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NRG Energy, Inc. (NRG)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen and thank you for your patience. You've joined the NRG Energy Inc., Second Quarter 2019 Earnings Call. At this time all participants are in a listen-only mode. Later we will conduct the question-and-answer session and instructions will be given at that time. [Operator Instructions] As a reminder this conference may be recorded.

I would now like to turn the call over to your host, Head of Investor Relations, Kevin Cole. You may begin.

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

Thank you, Lateef. Good morning and welcome to NRG Energy's second quarter 2019 earnings call. This morning's call is scheduled for 45 minutes in length and is being broadcast live over the phone and via webcast, which can be located in the Investors section of our website site 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 now 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. Good morning, everyone. And thank you for your interest in NRG. I'm joined this morning by Kirk Andrews, our Chief Financial Officer. Also on the call and available for questions, we have Elizabeth Killinger, Head of our Retail Mass business, and Chris Moser, Head of Operations.

Over the past three and a half years we have made significant progress in transforming our company from a traditional IPP to an integrated power company focused on our customers. We monetize our excess generation and rebalance our portfolio. We streamline our operations, which last our debt. We achieved our targeted credit metrics. We are perfecting our business to make it more stable and through all of these efforts we created tremendous financial flexibility.

As you can see, we have come a long way and I am very pleased with our progress and excited about the opportunities that lie ahead. However, the recent stock price performance does not reflect our confidence in the resiliency of our integrated model to deliver predictable and robust results. Our confidence in the business remains absolutely unchanged. We will continue to demonstrate the value of our business year-after-year.

So with that, on slide 3, we have outlined the key messages for today's presentation. First, our business delivered another quarter of stable results, demonstrating the value of our integrated platform during a period of volatile prices. And today, we are reaffirming our full year financial guidance. Second, we continue to perfect our integrated platform with the acquisition of Stream Energy and the execution of approximately 1.3 gigawatts of solar PPAs in ERCOT.

And third, we are making good progress on our capital allocation plan. During the quarter, we fully completed our debt reduction program and we have finally achieved our targeted investment grade credit metrics. In addition, we are announcing an incremental $250 million share repurchase program, which brings our total 2019 share repurchases to $1.5 billion.

Moving to the financial and operational results for the second quarter on slide 4. We achieved top decile safety performance and delivered $469 million of adjusted EBITDA. The second quarter results were driven primarily by higher wholesale power prices, offset by higher retail supply cost and mild weather, demonstrating the complementary nature of our Generation and Retail businesses. On the right-hand side of the slide, similar to last quarter, we have provided our EBITDA on a same store basis, adjusted for asset sales and deconsolidations.

As you can see, for the first half of the year, our business delivered $801 million or 7% higher than last year. Now beyond these financials, we made significant strides in further perfecting the stability and predictability of our platform. We launched our previously announced capital-light strategy, signing approximately 1.3 gigawatts of solar PPAs in ERCOT at an average length of 10 years, which complements our Generation portfolio, allows us to better serve our customers and further balances our integrated platform.

In addition, we close on the acquisition of Stream Energy. This acquisition increases our national multi-brand retail leadership position and that's more than 600,000 residential customer equivalents or RCEs with a run rate EBITDA of $65 million.

We also achieved our investment grade credit metrics by reducing our total debt by $600 million and executed on a number of transactions in the debt market at very attractive levels. This completes our balance sheet strengthening program and Kirk will provide additional details in his section.

Also during the quarter, we completed the latest $1 billion share repurchase program, bringing our total year-to-date to $1.25 billion. In addition, we are announcing an incremental $250 million share repurchase program to be completed by year end.

We will address our plans for the remaining $259 million of 2019 excess cash as we usually do on the third quarter earnings call. However, we're reserving up to $124 million of this capital for the Petra Nova project.

Let me give you some context. Back in 2014, when we closed the financing for this project, NRG and our 50-50 partner, JX Nippon, provided a financial guarantee to Petra Nova's lenders. These guarantees were to remain in place to support a one-time debt service ratio test, which prescribed a prepayment of principal in the event the ratio fell below the threshold. We have been in active negotiations with the project lenders and we now expect to fund the prepayment in the third quarter. Although, the final prepayment amount has not yet been determined, our obligation is limited to the guarantee amount. Once a debt repayment is made, the guarantee will terminate and the remaining debt will become non-recourse to NRG.

So now moving on to our summer update on slide 5, I wanted to provide you a brief update on the position of our integrated model even though we are only in the middle of the summer. As you can see on the left-hand side, second quarter weather was milder than normal, particularly in June, which impacted both prices and load.

Our portfolio so far is performing well. Starting with Retail, [Technical Difficulty] (00:08:13). We're also providing energy conservation alerts and demand management programs, which help consumers manage load during peak hours. The milder weather during the second quarter has resulted in lower volumes; unlike any other consumer business, if we sell less of our product, it will impact our results.

