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NRG Energy, Inc. (NRG)

Q3 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. Third Quarter 2023 Earnings 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 first speaker today, Kevin Cole, Head of Treasury and Investor Relations to read the Safe Harbor and introduce the call.

Kevin L. Cole
Senior Vice President, Treasurer & Head-Investor Relations, NRG Energy, Inc.

Great. Thank you, Darian. Good morning and welcome to NRG Energy's third quarter 2023 earnings call. This morning's call will be 45 minutes in length and is being broadcast live over the phone and being webcast, which can be located in the Investors section of our website at www.nrg.com under Presentations & Webcasts.

Please note that today's discussion may contain forward-looking statements which are based on assumptions that we believe to be reasonable as of this date. Actual results may differ materially. We urge everyone to review the Safe Harbor in today's presentation, as well as the risk factors in our SEC filings. We undertake no obligation to update these statements as a result of future events except as required by law. In addition, we will refer to both GAAP and non-GAAP financial measures. For information regarding our non-GAAP financial measures and reconciliations to the most directly comparable GAAP measures, please refer to today's presentation.

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

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

Thank you, Kevin. Good morning, everyone, and thank you for your interest in NRG. I'm joined this morning by Bruce Chung, Chief Financial Officer, and also on the call and available for questions, we have members of the management team.

Before we go into the quarterly review, I'd like to start with an overview of our value proposition. Over the last six years, we have taken the necessary steps to position NRG at the center of the energy transition. Our consumer energy business benefits from the increasing electrification of our economy while generating significant excess cash well beyond its business needs. A complementary Smart Home business that increases the lifetime value of our customers and enables greater optimization of our customer's energy demand, and the financial flexibility to return significant capital to our shareholders while maintaining a strong balance sheet.

As you can see, we deliver compelling value today and importantly, we have positioned our business to deliver value well into the future. So with that, I'd like to turn to the three key messages of our earnings presentation on slide 5. First, we are raising our 2023 financial guidance driven by strong financial and operational results, both in the third quarter and year to date. Second, we are initiating 2024 financial guidance above the plan we shared with you at our June Investor Day. And finally, with line of sight to achieving our 2025 growth roadmap, we are accelerating our focus on behind the meter load management opportunities for homes and businesses.

Starting with our third quarter results on slide 6, we delivered top decile safety performance and $973 million of adjusted EBITDA, a 103% improvement from the same period last year, driven primarily by strong operational performance across the business and the addition of Vivint. This brings our year to date results to $2.438 billion of adjusted EBITDA, a 74% increase above the prior year. On our last earnings call, we indicated that we were trending toward the top end of the guidance range. With strong third quarter performance and our current outlook for the balance of the year, we are increasing and narrowing our 2023 financial guidance ranges, which includes the close of STP and an increase in the company's annual incentive plan given the expected outperformance for the year.

During the quarter, we continued to make good progress on our strategic priorities. Vivint integration is well underway and with early success on our growth initiatives, we are raising again our 2023 target from $60 million to $75 million. This is a 150% increase from our original $30 million target set in May. Also during the quarter, we continue executing on our portfolio optimization efforts with the retirement of the Joliet Power Station and the sale of Gregory and our interest in STP.

Turning to capital allocation, we are raising our 2023 share repurchase target by 15% to $1.15 billion. We have completed $200 million of share repurchases year to date. And with the close of STP, expect to execute the remaining $950 million under an accelerated share repurchase program. Next, we have executed $800 million of debt reduction as part of our liability management program. Bruce will provide more details in his section. Finally, we're initiating 2024 financial guidance ahead of our June Investor Day plan. This earnings expansion is durable and represents high quality growth and overall strengthening of our business.

On capital allocation, we allocated $500 million to debt reduction and the remaining excess cash allocated 80% to return of capital and 20% to growth.

