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NRG Energy, Inc. (NRG)

Acquisition of Vivint Smart Home, Inc. by NRG Energy, Inc. Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and thank you for standing by. Welcome to the NRG Energy, Inc.'s Business Update 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'd now like to hand the conference over to your speaker today, Kevin Cole, Head of Investor Relations. Please go ahead.

Kevin L. Cole

Senior Vice President-Investor Relations, NRG Energy, Inc.

Thank you, Shannon. Good morning and welcome to NRG Energy'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.

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, and good morning, everyone, and thank you for your interest in NRG.

Today, we have an exciting business update that is consistent with our strategy of moving closer to the customer. I am joined this morning by David Bywater, CEO of Vivint Smart Home; Alberto Fornaro, Chief Financial Officer of NRG. Also on the call and available for questions, we have Elizabeth Killinger, head of NRG Home.

I want to start with the three key messages for today's call on slide 4. First, we have reached an agreement to acquire Vivint Smart Home. This transaction further integrates NRG into the home and creates the leading essential services platform in North America, accelerating the growth plan presented at our Investor Day last year. Second, Vivint is a highly complementary business as it expands our customer network by nearly 40% and provides the smart home technology needed to strengthen our platform and drive better customer insights. Finally, this transaction creates significant shareholder value. It exceeds our stated hurdle rates, maintains our strong balance sheet, and improves our earnings profile.

I'd like to go right into a summary of the Vivint acquisition on slide 5. Over the last few years, we have been very clear about our intent to grow and deepen our relationship with customers by offering adjacent products and services through a combination of organic growth, M&A and partnerships. The acquisition of Vivint significantly advances our customer-focused strategy with a highly accretive and complementary business, while maintaining a strong balance sheet and financial flexibility. Vivint is a leader in the smart home sector and will bring new capabilities, long-duration customers in attractive markets, a robust sales channel, and a scalable technology platform that we can leverage across our business.

This transaction is compelling at an implied multiple of 6.3 times EV to EBITDA after synergies. We will leverage our operating platform to achieve $100 million of run rate synergies over the first three years. We have agreed to purchase Vivint for $12 per share or $2.8 billion. This transaction will be financed through a mix of debt, hybrid securities, and cash on hand. We intend to keep the existing $2.4 billion of Vivint net debt in place, which significantly de-risks our financing plan for the transaction.

Alberto will provide more detail around our financing plan and the impact to our 2023 capital allocation and financials later in the presentation. For 2022, there will be no changes to our capital allocation plan. Finally, we anticipate closing in the first quarter of 2023. Hart-Scott-Rodino is the only approval needed to close the transaction. Notably, we have already received consent from Vivint shareholders representing a majority of shares outstanding in support of this transaction.

Now, turning to slide 6. During our Investor Day last year, we provided you a strategic road map for how we plan to evolve beyond power and become further integrated into the home. Our road map was also informed by the consumer trends we saw in the marketplace, which continue to guide our strategy today. We spoke to consumers to fully understand what was missing in their current experience. The feedback we received matches many of the macro trends we all know to be true. Electrification continues to grow, cleaner and more resilient energy is needed at home, simplicity matters and brand trust is everything.

Since Investor Day, we evaluated adjacent areas of expansion like home solar, EV charging and batteries, all complementary to our portfolio. Through our test and learn process, it became clear that there is a tremendous opportunity to bring together an integrated ecosystem on connected products and services. Over the course of today's presentation, you will see how Vivint fits perfectly into our strategy and truly enables us to create a unique platform with expanded capabilities.

So, let me start with how Vivint brings some of those capabilities on slide 7. Vivint is a leader in smart home solutions with almost 2 million highly engaged and long duration customers. The suite of products that they offer focuses on security, automation, and residential solar, all integrated under a single technology and data platform. As we think about their business, they are very complementary to ours. First, they have a well-established technology and product center that maintains and operates a unique cloud-based platform. And second, they have an acquisition and service engine based primarily in the direct-to-home channel with a proven track record for growth and customer satisfaction.