For Generation, we are maintaining excess length to help ensure against unplanned outages and load spikes. We expanded our pre-summer maintenance program to ensure our units can withstand increased run times. And we returned to service our Gregory plant. A 385-megawatt combined cycle plant, which provides additional reliability to our platform and to the ERCOT system ahead of this tight summer. Given how we hedge our portfolio, we expect to have limited exposure to price or volumetric risk.

I know we're only halfway through the summer and as we're seeing this week, ERCOT is in the middle of a high load, high volatility period with the rest of August still ahead of us. We remain focused across the organization on ensuring reliable operations and a successful summer.

Now turning to slide 6, I want to provide you an update on the ERCOT market. The supply/demand balance remained the tightest that it has ever been given strong load growth, previous asset retirements and lack of new builds.

In May, ERCOT released their semi-annual Capacity, Demand and Reserves report, or CDR, which outlines the expected supply/demand balance in the system and is shown in the upper left side of the slide. As you can see, future reserve margins are dependent on new builds, particularly wind and solar.

While the CDR report is helpful in understanding what is planned or possible, it has historically been a poor indicator of what actually gets build in the [ph] prior year (00:10:30). In fact, we have seen less than 50% of renewable projects included in the CDR reports, completed.

A closer look at the report revealed that 1.7 gigawatts are included from three natural gas plants that have already been delayed by an average of five years with no signs of moving forward. The report also does not yet include nearly 1.4 gigawatts of thermal generation that has already announced plans to retire. Together, this accounts for 4% of the reserve margin. Keep in mind that a little more than half of the 7 gigawatts of solar included in the report, have posted financial security for interconnection.

In the table on the lower left-hand side, we tried to adjust for some of these factors and estimate what is the amount of megawatts required from solar to maintain a reserve margin of 10% to 12%. As you can see in the table, we estimate over 17 gigawatts of new renewables are necessary to achieve those reserve margins in the next three years. We see this as a challenging given our recent experience signing solar PPAs and the backward dated forward power prices. Let me be clear, the ERCOT market needs a tremendous amount of investment to just simply maintain the low reserve margin it currently has.

Now from our platforms perspective, we're looking to facilitate solar new builds to improve grid reliability and rebalance our portfolio by entering into medium-term PPAs. These PPAs help enable the developers to attain cost effective financing and tax equity to economically develop the project. And for us, they complement our generation profile, lower our cost structure and allows us to better serve our customers.

From a market perspective, we expect ERCOT to remain tight and volatile for the foreseeable future even in the face of a large renewable build-up. This price environment should prove difficult for pure retailers or generators that will be exposed to swings in the market. Our integrated platform is well-positioned to thrive during this volatile and emerging renewable new build cycle. And you can expect us to deliver strong and predictable results.

I want to give one last comment regarding our markets. As you all know, FERC issue an order earlier this month directing PJM to delay the August capacity auction. While we're hopeful a final order will be issued by the end of the year, the timeline for FERC action remains uncertain. We continue to view a strong MOPR as the simplest and most cost effective way to reduce the harmful impact of subsidies on the capacity market.

As I mentioned at the beginning of the call, we have come a long way in achieving our goals. Slide 7 summarizes how we have transformed our business. We have significantly rebalanced our portfolio and streamlined our operations. Today, we have two complementary and countercyclical businesses that provides a stable and predictable earnings on their various market conditions. We are focused on perfecting our business and making it even more stable with a generation fleet that supports our Retail operations.

The more balanced we are the less exposure we have to the market and the more synergies we can achieve between the two businesses by crossing more Generation with Retail. We are no longer your traditional IPP exposed to the feast and famine of power cycles.

Now having deliberately changed the risk profile of our business, we have also realigned our balance sheet and achieved investment grade credit metrics. Now our focus will turn into achieving investment grade rating. We recognize that this business model is relatively new, but we're working hard to demonstrate the stability of our platform.

Finally, we have created tremendous financial flexibility for our business with our actions. Now with our deleveraging program behind us, we will focus our excess cash in 2020 and beyond on perfecting our model and returning capital to our shareholders.

With that, I will turn it over to Kirk for the financial review.

Kirkland B. Andrews

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

Thank you, Mauricio. Turning the financial summary on slide 9, for the second quarter, NRG delivered $469 million in adjusted EBITDA and $230 million in consolidated free cash flow before growth. This brings total adjusted EBITDA for the first half of the year to $801 million. As we did last quarter, we provided a walk from our first half 2018 results to 2019 to provide some additional details behind the year-over-year drivers for our results.

Starting with our first half 2018 results, we again eliminate the impact of asset sales, retirements and deconsolidations from our prior year's results. Deducting the $103 million impact of these items from 2018 results provides a baseline for comparison to our reported results for the first half of this year. Year-to-date, our results are positively impacted by incremental savings and margin enhancements from the Transformation Plan, which positively impact results by $66 million versus the prior year.

Next, year-to-date Retail results are $123 million lower primarily due to higher costs which impacted gross margins, with the remaining variants coming from XOOM Energy, which closed June 1st of last year and weather, as 2018 saw a positive benefit while the milder weather through June negatively impacted our 2019 Retail results, leading to a $35 million year-over-year impact.