Now turning to slide 7 for an update on our integrated energy business, we experienced the hottest summer on record in our core Texas market, breaking the previous peak demand record 10 times. While the power grid was strained given record demand, it performed quite well with only a few periods of scarcity pricing when the normal output was low. Importantly, the efforts we undertook in our summer readiness and spring outage program resulted in a significant increase in our plant reliability. In the bottom left-hand chart is our in the money availability, indicating the availability of our units during periods when they are profitable, which is a relevant metric for our business and shows a significant improvement. Retail saw strong performance through the quarter with in-line customer growth and better than expected retention. We continue to improve our digital experience with customers engaging more, increasing monthly average app usage by 20%.

Moving to retail supply, the steps we have taken to enhance our diversified supply strategy were successful in providing predictable supply cost under different load and price scenarios. Beyond investing in our plants, we adjusted our hedge ratios to lean long in key summer and winter months. Finally, we are beginning our efforts in residential demand response and have increased participation by 10% this year. We also manage a large C&I demand response business with 2.5 gigawatts of capacity under management. I will provide more color on the behind the meter opportunity later in the presentation.

Our Smart Home business also performed well with strong customer growth and margin expansion, as you can see on slide 8. We continue to advance our technology platform with the launch of new innovative products, improving our customer experience that is consistently recognized as best in the industry by consumer publications. On the right-hand side of the slide, you will see the key performance indicators that we introduced in our last earnings call. We continued to see exceptional performance in Smart Home with 7% subscriber growth, 9% revenue growth, and 9% service margin improvement versus the same period last year, consistent with improvements we reported in our second quarter results.

Acquisition costs are higher due to the impact of more products being sold and higher interest rates, but were more than offset by higher revenue on new subscribers. Our customers are engaging more with our platform and are staying for a longer period of time. We are very encouraged by the performance we're seeing across the business and the opportunities that are arising inside the home.

Now, I want to provide an update on the opportunity for demand management we see behind the meter or virtual power plants on slide 9. We have been managing energy optimization programs for commercial and industrial customers for years and now we are seeing a growing opportunity in the residential space. New distributed technologies and a growing penetration of connected smart devices in the home have materially changed the industry, providing greater control to the consumer. Grid reliability has also played a role in accelerating adoption as flexible demand represents instantaneous peak in capacity when the grid is at peak low or in scarcity conditions.

We see two primary pathways for us to create value in this market. First, through optimizing our existing customer peak demand in ERCOT and PJM, where we can benefit from both energy and capacity value as well as reduce market risk. Second, through VPP services for Smart Home and utility customers, both in regulated and competitive markets. We are uniquely positioned to win this space. We have the scale with 7.6 million customers, decades of commercial and market expertise, and an integrated energy business that allows NRG to monetize the value without having to go to the wholesale market or requiring regulatory change.

We also have vast data and insights from running the third largest commercial and industrial demand response program in the country. While our focus in the near term continues to be optimizing our core and integrating Vivint, over the medium and long term, we see a significant value opportunity from these programs. This value is not included in our June Investor Day plan, and I look forward to providing you updates on our progress in the future.

Moving to slide 10 for an update on our integration efforts. We are making good progress across our initiatives and are reaffirming the full plan targets totaling $550 million of recurring free cash flow before growth by the end of 2025. Our growth and cross-sell efforts have yielded strong results, allowing us to increase our 2023 growth target to $75 million. On the right-hand side of the slide, you will see the increasing number of customers buying two or more products. I want to highlight that this is not exclusively cross-sell between Energy and Smart Home, but includes other consumer products sold across NRG that generate recurring revenues. We have been hard at work executing pilots and collecting critical insights as we prepare to scale Energy and Smart Home cross-selling in 2024 and beyond.

In the appendix of today's presentation, you will find our latest Growth and Cost Plan Scorecard so you can track our progress. So with that, I will pass it over to Bruce for the financial review.

Bruce Chung

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

Thank you, Mauricio. Turning to slide 12, NRG's third quarter and year to date financial performance significantly exceeded the same periods last year. NRG produced adjusted EBITDA of $973 million in the quarter, which is $493 million higher than the third quarter of 2022. As you can see in the chart at the bottom of the page, even when normalizing 2022 results for transitory items and the W.A. Parish outage, 2023 adjusted EBITDA still exceeded the prior year by $350 million. Compared to a normalized 2022, third quarter 2023 performance was driven by $125 million of improved operations and margin expansion in our core energy business and $225 million of Vivint EBITDA, which was not included in our 2022 results.