Their integrated smart home approach creates engaged and durable customers with an average tenure of nine years, which results in stable and recurring earnings from their subscription-based model. The high engagement ecosystem also allows them to access significant amounts of data and the right insights that are used for driving product and customer experience innovation. Later in the presentation, David will provide additional details on Vivint's business and capabilities. But as you will hear throughout the call today, we are very excited about the complementary nature of our two businesses and the value we can unlock together through this combination.

One of the key benefits for this transaction is that it accelerates and materializes the growth plan we presented at our Investor Day last year. On slide 8, we compare our plan targets with the transaction pro forma. The short story is this. We exceed our targets in every category today and at value. If you recall, our growth plan contemplated $520 million of incremental EBITDA. We told you we were going to launch several test and learn initiatives to validate our assumptions and determine the right business model and go-to-market strategy. Well, this highly accretive transaction provides the certainty on how we're going to achieve these goals and when. We now expect to deliver $835 million of incremental EBITDA in 2025, a 60% increase from our baseline. We will double our customer growth target two years ahead of schedule and we will have a stronger platform to connect our suite of products, increasing the opportunity to cross-serve and optimize our expanded customer network.

So, with that, I will pass it over to David.

David H. Bywater

Chief Executive Officer & Director, Vivint, Inc.

Thank you, Mauricio, and thank you, everyone, for joining us today. This truly is an exciting day for both Vivint and NRG. Today's announcement marks an important milestone for Vivint and our stockholders. Our agreement with NRG received unanimous support from our Board of Directors and is the culmination of our board's ongoing pursuit of maximizing value for Vivint stockholders. This transaction delivers immediate and certain cash value of $12 per share to Vivint stockholders. With that said, I'd like to now share more about how we got here.

As noted on slide 10, Vivint is an integrated smart home platform focused on a seamless end-to-end consumer experience spanning hardware, software, sales, installation, support and professional monitoring. Vivint has built an incredibly strong brand over the past two decades. Since our founding in 1999, Vivint has grown from a small security systems company into a premium provider of smart home technology and services. Our mission is simple, to redefine the home experience with technology and services to create a smarter, greener, safer home that saves our customers' money every month. Today, Vivint features 11,000 employees nationwide and has services available in 98% of the US ZIP codes, serving nearly 2 million customers throughout the United States.

Our average smart home customer installs approximately 15 devices in their home, interacts with our system more than 12 times per day and stays with us for approximately nine years. Our strategy of developing our own platform and technology allows us to innovate and continuously improve the customer experience, which leads to increased loyalty, lower attrition, longer customer life, and expanding customer lifetime value.

Turning to slide 11, throughout our steadfast focus on developing a comprehensive suite of smart home products, we've helped our customers create a smarter, greener and safer home. This includes creating a proprietary cloud-based home platform to connect the home, as well as the Vivint operating system, that seamlessly integrates our products into a unified, intuitive experience.

As a result, Vivint has built a unique, integrated business model and platform that provides a distinct advantage in a rapidly expanding smart home market. Over the last several years, NRG has been executing a strategy to expand beyond its core energy business into retail and home services and Vivint is a critical part of that vision. Simply put, [Vivint] and NRG are a strong strategic fit. NRG has a clear vision for the future of smart home that is a perfect complement to Vivint's mission.

If you reference now page 12, by joining forces with NRG, we will create a leading essential home services platform fueled by unparalleled insights on the home, proprietary technologies and complementary sales channels. Because we own our back end, we have over 1.4 billion events per day of data. This will allow us to bring to NRG a very intelligent ecosystem fueled by AI and machine learning. The richness of that data will significantly benefit our ability to serve our customers in an integrated fashion moving forward.

Now, let's turn to page 13. We are the premium provider within a large and rapidly growing smart home market. We provide a seamless end-to-end customer experience spanning hardware, software, sales, installation and support. We have a proprietary cloud-based platform with differentiated technology advantages, and our subscription model with highly predictable contracted recurring revenue is highly attractive with the average customer lifespan of nine years and growing. NRG plus Vivint will create the leading integrated smart home provider, fueled by proprietary technologies, complementary sales channels, and a network of over 7.4 million customers. Together, we will continue to deliver peace of mind by providing smarter energy, innovative services and essential connections, leading to greater customer satisfaction, support and cost savings.