Year-to-date Generation results were $108 million higher as more robust wholesale prices drove higher gross margins, offsetting the opposite impact of supply cost out of Retail, further validating the effectiveness of the integrated model. Behind the higher wholesale – beyond the higher wholesale price impact rather, higher emissions credit sales in 2018 were offset by the benefit of the Midwest Generation asbestos settlement in 2019. While we increased major maintenance expenditures in 2019 to ensure our Texas fleet, including the Gregory plant was fully prepared for reliable operations ahead of the valuable summer months.

With our strong outlook for the summer, together with our significant hedge position for the balance of the year, we are reaffirming our 2019 guidance ranges of $1.85 billion to $2.05 billion in EBITDA and $1.25 billion to $1.45 billion of free cash flow. While we are maintaining our ranges for the subcomponents of our businesses as well, given year-to-date results and our outlook for the remainder of the year, Retail results are more likely to trend below the midpoint while Generation is trending above its midpoint.

As in years past, we expect a bulk of our EBITDA to come in the third quarter, which, consistent with past performance, is expected to represent more than 40% of our annual results. We will update and narrow our guidance ranges on the third quarter earnings call.

During the second quarter, we deployed over $1 billion in excess capital, continuing to return capital to shareholders as well as achieving our balance sheet targets. Specifically, we completed the remaining $500 million of our share repurchase program announced on our fourth quarter earnings call, bringing year-to-date share repurchases to $1.25 billion, reducing share count by over 10% or 32 million shares at an average price of $38.80.

And as Mauricio mentioned earlier, we are announcing an additional $250 million share repurchase program, which brings total 2019 capital allocated to share repurchases to $1.5 billion. This past quarter, we also successfully executed a number of transactions in the debt markets through which we completed $600 million in debt reduction in order to achieve our target investment grade metrics, extended our nearest maturities and significantly reduced our interest costs. Part of our refinancing included repaying our secured term-loan in its entirety using both the $600 million in cash with the balance funded with the new secured notes.

These new secured notes contain fall-away covenants which automatically release the collateral, making the notes unsecured upon NRG receiving investment grade ratings from two ratings agencies. This covenant feature allows us a clear path to ensure the profile of our balance sheet aligns with that of investment grade without the need for additional refinancings in order to do so. Our refinancing and debt reduction activities this past quarter in total will also result in over $25 million in annual interest savings.

Turning to slide 10 for an update on capital allocation, with our refinancing activities during the second quarter, we have completed the allocation of 2019 capital toward improving our balance sheet, enabling the achievement of our targeted investment grade metrics and further improving our overall maturity profile.

Our new $250 million share repurchase program announced today brings total capital allocated to return of shareholder capital to over $1.5 billion in 2019 or more than 50% of 2019's excess capital returned to shareholders.

On August 1st, we closed the Stream Energy retail transaction, which, including transaction costs and working capital adjustments, totaled $325 million. With the closing of Stream and our new $250 million share repurchase program, based on the midpoint of our reaffirmed guidance, we expect approximately $250 million in 2019 capital remaining to be allocated as we generate the remainder of our free cash flow over the balance of the year.

As Mauricio mentioned earlier, during the third quarter we now expect to finalize the contractually required one-time leverage test for our Petra Nova project, which provides a formula for principal repayment in the event that debt service ratio falls below the defined minimum threshold.

Having successfully extended the deadline for this one-time test originally scheduled for 2018, as the operator of the oil field had taken steps to improve production, our expectation was the extended timeline would allow time for the ratio to exceed the threshold and avoid or delay any repayment.

As the year progressed, despite the production improvement initiatives, oil field production continued to lag expectations. And based on our latest discussions with the lenders, and the updated reserve forecasts they provide, we are now unable to further extend the deadline to allow more time for improvement and expect that this test will result in NRG being required to fund our 50% share of the required prepayment in the third quarter.

Although the exact prepayment amount is not yet finalized, NRG's obligation could be up to $124 million or 50% of the project's debt. As a result, up to $124 million of our remaining excess capital is now reserved to fund this obligation during the third quarter. Following the prepayment of the Petra Nova debt, which is not consolidated on NRG's balance sheet, the guarantee supporting the contingent prepayment obligation is then eliminated and any remaining debt is non-recourse to NRG.

Finally, turning to slide 11, with our targeted de-leveraging now complete, NRG's total debt is now under $6 billion or approximately $5.4 billion net of only our target $500 million minimum cash balance. That of course assumes that all capital is fully allocated.

Based on the midpoint of our 2019 EBITDA guidance, this places us at the midpoint of our targeted investment grade credit metric range or 2.625 times net debt to EBITDA. Including, however, a full year's run rate EBITDA contribution from the Stream Energy acquisition, this ratio reaches the lower ratio of our investment grade metric range or approximately 2.5 times, placing us in an even stronger balance sheet position as we move into 2020.

And I'll turn it back to you, Mauricio.