Similar to the first two quarters of the year, our core energy business continued to benefit from expanded margins, near-record retention and increased customer count. Our diversified supply strategy and solid plant performance continue to provide predictable supply costs through volatile load and price conditions in Texas. Looking at our segments and starting with Texas, adjusted EBITDA increased by $356 million versus the prior year on the back of higher gross margin of $378 million. Continued unit margin expansion from lower supply costs coupled with improved plant performance were the primary drivers for the increase in gross margin. This increase in gross margin was partially offset by increased OpEx from higher selling and marketing in home energy, where we increased 50,000 customers year over year.

In the East/West segment, adjusted EBITDA declined $88 million versus last year, driven primarily by lower spark spreads and Cottonwood discontinuation of equity earnings treatment for Ivanpah and an increase in accruals as part of the company's annual incentive plan, reflecting the expected financial outperformance for the year. In Q3, Vivint continued to deliver strong financial results, contributing $225 million in adjusted EBITDA. Revenue grew 9% year over year, driven by subscriber growth of 7%, favorable retention and higher recurring monthly revenue per subscriber, which combined with reductions in monthly service cost per customer drove a 15% increase in adjusted EBITDA compared to 3Q 2022.

NRG's free cash flow before growth was $355 million for the quarter, bringing our year to date total to $983 million. This represents a significant improvement over 2022 totals, driven by growth in adjusted EBITDA. As a result of our year to date financial performance, we are raising and narrowing our full year 2023 guidance ranges, $3.15 billion to $3.3 billion for adjusted EBITDA, and $1.725 billion to $1.875 billion of free cash flow before growth. The midpoint of our new guidance represents a $95 million increase in adjusted EBITDA and a $60 million increase in free cash flow before growth to the midpoint of our original guidance ranges.

Turning to slide 13 for an update on our 2023 capital allocation, we have updated our 2023 excess cash to reflect the final net proceeds of divesting our interest in STP, the net proceeds from the sale of Gregory and the increase to our free cash flow midpoint for the year. The remaining numbers on this slide are largely consistent with the update we gave on the second quarter earnings call, with a few notable exceptions. Moving from left to right, we have updated the capital we will spend on Vivint integration from $145 million to $50 million. This does not reflect lower costs associated with the integration, but rather a shifting of those dollars to 2024 and 2025. Much of the move is driven by systems integration decisions, which shifted the timeline for those costs to be incurred. Continuing on, as you can see in the debt reduction column, we have made significant progress toward our target of $1.4 billion in debt reduction, with $800 million achieved through October 31 of this year. With the closing of the STP transaction, we will complete the remaining $600 million of debt reduction by the end of 2023 through a targeted liability management program.

Finally, moving to the share repurchases column, you will see that we have completed $200 million of share repurchases thus far in 2023. This includes the $50 million we completed at the time of the second quarter earnings call and the $150 million we recently completed on October 31. With the closing of the STP transaction, we intend to launch a $950 million accelerated share repurchase program imminently. Between the $200 million already completed and the $950 million accelerated share repurchase program, our total share repurchases for the year will be $1.15 billion, which is $150 million more than what we had communicated at Investor Day and 2Q earnings.

Moving to slide 14, we are excited to introduce our guidance for 2024. We are guiding 2024 full year adjusted EBITDA with a range of $3.3 billion to $3.55 billion, representing a midpoint of $3.425 billion. We are also guiding 2024 free cash flow before growth with a range of $1.825 billion to $2.075 billion, representing a midpoint of $1.95 billion. As you can see in the chart at the bottom of the page, there are several drivers of year-over-year guidance. Incremental Vivint EBITDA reflecting a full year's worth of ownership is effectively offset by the lost EBITDA from the drag from the STP and Gregory asset sales. Our growth plan and cost synergies contribute $240 million of incremental EBITDA, but is partially offset by an increase in the Vivint EBITDA harmonization adjustment. The final driver reflects a continuation of the improved operations and margin expansion impacting our 2023 results and contributes $160 million to our 2024 midpoint. As you can see, with the impact of improved operations and margin expansion, our 2024 guidance midpoint exceeds the pro forma we provided in our Investor Day plan.

