02-Aug-2018

NRG Energy, Inc. (NRG)

Q2 2018 Earnings Call

CORPORATE PARTICIPANTS

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

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

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

Elizabeth R. Killinger
Executive Vice President, NRG Retail, NRG Energy, Inc.

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

OTHER PARTICIPANTS

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Greg Gordon
Analyst, Evercore ISI

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

Steve Fleishman
Analyst, Wolfe Research LLC

Praful Mehta
Analyst, Citigroup Global Markets, Inc.

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

Michael Lapides
Analyst, Goldman Sachs & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to NRG Energy Inc.'s Second Quarter 2018 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be provided at that time. [Operator Instructions] And as a reminder, this conference is being recorded for replay purposes.

I'd now like to turn the conference over to Kevin Cole, Head of Investor Relations, please go ahead.

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

Great. Thank you, James. Good morning and welcome to NRG Energy's second quarter 2018 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.

As this is the earnings call for NRG Energy, any statement made on this call, that may pertain to NRG Yield, will be provided from NRG's perspective. Please note that today's discussion may contain forward-looking statements, which are based on assumptions that we believe to be reasonable as of this date. Actual results may differ materially. We urge everyone to review the safe harbor in today's presentation, as well as risk factors in our

SEC filings. We undertake no obligations 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. Joining me this morning is Kirk Andrews, our Chief Financial Officer. And also, on the call and available for questions, we have Elizabeth Killinger, Head of our Retail Mass business; and Chris Moser, Head of Operations.

I'd like to start with the key messages for the second quarter on slide 3. Our business performed exceptionally well during the quarter with earnings up 23% from the same period last year. We are making excellent progress on our Transformation Plan initiatives and we are on track to hit all targets. Finally, our portfolio is demonstrating once again the value of integration between retail and generation during the volatile summer months, particularly in Texas. I am very pleased with our results so far, and I am confident we are well positioned for the rest of the summer and beyond.

So, now moving on to the highlights of the quarter on slide 4. As you can see on the left-hand side of the slide, we delivered $843 million of EBITDA during the second quarter, driven primarily by higher realized prices in Texas, higher retail loads, and the impact of accretive cost-savings. Kirk will provide additional color on our results and the impact on our credit metrics.

For the first half of the year, our business has performed exceptionally well, but with the warmest and historically most volatile months still ahead of us, we are maintaining our 2018 EBITDA guidance range of $2.8 billion to $3 billion. And as has been our practice, we will update our 2018 guidance and initiate 2019 guidance on the third quarter call.

During the quarter, we also completed our first $500 million share buyback in which we repurchased almost 16 million shares at an average price of $31.80 per share. Our commitment to returning shareholder capital continues, and we are on track to execute on our second $500 million share buyback

following the close of either NRG Yield and Renewables or our South Central portfolio.

I also want to highlight the progress we have made on GenOn, which continues to move forward towards final resolution. In July, we executed a settlement in which we received associated releases from GenOn. And on August 15, we will terminate shared services. GenOn is planning to exit bankruptcy on October 1 of this year.

We are also making significant progress on our Transformation Plan, which you can see by our scorecard on slide 5. During the quarter, we removed an additional $145 million of costs, bringing our savings through the end of June to $225 million and placing us well on the path to achieving our 2018 target. We also continue to make progress on our margin enhancement program. You will begin to see the results of this program on our scorecard during the second half of 2018 with the results really ramping up in 2019 and 2020. Both of our cost savings and our margin enhancement efforts remain on track for their current year and full plan targets.

As you know, asset sales remain a key focus for the organization. We closed on the sale of Boston Energy Trading and Marketing or BETM and our Spanish Town asset, while reaching an agreement to sell our interest in two additional assets, Keystone and Conemaugh. We actually had anticipated selling these assets in 2019 but we were able to accelerate this timeline and execute on the opportunity to monetize these assets ahead of schedule.

Our NRG Yield sales process is moving along very well. We have received all necessary regulatory approvals and are finalizing the consents. We are making every attempt to bring this to conclusion as swiftly as possible and are working hard to make this a third-quarter close.

The sale of our South Central portfolio is also making good progress, and we continue to expect that this transaction will close in the second half of this year.

Although we are in the middle of the summer in Texas, I wanted to provide you a brief update on the positioning of our integrated model on slide 6. And as you all know, ERCOT supply/demand balance is the tightest it has been in many, many years. Following the retirement of nearly 5 gigawatts in the past 12 months and steady load growth. This market tightening led to an increased probability of scarcity conditions this summer, which was reflected in higher forward prices. So far, demand has not disappointed, setting a new record peak of over 73 gigawatts in July. However, this record load was met with equally impressive reliability across the grid, which temper real-time pricing as you can see on the left-hand side of the slide. In other words, it took nearly perfect system-wide reliability to meet the summer peak demand.

Now, our generation fleet perform exceedingly well during this period, driven by the extensive planning and preparation we put going into the summer. I would like to commend our operational teams for achieving excellent results and having no recordable injuries during this recent heat wave. We also took measures to ensure the stability of our retail business. This included leveraging our integrated approach with generation to help manage supply cost and proactively helping our customers manage their bills.

