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NRG Energy, Inc. (NRG)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the NRG Energy Inc. First Quarter 2024 earnings call. At this time, all participants are in 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 first 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 first 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 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 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 Dr. 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 very much, Kevin. Good morning, everyone, and thank you for your interest in NRG. I'm joined this morning also by Bruce Chung, our Chief Financial Officer, and we also have members of the management team on the call who are available to answer questions.

Let's begin with the three key messages for today's presentation on slide 4. First, our business performance exceeded expectations in the first quarter. I'm incredibly pleased with our strong start to the year and in reaffirming our 2024 financial guidance ranges. Second, electrification trends compounded by GenAI data center growth forecast a signal of transformative rises in power demand. As a result, we expect competitive markets to realize outsized benefits driven by business-friendly environments, available resources and the ability to site projects quickly.

Finally, NRG is well positioned to capitalize on tightening supply and demand in our core markets. Our technology-led consumer platform, our diversified generation portfolio, our leading business energy platform, and a real estate site portfolio present a unique opportunity to create significant shareholder value. I'm going to give you visibility into this later in the presentation.

Let's move to slide 5, because I want to share again our value proposition, which may not be familiar to those of you who are new to NRG, and I understand there are several of you on this call. We serve nearly 8 million residential customers and operate the second-largest C&I energy and natural gas retail business by volume in the United States. Our company sits at the intersection of energy and technology in the home and the grid. We generate significant excess cash well beyond our current business needs, resulting in the financial flexibility to grow earnings while returning significant capital to our shareholders and maintaining a strong balance sheet. The strength of our business and financial outlook has us uniquely positioned to capitalize on what we believe to the beginning stages of an exceptional time for our industry. It's an exciting time for our company. We remain on track to achieve our 15% to 20% free cash flow before growth per share CAGR target, even as our rising stock price means buying shares at higher prices than projected a year ago.

Turning to slide 6. In recent months, we've received numerous questions about the impacts of the forthcoming power demand growth super-cycle on the industry and in NRG in particular. Today, I'd like to talk about what we are seeing. Bruce will then discuss the first quarter results later in the presentation.

Starting with macro trends, we're seeing clear signs of a step-change in the long-term fundamentals of power demand from multiple catalysts. This marks a departure from an extended period of stagnant power demand during which energy efficiency outpaced usage growth. For the first time in decades and perhaps in my 40 years in this business, we are experiencing fundamental improvements driven by demand rather than commodity prices.

We, along with every other forecasting expert I have read, are now expecting a step-change in long-term power demand. This increase in demand is attributed to several factors, including electrification, manufacturing, onshoring, LNG, crypto, greater industrial loads and data center growth. Recent advancements in GenAI are compounding and accelerating these factors, leading to the formation of the next power demand super-cycle.

At the same time, the US power supply that is expected to accommodate this growth will increasingly depend on intermittent resources, which highlights a growing and unprecedented imbalance between dispatchable supply and demand. To be clear, it takes only a fraction of what is being forecasted to nudge us into this super-cycle. And this super-cycle will require an all of the above supply approach, including retaining existing generation assets, developing new generation, and approaching supply and demand differently through the adoption of technology by shifting large loads, residential VPP and other forms of demand and energy management. This is a transformative opportunity for our sector and for NRG.

If you turn to slide 7, you'll see why competitive markets such as those in which NRG operates, are best positioned to realize outsized benefits of this large load growth. It's due to the competitive framework that offers speed to market, affordability and resource availability. We see Texas and portions of the Northeast as the most favorable markets.

Texas stands out as it is already a preferred destination for large loads, including crypto, LNG, and manufacturing onshoring, which all have experienced substantial growth in recent years and are exhibiting strong outlooks on the future. Texas benefits from its business-friendly practices, favorable regulatory environment, tax incentives and large land footprint, positioning it as a winner in the era of generative AI and other large load growth. Furthermore, coupled with our ability to site projects years faster than in regulated markets and its proximity to main fiber channels, I expect Texas to continue to be a leader in load growth.

