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NRG Energy, Inc. (NRG)

Business Update Call

CORPORATE PARTICIPANTS

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

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

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

OTHER PARTICIPANTS

Greg Gordon
Analyst, Evercore Group LLC

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

Steve Fleishman
Analyst, Wolfe Research LLC

Michael Lapides
Analyst, Goldman Sachs & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the NRG Energy Inc. Business Update Call. At this time all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. [Operator Instructions] And as a reminder, this conference is being recorded.

I would now like to introduce your host for today's conference, Mr. Kevin Cole, Head of Investor Relations. Sir, you may begin.

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

Thank you, Amanda. Good morning, and welcome to NRG's Business Update Call. This morning's call 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. As this is a call for NRG Energy, any statement made on this call that may pertain to NRG Yield will be provided from NRG's perspective.

Please note that today's discussion may contain forward-looking statements, which are based on assumptions that we believe to be reasonable as of this date. Actual results may differ materially. We urge everyone to review the Safe Harbor in today's presentation as well as 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 presentations. Today's call will end sharply at 9 AM to allow participants to dial into NRG Yields' 9 AM call.

With that, I'll 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, and good morning, everyone and thank you for your interest in NRG. Also on the call and available for questions is Kirk Andrews, our Chief Financial Officer. Today, we're taking a significant step in simplifying our value proposition, optimizing our portfolio, and strengthening our balance sheet.

Starting on slide 3, I am pleased to announce the agreement to sell our Renewables business including our interest in NRG Yield and our South Central business known to many of you as LaGen, resulting in $2.8 billion in cash proceeds and the removal of $7 billion of debt from our balance sheet. This outcome is the result of rigorous and highly competitive sale processes that culminated in today's announcement. I want to commend everyone in the organization for their focus and commitment to operational excellence during this critical period. Our objective was to maximize the value of these high quality businesses and I am very pleased to have achieved this outcome. In addition, we were able to attract highly knowledgeable, well-capitalized and experienced buyers, which makes me confident in our ability to bring these transactions to a swift close.

Second, with these agreements in place, we now have greater visibility into total expected asset sale proceeds and are revising our target to $3.2 billion. Importantly, the transactions announced today coupled with those completed in 2017 now bring our cumulative asset sale proceeds close to $2.9 billion.

Finally, our comments during this call will be limited to the transaction details announced today. We will have an opportunity to provide you with greater detail on our Transformation Plan progress in just a few weeks during our next earnings call. You can also expect us to provide you with a comprehensive capital allocation plan by our Analyst Day in late March.

Turning to slide 4 for an overview of our Renewables and Yield transactions. Together, these transactions will generate almost $1.8 billion in cash proceeds and remove $7 billion in debt from our balance sheet. We have signed an agreement to sell our Renewables business, including almost 7 gigawatts of operating and in-development assets and our interest in NRG Yield to Global Infrastructure Partners for $1.375 billion in cash proceeds.

Consistent with our objective to maximize value and deconsolidate debt, we found that a 100% sale of our interest in NRG Yield coupled with our entire integrated Renewables platform to be the most valuable outcome after having considered a full range of options. This was a process that was both exhaustive and well-coordinated. We work closely with Yield's independent directors, management, and financial advisors towards a transaction that is highly beneficial for both companies and results in a new strategic sponsor for NRG Yield.

GIP has an excellent track record in this space. They have a complementary business that is well known, well capitalized and can provide the support necessary to foster NRG Yield's growth strategy. We're confident in our ability to work with GIP to bring this transaction to its expected close in the second half of the year.

Now, as part of this transaction, we're also announcing new drop-downs and amendments to our ROFO with NRG Yield. We're accelerating the drop-down of Carlsbad and Buckthorn Solar and have executed agreements with NRG Yield to monetize these assets for additional cash proceeds of $407 million, resulting in additional $500 million in debt to be removed from NRG. Upon closing with GIP, we will amend the ROFO agreement to no longer include Ivanpah. Last, we will maintain our ROFO agreement for Agua Caliente, but expect to monetize this asset by early next year.