Not only do we have complementary businesses, but our companies also share strong cultural alignment centered around safety, compliance, innovation and serving our customers and communities. This transaction is a testament to the hard work and dedication of all of our employees. They have risen to meet every challenge and have consistently exceeded expectations to deliver quality solutions to our customers. We look forward to being part of NRG to create exciting opportunities for our employees and our customers as part of a larger platform. As we look ahead, I am confident that the future is exceptionally bright for Vivint as an NRG company.

With that, I'll turn the call back over to Mauricio.

Mauricio Gutierrez

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

Thank you, David.

Turning to slide 15, you can clearly see how we're creating the leading essential services platform across energy and home services. A combination of trusted brands, bundled offerings and a scalable operating platform is a powerful value proposition, and this is why we're so excited about the opportunities ahead. NRG has built the only residential electric and gas provider that leverages a national platform, provide unique insights and convenience for customers with their energy needs. The addition of Vivint supercharges the in-home experience with a technology backbone that can enable seamless integration of our collective services. It also adds security, home automation and residential solar to our offerings. Importantly, the energy and home services we provide to consumers are essential to their lives. Everyone needs power. Cleaner and more resilient energy is in demand. People who own their homes want to protect it. And more than ever consumers have an expectation that all of these pieces can be connected in a way that provides a seamless experience. And that is what NRG plus Vivint will do together, deliver peace of mind from a trusted service provider.

Now, turning to slide 16. This transaction goes beyond the expansion of our product capabilities. It strengthens our entire core operating platform and sets the stage for continuous growth and execution of our strategy roadmap. As I said before, data and connected devices provide a new backbone for our customer experience. Our platform will be integrated into a smart home ecosystem drawing on hundreds of events around the home to generate an unparalleled level of actionable insights. These large and comprehensive datasets will not only personalize our customers' specific needs and wants, but also provide new revenue stream opportunities.

The acquisition also strengthens our sales channel strategy. Vivint's leading direct-to-home sales force provides a consultative approach to sales that is key not just for smart home, but also for other products like solar and batteries. Because of the complementary nature of our business, one of the immediate opportunities we have is to cross-serve across our expanded network of customers. Let me put a finer point on this opportunity on slide 17.

Our combined offerings will have complementary products that can be bundled to create high-value services. Our geographic overlap allows for rapid deployment in key markets. Under a common operating platform, we can reduce both cost of acquiring customers, but also the cost to serve them as we integrate both businesses and achieve economies of scale. The opportunity to sell energy to Vivint's customers and to sell smart home and solar to NRG customers will translate into meaningful value. We estimate that every 10% of cross-sale penetration on our respective customer groups would generate approximately $300 million of incremental EBITDA per year. This creates a tremendous opportunity within our existing customer base. Beyond this opportunity, I see further upside value that will be unlocked in two ways, as you can see on slide 18.

First is to expand customer lifetime value over time. As our operating platform evolves, it will create a cycle of increased insight with billions of interactions from smart home and energy solutions, we will strengthen our understanding of customer needs and preferences. These insights will drive enhanced cross-serve opportunities, optimize our cost to acquire and increase margin. The impact of all of these combined benefits could increase customer lifetime value 2 to 3.5 times. Second, the markets we're entering provide us tremendous amount of growth potential. Our current retail energy markets are very attractive, but they have modest growth rates and regulatory constraints that limit our market share. Markets such as home automation, home services and energy services represent a combined $165 billion total addressable market, with double-digit growth rates, reflecting the consumer trends I discussed earlier in the presentation. Between higher customer lifetime value and larger market opportunities, we are poised for considerable growth.

I will now turn it over to Alberto to provide a financial review of the transaction.

Alberto Fornaro

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

Thank you, Mauricio.

On slide 20, we outline the pro forma debt structure and the acquisition financing strategy. Given current market conditions, we minimize the acquisition financing risk by adopting a ring-fenced debt structure that maintains in place the current Vivint bond and debt instruments. These options allow us to considerably decrease the amount needed to be raised from the market, maintain the more favorable terms and condition of Vivint debt instruments compared to current market and minimize the one-time cost associated with the potential redemption of Vivint debt instruments.