On slide 8, I'd like to highlight four of the many key opportunities for value creation that exist across our platform. To leave no doubt, each of these opportunities represents upsides to our June 2023 Investor Day Growth Plan, and it's not reliant on potentially transitory subsidies or Inflation Reduction Act funding. First, we're the only company to have residential energy and smart technologies at scale, with nearly 8 million customers. We're a trusted provider and have the unique capability to provide novel energy management through our Smart Home ecosystem, a capability that will be necessary in increasing value in a tightening market.

Second, you may not be aware or fully cognizant of the opportunity that it represents, but we are the second-largest business-to-business electricity and largest natural gas provider by volume in North America. Beyond selling customers more of our products, we are a leader in premium services. We offer tailored energy management solutions that focus on optimizing and stabilizing energy costs. We're also able to commercially help our customers achieve their sustainability goals. These customers include many of America's largest industrial players and corporations as well as the hyperscalers.

Third, our Texas generation fleet mix is a diverse set of assets that enable us to deliver stable supply cost, while maintaining insurance for volatility through higher cost units that are not economical in the current year. These uneconomic units are primarily higher heat-rate natural gas assets that in recent low-price times may have run for only a few peak hours per year. We primarily use our generation fleet to supply our residential retail portfolio, with customer fixed price contracts typically lasting a year or two. As a result, our generation fleet is mostly open 18 to 24 months out. This creates a significant opportunity to swiftly capitalize on rising power prices and rising demand as the value of our products increases, and equally importantly, units that have historically operated only a few hours annually could now see increasing run times, and of course, profitability.

Lastly, our real estate portfolio has several potential development sites for co-location of large loads for power plants. We own 21 sites with 21,000 acres at retired and existing generation facilities that generally have existing or access to grid interconnection. They are in competitive markets, and given the extreme focus on project speed potentially provide another avenue of value creation.

Let's try to unpack each of these a bit. Turning to slide 9, we operate one of the leading business-to-business power and natural gas platforms in North America. We serve nearly 100 terawatt hours of electricity and almost

1.8 trillion cubic feet of natural gas annually. As demand growth scales, we anticipate increasing electric and natural gas sales volumes. Through our business platform, we have large load customers accomplish their intended goals through tailored plans, including stabilizing their energy costs, delivering specific attributes for their sustainability commitments, and optimizing their usage through services such as demand response. At heart, these customers are looking for a partner to help them navigate complicated energy markets, while minimizing their risk. We stand ready to provide the services they need as a large market participant with a best-in-class commercial operations platform and a track record of high-quality customer experiences.

With respect to data centers, it is still the early days, but we are seeing signs that they are planning to ramp up capacity in the current year. As an anecdotal example, a data center customer approached us about increasing their capacity by 3 times at an existing facility in the next 36 months. We are seeing and experiencing demand growth in real time.

Moving to slide 10, our Texas generation fleet is diverse in technology, age and merit order. We operate 8.5 gigawatts of generation capacity in Texas, supplemented by 1.6 gigawatts of long-term power purchase agreements. We also have 1.5 gigawatts of shovel-ready brownfield projects in development. This strategic diversification across technologies, fuel types and merit orders ensures near-term stability and positions us to capitalize on opportunities for medium- to long-term margin expansion driven by higher power prices.

On the right hand of the slide, we provide our Texas generation open gross margin sensitivity to changes in around the clock power price scenarios. This sensitivity provides insight into our generation portfolio's earnings power as economic generation increases in value and currently uneconomic generation becomes not only economic, but very profitable.

On slide 11, we provide a more detailed look at our Texas generation gross margin sensitivity. This analysis focuses on changes in power prices, assuming flat natural gas pricing and normal weather. On the left side of the slide, we have included Texas is around the clock, complete pricing forwards for July 2023 and April 2024, which represents the assumed pricing in our 2024 guidance and our compared to today's forwards.

As you can see, ERCOT forward pricing has moved up significantly. The only explanation for this is that the market is starting to reflect increased power demand from large load growth. Also noteworthy is that the curve is no longer backward-dated, suggesting a view and a long-term view of sustained tightness in the Texas power market.

Building upon last quarter's additional modeling disclosure, on the right side of the slide, we have provided the necessary components to directionally model the gross margin opportunities for our Texas fleet in a dynamic pricing environment. We begin with the 2024 Texas generation base gross margin and include expected hedge positions of nearly fully-hedged in year one, roughly half in year two and less than 25% in year three for economic generation respectively. We have also included an open gross margin scenario, which assumes no hedges.