These tight market conditions in Texas also created longer term opportunities to [ph] ensure (00:08:26) the predictability of our earnings. We took advantage of higher prices and executed power hedges at attractive levels for the summers of 2019 and 2020. This is exactly the period that saw the majority of price increases. We also took the opportunity to hedge our shoulder months and off-peak periods with natural gas as a proxy for power in those same years.

I mean, this summer so far has showcased the strength of our integrated model with complementary businesses that increase the predictability of our earnings. As I said before, we're only halfway through the summer and historically, the more volatile months are still ahead of us. So, we all at NRG remain focused across the organization on ensuring a successful summer.

Now, moving to our market outlook and starting with ERCOT on slide 7. Much like this summer, the longer term outlook for ERCOT fundamentals remain very strong. As you can see on the left-hand chart, on a weather-normalized basis, total loads remain very robust and growing and continues to grow at 2% per year. This is a dynamic we don't expect to change anytime soon. We also continue to see project delays of new generation anywhere between three to five years. And given that forward prices remain below new build economics, we also don't anticipate this dynamic to change in the near term.

So, bottom line, and for the foreseeable future, we expect tight reserve margins in ERCOT with higher probability of scarcity pricing and greater volatility as the system works to stay in balance. These conditions create an opportunity for both sides of our business and highlight the longer-term value of our integrated approach, as you can see on the right-hand side of the slide.

Our retail business is in a stronger position relative to other players in the market due to the integration with generation and a scalable customer acquisition and retention engine. Increasing loads means an increased opportunity for new customers while potential volatility creates opportunities to take market share from other competitors. And our generation business benefits from higher prices with greater opportunities to hedge the portfolio at attractive levels. Also, higher hedged prices allows us to invest in our fleet to achieve higher reliability, increase the predictability of our earnings, and mitigate the impact of volatility on our retail business.

Now, onto the East on slide 8. PJM held its capacity auction for the planning year 2021-2022 this past May. The results reflected less new builds and significant amounts of unclear capacity, signaling more disciplined development and bidding behavior. As you can see on the left-hand side of the slide, on a same-store basis, NRG cleared more megawatts at higher prices than the previous auction.

As we continue to optimize the fleet, we will focus on maintaining our assets in premium locations. We now have 85% of our PJM fleet in the premium ComEd zone, which, once again, separated to clear at a price of $196 per megawatt day. Throughout the East, we are encouraged by the multiple regulatory avenues for market reform that could benefit both our generation and retail businesses. For example, FERC recently committed to protecting PJM's capacity market against the impact of state-driven subsidized generation. It's clear to us that FERC wants to see the true cost of all resources reflected into the market by putting a price floor on subsidized generation. This is a strong and clear pro-competitive position coming out of FERC.

As part of this process, FERC also requested additional comments on the possibility of carving out low and subsidized generation from the market. This is referred to as the Fixed Resource Requirement or FRR. We believe these requests for comments and the idea of taking single units out of the market is counter to the spirit of FERC's ruling. We remain confident that FERC will act consistent with the pro-market principles communicated in its recent orders and either fix the FRR, to ensure that it does not negatively impact price formation, or perhaps rejected in its entirety. That said, details matter and we're looking forward to actively engaging on this issue both with PJM and FERC.

So, with that, I will turn it over to Kirk for our financial summary.

Kirkland B. Andrews

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

Thank you, Mauricio. Turning first to the financial summary you'll find on slide 10. For the second quarter, NRG delivered $843 million in adjusted EBITDA, which is a 23% increase over the prior year. Our strong second quarter results were driven primarily by higher power prices and retail load in Texas and further enhanced by the impact of cost reductions across the organization as we continue our progress on the Transformation Plan.

And for the first half of the year, NRG has delivered nearly $1.4 billion in adjusted EBITDA and our cost improvement program is only now beginning to hit its stride. Although we're very pleased with these year-to-date results and the summer prices in ERCOT continued to show strength, we are nonetheless maintaining our 2018 guidance ranges of $2.8 billion to $3 billion in EBITDA and $1.55 billion to $1.75 billion in free cash flow.

I will note however that our first half results, combined with our outlook for the balance of the year, currently plays to our expectations for 2018, well above the midpoint of our guidance range. And we will update and narrow these ranges on our third quarter call. At that time, we'll also provide guidance for 2019, which will include the impact of more robust targets for cost savings and margin enhancements, with nearly $200 million in additional EBITDA expected from these initiatives in 2019 versus our 2018 targets.

As Mauricio mentioned earlier, we've also completed phase one of our $1 billion share buyback program with 15.7 million shares repurchased at a price – average price of $31.80. We remain highly focused on closing our two large asset sale transactions, and we'll launch in the second half of that $1 billion share repurchase program following the first of these two transactions to close, which is likely to be the sale of NRG Yield and Renewables later this quarter.

