Corrected Transcript

04-May-2023

NRG Energy, Inc. (NRG)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the NRG Energy First Quarter 2023 Earnings Call. At this time, all participants are in listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your first speaker today, Kevin Cole, Treasurer and Head of Investor Relations.

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

Thank you, Sean. Good morning and welcome to NRG Energy, Inc.'s first quarter 2023 earnings call. This morning's call will be 45 minutes in length and is being broadcast live over the phone and via webcast, which can be located in the Investors section of our website at www.nrg.com under Presentations and 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 of 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, please see the reconciliation at the back of the earnings presentation.

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

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

Thank you, Kevin, and good morning, everyone, and thank you for your interest in NRG. I'm joined this morning by Alberto Fornaro, Chief Financial Officer, and also on the call and available for questions are other members of our management team, including Rasesh Patel, Head of Vivint Smart Home.

I'd like to start on slide 4 with the three key messages for today's presentation. First, our wholesale and retail businesses performed well during the first quarter and delivered strong financial results. We are focused on our core energy operations and have taken steps to make our platform more predictable and resilient. This brings me to my second point. We are seeing improving market fundamentals that should benefit our portfolio as we head into the Summer. Finally, we completed the Vivint Smart Home acquisition and integration efforts have now begun in full. We are also updating our 2023 guidance ranges to account for this acquisition.

Moving to the first quarter results on slide 5. We delivered top-decile safety performance and $646 million of adjusted EBITDA. This is a 28% improvement from last year when adjusted for asset sales and retirements. These results were driven primarily by strong operations in our core energy business, Direct Energy synergies, and the addition of one month of Vivint earnings.

During the quarter, we made good progress advancing our strategic priorities. We are on track to achieve the full synergy target for Direct Energy this year. We continue to be opportunistic on our portfolio optimization efforts with the sale of Astoria, and we closed the Vivint acquisition in early March. Integration efforts for Vivint are now fully underway. Day one activities went well, and we have now defined the growth synergy target of $30 million for 2023. We will share additional details for the total program at our upcoming Investor Day.

I want to take a moment and welcome the Vivint team to the NRG family. I continue to be impressed with the business and particularly, the alignment in our corporate values that focuses on safety and customer experience.

Finally, we are updating our 2023 guidance ranges to include Vivint and the alignment of adjusted EBITDA between our two companies. Alberto will unpack this in more detail, but let me provide you a quick overview. We're updating our full-year guidance to $3.01 billion to $3.25 billion adjusted EBITDA and $1.62 billion to $1.86 billion of free cash flow before growth. This includes 10 months of Vivint, expected growth and cost synergies for this year. This also reflects the harmonization of adjusted EBITDA to align both companies more with the consumer services industry. Excluding the impact of these changes, the traditional core energy business of NRG remains unchanged with previous stand-alone 2023 guidance ranges.

Now, turning to slide 6, I want to provide a brief market update for Texas. We continue to see robust segment demand growth on a weather normalized basis north of 3%, driven by population growth and a strong state economy. We expect this trend to continue in the foreseeable future. As you can see in the chart on the left-hand side of the slide, the first quarter was characterized by mild weather and much lower natural gas and power prices, which settled well below market expectations. This benefited our integrated platform by allowing us to bring down our power plants during periods of low prices and perform additional preventive maintenance while buying power from the market cheaper than our own generation. This resulted in margin expansion fully offsetting lower weather driven demand, and this is exactly how our platform was designed to perform.

Looking ahead to the summer, our portfolio is well-positioned to deliver stable results. Supply chain constraints are for the most part behind us and our power plants are ready to run as we progress on our second year of increased maintenance spend. We are also more conservative on our hedging and the operating assumptions we're using for our power plants. Importantly, W.A. Parish Unit 8 remains on track to return to service before the summer. As you can see, we have taken steps to make our portfolio more predictable.

Finally, I want to provide a brief update on ERCOT market design enhancements. After considering many alternatives during 2022, the Public Utility Commission of Texas unanimously approved the Performance Credit Mechanism or PCM. This is a market-based solution that is widely supported by competitive entities and regulators. The Texas legislature is currently reviewing the PCM and other enhancements. We expect market design resolution by the end of May with the Texas legislative session concluding on May 29.

We anticipate that PCM will take a few years to be implemented. In the interim, ERCOT and the PUCT are considering a bridge solution that enhances the Operating Reserve Demand Curve, or ORDC, to increase online reserves. We applaud the efforts by the governor, legislature, PUCT and ERCOT to improve the reliability of the grid through market-based solutions. We have several brownfield projects in various stages of development, but all of them will require regulatory certainty before they can move forward.