You will observe that our price sensitivity doesn't follow a linear pattern. Unit is becoming economically viable at different price levels, resulting in disproportionately larger benefits from increases in power prices compared to decreases. With ERCOT forward pricing rising $10 in the outer-years on an open gross margin basis, this implies more than $400 million of margin benefit compared to 2024. Assuming we are 25% hedged in the year that that move occurs, it translates to approximately $350 million of upside compared to 2024. And this is simply the beginning.

This sensitivity analysis demonstrates that our portfolio is well-positioned to capture significant margin upside in a rising price environment and that the underlying fundamental value of our fleet has materially increased. Supported by our diversified supply strategy, we have the agility and flexibility to leverage these markets dynamics and translate them into significant and durable shareholder value.

On slide 12, I want to close by providing details of our site portfolio. Driven by the need for more capacity and the highly-valued attributes these sites possess, we are incredibly excited about their potential value. We have 21 sites with 21,000 acres of land within competitive markets that are prime locations for new large loads and power plant development, with co-location opportunities both behind and in front of the meter. These sites offer a mix of valuable and critical access to infrastructure, including transmission, interconnection, water, abundance of land and proximity to long haul fiber networks.

Of particular significance to data centers, these attributes offer expedited construction timelines measured in years of time savings. We have established a dedicated team focused on maximizing the value of our site portfolio. When the analysis is complete later in the year, you can expect to hear more information from us regarding the potential for these sites and what would be required to turn them into new capacity data center locations or behind-the-meter projects.

With that, let me turn it over to Bruce for the first quarter review.

Bruce Chung

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

Thank you, Larry. Turning to slide 14, our top decile safety and strong operating performance resulted in first quarter adjusted EBITDA of $849 million, exceeding the first quarter of 2023 by $203 million. This represents a 31% increase in our adjusted EBITDA from the prior year. $150 million of the year-over-year increase was the result of the inclusion of a full quarter's worth of Smart Home EBITDA. The remaining increase was attributable to outperformance in our East and West segments, driven by lower realized supply costs, partially offset by a slight decline in our Texas region due to mild weather.

Our Consumer Energy and Smart Home platforms increased customer counts year over year by 8% and 6% respectively. Most notably, we added 35,000 customers from the newly opened Lubbock market in Texas, representing a healthy share of the available customer base. This is a testament to the hard work of our Consumer Energy team over the past two years to position NRG and its brands as the electricity provider of choice in Lubbock.

Similar to 2023, our Smart Home platform continued to demonstrate strong execution. In addition to growing customer count 6% year over year, service margins increased 5% year over year, and monthly recurring revenue per subscriber grew 5% over the same period. It is clear that customers recognize the value of our Smart Home services, as evidenced by our growth in the face of various macro headwinds affecting the consumer discretionary sector.

Our diversified supply strategy continued to deliver, ensuring that we sustain the level of margin expansion we saw in 2023, while also providing the necessary coverage against potential volatility in the winter months. As we discussed in our last earnings call, our fleet performed well in the first quarter, demonstrating a 12% improvement in our In-the-Money Availability factor winter over winter. We have taken advantage of the mild winter in February and March to conduct our maintenance activities more proactively. And we feel confident about fleet performance heading into the critical summer months.

Next, I would like to highlight some of what we have focused on as an organization through the first quarter, as well as what we continue to remain focused on through the balance of the year. During the quarter, we concluded the $950 million accelerated share repurchase program we launched in November of last year. Through that program, we repurchased nearly 19 million shares at an average price of $50.43 per share, or almost 10% of the shares outstanding at the time that we launched the ASR.

We remain committed to our capital allocation plan and we are reaffirming our 2024 return of capital amount of approximately $1.2 billion comprised of our common dividends, which we increased earlier this year, and a further $825 million in share repurchases. As Larry discussed, we continue to advance our 1.5 gigawatts of brownfield development in Texas. We will be filing our notices of intent for the three projects to the Texas Energy Fund in the coming days, and we anticipate filing formal loan applications in early June when they are due.

Our brownfield development portfolio comprised of two peaking plants and one combined cycle project with CODs ranging from 2026 to 2028 is shovel-ready and represents some of the most real natural gas-fired development opportunities in the ERCOT market. We have been developing these projects since 2021 and we believe that the advancements we have made on the permitting and equipment procurement fronts should position these projects at the front of the queue for consideration by the PUCT for funding out of the loan program.

