer tenure of six years. This is a testament to the strength of our brands and customer experience.

Our East/West/Services segments were lower by $142 million versus the prior year. This was due to $60 million from asset retirements and sales, with the remainder of the variance from the combination of lower average realized pricing at the Cottonwood facility, as well as a challenging housing market and more conservative consumer discretionary spending impacting our HVAC and Goal Zero services businesses.

Finally, the addition of Smart Home contributed $753 million in adjusted EBITDA, finishing above the high-end of our upward revised guidance for this segment. Throughout 2023, Smart Home delivered across all of its key metrics. Most notably, Smart Home achieved 6% ending subscriber growth in an otherwise challenging macro environment, in addition to improving monthly recurring service margins of 9% through increasing average monthly revenue per subscriber, coupled with a continued focus on cost efficiency.

Turning to free cash flow before growth, NRG achieved $1.925 billion in 2023, setting a new record for the company. This represents an improvement of $1.4 billion over the prior year, primarily driven by our stronger EBITDA performance, along with improved working capital initiatives across our businesses. At our Investor Day in June, we communicated a 2023 target of $8.50 of free cash flow before growth per share. Our strong performance in 2023 resulted in $9.25 of free cash flow before growth per share even after repurchasing shares at a 25% premium to what we had originally assumed in our Investor Day plan.

Our platform is designed to generate significant cash flow, and based on that $9.25 per share and our current share price, that represents an implied free cash flow yield of 18%. Given this dislocation, repurchasing our shares remains one of the best investments we can make, and as such, we remain firmly committed to staying the course with our capital allocation framework. Throughout 2023, we have demonstrated the strength and resiliency of our strategy, and coupled with the compelling long-term macro tailwinds from the increasing electrification of the economy and convergence of energy with smart technologies, we are confident in the outlook for our share price.

Turning to the next slide, I'd like to provide some additional context for 2023 financial results. On the left side of the page, we highlight the resiliency of our core energy business. Our Texas fleet performed well through the second hottest summer in Texas history and most recently continued to perform through the volatility experienced during January's Winter Storm Heather.

Over the last few years, we have strategically invested capital in improving the reliability of our facilities in anticipation of volatility across both summer and winter conditions, and we are seeing the impact of those investments through material improvements in our In-the-Money Availability factor. This is a performance measure illustrating the availability of our generation assets during periods when we need them the most.

As you can see in the bar chart, we realized a 14% and 13% improvement in summer and winter respectively in this metric. Furthermore, we saw a nearly 20% improvement in this metric when comparing the fleet's performance during Winter Storm Heather versus Winter Storm Elliott. This level of improvement was and will be critical to ensuring we are able to serve our retail load cost-effectively.

Moving to the right side of the page, our Smart Home business surpassed original expectations, primarily driven by expanded monthly recurring service margins. Notably, the margin expansion was a function of both higher average revenue per subscriber, coupled with lower cost to serve. We're also seeing higher take rates on Smart Home products and services at the point of sale, which is a testament to the effectiveness of our Smart Home sales channels and Smart Home customers recognizing the benefit of increasing the intelligence of their homes through additional seamlessly integrated devices.

Turning to slide 12 for an updated view of our 2024 capital allocation, as you can see from the slide, not much has changed since our third quarter earnings call, where we provided our initial view on 2024 capital allocation. We are still planning on $500 million of debt paydown in 2024 and expect to return nearly $1.2 billion to shareholders in the form of share repurchases and common dividends. Coupled with the 2023 share repurchase program, we will have executed nearly 75% of the current $2.7 billion authorization by the end of 2024.

We expect the 2023 accelerated share repurchase program to conclude by the end of Q1 this year, at which point we will begin executing our 2024 repurchase plan on a more regular and programmatic basis throughout the year. As I mentioned earlier, at an implied yield of 18%, we see our shares as an excellent investment for shareholder capital, and as such, remain committed to the 80/20 principle we rolled out during investor Day.

In terms of incremental changes since our last earnings call and moving from left to right, 2024 excess cash increased $74 million because of the overperformance in 2023. Other investments increased $33 million, primarily from a calendar year shift in integration costs and capital deployed to small book acquisitions in our residential retail business. Finally, we have $41 million of unallocated capital available for allocation in 2024, which we will evaluate the use of as we move along the year.

