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NRG Energy, Inc. (NRG)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the NRG Energy, Inc. Second Quarter 2021 Earnings Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Kevin Cole, Head of Investor Relations. Please go ahead.

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

Thank you, Rei. Good morning and welcome to NRG Energy's second quarter 2021 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 & Webcasts.

Please note that today's discussion may contain forward-looking statements which are based on assumptions that we believe to be reasonable as of this date. Actual results may differ materially. We urge everyone to review the Safe Harbor in today's presentation as well as the risk factors in our SEC filings. We undertake no obligation to update these statements as a result of future events except as required by law.

In addition, we will refer to both GAAP and non-GAAP financial measures. For information regarding our non-GAAP financial measures and reconciliations to the most directly comparable GAAP measures, please refer to today's presentation.

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

Mauricio Gutierrez

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

Thank you, Kevin. Good morning, everyone, and thank you for your interest in NRG. I'm joined this morning by Alberto Fornaro, Chief Financial Officer. Also on the call and available for questions, we have Elizabeth Killinger, Head of Home Retail; and Chris Moser, Head of Operations.

Just a few weeks ago, we hosted our comprehensive Investor Day. Since then, we have had the opportunity to speak with many of you in detail about our strategic plan, which will position us as the leading energy consumer services company and create tremendous stakeholder value. I look forward to updating you on our progress in the coming quarters. But for this call, we will keep our remarks brief and focus on our quarterly results.

Turning to slide 3, I would like to start with the three key messages for today's call. Our integrated platform delivered strong results during the second quarter, up 14% compared to the same period last year. And today, we are reaffirming our 2021 guidance ranges.

Next, following Winter Storm Uri, the Governor and Texas legislature acted swiftly to begin to address critical issues and improve grid reliability. The public utility and railroad commissions are now in the process of implementing these directives to strengthen both the electric and natural gas systems to improve reliability and protect customers. I want to thank the Governor and the Texas legislature for their leadership on these issues. Finally, in June we held our Investor Day focused on our long-term strategic outlook, our road map through 2025 and the compelling value proposition of our consumer platform.

Now moving to the financial and operational results for the quarter on slide 4. Beginning on the left hand side of the slide, we again delivered top decile safety performance. This is the ninth straight quarter we have achieved top decile safety, an incredible accomplishment for the entire company. As we start to come back to the office, we will continue to adhere to the CDC guidelines to ensure the safety and well-being of our people.

During the quarter, we continued to make progress on our strategic initiatives with focus on integrating Direct Energy, advancing our capital-light decarbonization efforts and expanding our secondary product capabilities.

Starting with the Direct Energy integration. Through the second quarter, we achieved $89 million in synergies, or two-thirds of our 2021 target. Today, we're reaffirming both the 2021 and full plan targets. Next, we continue to perfect our customer-centric model through advancing noncore asset sales and retirements and expanding our renewable PPA strategy across all of our markets.

Moving to the right hand side of the slide, we are reporting $656 million of adjusted EBITDA for the second quarter, or 14% growth year-on-year, and $1.223 billion or 33% growth year-to-date. Strong second quarter results were largely driven by the Direct Energy acquisition and favorable weather in the East, further demonstrating the value of our diversified platform of consumer services. Alberto will discuss in more detail the quarterly drivers in his section.

Turning to slide 5 for a brief update on our core markets. Beginning on the left hand side of the slide, following Winter Storm Uri in February, it was clear that market reforms were necessary to improve grid resilience. In the months following the event, we actively engaged in discussions with legislators, regulators and other market participants to introduce comprehensive and competitive solutions across the entire system to address areas that failed, and to ensure an event like this does not happen again.

The Texas legislature acted swiftly in addressing these issues passing Senate Bills 2 and 3, which were signed into law by the Governor on June 8, focused on reliability from the wellhead to the light bulb. Importantly, Senate Bill 3 provides the Public Utility Commission, Railroad Commission and other parties the tools and mandate need to get it done right. The PUCT and ERCOT are now working to implement the power market portions of the reform. We are focused on supporting them in the implementation of these policies and procedures to ensure the market functions properly in the future.