On slide 15, we are providing our 2024 capital allocation plan. As you can see, our capital allocation plan adheres to the 80/20 principle of return of capital versus growth, while ensuring we continue to meet our debt reduction commitments. Our plan currently calls for debt reduction of $500 million in 2024. As we've always said, we are committed to a strong balance sheet and this debt reduction ensures that we remain on the path to achieving our target credit metrics by the end of 2025. Our return of capital plan is comprised of $825 million of share repurchases and $330 million of common dividends. The common dividends reflect an 8% increase in the common dividend per share from $1.51 to $1.63. Between capital returns in 2023 and the expected capital return in 2024, we will have executed over 70% of our current share repurchase authorization and returned $2.65 billion to shareholders.

In summary, our third quarter and year to date results show robust financial performance across the company. And with our increased 2023 guidance, we are poised to close out the year in a strong position and enter 2024 on a similarly high note. We remain committed to executing the Investor Day plan we shared back in June, and our focus on maintaining a high level of operational performance will not waver as we head into the end of the year.

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

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

Thank you, Bruce. I want to provide a few closing thoughts on today's presentation on slide 17. As you can see, we have made significant progress across all of our key priorities and are also ahead of the five year plan we provided to you during our Investor Day. I want to take a moment to thank all my colleagues at NRG for keeping focus on execution and for their hard work in achieving these results. We have the right strategy and the right team to deliver exceptional value today and well into the future.

So with that, I want to thank you for your time and interest in NRG. Darian, 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 the line of Shahriar Pourreza of Guggenheim. Your line is now open.

Shahriar Pourreza Q
Analyst, Guggenheim Partners

Hey guys. Good morning.

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

Hey. Good morning, Shar.

Shahriar Pourreza Q
Analyst, Guggenheim Partners

Good morning. Mauricio, can we just unpack the $160 million in improved ops and margins that you're calling out in the 2024 EBITDA guidance walk a little more? How much of that is margin expansion and how sticky is that overall as we look to refine our models for 20225 and beyond?

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

Sure. Bruce?

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

Sure. Hey, Shar. Good morning.

Shahriar Pourreza Q
Analyst, Guggenheim Partners

Hey, Bruce.

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

So I would say that really when you think about the $160 million, it's pretty much margin expansion across the entirety of the complex. So if we think about our home energy business, we're really seeing margin expansion there really on two fronts. One is on revenue management and on the cost of supply. So when you think about the durability of that, the revenue management side of it is really a function of the efforts we have done over the past several years around data-driven analysis to really make sure that we're targeting proper revenue rates for customers. And then on the cost of supply, that's really representing the benefits of our diversified supply strategy and just general better plant performance relative to history.

On the C&I side, we are seeing margin expansion there, which we would also believe is durable. As we know, there has been volatility in the market and customers are locking in higher revenue rates, reflecting that volatility. And obviously those contracts tend to be longer tenor. And so that should also provide durability.

And then lastly, on the Smart Home side, as you saw with the KPIs, we are seeing margin expansion both on the revenue front in higher revenue per subscriber as well as lower cost to serve as we continue to optimize that piece of the business. And again, given the long duration nature of those customers, we would expect that to also continue to be durable. So all in all, higher expansion on the margin side with durability.

Shahriar Pourreza
Analyst, Guggenheim Partners
Q

Got it.

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

So, Shar, I mean, this is really just the reflection of the improvements we have done in the business. And I see them as durable, sustainable for the foreseeable future.

Shahriar Pourreza
Analyst, Guggenheim Partners
Q

Perfect. And, Mauricio, the 2024 free cash flow conversion rate looks like it's in the mid to high 50s. I know you've indicated at the Analyst Day your target is to step up through the plan into the mid to high 60s. Can you just walk us through how you see that stepping up and what kind of shape that may take, i.e., linear as we also continue to update our models? Thanks.