Vivint's debt totals $2.7 billion and include two bonds maturing in 2027 and 2029 for a total of $1.4 billion, and a pre-payable term loan for approximately $1.3 billion maturing in 2028. The equity purchase price and the transaction costs amounting to approximately $2.89 billion will be funded through a mix of cash and debt instruments and backstopped initially by a bridge facility. The breakdown includes $600 million of cash on hand, of which $200 million is from Vivint excess cash, $500 million from upsizing the NRG revolver credit line and $1.4 billion from a mix of additional bond and non-convertible preferred security to be raised in the capital markets. Once these financings are completed, NRG recourse debt will only include $1.1 billion of bonds maturing between next year and 2026 will be mostly fixed rate with a significant portion pre-payable or callable. We have laid out a detailed plan to finance the Vivint acquisition. However, the reduced need to access capital markets and the availability of the bridge financing give us flexibility on the timing, type, and mix of the instruments that we ultimately decide to issue.

On slide 21, you can find the summary of the pro forma combined 2023 key financial metrics and 2025 equivalent run rate for the combined businesses. For NRG, we are using the midpoint of the 2023 guidance recently released, while for Vivint, since they've not issued yet a 2023 guidance, we are using its 2022 EBITDA as a baseline for the pro forma calculation and a consistent estimate of its equivalent free cash flow before growth, assuming the transaction closes on January 1, 2023.

We expect to achieve $100 million of cost synergy over the next three years, of which $35 million is expected in 2023. Approximately 80% of the synergies are expected to be realized as a reduction of general and administration expenses, mostly optimization of corporate, IT and other expenses, while the remaining amount is related to lower consumer financing program costs.

As indicated by Mauricio, we have not included in our pro forma run rate any revenue synergies which are a significant upside. Overall, Vivint's contribution to the combined free cash flow before growth is estimated to be around $170 million in 2023 and reach $255 million by 2025, driven by the realization of synergies and the reduction in interest expenses to be achieved through a partial reduction of Vivint's debt.

We also expect that the net interest expenses on the additional debt incurred for the acquisition will be reduced to zero by 2025. Overall, this transformational transaction allow NRG to dramatically accelerate to 2023 the execution of our 2025 growth plan.

Let's now move to slide 22. The main objectives of the 2023 capital allocation are Vivint acquisition financing and the accelerated reimbursement of debt to bring the leverage ratio back in line with 2022 year-end levels. Going now into the details, let me say first that the 2022 capital allocation remains unchanged and therefore, we plan to fully execute the $1 billion share buyback plan announced in December 2021. In our Q3 earning call, we anticipated that 2022 excess cash not allocated was equal to $286 million, adding approximately $300 million of Vivint excess cash and the 2023 pro-forma free cash flow before growth next year, capital available for allocation reaches $2.3 billion. We plan to use $100 million to increase our minimum cash requirement and $600 million of cash for the Vivint acquisition. During the course of the year, we will reduce our leverage by $900 million, targeting NRG pre-payable debt. We've also included $145 million for Vivint integration costs and one-off expenses after the acquisition. We've also added to the dividends to our common equity shareholders an additional $70 million for the holders of the to-be-issued preferred equity instruments. After accounting for some remaining cash to be absorbed by other net investments, we will have $150 million of capital to be allocated in the future.

Moving to slide 23, we believe that it is critical to mitigate right away and then eliminate the impact of the acquisition on our credit profile. Our capital allocation objective is to bring the leverage ratio at the same levels of 2022 by the end of 2023, as well as strengthening the balance sheet through the issuance of quasi-equity instruments. And this has been understood and appreciated by the rating agencies. During our extensive conversation with them, we have highlighted the key benefits of this business combination. The possibility to count on significant additional long-term contractual revenues, the contribution of the cost synergy to the bottom line and a significant opportunity over time to multiply the interaction with final customer and in this way improve retention and drive additional product and service sales is a decisive step for NRG to continue its transformation into a consumer products and services company. Based on our conversation with the rating agencies, we don't expect that this transaction will have a material negative impact on our credit profile.

Back to you, Mauricio.

Mauricio Gutierrez

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

Thank you, Alberto.