Now turning to slide 5, we have agreed to sell our entire South Central business to Cleco Corporate Holdings for $1 billion in cash proceeds. This transaction includes our Cottonwood, Big Cajun I, Big Cajun II, Bayou Cove and Sterlington assets. It also includes associated load contracts with co-ops and munis with an average weighted contract length of over seven years. As part of this transaction, we will be leasing Cottonwood, a highly efficient 1,300 megawatt combined cycle plant back from Cleco through May 2025. NRG will continue to operate and commercially optimize the plant during the lease term in exchange for a rent payment to Cleco.

This structure is an opportunity to enhance value for both parties. Cleco currently have sufficient generation in the region, while NRG's Commercial Operations group has nearly a decade of experience trading Cottonwood and creating significant value, selling power and capacity within [indiscernible] (00:07:28). This is truly an outcome that strengthens the economics of the deal for both parties.

Importantly, this structure will not impact our balance sheet metrics. We are pleased to have Cleco as the new owners of the business and we look forward to working with them to close this transaction by the second half of this year.

Turning now to the financial details behind today's announcement on slide 6. I want to briefly review and summarize our updated asset sale score card and revised target proceeds. The asset sales announced today combined with those completed over the second half of 2017 bring our total Transformation Plan related transactions to over $2.9 billion. With another $275 million expected from additional targeted asset sales, our revised target comes to $3.2 billion, significantly enhancing capital available for allocation.

These transactions also represent significant progress toward our objectives to deleverage and simplify our capital structure. The sale of our interest in Yield, as well as our integrated Renewables business will result in the removal of approximately $6.5 billion in consolidated debt. We are also able to eliminate debt related to the accelerated drop-down assets to NRG Yield.

Additionally, our remaining stake in Agua Caliente as a continued ROFO asset is included in our remaining target asset sales and also provides another opportunity to remove its nearly $1 billion in associated debt from our balance sheet. In total, these transactions will result in $8 billion in consolidated debt removed from the balance sheet and represent over 90% progress toward our goal of removing of nearly $9 billion in consolidated debt announced as part of the Transformation Plan rollout last year.

Turning to slide 7, we have provided an updated pro forma view of the impact of asset sales on EBITDA and free cash flow using the midpoint of our 2018 consolidated financial guidance. As you may recall, on our third quarter call we provided a similar walk based on the full year impact of targeted divestitures.

This updated slide provides greater detail based on today's announcement and revised asset sale target. First, today's announcement represent approximately $1.135 billion in 2018 EBITDA and $520 million in consolidated free cash flow before growth, $175 million of which is at the NRG level. The remaining assets targeted for divestiture represent an additional $170 million of midpoint 2018 EBITDA, $120 million of consolidated free cash flow, and $90 million of NRG level free cash flow.

The impact of these announced and planned assets sales brings our total – our 2018 pro forma midpoint EBITDA to $1.6 billion and free cash flow to $1 billion. These pro forma results also include the full year impact of our 2018 cost savings and margin improvement targets, as noted in the lower right of the slide.

Importantly, by 2020, we remain on-track to fully achieve our run rate target, improvements representing an additional $275 million in EBITDA and free cash flow benefits beyond those expected in 2018.

So before I turn to Q&A, I want to quickly summarize the excellent progress we have made to-date. With these transactions, we have now announced over 90% of our revised target cash proceeds and have identified over 90% of our target debt to be removed. Throughout the organization, we remain focused on achieving best-in-class operations and strong financial results while comprehensively strengthening our business. I am pleased with our progress to-date and confident on our ability to fully execute on our plan.

Finally, I want to remind you that our comments today will be focused exclusively on our announced transactions. Further detail on our full Transformation Plan score card and detailed capital allocation plan will be announced over the next several weeks. Thank you again for your interest in NRG.

And with that, operator, we can open the lines for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from the line Greg Gordon of Evercore. Your line is open.

Greg Gordon
Analyst, Evercore Group LLC
Q

Thanks, guys. Patience has finally been rewarded. We appreciate it.

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

Thank you, Greg.

Greg Gordon
Analyst, Evercore Group LLC
Q

Can you give us a sense of what the remaining asset portfolios that you're looking to monetize, what general framework is in terms of the remaining assets that you're looking to sell, the types of assets or businesses?