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

Sure. Bruce, do you want to?

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

Yeah, I would say, Shar, I think we continue to remain focused on that conversion rate. I don't think it will be linear because most of that conversion improvement is going to come from increasing the conversion at Vivint, right. And so if you remember, we provided some information that showed a free cash flow growth profile at Vivint going from $140 million to $445 million by the end of 2025. So that's a pretty steep increase in the cash flow at Vivint, which is really going to help to drive that conversion higher on a go-forward basis.

Shahriar Pourreza
Analyst, Guggenheim Partners

Q

Got it. Perfect. And then, lastly, Mauricio just a strategy question, I guess. Can you just update us on how you're kind of approaching the prospects for new builds in ERCOT? I know there's obviously a lot of existing assets in the market right now. We've seen Cal and we've seen [ph] TexGen (00:26:20). Would you have any interest in second-hand plants? Thanks, guys. Appreciate it.

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

A

Sure. Well, as you know, Shar, we actually improved our diversified supply strategy. Some of it will be to own generation, some will be to rent and to complement with market purchases. So the team is constantly looking at the economics between buying from the market, renting or buying assets from other and creating options internally to develop those facilities, either as brownfield development. So we're looking at all of it. We are evaluating the economics.

At the end of the day, we are balancing operational risk, market risk, counterparty risk. That criteria permeates the evaluation that we're doing on all of these options. We are still awaiting to see changes in market design and other improvements to incentivize dispatchable generation. That also is going to shape the decision that we're going to make. So as you can tell, this is not just a linear and a myopic view on assets to be bought into market and development. We really also need to see what incentives are available, given the changes in the regulatory construct in ERCOT. So I have said before that towards, I would say, the end of the year, we're going to have more visibility on those changes in ERCOT that is going to inform the next steps we're going to take.

Shahriar Pourreza
Analyst, Guggenheim Partners

Q

Fantastic, guys. Congrats on the results. See you soon.

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

A

Thank you, Shar. Appreciate that.

Operator: Thank you. One moment for our next question. Our next question comes from the line of Julien Dumoulin-Smith of Bank of America. Your line is now open.

Julien Dumoulin-Smith
Analyst, BofA Securities, Inc.

Q

Hey, guys. Good morning. Thank you very much for taking the time. I appreciate it. Look, just checking in first on the buyback here, just a technicality. Can we talk a little bit? You have a big portion remaining for what you call "2023." You want to talk about your ability to get that done and then also how that might prove to be additive to kind of 2024 here, especially given the higher number [indiscernible] (00:28:50) guidance versus the initial plan.

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

A

Sure, Julien. So...

Julien Dumoulin-Smith
Analyst, BofA Securities, Inc.
Q

Can you get it done?

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

Yeah. As we mentioned, we're going to do the ASR imminently. That means as soon as possible. And what I will characterize the execution of that ASR, we're going to do it as fast and as efficient as we can. So I think that's the spirit and the intent of launching these ASR as soon as possible.

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

Hey, Julien. I would just add that, as you know, when you do an ASR, we obviously realize the vast majority of the shares have been bought in pretty much on an immediate basis but it takes time for the banks to be able to go and purchase their shares properly. And so my guess is we would probably anticipate that the program will be completed inside of the first quarter of next year. But to us, that's actually a pretty good situation because then that provides the ability to then roll into a regular way share repurchase program related to our 2024 capital allocation plan to really continue to maintain the momentum on the repurchase front.

Julien Dumoulin-Smith
Analyst, BofA Securities, Inc.
Q

Got it, guys. Thank you very much. I appreciate that. Maybe just pivoting a little bit back here. I mean, obviously very nicely done on 2024, nicely done on the comments on keeping it sticky. And the number [ph] you see on (00:30:29) next piece of this is you've talked up this virtual power play distributed opportunity on the call today in prior remarks. How do you see that feeding into, a, you're talking about in 2024? I presume that's not really necessarily reflected in size, but at the same time, you talk up an opportunity there. I presume that there's a certain degree of customer election and choice in that. But how do you see that scaling here? When does that really meaningfully impact things? And how meaningful are we talking here? I mean, I've heard some of your comments earlier, if you could elaborate.