I'd like to give you an update on capital allocation on slide 25. As you may recall, I shared our plan for 2023 on our third quarter earnings call where I indicated that we would allocate capital consistent with our long-term principles of 50% to growth investments and 50% to return of capital. As you can see on the slide, 2022 was heavily weighted to return of capital since it was a staging year for growth and share repurchases provided for a better return.

As we move into 2023 and given the compelling economics of the Vivint transaction, it is appropriate and consistent that we devote more of our capital to growth, expect to return to our 50:50 principles in 2024 with a continued commitment to growing dividends per share and achieving investment grade credit metrics.

Now, let me close with some final thoughts on our compelling value proposition. Through this acquisition, we have created the leading essential home services provider with a portfolio of respected brands and diverse products and services for nearly 7.5 million customers and now, it is underpinned by an end-to-end smart home ecosystem. We are positioned to grow in large and attractive markets where we can leverage our existing operating platform to achieve higher margins and increased customer lifetime value.

We have greatly improved and diversified our financial profile with a resilient, subscription-based model that will result in a stronger long-term financial profile. We remain committed to a strong balance sheet and maintaining the financial flexibility to invest capital at attractive returns, while returning significant capital to and creating sustainable value for all stakeholders.

And finally, we have great people. As I look at what each of our companies have accomplished, I am tremendously excited to bring them all together. We look forward to sharing more with you on our 2023 Investor Day.

So, with that, I want to thank you for your time and interest in NRG. Shannon, we're now ready to open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Shar Pourreza with Guggenheim Partners. Your line is now open.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC
Q

Hey, guys. Good morning. Good morning, Mauricio.

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

Shar, good morning.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC
Q

Mauricio, can you just – couple of questions here. Can you just maybe speak to the free cash flow conversion profile of the Vivint business itself? It looks like it's slightly lower than the platform you have today, if we pro forma. Is that just a structural attribute of the segment or will that improve through time? Just a little color there would be helpful.

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

Yeah, Shar. No, you're correct. The EBITDA to free cash flow conversion is lower than we have today. And I see that as an opportunity and I think we have a lot of room for improvement. So, there's a couple of things that are impacting that. First, I think there's an opportunity on the balance sheet and just the leverage that Vivint currently has and the optimization that we can do. Secondly, I think there are opportunities around efficiencies to lower the cost of acquisition and to lower the cost of – to serve, which can increase that cash flow conversion.

Importantly, Shar, and I think this is difficult to see on the financials. Their recurring subscription-based revenues, their cash – the EBITDA to cash flow conversion is close to 75%. So, you can see that, that free cash flow is impacted by the acquisition of new – of customers. But if you look at their recurring subscription-based revenues, their cash flow conversion is really, really high. So, as we gain scale overall in the platform, we're going to be increasing that cash flow conversion.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC
Q

Got it. Okay. That's perfect color. And then just based on the cross-selling potential here, you obviously indicated in the slides, in the remarks, 10% penetration of the existing network is potentially $300 million in EBITDA per year. I guess, what is the cost and timeline to get there? And with 80% of the customers outside of ERCOT, does not having proximity change the cross-selling opportunity maybe make it a little bit harder?

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

Yeah. So, a couple of things. Number one, in terms of timing, obviously, this is the path of least resistance to creating value, right? I mean, we know a lot about our customer network. There's no one that knows more about our customers than us. So, this is a way to optimize and to have a compelling value proposition for that and bundle our service both for NRG customers and for Vivint customers. We're going to cross sell. What I said in terms of the geographic overlaps, Shar, is that we have the capabilities, their team is ready in Texas and in other states for rapid deployment. What you actually don't want is a lot of overlap of customers because then the universe will shrink. But if there is little overlap in areas where we actually have operations, that just means very rapid deployment and increase the probability of conversion. So, this is what is incredibly, incredibly exciting and not factoring yet in our financials that we're presenting today.

We just put some stake in the ground and to give you an order of magnitude, if we're able to penetrate this by 10%, it's significant value creation. Significant value creation. So, obviously, there will be a cost associated with it. But net-net, I mean, the internal – the IRR that we get for every customer that we close are very, very compelling and this is one of the areas that we're going to be looking at on day one.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC
Q

Perfect. And then quickly, last one for me is some of the peers you guys included in the multiple expansion slide, that's slide 28, I think, they offer some more, let's say, capital intensive services like home generation. Is that a segment you could see yourself increasingly participating in or is the plan to really remain closer to the software service side?