Moving to slide 7. I want to provide an update on our consumer-facing businesses, beginning with our retail energy and services platform. Margins were up year-over-year by 7%, driven by lower supply costs and stable customer account. This was somewhat offset by lower load due to mild weather during the quarter.

In the east, we grew through our customer acquisition efforts to provide consumers an alternative to rising incumbent utility prices. We continue to see no material increase in bad debt, which is a direct result of the essential nature of the services we provide. Finally, we launched a modernized digital experience on our Web and mobile app that enables customers to manage their energy usage and provide actionable insights that we are uniquely able to generate regarding uses of energy in their home, for their EVs and through their solar solutions.

While we have only owned Vivint for one month, I want to provide their full first quarter statistics for comparison. Vivint grew customers by 9% and revenue by 14%, compared to the same period last year. Like NRG, Vivint continues to experience strong retention and stable bad debt. The company was also busy in the quarter enhancing their products and introducing innovative offerings, two of which I want to highlight. First, the Vivint app now includes solar production data, so our customers can actively monitor their energy conservation and cost savings. Second, they introduce a do-it-yourself product called Vivint Basics that makes it easy for owners and renters alike to get the starter system for less than $300. Having a viable DIY and single-point solutions is key to our strategy of creating more entry points for customers that we can later upgrade to our fully-integrated Smart Home offering.

Now, with respect to synergies, we are reaffirming our cost and growth targets for both 2023 and the full plan. Cost synergies are primarily the result of the combination of two public companies and are expected to total $100 million in recurring run-rate free cash flow before growth. Growth synergies of $300 million will be achieved through targeted cross-sell, Vivint organic growth, and sales channel optimization. In total, we expect $400 million of recurring synergies to be achieved over the next three years. The synergy and integration plan is now fully underway and is led by the same team responsible for the transformation plan and the Direct Energy integration.

On the right-hand side of the slide, you will see the scorecard for Vivint. We have now introduced 2023 growth targets and cost to achieve. We plan to update this scorecard in the coming quarters to provide further transparency and keep you informed on our progress.

I know I have said this before, but we are very excited about the opportunities for the combined company moving forward. Vivint brings a complementary business that expands our customer network by nearly 40% and adds Smart Home technology and infrastructure to strengthen our platform. Together, we create the leading essential home services provider in North America, serving a network of nearly 7.5 million customers. And the acquisition also accelerates the plan we laid out at our 2021 Investor Day and creates the opportunity to deliver significantly shareholder value.

During the first three years of integration, this value will be created through both cost and growth synergies, which are laid out on this slide. In the medium and long-term, I see even more opportunity to create value through growing customer count nationally, increasing the average number of solutions per customer, and materially expanding the customer lifetime.

So with that, I will pass it over to Alberto for the financial review.

Alberto Fornaro

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

Thank you, Mauricio.

NRG experienced a good start to the year and delivered strong results during milder-than-expected weather conditions. We entered the winter season, seeing high forward gas and power curves. Moderate weather and relatively geopolitical stability translated into much lower power volumes in Texas and in the East and much lower actual prices in most markets with the exception of California.

Additionally, NRG liquidity has significantly improved due to lower collateral requirements after the winter season and the proactive management of our collateral utilization. We also completed the acquisition of Vivint Smart Home and that included Vivint March performance in our financial statement.

Before we continue, let me provide a little bit more detail about Vivint. [ph] At close, (00:13:47) the EBITDA metric for the two companies was not identical; therefore, we have harmonized it. I will go into more detail in the guidance section but please note that all the figures, including prior year, reflect a consistent EBITDA across segments.

Let's go now to the first quarter results. NRG consolidated adjusted EBITDA of $647 million is $137 million higher than the first quarter of 2022. As you can see in the chart at the bottom of the page, legacy NRG results include the anticipated negative impact of asset sales and retirements in the second quarter of 2022, totaling $30 million. On a like-to-like basis, legacy NRG EBITDA increased by approximately $67 million.

Last year, transitory items including the Limestone Unit 1 extended outage, coal and chemical constraints and the temporary spike in ancillary costs impacted our profitability. Our Q1 2023 results show that these items have been fully recovered. We've also included Vivint's March results in our first quarter financials, which contributed $73 million of additional EBITDA. The remaining $27 million increase is related to EBITDA harmonization.