During the second quarter, we also completed the issuance of $575 million in new convertible notes with a coupon of 2.75%. By repurchasing an equivalent amount of NRG senior unsecured notes, NRG's aggregate debt balance will be unchanged, and we expect approximately $20 million in annual interest savings, further augmenting free cash flow as we retire shorter-dated and higher-coupon maturities.

To this end, we've already repurchased $89 million of senior unsecured notes of varying maturities to-date and have recently provided notice to repurchase $486 million of the 2022 notes, our nearest maturities, which will mark the completion of the senior note refinancing associated with the convertible issuance. As a reminder, we've also targeted $640 million of debt reduction, which we expect to complete later this year in order to achieve our 3 times net-debt-to-EBITDA target ratio.

And finally, this quarter, we successfully closed on the settlement with GenOn, which accelerated a significant portion of the items set forth in the original Restructuring Support Agreement, including the $261 million settlement payment by NRG and the repayment by GenOn of the intercompany revolver, which were previously expected to take place at emergence. With the financial commitments associated with the GenOn bankruptcy now largely behind us and GenOn well advanced in its [indiscernible] (00:17:40) efforts, GenOn is targeting an emergence from bankruptcy early in the fourth quarter.

Next, I'd like to take a few moments to update our pro forma financial summary, which you'll find on slide 11. As a reminder, this summary is based on the midpoint of our consolidated 2018 guidance and provides a view of 2018 EBITDA and free cash flow from retained businesses, net of any contribution for businesses and assets we are selling as a part of the Transformation Plan.

On the left side of the slide under the heading, prior pro forma, we start with the pro forma 2018 summary we provided on our last earnings call. Next, two second-quarter events gave rise to the need to adjust our pro forma view. First, the restructuring of the Ivanpah non-recourse project debt; and the amendment of some of the project's governing documents during the second quarter resulted in a change in the accounting treatment for Ivanpah. As a result, as of the second quarter, Ivanpah is no longer consolidated in NRG's financial statements but will appear as an equity investment.

On a fully consolidated basis, Ivanpah's contribution to the midpoint of our EBITDA range was approximately $100 million. The impact of deconsolidation is the elimination of our partner's 45% share of Ivanpah EBITDA, leaving approximately $55 million of EBITDA from Ivanpah, reflecting only NRG's 55% stake in our revised pro forma. Importantly, aside from the impact of the income statement and adjusted EBITDA, Ivanpah's total non-recourse debt of approximately $1.1 billion will no longer appear on NRG's consolidated balance sheet.

Turning to the second adjustment to our pro forma view, with the closing of the XOOM acquisition, we are adding the annualized expected EBITDA of $45 million from XOOM to the retail portion of our pro forma EBITDA. Of note, this is an annualized number for XOOM on a pro forma basis while the actual contribution for XOOM to our 2018 results will be a partial year, reflecting EBITDA only for the second half of the year.

The EBITDA adjustment for deconsolidation of Ivanpah is offset by the addition of the annualized EBITDA for XOOM and, as a result, our total pro forma adjusted EBITDA remains $1.6 billion. The impact of Ivanpah's deconsolidation is limited to EBITDA and, as a result, the $45 million increase from EBITDA from XOOM is reflected in our revised pro forma consolidated free cash flow before growth, which is now approximately $1.05 billion.

And finally, as I've noted previously, our pro forma EBITDA and free cash flow are based on the midpoint of 2018 guidance, which includes the impact of the 2018 Transformation Plan targets. Beyond 2018, we expect an additional $275 million of annual adjusted EBITDA and free cash flow by 2020 as the Transformation Plan reaches its final targets.

Turning to slide 12 for a very brief update on 2018 capital allocation. Our 2018 capital available as well as our committed capital items are largely unchanged from the previous update. The only exception on the allocation front is having now settled most of the financial aspects of the GenOn bankruptcy, our capital outlay for GenOn has been reduced by $18 million to $160 million.

As shown in the dotted box below the chart, the only capital allocation item associated with the GenOn settlement, which remains to be paid, is our annual pension contribution of approximately $14 million, which will take place in the second half of this year.

As a result of both the reduction in committed capital towards GenOn, as well as the receipt of $12 million in proceeds from smaller asset sales previously not expected to occur until 2019, our remaining 2018 unallocated capital, shown on the far right, has increased by approximately $30 million, resulting in approximately $700 million in 2018 capital remaining to be allocated.

Finally, on slide13, we've again provided the 2018 pro forma net debt to EBITDA calculation as well as the walk to our 2020 ratio, all based on our 2018 pro forma EBITDA. This calculation is based on revised pro forma EBITDA, which I reviewed earlier, and is largely unchanged from our previous disclosure. The adjustment for Ivanpah is now smaller due to the impact of deconsolidation.

As a reminder, in 2018, we are temporarily reserving just over $1 billion in cash in order to achieve our 3 times net debt to EBITDA, and we expect this cash will be made available for capital allocation beyond 2018 as the additional EBITDA from the Transformation Plan initiatives, again beyond 2018, allows us to free up this cash by 2020 while still maintaining that important 3 times net debt-to-EBITDA ratio.