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

No, I mean, we're going to be looking at, as I said, services and these now smart home ecosystem that is going to bring all our products together. Now, remember that we've been working on Goal Zero on a battery storage solution that we believe is a – it fits on every dwelling in the United States, not only the people that have big backyards or wherever they can put standby generators. I mean, this is something that they can put in any residence. So, you can now see how Goal Zero fits really well with the technology platform that Vivint has. And it will be an integral part of the offering – the smart home offering that we're going to provide. So, I don't think we're going to be looking at backup generators. I think what you need to be thinking about is how do we accelerate the adoption of our battery storage solution that we have in Goal Zero within Vivint's ecosystem.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC
Q

Got it. Perfect. Thank you, guys. Congrats on the deal, and it's good to see some transactions happening. Thanks. Appreciate it.

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

Thank you, Shar.

Operator: Thank you. Our next question comes from the line of Angie Storozynski with Seaport Research Partners. Your line is now open.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Thank you. So, my first question is about the timing of this transaction. Given that the economy is slowing or seemingly slowing, how do you think that's going to affect your EBITDA margins and customer acquisitions?

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

A

Yes, Angie. So, I mean, it is not lost on us the macroeconomic backdrop that exists. I believe that this is the right transaction at the right time and compelling economics. So, let me tell you what it does immediately for our business. I think it makes our platform stronger and more resilient in a downturn economy. So, the first thing it provides us with a recurring revenue stream with high credit quality customers with long duration, over nine years, number one. Number two, it creates a tremendous opportunity to unlock value within our own existing customer network whether you want to call it revenue synergies or other thing. This is what I was discussing with Shar, I mean, the first focus will be how do we create value within our existing network because we can actually acquire customers at much lower cost. And we know who those customers are and we know how to get to them. So, that's the second thing.

The third one, it makes our platform stronger from adding capabilities and connecting all these products and services together. So, as opposed to thinking about it – I think it actually makes our consumer services platform more resilient and with more clarity in terms of recurring revenues.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Okay. And just a quick follow-up, so given that there is a solar panel installation portion of the business, that's a business you chose to exit in the past. So, if you could just give me a sense how this past business versus this business compare?

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

A

Yes. No, Angie, so, as you know, this is not our first time to be looking at how do we go-to-market on solar. I told you about a year and a half ago, we were going to start some test and learn. We actually launched some pilot programs and I said specifically, we're not going to get into the installation and financing on solar. And guess what, Vivint actually, their business model is completely aligned with us. They don't do installation. They don't do financing. They're really just starting to ramp up their solar operations. And I have to say, even without much trying and, David, feel free to chime in here, they already have 100 megawatts installed per year. And these are relationships that you make with customers, not for three or four years. These are 15-year relationships that allows us to upserve and cross-sell a lot of our other products and services. So, first, I am really – when we identified Vivint, we saw their – how they're tackling their residential solar business and it was in complete alignment with us. Really, the value is around sales, acquiring customers and then connecting the solar into the ecosystem, the smart home ecosystem. But David, I don't know if you have something here to add.

David H. Bywater
Chief Executive Officer & Director, Vivint, Inc.

A

Yes, great question. And I know solar quite well because I ran Vivint Solar for five years. And as I approach this at Vivint Smart Home, like Mauricio said, we wanted to do it in an asset light way and a customer centric way. When we looked at what customers want to bundle with Smart Home, they had a high desire to bundle solar as a solar. So, our asset light approach, where we partner with installers and with financing partners, is a perfect way to do this and it will extend our lifetime value of the customers, will deepen that relationship. And I am so excited about what NRG brings to the equation, where we can bring rich data now around production, not only around activity in our home, but now around consumption. Just the richness of the opportunity set for us to delight customers is unparalleled. It's just incredible. So as Mauricio said, we happen to be on the exact same wavelength on how to approach this market. We think it's the right risk adjusted way to do it. It's an important market to be in. It is very complementary with everything that NRG represents and our ability to delight customers will be unparalleled. So, it is a – it's a great way to go about bringing residential solar to the NRG customer base.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Thank you.