Before I hand it back to Larry, I'd like to point out that we included some new slides in the appendix of today's presentation which provide more disclosure around our energy business. We believe this disclosure will enable investors to model our energy business with a level of granularity they did not have before. These slides will be updated with each earnings call we have going forward. We hope you find them helpful, and our Investor Relations team is more than happy to answer any questions you may have regarding the new disclosures.

With that, I will turn it back to you, Larry.

Lawrence Stephen Coben

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

Thank you, Bruce. On slide 14, I want to provide a few closing thoughts about 2024, our priorities and our expectations. We are laser-focused on delivering on our financial and operational commitments and adhering to capital allocation principles. We will continue to integrate Smart Home with our energy businesses and deliver on our growth and cost initiatives, all while advancing our energy transition and electrification strategy.

I have never been more excited about the future of NRG. We are seeing signs of step change improvement in fundamentals across our platform, including the convergence of energy and technology in the home and grid through smart devices and generative AI. We believe this will put a spotlight on the scarcity of the critical products and services we sell and the durability of our platform. Said bluntly, I believe this step change will signify a change in the depressed valuations for NRG and our sector that have resulted in 20%-plus cash flow yields. This will be good for NRG and the sector, and it's very exciting times. I look forward to updating you on our progress along the way.

With that, thank you for your time and your interest in NRG. We're now ready to open the line for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Julien Dumoulin-Smith with Bank of America. Your line's now open.

Julien Dumoulin-Smith
Analyst, BofA Securities, Inc.

Q

Excellent. Good morning, guys. Thank you very much for the time. I appreciate it. Look, I know you said it somewhat explicitly in the comments, but I wanted to come back to this. Obviously, with the shares materially higher here, how are you thinking about where you're positioned relative to the 15% to 20% FCF per share targets through the forecast period? I just wanted to kind of tackle that. Obviously, you're doing very well against those targets here out of the gate in year one. I just wanted to elaborate on that.

And then secondly, I just wanted to come back to 2024 here. Start of the year, it looks like probably robust load. How do you think about that positioning you and – as you think about reflecting that within what you have out there on targets, just in terms of the colder weather in Texas specifically?

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

A

Go ahead.

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

A

Sure. Hey, Julien. It's Bruce here. So, with respect to the 15% to 20%, we still are committed to achieving that 15% to 20% growth in free cash flow before growth per share. We believe that we're increasing both the free cash flow and the EBITDA, as you know. If you look at the 2024 number, that's about $150 million above what we had already kind of indicated as part of the Investor Day plan. So, we are seeing drivers both in the numerator, and then obviously we remain committed to the capital allocation plan. And so, we're going to also be driving the denominator. So, we still remain committed to that 15% to 20%.

With respect to the other question, as we think about 2024, we're basically positioned in the same way as we were in 2023. And so, that gives us a lot of comfort in terms of being able to handle what may be on the – what may be coming for us from a load perspective. Winter Storm Heather, we performed very well, the fleet performed very well. And so, we're pretty confident about where we stand at this stage.

Julien Dumoulin-Smith
Analyst, BofA Securities, Inc.

Q

Wonderful. Excellent. If I could just nitpick a little bit on the comments from the – you provided a second ago, you talk about longer term storage contract opportunities. This would presumably be an offtake arrangement in which you're an offtaker to some sort of battery investment that someone else makes, if I'm hearing you right. I just want to make sure I understood how you are thinking about batteries and presumably [ph] ERCOT here (00:26:35).

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

A

[ph] Yeah, excellent (00:26:36). Look, I think that, yes, that is the answer. But we'll always come back and take look at the capital that we do have to allocate. But there is an awful lot of people here in Texas who are willing to spend their money on putting – on providing storage for us, and that will probably be the optimal use of capital. But as you know, Julien, we always evaluate and reevaluate it as we put our supply strategy together to optimize our capital structure.

Julien Dumoulin-Smith
Analyst, BofA Securities, Inc.

Q

Excellent. All right, guys. We'll leave it there. Thank you, guys, very much. Congrats again. Nicely done.

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

A

Thank you, Julien.

Operator: Thank you. One moment for our next question. Our next question comes from Shar Pourreza with Guggenheim Partners. Your line's now open.

Shahriar Pourreza
Analyst, Guggenheim Partners

Q

Hey, there. Good morning.

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

A

Good morning, Shar. How are you?