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

Yeah. I mean, most of them – I mean it's a combination of Conventional and Renewables assets. I think, we provided some specifics on the Renewables. We saw the smaller plant that we have, [indiscernible] (00:13:59), other small renewable assets. Obviously, we have the additional monetization of Agua Caliente. And then, on the Conventional side we haven't provided specifically the assets. We're going to remain – we have some processes that are ongoing. So, for competitive reasons, we choose not to disclose the specifics, but we provided already the general guidelines in terms of the total of – megawatt. But I think it's fair to say, like I mentioned in my – in the call, the vast majority of these asset sales have already been achieved from what we have line of sight today. 90% of asset sale proceeds now have been announced and – based on our revised targets.

Greg Gordon
Analyst, Evercore Group LLC

Q

Great. And you said that today's announced transactions are expected to close in the second half of 2018. Is it still the expectation that the asset sale process in its totality will be complete by year-end 2018 or do you think that the last round of proceeds might come in, in early 2019?

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

A

Well, our expectation is to continue to target 2018. Obviously, in the case of Agua that will be in 2019, but we remain – our plan is to have all these announced by 2018.

Greg Gordon
Analyst, Evercore Group LLC

Q

Great. And then, final question. You may want to punt this to the earnings call, but while – the asset sale proceeds numbers have come in and they may be a little bit lower than your initial aspirations. When we look at other aspects of the business, especially what's happened in Texas in terms of the outlook and underlying fundamentals for the core assets, is it fair to say that we're – that the outlook's demonstrably improved since you gave us the last update?

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

A

Well, I think if you look at what has happened in Texas, you know the improvements in spark spreads and power prices, the fundamentals have been stronger. And in the next 45 days, we'll have an opportunity to have an earnings call and then an Analyst Day just a few weeks after. At that time we will provide you with a comprehensive update on our Transformation Plan, you know on the three big objectives, cost savings, margin enhancement and now we will [ph] fall (00:16:28) the impact of the asset sales announcements that we're making today and provide you a fuller picture.

Greg Gordon
Analyst, Evercore Group LLC

Q

Okay. Thank you, guys.

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

A

Great. Thank you, Greg.

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

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

Q

Good morning, and congratulations.

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

A

Thank you, Abe. Good morning.

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

Q

I have a couple of, kind of detailed questions. How much equity if any does NRG need to invest in Carlsbad and Buckthorn between now and the COD dates?

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

A

Over the course of the remainder of the year, that equity in those two, we haven't disclosed the specific amount. But if you look at the growth investments section, going forward in 2018, that's all subsumed within that. So, the capital would go out during this particular year to complete primarily Carlsbad which had the COD date late this year. At COD that's when the Carlsbad transaction closes. So, think about it this way: it's dollars in for Carlsbad and then replenished on the basis of, the sort of the prewired monetization that's simply subject to arriving at COD later this year.

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

Q

Okay.

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

A

So it's literally neutral-plus in the context of the confines of 2018 in terms of capital allocation.

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

A

And that's the important part, I mean, the COD is late in this year. So it's within – it's just a temporal use of our capital.

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

Q

Great. And then what is your plan for Ivanpah and are there other – any other renewables left at NRG besides Agua Caliente which looks like you'll be selling later this year?

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

A

Yeah. Like I – yes, so Agua Caliente, we'll be monetizing that in early 2018. We are now in the process of marketing the other renewable projects that we're evaluating all options for Agua.

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

Q

Okay. That's all I have. Congratulations again, guys.

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

A

Great. Thank you, Abe.

Operator: Thank you. Our next question is from the line of Steve Fleishman of Wolfe Research. Your line is open.

Steve Fleishman
Analyst, Wolfe Research LLC
Q

Yeah. Hi. Good morning.

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

Hi. Good morning, Steve.

Steve Fleishman
Analyst, Wolfe Research LLC
Q

Hey, Mauricio. Just one clarification question. The 2018 pro forma for divestitures, the adjusted EBITDA is $1.6 billion now and when you gave this last time was $1.5 billion. So it's gone up $100 million. Can you just explain that change?

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

Yes. Well, I mean – Kirk can elaborate specifically. What I will tell you is – and I think the key message here is, when you think about that $1.6 billion and the incremental benefit from the margin enhancements and cost savings, we're very comfortable with the targets that we provided to you as part of the Transformation Plan, but... Kirk?