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

Yes. So well, the first thing that I will say is that this opportunity is not included in the plan that we provided at Investor Day. The second thing I will say is just given the focus and the availability of technologies today, we are accelerating the scale of this opportunity. I initially thought that this was going to be a five-plus year opportunity. What we are experiencing is that this is going to be able to be implemented and scaled up faster than that. I would say it's probably a three-plus year. And I provided some initial numbers that I think are very realistic on what we can accomplish. So if you look at a 1 gigawatt [ph] VR position (00:32:00) in Texas this past summer, it represented close to $200 million of gross margin. And 1 gigawatt for our portfolio is basically less than 10% of the load, or the peak load that we currently serve, so it's very achievable. And that gives you just some indication that you're not talking here about a small opportunity. You're talking here about a very large opportunity.

The other thing that I will say is that this product that we're talking about is really leveraging the devices that we use to protect homes, plus the distributed technologies available today to help consumers optimize demand. Don't think of these as a conservation effort, opt-in conservation effort. This is about optimizing and about convenience for our customers. So it is a very different product from the traditional VR. That's why we're calling it more as an optimization of the energy demand behind the meter as opposed to a traditional demand response. That's why we're so excited, because this is something that consumers want and this is something that NRG is uniquely positioned not only to provide to consumers, but to be able to monetize that value in the wholesale market. There is no other entity with the scale of NRG that can do that today. That's why we are an early mover on this.

Julien Dumoulin-Smith
Analyst, BofA Securities, Inc.

Q

Awesome. Excellent. Thank you. Just quick clarification from the last question from Shar. When he asked you about acquisitions and divestments on the gas, I presume that what we saw with Gregory here is perhaps an indication of the margin of continued divestment on the margin of your portfolio as you move over time, right. We should set the expectation that more of these kinds of transactions are in the wings. Again, I get that Gregory was a very specific back pattern [ph] here we're seeing (00:34:05).

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

A

I think we're for the most part done on the optimization front. I mean, remember, the optimization of our portfolio is driven by what we need to serve our load in the best possible way. STP, I already talked at great length. It's block power, it's not flexible, it doesn't move. We can replace that in the market. Gregory was also very specific. This is basically a plant that was built to provide steam to [indiscernible] (00:34:37). So it really didn't provided the attributes or the characteristics that we wanted from a flexible asset. I think after Gregory and STP, I would say our optimization efforts are largely done.

Julien Dumoulin-Smith
Analyst, BofA Securities, Inc.

Q

Awesome, guys. Thank you.

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

A

Thank you, Julien.

Operator: Thank you. And one moment for our next question. Our next question comes from the line of Angie Storozynski from Seaport. Your line is now open.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Good morning, guys.

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

A

Good morning, Angie.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Good morning. So, first on Vivint. So one, I was just wondering if you heard any feedback from your activist investor about how holding on to Vivint is working out for you and the stock? So that's one. And number two is so, you mentioned a number of positive updates on Vivint, one of the main ones at least that stuck up with me is the basically lower attrition. So is it fair to say that the higher interest rates and the lower migration is actually what's benefiting your platform, again, not something that I would ever think to link higher interest rates as a benefit for a business like yours? But it feels that way.

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

Yes, Angie. So let me take the first one and then I'll going to ask Rasesh to answer your second question. The focus of the management team and the company is to execute on our consumer strategy. And I think what you're seeing in the last two quarters is that we're basically delivering on the commitments that we provided to all of you at Investor Day. That's our focus. I have been on the road talking to investors to help them better understand the strategy, to help them better understand the value proposition that this consumer strategy represents, and not just to the activist, but to all shareholders. And that's been our focus. That's what we can do as a company, as a management team. And I am very pleased with the results that we're delivering. And I think shareholders in general are appreciating the value of our consumer strategy. But I will say that also market participants as a whole, whether it's ISOs or whether it is regulators, they're starting to see the benefit and the opportunities the demand represents to better manage the entire power grid, given the greater electrification that we're going to see in the years to come.