Next, we continue to remain on track to achieve our $550 million program of growth and efficiency initiatives across our business platforms. As I mentioned earlier, our consumer platforms continue to drive strong standalone growth and we continue to see positive momentum in our ability to generate more margin per customer. A great example of this is the tremendous progress we've made in selling the Vivint Protection Plan. We started selling this plan shortly after closing the Vivint acquisition, and to-date we have about 15% penetration of the existing Smart Home customer base or over 300,000 active plans, with each plan generating approximately $9 of monthly revenue per customer.

Finally, we are reaffirming our 2024 guidance for both EBITDA and free cash flow before growth. We have tremendous momentum in both our consumer and business platforms, and the measures we are taking in our diversified supply strategy should set us up well for the balance of the year.

Turning to slide 15 for an updated view of our 2024 capital allocation, as you can see from the slide, there have been no substantial changes since our last earnings call in terms of the quantum of capital allocated to liability management and capital return. As you may recall, we had planned $500 million of debt reduction in our last earnings call as part of the 2024 capital allocation plan. As you can see from the slide, that has changed slightly, given our efforts in Q1 to address our outstanding convertible notes.

Through April 30, we repurchased $343 million of the outstanding principal of the convertible notes, resulting in $257 million of additional premium paid to retiring noteholders. Given the cash allocated to settle the convertible note premium, that reduced our net debt reduction to $243 million planned for the year. Our strong share price performance over the past year made the convertible notes one of the most expensive pieces of paper in our capital structure. Therefore, we believe that made the most economic sense to pursue a retirement of that instrument before it would get even more expensive, as our share price continues to reflect our fair value.

Moving a few columns over to the right, you will see that the share repurchase column is $865 million versus the $825 million we showed in our last earnings call. The reason for that is because we now include $40 million of cash allocated to settle tax matters related to our 2023 share repurchases and employee stock compensation plan. This would include the excise tax on share repurchases instituted as part of the passage of the Inflation Reduction Act. Previously, we had bucketed that allocated cash into other categories, but we decided to move those dollars into the share repurchases category in order to more accurately reflect what the cash is being used for. Finally, similar to our last earnings call, we continue to show $41 million of unallocated capital available for allocation in 2024, which we will evaluate the use of as we move along the year.

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 very much, Bruce. On slide 17, I want to provide you a few closing thoughts on our 2024 priorities and expectations. We remain laser-focused on execution and on delivering on our financial, operational and safety commitments. We are seeing a step-change improvement in fundamentals across all of our platforms. We believe that this will put a spotlight on the scarcity of the critical products and services we sell and the durability of that platform. We are uniquely positioned to deliver significant shareholder value for years to come.

Again, we are the only company to combine residential energy and smart technologies at scale, with nearly 8 million customers and the necessary capabilities to create sustainable value through both tightening and loosening power market conditions. We operate the second-largest business-to-business electricity and largest natural gas platform in North America, positioning us as a leader in premium services and tailored energy management solutions. Our integrated supply strategy provides incredible capabilities to stabilize near-term earnings, while capturing medium- to long-term margin expansion opportunities from higher power prices. And we own a large land portfolio with premium attributes for what is to come in the super-cycle of power demand.

In my 20 years at the company and over 40 years in power, I have never been more excited about the future of our sector in NRG. The step-change in demand should lead also to a change in the depressed valuations for NRG and its peers. These depressed valuations have resulted in double-digit cash flow yields such as ours. This revaluation will be good for NRG and others in our space and it's very exciting times. I look forward to updating you on our progress along the way.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we will conduct the question-and-answer session. [Operator Instructions] Our first question comes from Shar Pourreza with Guggenheim Partners. Your line is open.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC Q

Hey, guys, 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 Securities LLC Q

Good morning, Larry. How are you doing?

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

Good.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC Q

Excellent. Just, Larry, on the curves themselves, there is obviously a lot of chatter in the industry right now about some large generators like nukes to go behind the meter. Is this something, I guess, that concerns you as you look at your length in the eastern markets? So as you go out to the market to match load, are suppliers raising any kind of concerns there?