Operator: Thank you. [Operator Instructions] Our next question comes from Steve Fleishman with Wolfe Research. Your line is now open.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Yeah. Hi. Good morning. Could you give more color on Vivint's current business mix by service?

David H. Bywater
Chief Executive Officer & Director, Vivint, Inc.

A

I'll take that, if you don't mind. So, the vast majority of what we do is Vivint Smart Home. So, this year, we'll do about $100 million in revenue from solar. We're $1.718 billion in total revenue. So, the majority of this is, as Mauricio described, reoccurring business models with an average lifespan of nine years, with extremely attractive service margins and that length of duration has continued to expand year after year after year. So, this is really a smart home play. That's our core business. And the solar is becoming an increasingly important complementary piece of it. But that represents $100 million of our total revenue profile.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Okay. And is smart home mainly home security, or is it – yeah?

David H. Bywater
Chief Executive Officer & Director, Vivint, Inc.

A

For us, home security is part of smart home. When you – today, our customers when they buy us, they always get the security component, but they are always buying cameras. They're always buying sensors, locks. It's – about 40% of it, I would say, is kind of a security need. The other 60% has really evolved over the last 10 years and has really driven up the stickiness of our customers and the engagement. Mauricio made a comment earlier today that it's so important. On average, our customers interact with us 12 to 13 times per day. There is incredible intimacy and engagement with our customers and the smart on the full complement of smart home just brought that stickiness. We are with them every day. We drive decisions with them every day. And I think that's what allowed us to have industry-low attrition, industry-high growth and consistent growth, both economically challenging times and economically rich times. But it's really just the smart home play that incorporates, encapsulates security.

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

A

And Steve, if I'll just put a finer point there because I think it's incredibly important is the amount of information, data and insights that we're going to have from the home is unparalleled. I don't think there is any company that will have the visibility and the insights that we will have to better understand our customers, to improve that customer experience that drives loyalty to the brand, that drives higher retention and ultimately lifetime value of the customer. So, if you understand, if you are engaging with them every single day, the brand awareness and the brand loyalty that you develop through that interaction is incredibly valuable. And I think people are going to start to appreciate that.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Okay. I may have some follow-ups here later. But just on the financing, how much of the $1,390 million will be the hybrid? Is that just going to be – is it going to be convertible or not convertible?

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

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No, it is not going to be convertible, first of all. And regarding that, imagine we are thinking something like a 50/50. But again, we will keep the flexibility of that depending on the market, and particularly the time we go to market. So, it has been – the reason we have gone into that direction is because it help us to strengthen our balance sheet. And at the end of the day, it avoids to go to the equity market and keep everything inside the bond and into the equity – similar to equity. That's the reason we have considered that inside our capital structure. It's also a way to diversify our sources. And it will be – will create some financial flexibility because it's an instrument that normally is callable after five years.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Okay, great. One last question just on this follow-up to Shar's on the CapEx of the business. So, I guess it's just kind of a footnote that says, that it's the cost to acquire new customers, but then it also says you're excluding the cost to grow customer count. So, I'm trying to just understand what is in the CapEx and what's not in the CapEx.

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

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Yes, yes, Steve, I mean, one is to maintain the customer base. The other one is to grow the customer base. So, I think that the trend of the line of the demarcation that we're using between just maintaining the business and growing the business. Alberto?

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

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Yeah. So, when you look at the net capitalized cost to what we have done because we used the definition of free cash flow before growth, we're basically trying to highlight how much of these net capitalized cost are going to customers that are simply replaced, and it's due to attrition to the piece instead to that increased the number of customers. And that's why we had split the number in two pieces and provide it in the footnote.

Steve Fleishman
Analyst, Wolfe Research LLC

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Okay. That's helpful. Thank you.

Operator: Thank you. This concludes the question-and-answer session. I'd now like to hand the conference back over to Mauricio Gutierrez for closing remarks.

Mauricio Gutierrez

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

Thank you. Thank you, everyone, for your interest in NRG. This is a truly, truly exciting time. This is a transformational acquisition that we're making that is going to make our business much stronger. And I want to thank David for joining us today on the call. So, I look forward to speaking with all of you soon. Thank you.

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