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

Thank you, Kirk. Turning to slide 13, I want to provide you a few closing thoughts. During the quarter, we made significant progress on our priorities of perfecting our platform, maintaining a sector appropriate capital structure and disciplined capital location. Today, I'm pleased with the conclusion of our nearly four-year chapter of strengthening our balance sheet. I want to thank Kirk and the entire team for their relentless discipline in getting us to a best in industry investment grade balance sheet.

The financial flexibility that we enjoy today, enabled us to further perfect our platform through the recent acquisition of Stream Energy, pursue our capital-light PPA strategy and take advantage of the current dislocated stock price through incremental share repurchases. NRG is clearly stronger than it has ever been. We now have a stability and financial flexibility to thrive and take advantage of opportunities through all market cycles.

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

QUESTION AND ANSWER SECTION

Operator: Yes, sir. [Operator Instructions] Our first question comes from the line of Julien Dumoulin-Smith of Bank of America. Your line is open.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Q

Hey. Good morning, team.

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

A

Hey. Good morning, Julien.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Q

Hey, pleasure. Wanted to first ask about the solar PPA announcements, certainly very interesting strategic decision here. How are you thinking about scaling these commitments over time, both with respect to PPAs rather than necessarily owning assets outright?

And then secondly probably relatively more critically, how do you think about this shifting your perspectives on further build out of solar in Texas? Certainly, we hear a variety of different viewpoints out there. You're not necessarily using your balance sheet obviously but you are seeing other developers pivot. How do you think about that in [ph] the fate of the (00:26:27) portfolio that you have?

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

A

Yeah. Well, first of all I'm very pleased with the execution of this capital-light strategy, kudos to the origination team. As we disclosed today, we closed on 1.3 gigawatts. That's a good progress. But what I can tell you is that we continue to be in the market, executing on additional volumes. Our goal is to complement the existing generation portfolio that we have to better match our retail load.

So when you think about how much more, you need to think about the retail load as the guideline on how much we're going to complement more our Generation product portfolio either through solar PPAs or other efficient ways of acquiring, I guess, length or generation.

Now with respect to the solar – the second question that you had around the solar view, what we wanted to do was to illustrate, if we were to maintain a 10% to 12% reserve margin, which we think is the minimum to have reliable operations over the long-term. We wanted to put it in context of how much solar you will need.

And as you can see, it's a pretty significant number, I mean over 17 gigawatts, including solar and wind. I can't tell you whether it's going to be one or the other, or if the price signals will change, that will make a thermal generation or conventional generation being built. What I can tell you is that, ERCOT needs a lot of generation, it needs a lot of investment. And even the numbers that we're providing you are only sufficient to maintain the current low reserve margin that we have. I think that's the main point that we were making.

Obviously the implication of that is we expect the ERCOT market to continue to be robust over the foreseeable future but more importantly to be pretty volatile, and we know that our business does well when we have both a lot of volatility and perhaps less of other robustness because we have really reduced our exposure to market by balancing our Generation and Retail businesses.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Q

Excellent. And then if I could just follow up here real quickly strategically, I mean we've seen some comments from your peers of late about their views about the depressed market environment and valuations. Anything comparable that you would offer up at this point, I mean just with respect to your differing business models and take private scenarios et cetera, just any commentary there?

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

A

Well, that's a lot of questions in one question, Julien, so let me see if I can just touch...

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Q

Take it as you will.

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

A

No, no, on the integrated model or our view on how we are positioning our company given the market trends that we're observing today. And I'm glad you're asking that because I do believe that we actually have a very unique and differentiated platform. As I mentioned to you, our goal is to better balance our Generation and our Retail businesses. I mean, these are two complementary and countercyclical business. So to the extent that we match them better they become even more complementary on a relative basis.

Now when I say better balance, it also brings other benefits. We can actually increase the matching internally between our Generation and Retail, which maximizes the synergies that we have talked about now for 10 years, collaterals synergies, friction cost synergies. To the extent that we better match those two, we reduce our exposure to the market. I mean, we will continue to interact with the market but we don't necessarily have to, if it's perfectly matched, which makes our platform a lot more stable, which is one of the goals that we're trying to achieve with these new integrated platforms, stable and predictable earnings.

If you look at the better balance, we have, as I said, more complementary and it's important on a relative basis. So if you think about where we were, let's say, five years ago when our Generation business was outsized from our Retail business, we actually had excess generation and that excess generation was exposed to wholesale power prices. Now we have reduced that significantly. I'm not saying that's good or bad, all I'm saying is that that's not the model that we're pursuing. We're pursuing a model that is a lot more balanced than it has ever been.

Now from a dynamics standpoint, when you have a more integrated portfolio like we do, in a rising commodity price environment, obviously our Generation margins will increase and our Retail margins will slightly decrease. And when the commodity prices are declining the opposite happens, our Generation margins decrease and our Retail margins increase. What I can tell you is that we actually have a lot more degrees of freedom in terms of how much of the wholesale price increases or decreases, we can actually pass to our customers.