Shahriar Pourreza
Analyst, Guggenheim Partners

Q

Not too bad. Good morning. Larry, I wanted to ask a bit of a higher level question, and it's obviously building off of Bruce's new disclosure comments and in light of the sort of maybe that step function change in valuation we saw with one of your peers yesterday. Have you given any consideration to maybe transitioning to EPS at some point in the future and providing maybe a bit of a longer range look?

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

A

Yes.

Shahriar Pourreza
Analyst, Guggenheim Partners

Q

All right. Well, I'll leave it at that one. Oh, I'll leave it at that one.

[indiscernible] (00:28:14)

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

A

The answer, Shar, is yes.

Shahriar Pourreza
Analyst, Guggenheim Partners

Q

All right. [indiscernible] (00:28:21).

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

A

Yes, stay tuned.

Shahriar Pourreza
Analyst, Guggenheim Partners

Q

All right. I love it. I love it. And then, perhaps maybe just going back to the CEO search process, I mean, obviously, it's gotten a little bit more competitive recently with – sort of on the power and utility headhunting side. Can you just give us some more color on where things stand today in terms of down-selecting and curious if you're now a bit more focused on a power person or a retail consumer person? Thanks.

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

A

Sure, Shar. I won't take it personally that you seem to be anxious to get rid of me, but...

Shahriar Pourreza
Analyst, Guggenheim Partners

Q

I want you to stay, but that's not reality.

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

A

No. Look, Shar, I don't – I think we are still looking for a person who spans the two types of things that we're doing, consumer and energy, as we said before. We have a terrific committee that's working exceptionally hard. And as I said to you, we had a huge list of candidates when we started and they are whittling away at that. I think when we talked three months ago, I said three to nine months, and I still would stand by that timeframe. So, I guess that would be zero to six months from now if I do the math correctly. And there's a tremendous number of people who are looking at NRG, are excited by the prospects, are excited by the ability to drive valuation given the incredible cash flow yield, given the incredible prospects that we have at the confluence of energy and Smart Home. And so, I'm excited by the people that we're seeing, and I think you will be too.

Shahriar Pourreza
Analyst, Guggenheim Partners

Q

Perfect, perfect, and thank you, guys. And for the record, Larry, I personally would like you to just stay. But that's not reality [indiscernible] (00:30:08).

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

A

Thank you, Shar.

Operator: Thank you. One moment for our next question. Our next question comes from Angie Storozynski with Seaport. Your line's now open.

Angie Storozynski
Analyst, Seaport Global Securities LLC
Q

Good morning.

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

Good morning, Angie.

Angie Storozynski
Analyst, Seaport Global Securities LLC
Q

Good morning. So, just also a big picture question. So, I mean, if there's one thing that we've learned over the last couple of weeks is that investors increasingly value physical power plants, especially those that don't get a participation medal for just showing up. So, I'm just wondering, how does that fit in your strategy of being asset-light on the generation side in light of the tightening supply-demand fundamentals in power? Again, I understand that there is demand response and other ways to probably fit in in this new picture. But I'm just wondering, just simplistically speaking, how do you deal with that?

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

Sure. Angie, I'm going to let Rob expand on that. But I've never – I don't think we're asset-light. We're asset-optimal, and we'll always be asset-optimal. And that may be semantics, but I think it's a very important semantics. We have three brownfield projects that are ready to go, and you'll get some updates on those pretty soon. But that's 1.5 gigawatts of dispatchable capacity, and we have some more potential in the pipeline. Maybe, Rob, you want to expand on that, please?

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

Sure. So, Angie, look, we're excited by the growing demand for power, like I think that it's real. We know it's real because we talk to a lot of the growth guys. So, it's the hyperscalers and others that you've all heard about, and we talk to them a lot. And it's exciting for NRG for a couple of reasons. One, we sit in competitive markets, which is where I believe most of this demand growth is going to be. We're going to see expanded margins on our existing fleet, right. So, as the product goes up, we're going to see more earnings off of our generation, and we've spent and invested inside of those plants, so that we can capture that.

Like Larry said, we've got the three projects that are ready to go. And then, the other thing to think about, Angie, is we've got 21 plant sites across the country. So, if this growth continues and we see it makes economic sense, then there's an opportunity there. But ultimately, these guys are going to turn to partners like NRG. As the market tightens, they're going to look for people who've got the expertise that we have. So, it's going to be good for the industry, but it's definitely going to be good for us.