Going now to segment performance on the top left. Across the different geographical region, we have, in general, experienced an expansion of unit margins that have been mitigated by lower volumes and usage. Starting with Texas, adjusted EBITDA increased by $43 million versus prior year and gross margin was $120 million higher. Opportunistic plant outages, insurance premium and pension cost increases and the return of bad debt to historical levels contributed to an increase in operating expenses compared to the first quarter of 2022.

In the East, West and Services and Other segment, adjusted EBITDA declined $6 million versus last year, driven primarily by asset sales and retirement. Similar to Texas, gross margin increased year-over-year, a lower power supply cost more than offset the negative impact of a volume decline. As said, we have included March results in our Q1 EBITDA, and these results were better than prior year on a comparable basis.

While we are not reporting full Q1 quarterly results for Vivint, we are very encouraged by the results. On a stand-alone basis, all major KPIs, including profitability metrics, have improved compared to the prior year. We have begun integration in cross-selling activities, and targets have been confirmed and are expected to be realized as planned.

NRG free cash flow before growth was $203 million, in line with our expectation, but impacted by mild temperatures that drew power purchases up and power generation down, thus increasing fuel inventory levels. We have identified initiatives to reduce inventories but expect to defer any action until after the summer season.

Lastly, on NRG balance sheet, cash collateral received by counterparties, positive mark-to-market of the derivative portfolio, and the account receivable and account payables are all trending down. This is an inversion of the trend that we have seen in the last six quarters.

Let's move now to slide 10 to discuss the guidance for 2023. As mentioned, we are providing additional detail for adjusted EBITDA. Prior to the acquisition, NRG and Vivint accounted for items within adjusted EBITDA differently and we are now harmonized to what will be included in these metrics going forward.

Capitalized cost can be split into acquisition costs and fulfillment costs. The amortization of capital customer acquisition costs, mostly sales commission paid by both NRG and Vivint, will be excluded from adjusted EBITDA. The amortization of capitalized fulfillment costs, mostly leading to product and installation expenses, will no longer be excluded from adjusted EBITDA. Stock-based compensation expenses will also be excluded from adjusted EBITDA. There are no impacts to free cash flow.

Moving to the work at the bottom of the page, legacy NRG 2023 guidance is substantially unchanged compared to our Q3 earnings call. The only exception is a $120 million increase due to EBITDA harmonization. For Vivint, guidance includes pro forma 2022 EBITDA unchanged from December. This has been pro-rated for 10 months of ownership. We have added $65 million in expected 2023 synergies and growth minus $35 million from the EBITDA harmonization. Overall, the net impact in 2023 is positive and we are updating guidance accordingly.

Free cash flow before guidance is simply the sum of the legacy NRG guidance and the $110 million pro forma free cash flow number from December 2022. This has increased by the group contribution and pro-rated for 10 months. As a reminder, the original 2022 pro forma free cash flow before growth for Vivint included the free cash flow before growth, the impact of synergies and the additional interest on the acquisition. Lastly, given the addition of Vivint to our guidance, we have incorporated a slightly higher range of plus or minus $120 million from the guidance midpoint on a consolidated basis.

Now turn to slide 11 for a brief update on our 2023 capital allocation. Moving left to right with blue shading indicating updates, 2023 excess cash equals $1,999 (sic) [$1,989] million. This includes roughly $250 million of excess cash for 2022, including $209 million in proceeds from the sale of Astoria. And the full-year free cash flow below (sic) [before] growth of $1,740 million, inclusive of NRG standard-alone guidance of $1,620 million, plus $120 million for Vivint. This also capture the expected impact of the addition debt finance. There is no change to the $500 million target of leverage neutral net inflow from asset sales.

Moving on the cash utilized for Vivint, this includes the additional requirement of $100 million in the cash minimum balance, about $250 million of NRG cash utilization net of Vivint cash, a $145 million Vivint integration expenses, and $900 million of expected debt reduction.

Next, we have the remuneration of our equity holders and the dividends to the preferred issued in March. The allocation of cash to investments totaled about $190 million, including $90 million for growth initiative.

Now, moving to the far right bar, we expect a total of $506 million available for future allocation. This will fund the remaining share repurchase program upon full visibility of achieving our 2023 target credit metrics which are detailed in the next slide.

Quickly turning to slide 12, we remain committed to a strong balance sheet. This slide has not substantially changed since our last update. We just updated partially the – we updated the higher NRG EBITDA, partially mitigated by lower adjustment [indiscernible] (00:22:11).