Having previously focused exclusively on 3 times net debt-to-EBITDA ratio established with the Transformation Plan in these updates, this quarter, we're also providing two additional key credit metrics: adjusted cash from operations to net debt, as well as the cash interest coverage ratio to provide you a more complete picture of the strength of our balance sheet and credit profile.

Although we remain a BB-rated company, this rating does not fully reflect the strength of these credit metrics. With consistent execution continuing to demonstrate the strength and resiliency of our integrated platform, supported by our improved and simplified balance sheet, I believe we have the opportunity to earn and improve credit rating.

And with that, I'll turn it back to Mauricio for his closing remarks.

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

Thank you, Kirk. Turning to slide 16, I want to provide you with a few closing thoughts on our 2018 priorities and expectations. We continue to deliver solid financial and operational results while remaining on track with all of our cost and margin targets under our Transformation Plan.

Our integrated platform is working as designed through the volatile summer months and remains well-positioned for tight market conditions in the future. As I said, winning the summer and closing on our announced asset sales is our most immediate focus. I look forward to updating you on our progress and providing you more clarity on our capital location as we move into the second half of the year.

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

QUESTION AND ANSWER SECTION

Operator: Yes, sir. [Operator Instructions] Our first question will come from the line of Julien Dumoulin-Smith with Bank of America Merrill Lynch. Your line is now open.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Q

Hey. Good morning. How are you?

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

A

Good. Good morning, Julien.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Q

Hey. So, I wanted to follow up here on the asset sale progress. Just wanted to get a little bit of clarity. First, with respect to the next round of buybacks and capital allocation, would you expect to potentially provide that prior to the next third quarter call, seeing a timeline potentially on an expedited basis to close some of these larger transactions?

And then, separately, with respect to the asset sales, how do you think about the execution of the balance, the smaller set that have yet to be announced? Obviously, you announced the Keystone/Conemaugh stuff today. But what's the commitment level? Have you kind of reviewed the balance of the portfolio? And are you opting to hold on to some of the smaller stuff?

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

A

Yes, Julien. So let me start with the first one. I mean, we're going to launch the next round of – the next $500 million of share buyback once we close on either Yield, Renewables or our South Central portfolio. So, if that happens before our third quarter call, you will know and all the investors will know.

With respect to your second question about the balance of the remaining asset sales, we're going to be providing you another update as we go through this evaluation towards the end of the year. But just keep in mind, I mean, right now, our focus is to close on these two transactions. And as we move into the year, the team is now shifting gears and evaluating the other asset that will be done for closing. Now, as you can tell, if we see an opportunity like we did with some of the asset sales that we accelerated from 2019 to 2018, we're going to do it. But I just want to make sure, I mean, all the resources that we have right now are completely focused in closing Yield and Renewables and South Central.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Q

Got it. Understood. And then secondly, on retail, can you talk a little bit more about what you did in the quarter? You obviously alluded to it in the prepared remarks, but where does attrition stand today through kind of this period in August, and how do you think about the resiliency kind of going forward? Are you actually adding customers at this point? I mean, I'm just sort of curious.

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

A

Yeah. So, let me start by saying that retail had a phenomenal quarter in the second quarter. We had warmer-than-normal temperatures. That basically pushed our loads and load usage. Keep in mind that we also added XOOM for one month. And Business Solutions also performed well. So, it was a good quarter all around for retail. But Elizabeth, I mean, with respect to some of the attrition questions.

Elizabeth R. Killinger
Executive Vice President, NRG Retail, NRG Energy, Inc.

A

Sure. Thank you, Julien. We actually saw, as you can tell by our results, customer counts up over 10%, largely driven by XOOM. We have what I would call pretty steady attrition and retention performance. There's a little bit of pressure but nothing that, I would say, is out of the ordinary or unexpected. We're really pleased with the performance of both the acquisition and the retention engine through second quarter and are looking forward to a strong third and fourth quarter as well.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Q

Bottom line, on track with the targets that you delineated previously on the retail side.

Elizabeth R. Killinger
Executive Vice President, NRG Retail, NRG Energy, Inc.

A

Yes, sir.

Julien Dumoulin-Smith
Analyst, Bank of America Merrill Lynch

Q

Excellent. Thank you, all.

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

A

Thank you, Julien.

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

Greg Gordon
Analyst, Evercore ISI

Q

Thanks. Good morning. Congratulations on a good quarter.

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

A

Good morning, Greg. Thank you.

Greg Gordon
Analyst, Evercore ISI

Q

So, there's a bit of a debate in the market, Mauricio, that I'd like to hear your perspective on. On the one hand, the lack of really, really high levels of volatility this summer despite the strong load has been disconcerting to some investors who thought that those high levels of volatility would validate the thesis on the Texas market and your long-term view on power market there.

But on the other hand, the lack of massive volatility has allowed you to continue to print stable profit margins and, actually, do some really solid hedging that may or may not have been actually maybe upside relative to what you promulgated in your outlook.