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

Hey, Shar. It's Rob.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC Q

Hey, Rob.

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

Good morning. The – like it doesn't raise any concerns for us as far as trying to purchase supply so that we can meet retail obligations. Even if they do go behind the meter, there's plenty of players in the east, it's a very liquid market.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Q

Okay. Got it. Perfect. And then, maybe just a little longer-dated, but as you're kind of highlighting the Texas fleet heavily here, it seems warranted, how would just the recent sort of the EPA regs, as they stand, impact your generation profile maybe over the next couple of years, right? Is it just additional CapEx? Could we see an acceleration of gas development work beyond the 1.5 gigs that obviously Bruce was highlighting of shovel-ready proposals? Just more color on how these items are kind of interacting? Thanks.

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

A

Sure. So, when you think about the regulations that were promulgated, the first thing I would say, Shar, is that they're all going to be litigated, right? AG, states, ISOs, consumers, everyone has a view and a reason to make sure that these rules get set in place in a way that works for the system and provides reliable and affordable power over time. As far as specifics around us, some of the rules, I'd like to see how they pan out at the end. But what I would tell you is that our decisions to invest around the gas fleet or the 1.5 gigs that Bruce talked about earlier, have nothing to do with these regs. It's all about the opportunity that we see in the markets. And we'll continue to drive that way. Does that make sense?

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Q

Yes, that was perfect. And then, Larry, it sounds like you're having a really good time on the job right now. So maybe you're not in a rush. But is there anything as far as any updates on the CEO search or are you having too much fun?

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

A

Well, Shar, I am having a lot of fun. But, look, it's a great team and it's a great company, and look, it's a fantastic job. The committee continues to do its work. I think they're still on the timeframe that I talked to you about. But there's no rush. I've told them that – you know, to take their time, and that I will continue in this position as long as necessary until they find the right person that they're happy with to be the next CEO of NRG. But being given all the opportunities that we have and everything that we've been talking about on this call, you're right, Shar, I am having fun and I think you're supposed to have fun.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Q

Perfect. Thank you, guys. Appreciate it. And a really big congrats to Elizabeth. She's been such a fantastic face for NRG for some time. So good luck on the next step.

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

A

Thank you, Shar.

Operator: One moment for the next question. The next question comes from Angie Storozynski with Seaport. Your line is open.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Good morning, guys.

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

A

Good morning, Angie. How are you?

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

So first – very good. Okay. So first, for the last maybe 20 years, you were trying to convince us that you are power price agnostic, clearly not any longer. That's number one. So how do we think about it, this new backdrop, how it impacts your retail business versus wholesale business? Is this additional margin going to be realized by selling this more expensive power to the retail arm? So that's number one. Number two is, so this is gross margin. Is there like an additional O&M layer we should think about or on maintenance, both on the cost side and CapEx side, just to get a sense of how big an impact it will have on the EBITDA, the swing in power prices?

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

A

Angie, let me have Rob talk a little bit about the CapEx and repair side and then I'd ask Rasesh to talk a little bit about the margin side. Rob?

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

A

Hey, Angie, food morning. When you think about taking the gross margin expansion that you see on the chart and then trying to translate that across over to EBITDA, I would point out to think about in two pieces, right? So on the plants that are – or the generation that's currently running today, right, the stuff that was built into our numbers and are running today, when you see a step-change in power that has zero impact on OpEx for those megawatts because they're already running. The place where you'll pick up additional OpEx and translate that down to EBITDA is on the stuff that's running more. So we've talked to you guys with historically about an increase in run times on some assets, given a change in price, it's those additional hours that actually cost you more. And the way that I would translate that down would probably be at the same kind of rate, which is, Bruce, correct me if I'm wrong, 80%?

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

A

Yeah, we would probably see something like an 80% transition to EBITDA, and then probably like a 75% transition to free cash flow.

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

A

Does answer your question?

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Yeah, thank you.