We are focused on achieving our 2023 target credit metrics, which include a leverage ratio approximately 3.2 times net debt adjusted EBITDA and we are on track for investment grade credit metrics by late 2025 and 2026 through both debt reduction and growth.

Back to you, Mauricio.

Mauricio Gutierrez

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

Thank you, Alberto.

Turning to slide 14, I want to provide a few closing thoughts on today's presentation. We deliver strong results for the first quarter and are well-positioned for the balance of the year. With the Vivint acquisition complete, we turn our focus to integration, growth and synergies. Our efforts are well underway and it is now all about execution. I look forward to providing you a comprehensive update on our home business and strategy at our upcoming Investor Day.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. And at this time, we will conduct the question-and-answer session. [Operator Instructions] And our first question comes from Julien Dumoulin-Smith with Bank of America.

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

Hey. Good morning, team. Thank you, guys, very much for the time. Appreciate it. Nicely done here.

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

Hey. Good morning, Julien.

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

Good morning, Mauricio. Pleasure. Just wanted to follow up on the synergy scorecard here and just thinking through Vivint here. I mean, you're laying out – you've got the $300 million and the $100 million in revenue and cost synergies, respectively. How do you think about that translating back to consolidated EBITDA for Vivint here again and/or how does that fit with the 12% to 15% FCF target as well? Just want to try to tie it out at least through 2025 as best you can today; if we can be a little bit more specific.

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

Yeah. So, Julien, I'm assuming that you're talking about the target that we provided on a free cash flow per share that supports a 15% to 20% growth. And when you look at the EBITDA and free cash flow generation capability of NRG and then you layer on top of that the $400 million of cost synergies and revenue synergies, we feel very confident that we're going to be on path to achieve that 15% to 20% free cash flow per share return.

As a matter of fact, the acquisition of Vivint now gives us a little bit more control on achieving that. Remember, before, we have tremendous financial flexibility and we generate excess cash well beyond what the traditional NRG needed that we have used to reduce the denominator. The one variable that we cannot control there is at the price that we can buy back our stock. Now, with the Vivint engine and the opportunity to create this $400 million of incremental value, we just increased the tools that we have to increase the numerator and put more in control the achievement of this $12.50 that we have laid out for 2025. So I feel very comfortable that with what we laid out today and in previous call that we are on track to achieving that $12.50 a share by 2025.

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

Right. I'm sorry – yeah, clearly, 15% to 20%. And more to the point, as you think about layering on additional assumptions, rolling out potentially updated guidance with this Analyst Day, any initial thoughts on what else can be done with the Vivint platform to continue to grow it? I'll note that the commentary here at the outset is really focused on synergy. You talked about revenue and growth here in the first couple of years. How do you think about compounding that beyond the 2025 period that you're providing here today? And maybe any initial thoughts of how far you can go at this prospective Analyst Day?

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

Right. Well, the first thing that I will say is when I think about the Vivint business, there are three big leverages that we're going to be focused on. The Vivint business was high – has high leverage. It has a high acquisition cost, and there was also an opportunity on the consumer financing. So these are three specific buckets that we're focused on optimizing; and for me, it creates an opportunity for value creation.

Now, right now, we're focused on optimizing the 7.5 million network customers that we have. We have opened the lines of communication across our sales channels. We're going to continue to optimize them. We're going – we have introduced bundling. We now are doing cross-sell between our call centers and our digital assets. We are testing in the market bundle. So, that is the focus right now.

When I think about 2025 and beyond, it's really about how do we bring the NRG experience that we currently have with the Smart Home experience that we have, and recreate a best-in-class product for customers that is going to drive the growth on 2025 and beyond. This is something that we're going to be talking more about on our Investor Day on how this vision comes together with the two offerings that we have, one in Energy, one in Smart Home. So, we will make it, you know, more tangible and real for all our investors at the upcoming Investor Day.

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

Right. I'll leave it there. Thank you, guys, very much. Have a great day.

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

Thank you, Julien.

Operator: At this time, I would like to turn it back to Mauricio for closing comments.

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

Okay. Well, thank you. Thank you for your interest in NRG. I look forward to hosting all of you in our upcoming Investor Day that we should have in early summer where we're going to be talking about the Smart Home strategy, we're going to provide additional details on our growth plan, and provide you more transparency on our key performance indicators that will help you better model the business.

So, with that, I want to thank you for your interest and look forward to speaking with you soon. Thank you.

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