So, from a business perspective, what would you rather see, the conditions you have now or massive levels of volatility that put more stress on the business and potentially bring a faster new entry cycle?

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

A

Yes. Well, first is the – I think you need to look at the fundamentals in Texas. And what I was very pleased to see this summer is that demand is real. I mean, setting a new record peak of 73.3 gigawatts in July, which is not normally even the month that you'll see the most extreme weather, was very encouraging.

So, when you think about the fundamental picture of ERCOT, the supply/demand and the [ph] timings (00:29:57) that exist, it hasn't changed. And actually, this summer has validated that it's here for the foreseeable future. I think what you saw this summer is just a combination of a few things. One was a very strong demand, but that strong demand was met with, like I said, perfect performance by a degree. I mean, when I say perfect performance, you have to just look at the forced outages that we had in that peak [ph] there (00:30:22), and I mean, they were quite remarkable.

And also wind performed, as expected, very close to normal. So, obviously, when you have this type of a situation, yeah, I mean, real-time prices were below what people were expecting. They are not necessarily low, but they were below what people were expecting. And from my perspective, we want a market that has very strong fundamentals and that has a really good market structure on both generation and retail like the one we have in Texas, so that is the perfect combination. We don't want to see a market that is clearing too low that necessarily doesn't reflect the fundamentals of the market and that's why we have been so, I guess, frustrated over the past couple of years in ERCOT.

But also, we don't want to see a situation where you have a scarcity pricing that leads to perhaps shading low, and none of those two extremes are good for our franchise. Our integrated franchise of generation and retail is somewhere in the middle. So, the most important thing is that prices reflect the fundamentals of the market. And from where I see it, the fundamentals in Texas are incredibly strong. And they're going to be very strong for the foreseeable future. I mean, even if you look at the forward prices, I mean, they've been rising, but they are not at the point that are incentivized new-build economics.

So, supply continues to be delay on new generation. Demand, we just saw that it was very strong. So, I mean, I want to see a market that is well-functioning, not that is bouncing on either side of the extremes.

Greg Gordon
Analyst, Evercore ISI
Q

Great. Thank you. And are you in a position now to tell us where inside the guidance range you're trending year-to-date? Or is the rest of the summer just too much of a wild card, and you rather wait till Q3 to tighten the outlook?

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

Greg, it's Kirk. I actually gave you a little bit of that in my remarks. I anticipated that question. And what I'd said, just to repeat, is the performance year-to-date, combined with our current outlook for the balance of the year places us well above the midpoint of our current guidance range. So, [indiscernible] (00:32:44).

Greg Gordon
Analyst, Evercore ISI
Q

Sorry if I missed that. Apologies.

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

That's okay. It's okay.

Greg Gordon
Analyst, Evercore ISI
Q

And then, I also saw there were a couple small retail transactions in the quarter that I just – can you give us some more details on customer counts or multiples to EBITDA on those, or were they just too small to call out?

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

Yes, Greg. I mean, this is just the normal course of business. We actually buy books. I mean, we have an engine in Elizabeth and she's very effective in terms of identifying these opportunities. So, I wouldn't even think that they are representative of a transaction like XOOM. This is just a normal course of business. We're always looking for books that we can add to our retail business, and that's what they were.

Greg Gordon
Analyst, Evercore ISI
Q

Okay. Thank you, guys. Take care.

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

Thanks, Greg.

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

Thank you.

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

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

Good morning and congratulations on solid progress across the board.

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

Thank you, Abe. Good morning.

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

Thanks. Based on the forward curves and your hedging today, could there be more cash available, I mean, over the next couple years above the $4.3 billion? And then, have your thoughts on capital allocation changed at all, and do you remain confident that share buybacks are the best way to get the stock high or closer to fair value?

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

Yes. Well, let me just start by saying that we're not going to [ph] front-run (00:34:20) our third quarter earnings call, which we're going to be providing guidance for 2019.

My thoughts on share buybacks continue to be the same. And for that matter, all capital deployment, we're going to adhere strictly to our capital allocation principles. And as I see today, given where the price of our stock is, I don't think that there is any other more compelling and attractive investment than our own stock. So, until that changes, I think it's fair to assume that that's where we're going to be focusing on.

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

Great. And then, shifting gears a little bit to Texas, can you discuss how you balance your hedging strategy with your fundamental view of the reserve margin and prices, particularly in 2020?

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

Sure. Chris Moser?

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

A

Yeah. Good morning, Abe. This is Chris. Yeah. So, as we're looking at 2019 and 2020, obviously, we've got a view on where things should be compared to the clears that we're seeing. But make no mistake, as we did in 2019 and 2020 when prices get to be a good level and a good level above where it was 6, 8, 12 months ago, there's a certain amount of sense that comes from kind of sweeping some of that profit off the table and that's kind of the balance and the approach that we take.

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

Q

Got it. Thank you.

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

A

Yeah. And just to make sure, I mean, most of the hedging happen in the summer of 2019 and the summer of 2020, right, Chris?