So I think that's finally happening, but Rasesh, the second question, can you address it?

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

You bet. Angie, good morning. I think the results reflect the strong value proposition that we provide to consumers. If you think about a 7% subscriber growth, we are also seeing an increase in the number of products each subscribers is actually taking and so 5% growth in recurring revenue. Simultaneously, the cost to serve customers is down 19% on a unit basis year over year. And as you mentioned, one of the most powerful aspects of the value proposition is the near – this is a record low attrition rate for us in this economy to have a nine-year customer life. When you bring these things together, combined with the fact that the average consumer is engaging with our product 33% more than they were this time last year, it's a really robust flywheel that results in just improving customer lifetime value. And so we feel really good about the business and we think there is a long runway ahead for growth.

Angie Storozynski
Analyst, Seaport Global Securities LLC
Q

Okay. Just one follow-up on Vivint. So Rasesh, you remember, as you said yourself, you're bringing forward the DR-driven growth on the Vivint side. I thought that the reason why we had expected the growth to materialize only in 2025 and beyond was because you actually needed some software upgrades, some sort of investments to facilitate that growth. So have you pulled those forward? Hence the growth is materializing earlier?

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

Yeah. So I will say and we literally just finished a pilot where we are connecting our Smart Home technology to our commercial operations. So let me take a little bit of a step back. We already have our residential demand response program on our traditional energy business, and that is connected to the backbone of our commercial operations to make sure that we optimize the system. What we've been doing in the last couple of weeks is to connect now the Smart Home technology platform to our commercial operations backbone. That was very successful. That's why I said that we're accelerating those efforts and instead of being a five-plus year opportunity, I see that as a three-plus year opportunity. The improvements and the investment that we need to do on the technology backbone is included in that 20% of growth. We're not going to increase that. What I'm saying is that there is the need by the consumer and quite candidly by the power grid to accelerate these efforts. So really, really good progress there, Angie.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Okay. And then the last question and again, I understand the explanation behind the divestiture of STP, and I see that the EBITDA contribution from Gregory was very small, but you're getting shorter and shorter power in Texas. I mean, and again, I know that not for a given summer because you hedge, but we just survived the summer, I mean, better than survived. But anyway, I mean, all of these conservation alerts from ERCOT are causing anxiety among us and new investors, I'm sure. So just strategically speaking, getting rid of more power plants in Texas, how do we manage this risk of matching the retail load with self-generation in Texas?

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

A

Yes. So Angie, let me just say two things. Number one, when we serve our customers, we're not short. We're actually leaning long. We don't have to own every megawatt or produce every megawatt that we sell to our customers. That will be the first thing. The second thing is, and perhaps to your point about ERCOT, when I think about the market, my view is that the marginal unit, which means the most cost-efficient unit today, is renewable energy. It's going to be wind and solar, intermittent generation. That's zero variable cost generation. What that means is that for the most part of hours in the market is going to clear at a very low price, except for those periods where perhaps renewable is not performing as normal because the wind is not blowing and the sun is not shining.

So you're going to see very few periods of scarcity conditions, but for the most part, the rest of the intervals, the rest of the hours are going to be very low price. So that's why demand response and the optimizing demand management is so, so important because that basically gives you instantaneous peaking capacity exactly for the duration that you want, which is very short durations. I think the improvement that we have made on our supply strategy is very consistent with what we expect the market will behave in the future and the opportunity around demand management is again completely consistent with that expectation in terms of price formation and market behavior. So I believe we have positioned the company very, very well for the foreseeable future.

And I will just say one more thing. We literally experienced the hottest summer on record in Texas, and the grid handled it very well. The only time when we saw scarcity pricing was really at periods where we had low renewable output. And even there ERCOT was managing the grid very conservatively. So I will say that for those of you who really wanted to test the ERCOT market and the improved supply strategy that we have at NRG, this was the test and we passed with high flying colors, I think.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Great. Thank you.