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

A

Yeah. And then, Angie, on the retail margins, I mean, I think we've proven our ability to maintain strong retail margins over time. The increasing power prices really affect our competitors as well, and historically, you know, proven to be rational in pricing. And so when you look at quarterly move-ups of the curve like we're experiencing now, it gives us ample time to pass that through to consumers. And in fact, energy prices have gone up almost 75% COGS. From 2017 to 2023, we've actually been able to increase margin over that period. And so, we feel confident in our ability to do that.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Okay. And then, one other question, so, you're talking about the gas-fired new builds. I mean, I was just running some simple math here. Given growing supply of renewable power, right, so you probably can't necessarily count on very high capacity factors for these assets, which would suggest that power prices need to be multiples of what we are seeing in the forward curve in order to justify construction of these new gas plants. So I'm just wondering how you see it. Even in Texas, those peakers and combined cycle gas plant that you're pitching, even with subsidized loans, it's hard to imagine that these assets would be economic at a $60 around-the-clock ERCOT North price.

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

A

Hey, Angie. It's Rob again. I would tell you that the assets are economic. The way to think about the beauty of peakers or CCGT is that they can flex, meaning they can move and they can capture the value in the hours that matter. We've been trying to transfer our portfolio to something like that for a few years now. And so when you see prices move, right, so as you see the curves go up, particularly in ERCOT, it doesn't mean that every hour goes up by that same amount. It's the very tight hours that go up those exponential amounts that you're talking about. Is that cleared up? So think about the afternoon in Texas in the summer, that is going to go up 5 or 6 times versus morning of that same day it may have gone up once. And peakers are the things that make money [ph] in that world (00:36:37).

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

A

Yeah. Angie, let me just add that every one of these projects, even sort of without thinking about lots of rising pricing, without thinking about foregone insurance costs sort of things pencils out to be able – they all pencil out to be over our stated hurdle rate. And everything I just mentioned and the things that Rob just mentioned are upside on top of that.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

So, but in light of that – I'm sorry if I'm asking too many questions, but in light of that, the fact that the new build is materializing at these prices, wouldn't that suggest that there's a cap on the upside to power prices, because that's usually what it suggests, right? That the new build materializes and that sort of deflates the tightness of power markets?

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

A

Angie, I think if you look at the tightness versus the 1.5 gigawatts, the tightness far exceeds it. And so, yes, at some point, of course, if there's enough new build, that might exclude the tightness. But if you look at the number of projects that are on the books, not just ours, but everybody's, the time it's going to take to complete those, I don't worry about that tightness being loosened in any significant way for the next several years.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Awesome. Okay. Thank you, guys.

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

A

Thanks, Angie.

Operator: One moment for our next question. The next question comes from Steve Fleishman with Wolfe Research. Your line is now open.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Hey, good morning. Thank you.

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

A

Hi, Steve. How are you?

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Hi. Good morning. So just, I guess, following on Angie's first question, just wanted to try to reconcile kind of NRG and the old world of low prices for longer versus NRG now in this new world. I don't recall you talking about hedges rolling off and then suddenly being exposed to low power prices. There was the integrated model and the customers kind of side kind of hedged to low prices. So just why wouldn't I still not have to think about some kind of integrated model and maybe the retail margins coming down against the lower – I guess, the higher power prices or just how do I reconcile the two?

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

A

Steve, I think what it has to do with really is the step-change in the market. I mean, before when prices moved and really commodity-driven, those were sort of transitory and we were managing to – for the steadiness. I think what you're seeing here is a step-change where the flexible of the integrated model allows us to gear ourselves in order to take advantage of the higher prices. So the model hasn't changed. It's one of the things – the reason we never talked about it is we never saw a step-change like this. But one of the benefits of the integrated model that we've been pursuing is that it allows us to gear to price increases like this.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Got it. Okay. And then, on the kind of sites opportunity and also on the new build generation, could you give us maybe a little bit more color on how you're thinking about funding for those opportunities and how much might come from NRG versus kind of third-party buying stakes or making the investment, just maybe some kind of a broader overlay, how you're thinking about that?

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

A

Yeah. So, Steve, it's Bruce here. First on the new builds, obviously from a funding perspective, we intend to access the Texas Energy Fund. So, that's going to be 60% of the capital costs related to the new builds right there. The other 40% of equity, we feel confident that we could fund that from our own cash and cash flow without impacting any of our capital allocation commitments in terms of share repurchases and de-leveraging. So, from our perspective, we feel pretty well capitalized to be able to handle all that by ourselves.