We know having – been in the business now for over 10 years, with empirical data that consumers – that the wholesale price is only one factor that consumers take into consideration, but it is not the only factor. If that was the case, we would not have seen the growth that we have experienced in any of the premium brands that right now exist in the market. So I mean I hope that that at least provides you a – I guess perhaps a slightly different perspective on how I think about how we're repositioning the company going forward.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Q

In deed. Thank you for the detail. All the best.

Operator: Thank you. Our next question comes from Greg Gordon of Evercore ISI. Your line is open.

Greg Gordon
Analyst, Evercore ISI

Q

Thanks. Couple blocking and tackling questions. First, when I look at slide – in the back of the slide deck, slide 33, your guidance for cash flow from operations and free cash flow before growth is unchanged and it has $95 million working capital assumption for the year. But in the quarter there was a fairly large working capital – a collateral posting on slide 35, you showed $246 million. So is that basically expected to reverse out over the year? Can you give us some – [ph] I know the full (00:33:58) year guidance is still okay.

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

A

Yes. Greg, it's Kirk. That's correct. I mean typically speaking we're in the sort of the middle of our collateral or liquidity intensive period and it's always the case as we come through the summer and enter into the fall that's when we tend to get that collateral back from those postings or hedging that are more acute in summer and obviously the move into the power prices to effect that. So short answer is yes.

And the only other change that I'll note for you is obviously we adjusted the interest payments a little down to reflect a partially [ph] year impact us (00:34:32) on refinancing we did and we have a slight uptick in not really working capital but just changes in other assets and liabilities over the course of the year, so it has to do with the asbestos settlement. So that's the other reason for a little bit of the changes between the lines, EBITDA and adjusting cash from operations. But obviously we don't expect that to have an impact on the bottom line on free cash flow before growth. And we do expect collateral to return and we're in line with our year's expectations on cash flow.

Greg Gordon Q
Analyst, Evercore ISI

Thanks. Great. And Mauricio, when I look at like slide 15 and the realized cost savings margin enhancements, working capital improvements, et cetera on the scorecard, you didn't have anything in the script with regard to your feelings on being able to hit those targets but should we assume that you're still on track to hit those targets in 2019 and 2020?

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

Yes, absolutely. I thought we have something on the priorities but I'm very comfortable hitting our cost savings targets by the end of the year, margin enhancement this year and next year. So everything is on track, Greg.

Greg Gordon Q
Analyst, Evercore ISI

Great. And then when we talk about these – the potential [ph] further up to (00:35:49) $124 million Petra Nova reserve guarantee, it's obviously – it's in the 10-K – it's been in the 10-K, but probably still surprised some people. What is going to – you said that there was a proscribed calculation. Is it a fair – is it a certainty that you'll have to post $124 million or are there sort of a sliding scale of potential payments you have to make inside a range so to speak? And then should be our expectation that whatever the remaining CAFA is net of that obligation that you'll allocate that on the Q3 call?

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

I mean, the answer of that question – it's Kirk, I think as Mauricio said, we will update our plans [ph] further (00:36:34) excess capital for you on third quarter call, so the answer to that question is yes.

As to the $124 million that is the maximum amount. That is not necessarily the expectation. It depends on the finalization of that calculation. But as I indicated, once that calculation is made and that prepayment amount is set, which we do expect to happen in the third quarter, the obligation falls away. It is a one-time test, it's a one-time guarantee and any remaining debt is non-recourse to NRG. So in short what I would say is we expect to make a payment, we cannot tell you exactly what that payment is except to say it is absolutely limited to the amount of our guarantee, which is about $124 million.

Greg Gordon
Analyst, Evercore ISI

Q

Okay. My last question, Mauricio, sort of a different question along the lines of the solar contracts that you've entered into. I mean fundamentally, as you think about managing the business, you talk about really what you're trying to do is manage the spread between your cost of goods sold which is your fleet and your contracts and your revenue line which now is sort of fundamentally matched Retail. Are these – is this sort of strategy fundamentally reducing your run rate cost of goods sold in the marketplace? And is it one of the reasons why amongst other things you're confident that your EBITDA and free cash flow profile is sustainable over time? Can you talk about what that does in terms of offsetting people's concerns that perhaps over time Retail margins might decline – might come -- if Retail revenues to come down, if – your cost of goods sold would stays static and therefore margins would come under pressure. I think what you're telling us is that you can manage the numerator and the denominator through time and that's why you're confident that you've perfected the model?

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

A

Yeah, I mean that's exactly the goal of this strategy. I mean when we look at our total generation portfolio, our goal is to reduce, as you said, the cost of goods sold which now becomes our cost of generation and I will tell you that we have executed some of these PPAs at very attractive levels compared, particularly, to the market.

I mean, we are in the process right now of executing in the market and depending on the location because all of these PPAs are spread out depending on where we have the load. So they have very different pricing. Also, the tenure is different, I mean on average is 10 years, but some of them are a little longer than that, some of the them are a little shorter than that. The impact of these PPAs will come in full earnest, sometime in 2021. I can't give you – I cannot give you any more details in terms of where we have enter into these PPAs because obviously we're still in the market.