Angie Storozynski
Analyst, Seaport Global Securities LLC
Q

But does that mean that in a sense you're shifting a bit the growth on the energy side towards C&I customers? Because I remember that historically, that was a very small portion of the business and not a – well, meaningfully lower margins than the rest of the business. So, anyway, is there like a different earnings or margin profile for those tech companies versus the traditional C&I load that you used to serve?

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

A

So, generally, C&I margins themselves over the last few years have gone up. The difference in margin from a hyperscaler versus a traditional C&I customer, there isn't – like we haven't seen a growth in margin on the hyperscalers. The way you should probably think about it is if you're going to get a bunch of demand into the system, which we believe is real, that's going to create tightness for all customers. And so, C&I customers across the board, not just data center customers, are going to be looking for expertise, which means they're going to turn to the bigger players who can help them manage the risk in a higher price, tighter commodity environment. Does that help?

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Okay. Yes, thanks. And then, changing topics, your IG aspiration. So, I obviously see the metrics – or the targeted metrics for the end of 2024. Can you tell us if you've had any discussions with credit agencies how they see the business risks besides the – just hitting the numerical thresholds as a – I guess, vis-a-vis the investment grade rating?

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

A

Sure, Angie. So, just to clarify, we are not chasing an investment grade rating. As we've always said, we are making sure that we want to hit the metrics that we believe correspond with an investment grade rating. But that's not to say that we're necessarily going to be chasing it, because ultimately that is up to the agencies. We talk to the agencies very regularly, and they like the path on which we are heading from a credit perspective.

It's important to note that when you think about our credit metrics, it's not just debt to EBITDA that the agencies focus on. They obviously also look at cash flow-driven metrics. And so, we're kind of triangulating around all of that. Ultimately, whether we get the rating or not, like I said, is not necessarily within our control. But what is within our control is being able to hit those metrics. I'd say, as we sit here today given, as you note, where we're going to end up at the end of 2024, we think there's probably some flexibility in 2025 with respect to what our original deleveraging plans were as part of the Investor Day plan. But more to come on that as we move along in the year.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Good. Thank you.

Operator: Our next question comes from Durgesh Chopra with Evercore ISI. Your line's now open.

Durgesh Chopra
Analyst, Evercore ISI

Q

Hey. Good morning, team. Thanks for giving me time. I just wanted to kind of go over the cost improvements and the growth opportunity, the $550 million target that you have by 2025. So, obviously, this year, you've kind of hit the ground running, exceeded expectations. Maybe can you sort of help us break that apart, the $100 million in growth opportunities, how much of that is cross-selling versus how much of that is actual margin expansion within your existing services? And then, as we think about cost improvements, there's a big step change from $37 million this year to about $100 million. Maybe just walk through the drivers of that.

Rasesh Patel
President-Vivint Smart Home, NRG Energy, Inc.

A

Yeah. You bet. Good morning. So, in terms of the growth synergies, we feel obviously very good about where we sit one year into the plan through 2025. You can think about the mix as roughly 50% is actually driven by organic growth in the business units, we've had obviously a strong year in the base business, and the other 50% driven by a combination of cross-sell and think of it as a share of wallet-type initiatives that improve the revenue and margin profile per customer.

And so, we had a strong start. We have a very high degree of confidence for the $300 million, given we exceeded our initial guidance in year one. And then, as it relates to the cost side of things, the $100 million in cost synergies are really a function of the elimination of two publicly traded companies. And we also exceeded our year one target for the cost side, and we have full line of sight to the $100 million by 2025. In fact, we'll probably exceed our 2024 target towards that $100 million. And so, as we sit here, we feel good on both ends, Durgesh.

Durgesh Chopra
Analyst, Evercore ISI

Q

Got it. Thank you. And then, maybe just 1.5 gigawatt dispatchable generation opportunity, can you maybe walk us through your thought process here? It sounds like you'll be making decisions in the second half of this year. How do you kind of gauge that versus buying back shares, as I'm thinking about the long-term outlook, 2025 and beyond?