Obviously, as we've always said, to the extent that these projects are getting built, and there is a unique opportunity to potentially attract third-party capital at a very attractive proposition, then we would certainly give that some consideration. But right now, as we sit here today, we feel good about our ability to fund those projects on our own.

As far as the 21 sites, it's still early days. How it is that that ultimately translates into what sort of opportunities that results in are still to be discovered. And so, don't really have a perspective on any capital need in that regard as we sit here today.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Okay, thanks. And just last quick one. Obviously, at the higher stock price, you mentioned still reaffirming the 15% to 20% growth. So that, I assume, means you're expecting a better numerator there in terms of free cash flow to support that. And what is driving that? Is that mainly the higher power prices?

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

A

I always have my opportunity to give you a one word answer ala Larry Coben, but, well, the first part of your answer, yes. But look, I mean, I think we see obviously not only continued execution against our $550 million growth in cost program. But I think as you can see here, based on the sensitivities we provided you, there is going to be – we do see upside as a result of the forward curve.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Great. Thank you.

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

A

Thanks, Steve.

Operator: One moment for the next question. The next question comes from Durgesh Chopra with Evercore ISI. Durgesh, your line is open.

Durgesh Chopra
Analyst, Evercore

Q

Hey, good morning to you and thanks for giving me time.

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

A

Good morning. How are you?

Durgesh Chopra
Analyst, Evercore

Q

Good morning, Larry. Thank you. I'm well. Just maybe can you help us just frame very high level, on the 21 sites that you discussed, if there's a way to think about how many potential gigawatts that you can add over time and then also address how quickly you can add the gigawatts? Just the reason being that the demand, like you just said Larry, this is a step-change in demand, I'm just thinking about how quick the response can be to that.

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

A

Yeah, it's a great question, Durgesh, and it's one that we're working on and it's why we've set up this sort of new group to deal with data centers. I don't know the answer yet. We're trying to figure that out. We see ginormous potential, but obviously there's a ton of work to do in terms of, you know, to figure out exactly how quickly what's best on this site. Is it better for a data center or a power plant? Is it better for co-location behind the meter, in front of the meter? So we are spending a lot of time working through those. And I think, when we have more color on them, we'll certainly provide that to you all, but I'm not sure that will be in the next two or three months. It will probably be closer to the end of the year, because as you know, the power plant development, there's an awful lot of work.

Durgesh Chopra
Analyst, Evercore

Q

That makes sense. I appreciate that, Larry. Thank you. And then maybe just I know this is not going to be another tough question. But just can you share your calculus of how you're thinking about buybacks here, given how the stock has kind of gone up in valuation versus investing in these opportunities, which obviously have a tremendous runway? How do you think about that?

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

A

Look, let me begin by repeating what Bruce said, which is reaffirming our capital allocation that we promised everybody. Obviously, when your stock is trading at a 25% free cash flow yield, it's an easy decision. But we still believe we have enough capital to both do our investing and return capital to our shareholders. And I don't see that changing in the short- or medium-term. So I think we're going to just continue to be disciplined in terms of returning capital, and especially given the rises that we've been talking about here, well, I think we should actually have more capital to invest ourselves. And it won't surprise you to hear that there's an awful lot of people who also now want to co-invest with us in a lot of these kind of projects. So, I think the possibilities for doing accretive generation and related projects are there irrespective of our capital allocation principles.

Durgesh Chopra
Analyst, Evercore

Q

No, that's very clear. Thank you. I appreciate the time.

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

A

Thank you.

Operator: One moment for our next question. And next question comes from David Zimmerman (sic) [Dave Arcaro] (00:45:52) at Morgan Stanley. David, your line is open.

David Arcaro
Analyst, Morgan Stanley & Co. LLC

Q

Hey, good morning. Dave Arcaro here. Thanks for taking my question.

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

A

Hi, David. How are you?

David Arcaro
Analyst, Morgan Stanley & Co. LLC

Q

Good, good. Hey, following up on one of the earlier questions. I was wondering, just on the ERCOT market and pricing in the market in the forward curves, do you have a view from here on where ERCOT prices could go. Is there still room for upside, do you think, in terms of where the forward curve is currently pricing?

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

A

Hey, David, it's Rob. Yes, the markets can definitely go up. And if you look at the large loads that are coming to the state into the system, ERCOT is already beginning to monitor it and take a look at it. It's a lot. And you're seeing that priced in. There is more upside in the curves from here.