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

A

Yeah. The hedges that were put on in Q2, the power hedges were mainly summer on peak hedges. True.

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

Q

Yeah. Okay. Got it.

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

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Good morning. So, on the on the N Yield (sic) [NRG Yield] (00:36:13) sale, you mentioned you're just finishing up getting consents. Could you be a little more specific on what consents you still need?

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

A

Yes. Good morning, Steve. Yes, I mean in the Yield and Renewables, like I said, I mean all regulatory approvals are done, consents, we're well on our way to have all of them. At this point, we're not providing any specific details in which ones are remaining but what I can tell you is that I have confidence that we're going to be in a position to close on the third quarter. That's what I will share on that, Steve.

Steve Fleishman
Analyst, Wolfe Research LLC

Q

Great.

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

But we're making just great progress on the consents.

Steve Fleishman
Analyst, Wolfe Research LLC
Q

That's great. And then just – this is just, to make it clear, the market. So, should we expect that this buyback will be announced – assuming that closes in Q3 and that's the first one, the buyback $500 million will be announced at that time?

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

Yeah, not only will be announced, will be launched as soon as we close on that transaction.

Steve Fleishman
Analyst, Wolfe Research LLC
Q

Great. Okay. And then, just in terms of the additional hedges how meaningful were they to your kind of 2019-2020 portfolio? How much more hedged are you?

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

Yeah, Steve. If you look back in the Appendix, I don't – what is the page – page 21, you'll see the move there. We layered on a big chunk of natural gas equivalent hedges. Think of that as covering kind of the shoulder months and off-peak timeframe and the assets up in Chicago. And then you'll see that we did power hedging of 10% or 11% on an annual basis. But the hedge we're putting on were really more focused specifically in this summer.

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

Yes. So, Steve, I mean, from a percentage standpoint, while it appears on that disclosure on an annualized basis, think of it as they were all put in the summer. So, the summer percentage was much higher than what is showing in the...

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

Yeah. I mean it was the mini part of the curve, right? It was the thick part of the curve that we were trying to sell and use the liquidity that was out there. I'm very happy with the hedge we put on for 2019 and 2020.

Steve Fleishman
Analyst, Wolfe Research LLC
Q

Okay. And just in that light, I mean, your three-year guidance goes all the way back to last fall. Obviously, Texas prices are meaningfully higher since then; natural might be a little lower. In the totality, though, are these hedges being put on at premiums to what your plan has been?

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

Yeah. I mean, Steve, just to be perfectly clear, I mean, what we provided was a pro forma based on – back then, 2017, with the impact of the Transformation Plan. And yes, I mean, if you look at the curve, all else equal, I mean, it's been a positive move. Kirk?

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

Yeah. Steve, it's Kirk. First, overall the answer is yes. And the reason I say that is you can look no further to the fact that when we first established guidance for 2018, for example, that would be in the third quarter of the previous year, third quarter of 2017, generally speaking, our guidance is centered around the midpoint of our expectations, and those expectations are informed by what the summer prices are, in this case, in 2018 at that time.

And, I think, since our pro forma view is all anchored on that 2018, the degree to which 2019 and 2020 summer prices today, for example, are higher than where 2018 summer was at the time we established our guidance, and I can tell you the answer to that question is yes and you can quantify it by looking back, that would give rise to the fact that all things being equal, that would give rise to an increase in that pro forma view since 2018 would be higher than it would 've been expected at that time. And as I said – I confirm that our expectations are well above the midpoint of our range currently for 2018.

Steve Fleishman
Analyst, Wolfe Research LLC
Q

That's great. And one last, just quick thing on the Texas market, you mentioned a very strong plant performance and also, wind, I think being decent. Just how about demand response and how much is that impacting this in your thinking?

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

Sure. Chris?

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

Yeah. When I go back and if we look on the slide that Mauricio was talking about, I mean, load was about 500 megawatts – or just talking about the peak hour on the 19th there, load was around 500 megawatts higher or worse compared to the CERA expectation. You had generation around 1,000 megawatts better, which was just really flawless execution across the grid. And I'm happy to say we've put in some extra spring outages to be ready and that really paid off for us. We had fantastic performance from the operations group.

So, anyway, so those two net out to be, give or take, 500 megawatts better than the CERA. And the CERA had around 1,000 megawatts of space in it. So, we really didn't get into the position where we needed a ton of other things to come to bear to save the market. I will say that the market – it was an interesting setup because Thursday wasn't supposed to be the high day. So, this is the 19th. It was supposed to be that following Monday, the 23rd, which was actually forecast at over 76,000 megawatts for the better part of that week. And so, I think a lot of the DR and whatnot was being prepared to be brought to bear on that Monday, and they may have missed the party a little bit because it turned out to be that Thursday was the high day.

Steve Fleishman
Analyst, Wolfe Research LLC
Q

Okay. Thank you.

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

A

Thank you, Steve.

Operator: Thank you. Our next question comes from Praful Mehta with Citigroup. Your line is now open.