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

A

Look, let me just say, it will not impact one iota our capital allocation strategy or the buyback of shares. I want to make that clear again and again and again, and you can put that down as a headline. So, very, very clear on that. Strategically, it's really we have a supply strategy that Rob has laid out on several occasions and looking at how these plants fit into that supply strategy, both for our existing customers, but also for the customers who are coming online with things like data centers, like generative AI and some of the other things we've been talking about that are growth and tightening opportunities. Rob, do you want to add anything?

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

A

So, the only thing I would tell you is, recall, we've been working on these for a while. We continue to work today. So, we continue to get closer and closer to being able to make final commitments. In March, the rules for Texas come out, and then you can expect people to put their names in for the Texas Energy Fund probably June. I would expect that you guys will hear from us as to what we decide. But like Larry said, we're going to – our capital allocation plan sticks, and it all comes down to the financial opportunities that we see in either building the plants or doing something different. And right now, and as you guys have all seen, those plants have flexibility, which is good for how we manage our portfolio and ultimately good for what the grid needs in Texas.

Durgesh Chopra
Analyst, Evercore ISI

Q

Very clear. Thank you again.

Operator: Thank you. One moment for our next question. Our next question comes from David Arcaro with Morgan Stanley. Your line's now open.

David Arcaro
Analyst, Morgan Stanley & Co. LLC

Q

Hey. Good morning. Thanks so much for taking my questions.

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

A

Good morning, David.

David Arcaro
Analyst, Morgan Stanley & Co. LLC

Q

Maybe on the Smart Home side of things, again, strong KPIs in 2023. I was wondering if you could comment on how you're expecting a couple of those – like subscriber growth and recurring revenue, how do you see those trending now heading into 2024.

Rasesh Patel
President-Vivint Smart Home, NRG Energy, Inc.

A

Yeah. Thank you. We felt really good about how we exited the year in 2023, as we mentioned, with 6% subscriber growth, 11% revenue growth, 17% adjusted EBITDA growth. And really that's a function of a few things. First is the unit economics of the business are in great shape. If you look at the revenue per customer, the service cost reduction per customer of 21%, that really drives an expansion of our service margin, and we expect that increased elevated margin to continue into 2024.

As it relates to retention and brand loyalty, we are – we had amongst our best years ever in terms of retaining our customers with a strong and durable customer relationship. We expect that to continue as well. And then, in terms of the subscriber growth, we expect to be in the mid single-digits from a subscriber growth perspective as well. So, we feel good about how the business is set up in 2024. If you zoom out, we operate in a large, growing and fragmented market, and our products and services have a very high degree of engagement and loyalty relative to peers. And so, we think there is a lot of room ahead for us to continue to grow the business.

David Arcaro
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Got it. Thanks for that color. That's helpful. And then, I was wondering if you could maybe elaborate a bit more on the data center impact to the business? Am I understanding you correctly that as you see load growth from these data centers happen in ERCOT, for example, you could see, I guess, potentially higher pricing, more volatile pricing, and over time, that could lead to higher margins across the board, higher retail margins across customer classes for your business? Is that the right way to think about it?

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

A

It's Rob. Yes. So, generative AI is going to load – or create an additional demand across the markets. The way to think about how that affects the businesses generally is let's start with that expands the margins on our existing generation portfolio and also makes that 1.5 gigawatts more interesting. And then, when you think across the other parts of the business, C&I, you're going to see people turning towards bigger players like us. Like we've seen it historically, when things get tighter, they run to quality providers. We're there. And then, from a home perspective, a consumer perspective, we've had a retail platform that has historically and will in the future manage through different commodity cycles. And as prices move, our retail platform – because of the experience we have beyond just being a commodity provider, we do well in those markets too.

David Arcaro
Analyst, Morgan Stanley & Co. LLC

Q

Okay, great. Thanks for that. Much appreciated.

Operator: Thank you. One moment for our next question. Our next question comes from Michael Sullivan with Wolfe. Your line's now open.

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

Hey, everyone. Good morning. Appreciate the...

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

A

Good morning, Michael.

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

Hey. Appreciate the new disclosures on the energy business, by the way. But wanted to just go back to Texas and new build there, and just maybe if you could just frame the broader political dynamic there, where things stand just in light of the Lieutenant Governor making some comments, I think, asking for new build, that we kind of continue to see these headlines [ph] noisy around ECRS (00:45:12). I know we're not in a legislative session this year, but just kind of, yeah, where the politics stand on market structure and the like.