David Arcaro
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Got it. Thanks. And does that – as you're kind of hedging into that, then is that a view that you're embedding as you start to layer in hedges and firm up some of your out-year EBITDA forecast?

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

A

So when we think about our out-year EBITDA, remember that a big part of our hedging program is through the retail book, right? So, as we sell to our 8 million consumers, that ultimately takes a lot of that value and translates that over through the retail revenue rates. We're always looking way out the curve there. And if I thought that something was really high and out of whack, then I would say that we could take something off the table. But we like the position, we like the trend, and we like where our portfolio is.

David Arcaro
Analyst, Morgan Stanley & Co. LLC

Q

Got it. Thanks. And could you touch on what the competitive dynamics are that you're seeing in the retail energy business right now in terms of any pressure from new entrants or pricing pressure in the market that might push margin one way or the other right now?

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

It's been a very stable performance. As you saw, we had strong performance in terms of customer growth year over year. We saw similarly good performance in load growth and our margins. And so we feel very good. I think there are a couple of new entrants in the market, but as we look at our outflow reports, we don't really see any meaningful traction there.

David Arcaro
Analyst, Morgan Stanley & Co. LLC
Q

Okay, great. That's helpful. Thanks so much.

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

Thanks, David.

Operator: One moment for our next question. And the final question comes from Ryan Levine with Citi. Your line is open.

Ryan Levine
Analyst, Citigroup Global Markets, Inc.
Q

Thanks for taking my question.

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

Hi, Ryan. How are you?

Ryan Levine
Analyst, Citigroup Global Markets, Inc.
Q

Just to follow up on some of capital – hi, everybody. Just to follow up on some of the capital allocation framework, is there a price where you would reconsider buybacks or are you not trying to take any view on the value of the energy security?

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

Ryan, there is no price that we would necessarily sit here and tell you is the absolute line at which we would stop buybacks. We're always going to be looking what is implied in the share price with respect to our free cash flow yield. And we'll make determination from that standpoint. But as we sit here today, we see plenty of room to run for us to continue to be buying back shares.

Ryan Levine
Analyst, Citigroup Global Markets, Inc.
Q

Okay. And then as you're looking at on investment opportunities related to power generation growth in your service territory, are you – you're focusing you mentioned in a number of opportunities for new builds and partnerships. Do you have a preference for partnerships or would you prefer to own the assets outright?

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

A

I think for us it's just a maximization and optimization process. And so, I don't think we have a preference one way or another. It's related to cost of capital, operational flexibility. And at the end of the day, what falls best to our bottom line.

Ryan Levine
Analyst, Citigroup Global Markets, Inc.

Q

Okay. And given the economic outlook that you've suggested was attractive for these new builds, are there any customer commitments or duration of demand that you're looking for the data centers to commit to, to underwrite some of these new builds?

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

A

Hi. This is Rob. The answer to that is nope. The new builds that we've talked about are not set up for data centers or for to meet that load. The conversations we are in early days with around co-location or use of our sites, those will be a case by case basis as to whether or not it's a long-term deal or not, right, with a data center or other large load. But that's going to come as we evaluate each opportunity. But the things we've talked about thus far are for our book and our portfolio.

Ryan Levine
Analyst, Citigroup Global Markets, Inc.

Q

And just one last question in terms of retail margin on electricity, the movement in ERCOT forward prices, do you think that will have any impact on the margin that you'll ultimately be able to realize on that part of your business?

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

A

Well, we've proven the ability to maintain strong retail margins through various curves. And so, we have a very sophisticated analytic engine that gives us insights into the price sensitivity of customers. And when you have sort of these orderly shifts in power prices, we're able to pass them on to consumers over time. So we feel good about our muscle there.

Ryan Levine
Analyst, Citigroup Global Markets, Inc.

Q

Thanks for taking my questions.

Operator: This concludes our question-and-answer session. I would like to turn it back to Larry Coben, Chairman and Interim President and CEO for closing remarks.

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

Thank you all very much for joining us. I think you can hear the palpable excitement that we all feel here at NRG for the potential, and we look forward to continuing to deliver great results and executing on that upside in the days, months and years ahead. Thank you all.

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