Praful Mehta
Analyst, Citigroup Global Markets, Inc.

Q

Thanks so much. Hi, guys.

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

A

Good morning, Praful.

Praful Mehta
Analyst, Citigroup Global Markets, Inc.

Q

Good morning. So, Kirk, just to clarify, on the EBITDA guidance well above the midpoint, is that for the retained assets or is there a split between what is retained and what is being sold in terms of what's kind of driving that uptick?

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

A

Well, I'm not going to get specific about breaking beyond what our official guidance is, which is consolidated guidance. But if you take a step back, the big portion of the adjustment, if you will, to get to a pro forma view is a portfolio that consists of two things primarily. One being LaGen, which is kind of an integrated type of business, not to say it doesn't have upside and downside. And the bulk of what remains is Yield, which is largely contracted, relatively low volatility, right? And you can look at it because Yield provides point estimates on their own guidance, which is largely unchanged. So, I think you can infer from that, to a large degree, that outlook is anchored off of our expectations for the balance of the portfolio. But I wouldn't go so far as to give you specifics other than I think it's reasonable to infer on the basis of what I just described.

Praful Mehta
Analyst, Citigroup Global Markets, Inc.

Q

Got you. And that's super helpful color. All right. And secondly just following up on the ERCOT and PJM question. So, firstly on ERCOT, Mauricio, do you vary that if there is no spike in ERCOT [ph] and dry signal (00:43:31) in 2018 that you reach that point whereby 2019 or 2020, you have these unsustainable reserve margins which are so low that it's actually not suitable for your business? Is there a concern of that and how do you think that gets mitigated?

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

A

Yes, I mean, my concern is always that the prices do not reflect the fundamental view of the market. I mean, that to me is what keeps me up at night because if the prices don't reflect that, then developers, generators, we can't – perhaps we're making decisions with not the best information.

Now, obviously real-time prices are just one aspect of it. I mean, you have to look at the day ahead. You have to look at the forwards, and most of the decisions are made on forward pricing. The day-ahead market is also an indication on how people get set up. And then real-time prices is what happens. I mean, so far we have been talking about real-time prices which basically was the result of perfect performance of the grid and a very strong demand.

But as I think about 2019 and 2020, obviously I want to make sure that the prices are reflecting the fundamental situation in Texas. And to the extent that that lost, rational developments, rational market participants are going to react in the right way. So, that to me is the most important thing, strong fundamentals and a very strong market structure. That's what we're striving to do.

Praful Mehta
Analyst, Citigroup Global Markets, Inc.

Q

Got you. Thank you. And then, finally, on PJM, as you said, I think it's clear that FERC wants to do the right thing here and create the competitive market or the right competitive marketing signals. But there's a pretty big gap between that and what the proposals are right now. Do you think there is enough time between now and January to get this done or do you think this gets pushed out to next year maybe?

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

A

I mean, it's really hard to handicap the timing when it comes to FERC and when they're going to act. And so, I'm not going to venture into that. What I will tell you is just we have been very encouraged now for now a couple of orders on the position that FERC has taken in terms of protecting the integrity of competitive markets. If you go back to [ph] Mystic, the PJM and (00:46:10) capacity, I mean there has been a lot of consistency coming out of FERC. So, that's the data point that we have. Everything else we don't have the details, then it's a speculation. So, I don't think we will be venturing into something that we don't have enough information to even quantify. So, that's what I will say.

Praful Mehta
Analyst, Citigroup Global Markets, Inc.

Q

Got you. Really appreciate it. Thank you, guys.

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

A

Thank you.

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

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

Q

Thank you. So, okay, I'm going to go back to the share buybacks question. So, Kirk, you're saying that now you expect excess cash of almost $700 million. It seems like you do have a line of sight for the NRG Yield transaction closing and yet you are not launching the next batch of buybacks. What am I missing here?

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

A

Well, everything you just described is correct. The one thing to keep in mind is outside of the asset sale proceeds, which we've given some indication about timing, our organic free cash flow generation is relatively backend loaded, right? We need to get through the summer in order to start to build that cash.

So, as we come into the fall, our cash balances begin to appreciate. In the interim during the summer months, while still waiting on that cash, that also tends to be the more significant draw in liquidity, which we have ample supply of, but we have to be prepared that if we do see scarcity pricing events or the anticipation thereof in the forward market, that then entails a need for posting additional collateral. So, we have to balance the liquidity, the reality that the organic cash flow is backend-loaded, supplemented by the receipt of the asset sale proceeds which is obviously determined on closing. So, all of those factor into that timing in terms of the expectation in terms of launching Phase 2.

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

Q

Okay. But just one more follow-up here, I mean you seem to be indicating that you will be waiting for the transaction to actually close, NRG Yield I'm talking. I thought in the past we were just talking about a line of sight of that transaction and I know that it might be probably just a small difference as far as time is concerned, but I mean are you basically depending on that cash really entering your bank accounts so desperately before the buyback can kick off?