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

A

Well, if I could understand Texas politics, I'd be in a different business probably, Michael. But look, there's not a legislative session. I think it's fair to say that people are now looking to see whether everything that was passed in the last session is actually going to generate capacity in the state before people start breaking it up again and starting over. The PUC has a lot – awful lot of work to do just to implement the many things that were passed in the legislature.

And I think a combination of those measures, plus the tightening market and the improving economics in the market and the expanding margins will probably generate the capacity that Texas will need to meet growth in the foreseeable future. At least that's our view of what's happening in politics. That doesn't mean that people from time to time won't try to use the energy business as a political football. But on balance, we actually see a fair amount of stability on the legislative front.

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

Okay. That's helpful. Appreciate it. That's a tough one. And just if you do move forward with these brownfield plants, how long would it take to complete?

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

A

So, the – if you recall, the portfolio is three different projects. The Peakers, we could get in two years and – starting from whenever we broke ground, and then a CCGT takes about four. So, you could expect, if we were to go soon, 2026 and 2028 would kind of be good years to think about from an additional capacity perspective.

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

Okay, great. And then, just last one quickly. You mentioned the new Lubbock market. Any like rough sense of size of the opportunity set there and is any of that baked into your plan or is that all upside?

Elizabeth R. Killinger
Executive Vice President-NRG Home, NRG Energy, Inc.

A

Yeah. So, this is Elizabeth. Thanks for the question. So, we are really excited about the Lubbock opening. Two things about it. One, 65% of consumers made a choice and that – if you have a reference point like when the Texas market opened, 5% made a choice. So, demonstrating that consumers actually care who they do business with in energy.

NRG participated in the pre-sale process. That's where the 65% made the choice. And those customers will come on flow in March, and that is baked into our 2024 and beyond growth plan. The only other thing I would say is so far, NRG is overperforming. We have about 39% share of customers in Texas on the home front, and we are overperforming relative to that. So, again – and Larry mentioned it, but about 100,000 customers in the marketplace that are making a choice. And so, they'll start and be our and other retailer customers in March.

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

Great. Thanks for all the color. Appreciate it.

Operator: Thank you. One moment for our next question. Our next question comes from Ryan Levine with Citi. Your line's now open.

Ryan Levine
Analyst, Citigroup Global Markets, Inc.

Q

Good morning. I'm hoping to touch on retail energy gross margin outlook. It looks like your guidance is assuming about a 100 basis points [ph] degradation (00:49:04) there. How much of that's weather-normalized for 2024? And is there any conservatism embedded in that forecast in light of your comments? Any color you could share around potential upside there and in particular in Texas?

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

A

So, hey, Ryan. It's Bruce. The 2024 number is certainly on a weather-normalized basis. But the 2024 number does reflect a higher assumption on COGS for the retail business. And so, there's just a bit of a timing lag between the realization of that COGS relative to when that gets pushed through in revenue rate. But Elizabeth, if you want to provide a little bit more color there.

Elizabeth R. Killinger
Executive Vice President-NRG Home, NRG Energy, Inc.

A

Yeah. So, we've demonstrated margin stability over the years in the home space, and that comes from – and most of you were there – from some of the AI and machine learning revenue management tools and models we created back in the transformation program and since have continuously improved them. The other thing I would highlight is that over this, call it, the last decade, we've been able to deliver stable and growing margins in a variety of supply cost environment. So, this one – Bruce mentioned where costs have significantly increased over the last few years, and we've either grown or held margins through that timeframe, aside from the weather normalization that you mentioned.

Ryan Levine
Analyst, Citigroup Global Markets, Inc.

Q

How much cost escalation are you assuming for 2024 that's being offset by these other measures?

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

A

Ryan, that's probably one that we'll have to just get back to you on to make sure that we get you the right numbers on that.

Ryan Levine
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Thanks for the time.

Operator: Thank you. This concludes the Q&A portion of today's call. I will now pass it back to Larry Coben for closing remarks.

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

I want to thank all of you for joining us on the call today and for your interest in NRG. And I think you can see we are at the most exciting point probably in NRG's history. I think you can hear in the voices of the management and in our actual results what we have and are planning to achieve going forward. We look forward to speaking with you more in the days ahead. We'll be at the conferences in New York next week. In the meantime, please feel free to reach out to Kevin and Brendan with any further questions that you might have. Thank you all.

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