Operator: Thank you. Please wait one moment for our next question. Our next question comes from Michael Sullivan of Wolfe. Your line is now open.

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

Hey, everyone. Good morning.

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

A

Good morning, Michael.

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

Hey, just wanted to follow on one of the questions from earlier in terms of the growth target. Realization looking like that's coming in a little bit sooner than expected. Does that indicate any potential upside to the 2025 number of $300 million run rate?

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

A

I think right now we're comfortable accelerating the 2023 target just given the success on our growth and cross-sell. I think it's early to start thinking about moving the $300 million by 2025. What I will say is that that roadmap does not include the VPP or demand side management potential. And that's something that we're going to be talking to all of you, quantifying it, and how big can it be and when can we start realizing it? So that's more to come there.

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

Okay. Great. And then, just specifically on the ERCOT portfolio, next week's vote on the loan bill, does that drive any decision-making in terms of optimization of the fleet or new build or anything like that?

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

A

Yeah. I mean, it is one more data point that we're going to take into consideration. I think the first step for the loan program is vote. And then the second step is the rules around how the loan program is going to work. Obviously, all market participants are looking at it. Again, it will be one more data point for us to inform our supply strategy. But it is only one more data point.

Michael P. Sullivan
Analyst, Wolfe Research LLC

Q

Okay. Great. Thank you.

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

A

Thank you, Michael.

Operator: Thank you. One moment for our next question. Our final question comes from the line of Ryan Levine with Citi. Your line is now open.

Ryan Levine
Analyst, Citigroup Global Markets, Inc.

Q

Good morning. Hoping to start off something more on the strategic side at the Analyst Day, you indicated aversion to larger strategic acquisitions. Given that the free cash flow picture is becoming more painful and maybe pricing for assets is going down, how committed are you to that vision? And I think you highlight some potential VPP and power plant opportunities. Is there any scope around what type of incremental capital that could enable?

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

A

Well, the first thing I will say is, and as I mentioned on the Investor Day, we don't see any more acquisitions. Second, we are completely committed to this capital allocation framework of 80% of return, 20% to growth. And third, the 20% is inclusive of the opportunity that we see on VPP. So we will continue unpacking what that opportunity is and the investment. But it will be contained within the 20% during the planning period that we provided to you.

Ryan Levine
Analyst, Citigroup Global Markets, Inc.

Q

Okay. I appreciate the clarification. And then one more on the modeling side in terms of the Vivint subscriber acquisition costs coming up and net subscriber acquisition costs coming up. What's driving that and what are you seeing from a trend standpoint in terms of customer acquisition?

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

A

Yeah. It's really a function of two things. One is the increase in interest rates year over year. And two is a function of the consumer buying more products when they take our service. And on the second point, we feel very good about both the payback period as well as the IRR. You see the boost in recurring revenue per subscriber that's disclosed in the KPIs. I want to remind you that that's across the entire 2.1 million subscriber base. If we were to only look at the new customer acquisition cohort, the revenue increase, the service revenue increase is even more substantive than that. And so we feel very good about the payback of that incremental investment in the consumer as they take more product from us.

Ryan Levine
Analyst, Citigroup Global Markets, Inc.

Q

Is the customer composition or the customer mix evolving or any comments you're able to make around the characteristics of your new subscriber base?

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

A

No. Other than the new customers are sort of taking more product, as we continue to expand our product portfolio, there's no change in the mix. We have a very, very high quality subscriber base, high credit scores. And so it's a very resilient business from that standpoint.

Ryan Levine
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Appreciate taking my questions.

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

A

Thank you, Ryan.

Operator: Thank you. This concludes the question-and-answer session. I would now like to turn it back to Mauricio Gutierrez for closing remarks.

Mauricio Gutierrez

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

Thank you, Darian. Well, I'd like to thank all of you for your interest in the company and your support and look forward to providing you updates in the future. Thank you.

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