But what I can tell you just from a order of magnitude, so far we have reduced our – basically our cost of goods sold which translates into EBITDA. Let's say about 2% of our EBITDA, so I mean that at least gives you some order of magnitude in terms of what to expect. And as you said, as we lower our cost of production, we have a lot more degrees of freedom in terms of do we maintain the savings that we have or the cost competitive that we have, do we pass it to our customers to gain market share. I mean but then it – I mean it creates a lot more optionality for us.

And just keep in mind that this notion that if wholesale prices will decrease they will decrease our margins. It assumes that we basically will do nothing. We'll do nothing to change the cost structure and the repositioning of our company. And I have to remind everybody that starting in 2020 we have basically full financial flexibility. We don't have to wait one or two or three years. Starting in 2000 – even this year, we have financial flexibility but it will – so, if you think about our stable platform, this year, we produce between $1.3 billion, $1.4 billion.

By the time 2021 rolls in, I mean we're going to have over $2.5 billion that we can deploy to continue perfecting our platform. So, I just – I think it's important to put it in context, the position that we have put ourselves in place, we're done with our deleveraging and our strengthening of our balance sheet program and now we have this full financial flexibility to allocate into perfecting our model and returning capital to shareholders, which I think is incredibly important as a stable cash flow business that we have.

Greg Gordon
Analyst, Evercore ISI

Q

Mauricio, Kirk, thank you.

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

A

Thank you, Greg.

Operator: Thank you. Our next question comes from the line of Angie Storozynski of Macquarie. Your line is open.

Angie Storozynski
Analyst, Macquarie Capital (USA), Inc.

Q

Great, thank you. So I have only one question. So given what you've just said, right, that you have plenty of levers to react to lower power prices. Can you tell us if you can largely or fully mitigate the backwardation and the impact of the backwardation and forward power curves on your EBITDA or free cash flow i.e., there [ph] isn't – basically the shape (00:42:34) of your earnings is not similar to the one that we see currently in ERCOT power curves.

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

A

Yes, Angie, what I can tell you on equivocally is that we have created a platform that is a stable and predictable. What means a stable and predictable is year-in year-out, we're going to produce the excess cash that we produce today. Now we are going to have this incredible financial flexibility that we have afforded ourselves to have to increment that all. So the value proposition that we have today is to have a stable cash flow business that grows at a 2% to 4% a year with an investment grade balance sheet and significant excess cash to grow the business in an accretive way and to return capital – meaningful capital to shareholders.

We think that the combination of those three things will eventually change and rerate the valuation of stock, which if I'm not mistaken right now is somewhere in the mid-teens to high-teens free cash flow yield. We don't believe that business that I described to you today should be there and if it gets rerated closer to where we think should be then our stock price will be much, much higher than it is today.

Obviously, we also appreciate that this is the first year that we are showing the benefits of this platform. 2018 was a good test. We had a very volatile summer. 2019 is very important because it continues to demonstrate that our platform performs on there a lot of different price scenarios. So now it is up to us that if this continues to happen and we taken care of our balance sheet and we can demonstrate that to our shareholders and to rating agencies then we're on a path to rerate the stock.

Angie Storozynski
Analyst, Macquarie Capital (USA), Inc.

Q

Okay. And just one last question, I was definitely the one surprised by the Petra Nova mention. Is there any other legacy business that might have any types of cash flow implications like I don't know Ivanpah something else where there is parental guarantee?

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

A

Angie, it's Kirk. No. The two remains sort of legacies, In addition to Ivanpah, I would call [indiscernible] (00:45:18) we have obviously a minority stake with the remainder being owned by Clearway formerly Yield and the balance with Midwest Generation. That debt is non-recourse NRG, so there are no financial guarantees. This Petra Nova leverage test is a product that's unique, if you will, to Petra Nova.

Angie Storozynski
Analyst, Macquarie Capital (USA), Inc.

Q

Okay. Thank you.

Operator: Thank you. Our next question comes from the line of Shahriar Pourreza of Guggenheim Partners. Your question please?

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Q

Hey, guys. Two quick questions here. First, just on the on the IG status, can you maybe just elaborate a bit further on how the conversations are going with the agencies? And obviously [ph] outside of – Kirk, you're (00:46:04) presenting very healthy metrics today. Can you just get – can you get the agencies to look past their philosophical issues about having an IG rated IPP? Are they still trying to gain comfort around the Retail business and as you're thinking about timing or we think in the back half of 2020?

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

A

Shahriar, I'll answer the last part of your question. I think that's probably the realistic case. Back half of 2020 is probably the early timeline on, in fact, of when we would expect that movement to make. Obviously, on an unsecured basis, we're two notches away from the minimum threshold of investment grade that being BBB minus. That's not to say that's our aspiration, that's sort of the inflection point between sub-investment grade and investment grade. But I think on that timeline is probably reasonable. Certainly, between now and then we need to see at least a one notch uptick to be at least one notch away.