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

A

Angie, this is Mauricio. I mean, well, first, we launched the first 500 megawatts because we felt comfortable that the transactions had been announced and we were making good progress. And I was very pleased with how we performed on this first 500 megawatts. The second 500 megawatts is going to be launched when we – at close. We feel comfortable with that. And, as Kirk is saying, I mean, we have to balance when those [indiscernible] (00:49:23) are coming in and the back-end loaded of our cash flows come in in Q3 and Q4. Particularly with the type of volatility that we're seeing in the market, it is important that we take extra precaution.

And then once we do that, then on the third quarter call, what I said is any remaining capital that is available for allocation, we'll be providing that clarity. So, I think that's the sequence that you should be expecting, Angie.

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

Q

Okay. And my last quick question. So, you showed us the performance on your retail and generation portfolio in the second quarter. Can you say what happened in July in Texas, if that strength, especially in retail earnings, continued?

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

A

Yeah. I mean, what I will tell you is that we actually, with the benefit of the pricing that we receive in the forward markets, we got ready, both on our generation and our retail business, to perform the way we have described we performed in July. I mean, aside from that information, I don't want to front run the earnings, the third quarter earnings where we're going to be talking specifically about the summer months. But I felt it was important that many of you are investors and wanted to know just what happened in this first month.

And I think what I can tell you is that we're very pleased with the performance of the fleet. I'm very pleased with how our integrated platform performed as a whole, generation and retail in the first summer months. And that's – I mean, I think that's what I'm comfortable right now sharing with. I mean, like I said, we're just in the middle of the summer. I mean, the most volatile months are still ahead of us. Historically, August and September, that's where you see a lot of high – consecutive high temperature day.

So, I want to make sure that the entire organization remains focused, and there's still a lot that can happen in the next two months. And I will be providing you an update on the third quarter call on what happened this summer. But so far, I feel very good.

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

Q

Okay. Thank you.

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

A

Thank you, Angie.

Operator: Thank you. Our final question comes from the line of Michael Lapides with Goldman Sachs. Your line is now open.

Michael Lapides
Analyst, Goldman Sachs & Co. LLC

Q

Hey guys, congrats on a good quarter and good first half of the year. I want to come back to the hedging slide a little bit, slide 22, but I'm just kind of comparing it to the same slide in the prior-quarter deck. And I'm just looking at the total forward hedged revenue number, and I'm only looking at 2019 and 2020. So, 2019, it's $1.2 billion and 2020, it's $828 million. If I look at that same slide for the first quarter, cumulatively, if I just take the differences between what you had hedged then and what you have hedged now, it's $1 billion, $600 million in one year, $400 million in 2020. Does that all just drop to the bottom line meaning that $600 million – I mean, that's $1 billion of incremental cash flow that will likely flow into NRG relative to what you may have thought or had hedged or had locked in three or four months ago.

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

A

Yeah. Well, Michael, thank you and – I mean, keep in mind that this is just the top line. This is revenue. This is not gross margin. So, you have – first, you have another leg. I mean, you have to take into consideration what happened on the fuel side, right? I mean – and we haven't provided that here. And then secondly, I mean, I think as we have said, I mean, this reflects the hedging that we did, the incremental hedging that we did on both natural gas equivalents and power.

So, I don't think you should have – this is an indication, this is a direction, but it's not a one-to-one drops to the bottom line. I mean, there are other things that are not captured completely in that line.

Michael Lapides
Analyst, Goldman Sachs & Co. LLC

Q

Right. But if I just think about the fuel side, I mean, we haven't seen PRB coal move a lot or lignite move a lot and I think you had probably already procured your uranium. So, it's really just – and gas prices haven't exactly spiked a ton in the last couple of months. So, unless it's just something dealing with the retail offset and maybe having retail contracts that don't just pass through the fuel clause, I would assume that at least a large portion of this incremental billion dollars would flow to you, if not all of it.

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

A

Yeah. Well, I mean, with respect to retail, keep in mind that in 2019 and 2020, I mean, any price changes affect every single retailer. So, I think the dynamic that we have seen when prices increase and benefits wholesale generation and perhaps it put some pressure on retail, that doesn't happen in 2019 and 2020 because all retailers are exposed to the same price of electricity. So, I think that addresses your concern around retail.

And then with respect to – that's why we provide the sensitivities. I mean, I think the sensitivities give you a sense on how our portfolio behaves depending on the different market conditions. And I would actually – I think that's perhaps a more comprehensive way to look at the – how our portfolio will or how the changes in the prices will impact our portfolio. So, I would direct you more to the sensitivities as opposed to this one line that is very specific on revenue.

Michael Lapides
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Thank you. Much appreciated, guys.

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

A

Thank you, Michael.

Operator: Thank you. With that, I will turn the conference back over to Mr. Gutierrez for closing remarks.

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

Well, thank you. It was great talking to you and I look forward to continue our conversation in the third quarter call. Thank you, all.

Operator: Thank you. Ladies and gentlemen, that concludes today's conference. Thank you very much for your participation. You may all disconnect. Have a wonderful day.