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

Sure. Steve, no change in obviously the underlying guidance, that being the beginning point. That's basically the impact of what we've now announced, you know, being removed on a pro forma basis and then aspirationally. Specifically, aspirationally as Mauricio said, includes Conventional and Renewables, all of which were a part of the original list of assets that we had earmarked for sale as part of the Transformation Plan. The primary notable exception, as was identified in the previous question is Ivanpah. So, if you think about that variance, it's the difference between Ivanpah previously being included in the assets that we earmarked and marketed for sale, and now having removed Ivanpah at least from the ROFO and line of sight in terms of monetization, that's the primary difference between what the pro forma number was you saw in the third quarter call and the $1.6 billion that you're looking at today.

Steve Fleishman
Analyst, Wolfe Research LLC
Q

Okay. But I guess, one way to look at it is, is that maybe the – relative to your initial, up to $4 billion the asset sale number was lower but now we also have more remaining EBITDA.

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

Correct. That is exactly [indiscernible] (00:20:36). There were some ins and some outs, you know Ivanpah...

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Okay.

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

A

[ph] Quente, and... (00:20:41) Yes. So, that's the right way to look at it.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Okay. Okay. And I know you aren't ready to talk on capital allocation, but you did on the initial plan talk to the 12% to 15% unlevered return targets. Is that still the kind of high level plan?

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

A

Yeah. Our philosophy on capital allocation has not changed in terms of our priorities of first running the business and operating the business safely in achieving our credit metrics and then the recurrence of 12% to 15% for growth capital. So that philosophy remains the same and we will have an opportunity to provide you a more comprehensive review of our capital allocation plan in the weeks to come.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Okay. Thank you.

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

A

Thank you, Steve.

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

Michael Lapides
Analyst, Goldman Sachs & Co. LLC

Q

Hey, guys. Just real quick one. Kirk, with all the asset sales, can you give us – and with the guidance, what does that imply debt-to-EBITDA and net debt to EBITDA is for 2018?

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

A

Yeah, I think what I'd refer you back you there Michael is, as recently as the third quarter call I think we gave you a pro forma view there. Obviously that includes not only the impact of what we still plan on allocating – consistent with the original Transformation Plan, that's at $640 million of incremental deleveraging, but supplemented in the net debt equation by the significant amount of surplus capital that we have. So, certainly we have capital, if you do the math on that page now that we've made this announcement, well in excess of that which is necessary to achieve that three times on a net basis.

So what we'd looked to do is obviously maintain that three times and then that would inform – that surplus if you will on the ratio – that would inform the amount of excess capital we have for consideration for other allocation moving forward. But as Mauricio said, we'll provide you a comprehensive summary in the Analyst Day, but for the avoidance of doubt, we are very confident in our ability to be a three times net debt to EBITDA in 2018.

Michael Lapides
Analyst, Goldman Sachs & Co. LLC

Q

Got it. And just one quick question – follow-up and – why three times? Like, I'm just curious kind of how you got to that as the benchmark versus another number? And the only reason why I ask is that compares sometimes to some of the other NRG or other cyclical industries, and just want to make sure I have the framework in mind.

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

A

Yeah, totally understand the question. Well, first of all, as we've said before, that's not a static number; it's something we constantly review. We won't look it philosophically as, I said it and forget it if you will. But in context, I think that strikes the right balance in terms of flexibility, reasonable degree of leverage, so you get the right amount of performance on the equity side of the equation. Preserves our ratings, which are very important to us, that BB rating, so we have reliable access to capital going forward.

And I've heard this before – and we obviously look as you do comparatively speaking within and outside of our industry. And one of the things that informs our thinking, while EBITDA is obviously important, nominally speaking when it comes to that ratio, there is no substitute for cash. And what really fuels that difference and I think is important and we look through, it's the quality of that EBITDA turning into cash. So, if I'm looking at a lower leverage ratio on EBITDA for example, if $0.50 or less of every one of those dollars is turning into free cash flow that informs the quality of that metric. We look at it through the lens of, on a pro forma basis at least two-thirds of every dollar of EBITDA translates into cash. And to me that's the real deleveraging power and flexibility and that also – even though we don't talk about it normally in the three, is what helped inform the process to get comfort with that net debt-to-EBITDA at three times; it is the power of translating EBITDA into cash on a pro forma basis.

Michael Lapides
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Thank you, Kirk.

Operator: Thank you. And this does conclude today's call due to time. I would now like to turn it back over to Mauricio Gutierrez for closing remarks.

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

Thank you. Well, thank you for your interest in NRG and look forward to speaking with you in just a few weeks on our fourth quarter earnings call. Thank you.

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