And I think in much the same way is that although we're more frustrated with the reaction in the stock price and we've obviously got to demonstrate that to our equity investors, the mandate still holds on the other side of the equation with the rating agencies. I think delivering the numbers that we've now reaffirmed for this year, which affirms that notwithstanding the sell-off that probably represents some of crisis of confidence in our ability to do so, we are able to do so. So delivering on that this year continuing to execute.

And the background, as I may have said to you or others before, we've been very pleased with the level of dialog with the rating agencies. I think they've dug in to understand to their credit, the Retail business in particular a lot more. So I think the progression of the dialog and their perspectives on Retail and understanding how we operate the model and how Retail truly operates in tandem with Generation has been constructive and productive. And it's up to us to continue to execute, which we have every confidence to do so. But it will take probably that amount of time in order to get those two notches behind us or our way to [ph] three base (00:48:13).

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Q

Got it. And then just lastly on this token dividend, [ph] do you (00:48:17) guys still keep it. At what point do you make a decision to either grow it or remove it completely?

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

A

Yeah, well, when you think about capital allocation because, I mean that's really your – I think your question, Shahriar, is how do we think about capital allocation going forward and what I will tell you is that we have no changes either – neither on our philosophy on the principles that we have provided to all of you.

I think the only thing that has changed is the fact that we have completed one of our priorities, which is achieve an investment grade balance sheet, that's basically now out of the way. What that means is that we have all the excess cash that we will generate, it will be to perfect our model or return capital to shareholders. Like I said, Shahriar, I do believe that a business that is a stable and throwing a lot of excess cash needs to provide – needs to return a meaningful part of that to its shareholders. Today, [ph] that formed (00:49:20) the most efficient way to do it is through share buybacks.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Q

Right.

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

A

I think we speak with the $250 million incremental share buyback that we announced today to take advantage of what I believe is an undervaluation of our stock without any changes to the fundamental drivers – value drivers of our business. Now as we go into 2020, obviously we're going to evaluate all the other different options. I don't know what the market is going to – where it's going to be at the end of the year. I am going to evaluate all that. What I will tell you is that our goal is to rerate the stock...

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Q

Right.

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

A

...to its fundamental value and we're going to evaluate all options that we have available to us to ensure that we do that.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Q

Right. And then just, Mauricio, one last on the capital allocation. I just want to confirm, because obviously certain retailers have hit the block right now that you're – from a capital allocation standpoint you're sort of out of the market and you're not looking at further inorganic retail acquisitions?

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

A

That we are out of the market?

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Q

Right. I'd like – so are you looking at additional retail acquisitions similar to Stream or you're sort of out of the market?

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

A

Okay. I mean I don't comment on M&A neither specific processes or anything. What I will tell you is that when I think about inorganic growth, I will always adhere to the capital allocation principle that we have outlined for all of you. We have to meet the threshold, the financial thresholds that we have and there have to be a better investment than investing in our own stock.

I have said before that while we have rebalanced our portfolio pretty good the past couple of years, we can still perfect that platform. In Texas, our Retail is a little bit bigger than our Generation and in the East our Generation is bigger than our Retail. So we're executing on our capital-light strategy in Texas to rebalance our portfolio.

We acquired Stream to rebalance our Retail and we're going to continue to look at all the opportunities. I mean, that is the – I guess, the benefit that we have afforded ourselves with the financial flexibility that we have today. We can be opportunistic about when to do it, but obviously, where the stock price is today, the bar is a little bit higher than it was not too long ago when our stock price was starting to reflect the fundamental value of our business.

Shahriar Pourreza
Analyst, Guggenheim Securities LLC

Q

Right. Okay. Thank you very much guys.

Operator: Thank you. Our final question comes from the line of Praful Mehta of Citigroup. Your question, please?

Praful Mehta
Analyst, Citigroup Global Markets, Inc.

Q

Thanks so much. Hi, guys.

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

A

Hey, Praful. How are you?

Praful Mehta
Analyst, Citigroup Global Markets, Inc.

Q

Hi. Thanks again for all the color on the business model, it was very helpful. I guess, just following up a little bit on that, slide 20, you have the wholesale gross margins, which clearly have come down a little bit from Q1 given the drop in the power prices. But I'm assuming, as you talked about in your business model points that some of this drop in the wholesale gross margin will be made up for on the Retail side in 2020. Is that a fair way to think about how we should look at slide 20 today?

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

A

Yes. I think the way you need to think about ERCOT is an integrated model. So while we only give you one side of the leg, the generation, we haven't provided you the retail sensitivity to it. And to be candid, I mean that's been up – it's up to us to improve our disclosures.

When I think about our business, I don't think about it as two completely separate businesses, one Generation, one Retail. Our disclosures have been really good on Generation. I think where we need to do a better job is to enhance our disclosures to capture the integration of our business. Because when I think about how do we manage our business, I think about it as an integrated business where the gross margin – the combined gross margin is what matters. I care less about where it comes from whether it's Generation or Retail, I care about delivering the total gross margin year-in and year-out.

I mean there is other puts and takes. I mean in the Northeast you have capacity a little bit lower but that's been offset by margin enhancement and then we have the impact of Stream. I mean my point here is you cannot look at our business just on a static basis with the amount of the financial flexibility we have to improve it. It's like saying that we're not going to do anything but we have all these excess cash available to deploy it in the most meaningful way that creates value for our shareholders.

So, yeah, I'm very comfortable with our platform in 2020 and beyond. And as I said, our goal is to provide stable earnings, stable excess cash with a modest growth. That's our goal.

Praful Mehta
Analyst, Citigroup Global Markets, Inc.

Q

Got you. Yeah, [ph] no, (00:55:09) that additional disclosure on the retail side would be super helpful to kind of complement the points you made on the business model. I guess moving on to the PPA side for solar, I guess it's a little different from your perspective because you obviously have the option to sign more solar PPAs at pretty low prices which is helpful for your Retail, but then you're bringing in lot more generation at pretty low pricing but you're kind of drawing more solar into the market. How do you balance that where there's a benefit from your perspective as you said to have volatility, so just bringing in a lot of solar generation by offering them PPAs may not be the right solution from a holistic business perspective.

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

A

Okay. Well, [ph] I – you said it may (00:55:56) not be I think it is. And the reason why is that we have a very valuable franchise in ERCOT and we want to ensure that the competitive market continues to work and work well in the state. We need so much capacity to even maintain this current reserve margin. It really doesn't matter if we bring 10 gigawatts or 15 gigawatts of renewables. You're going to continue to have tight reserve margins, which is not going to affect the scarcity conditions in the system. I mean – or this is not going to be affected if you basically keep your reserve margin at 8%, 9%, [ph] that either (00:56:45) is administratively set.

So I actually think that if the competitive market works well, it's going to provide the right price signal and the cheapest technology is the one that is going to get built, the cheapest technology to meet the needs of the system. And if that happens, whether it's solar, wind or conventional with high ramping capacity, we think that that's going to require some time. And that's why I say for the foreseeable future in ERCOT, I expect really high conditions with strong prices and tremendous amount of volatility. Chris, is there anything that you want to add?

Chris Moser
Executive Vice President, Operations, NRG Energy, Inc.

A

No, I was just going to point out that we've seen ORDC has really been doing its job since the commission tweaked it earlier this year. There's been a noticeable difference in pricing whether it was like a $4.50 adder for this mild-July that we had which compares to like a $5 adder last year when July was smoking hot. Over the last couple days where we've seen $100 to $200 tacked on in these hot days of August. ORDC is just – like Mauricio said, just doesn't need costly marginal cost units to impact, it's administratively set. And to the extent that you could build almost 20 gigs of renewables and that you need to do that just to stay flat in terms of reserve margin. Yeah, I'm not too worried about it. And don't forget that there's another quarter turn of ORDC coming next March too. So, I think we're – I think we should be okay for a while.

Praful Mehta
Analyst, Citigroup Global Markets, Inc.

Q

Got you. All great points. And then just finally, clearly, you guys are executing on the business model and the market. I agree it needs time to understand and fully see the execution of the business model. But if at some point you don't see the stock price perform and [ph] you year-end (00:58:41) and we are still having the same conversation, is there a point where you look at that go private as a transaction that's possible or is that something that's not on the table at this point?

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

A

I'm sorry, the going private – this is the going private question.

Chris Moser
Executive Vice President, Operations, NRG Energy, Inc.

A

The market doesn't straight...

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

A

Yeah. Well, I mean, right now our focus is on executing the strategy that we have. As I already mentioned to you, Praful, I mean, we believe that this is a very compelling value proposition. I also recognize that this is a new business model for the competitive power sector. I rather no longer refer to us as IPP but as an IPC. We're truly now an integrated power company.

And – so to the extent that we continue to demonstrate the viability and the stability of this platform, not just to our shareholders but also to rating agencies. I think that there is an opportunity to rerate the stock. But obviously if that doesn't happen once we feel that we have exhausted all our efforts to demonstrate the stability of our business, then we will explore all options to maximize the value of our shareholders. So I mean that's something that we just have to do. But I don't think that time is yet. I mean, we've only have provided – we've proven this technology for two years; 2018 very successful, 2019, we are on track to do it very successfully. So recognizing that I think we need to give ourselves some time and we need to give our shareholders and the rating agencies some time to digest this strategic shift.

And when we feel that we have given enough time and the market is not responding, which I'm still hopeful that it will and I'm convinced that it will because we have a very strong value proposition, then we will evaluate something else. But right now, all our focus, a 100% of our focus is on executing this strategy.

Praful Mehta
Analyst, Citigroup Global Markets, Inc.

Q

Got you, understood. Super helpful. Thank you, guys.

Operator: Thank you. At this time, I'd like to turn the call back over to the CEO of NRE Energy, Inc., Mauricio Gutierrez, for any closing remarks, sir?

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

Thank you. Well, it was, as always, good to give you an update. Thank you for the questions and for your interest at NRG and look forward to talking to you in the near future. Thanks.

Operator: Thank you, sir. Ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day. You may disconnect your lines at this time.