We expect the focus over coming months to be on improving price formation through mechanisms to incentivize reliability. It will also establish clear winterization and maintenance outage standards and protocols for the electric system. Importantly, the PUCT is focused on customer bills and ensuring these actions do not materially impact affordability, which has been a compelling attribute of living and doing business in Texas. We believe that PUCT will be able to address the key issues of market design, system hardening and weatherization this year for the power sector.

Next, moving to the bottom left hand side of the slide. The Governor and legislature recognized the financial harm of socializing the cost of defaults by regulated entities like Brazos and Rayburn across competitive markets. The legislation also addresses unhedgeable costs due to ERCOT's management of the grid, particularly during the final 32 hours of the event. The Texas legislature passed and the Governor signed into law necessary securitizations to address both default allocations and uplift charges. We expect to have greater line of sight on our costs eligible for securitization later this year. Finally, our expected net financial impact from Winter Storm Uri remains unchanged at $500 million to $700 million. From last quarter, our gross impact increased by $85 million primarily due to resettlements and bad debt which we expect to be fully offset through our mitigation strategy.

Moving to the right hand side of the slide for an update on our ongoing portfolio and real estate optimization efforts. First, during the quarter, PJM held its first capacity auction in roughly three years, which provided disappointing results. Subsequently, given market conditions, we announced our intention to retire 1.6 gigawatts or 55% of our PJM coal generation by 2022, and a strategic review of our remaining PJM portfolio. Next, our previously announced 4.8 gigawatt asset sale remains on track to close in the fourth quarter. Finally, our portfolio repositioning and optimization is a continuous process. We are committed to our business model and will continue to provide updates on our progress.

On the next two slides, I want to review some of the highlights from our Investor Day, beginning on slide 6 with our strategy and platform. This was our first Investor Day since 2018. And in three short years, we underwent a significant transformation, doubling the number of customers we serve, optimizing our generation fleet to serve our customers, building an efficient operating platform and strengthening our balance sheet while returning significant excess cash to our shareholders. The acquisition of Direct Energy in January marked the next step in our journey as we completed the three-year Transformation Plan and began our decisive transition into a consumer services company.

While historically our core product has been electricity, the addition of Direct Energy brought scale to our retail natural gas and services businesses. With consumers increasingly seeking a trusted partner to provide home solutions, our advantaged consumer platform is uniquely positioned to meet our customer needs in ways other providers cannot match.

Just yesterday, Green Mountain Energy filed an application to provide its 100 renewable electric product in Arizona. We're constantly on the lookout for new markets and to grow our service offering in existing ones.

As we offer adjacent products and services, we can leverage our existing platform to access cost synergies. This economic advantage, coupled with better insights and more personalization, result in a better experience for our customers. For NRG, this advantage means broader insights into how consumers interact with their homes, additional margin, and better retention on our core product; and then the cycle repeats as we grow, creating a more valuable business.

As you can see on the right hand side of the slide, we have provided you a road map of our strategic priorities through 2025. Over the near term, our focus is on optimizing our core, which includes integrating Direct Energy, decarbonizing our retail supply, and expanding our current dual fuel customer base. Next, beginning in 2022 our focus will shift to growing the core through residential power and home services. Finally, throughout this entire period, we will be returning significant capital to shareholders.

To summarize our road map, we're starting with our foundation as a best-in-class integrated energy retailer. We will leverage our operating platform to become a trusted partner for power services, and then we will broaden our offerings and partnerships to become a provider of select home services.

Finally, we have quantified for you what I believe is an achievable growth opportunity over the course of this strategic road map. In total, we have identified $720 million of incremental EBITDA growth opportunity which will be achieved through the Direct Energy integration and the deployment of up to $2 billion of growth investments in both CapEx and OpEx opportunities. This capital will be deployed to the maximum return opportunity and you can expect transparency as we begin to allocate investment dollars. Given our near-term focus on integrating Direct Energy and growing dual fuel customers, you should expect this capital to be weighted toward the second half of our road map.

Now turning to slide 7, over the course of our strategic road map we expect to generate $8 billion in cumulative excess cash, which also excludes roughly $0.5 billion of excess cash still to be allocated this year. Applying our 50/50 capital allocation framework results in $4 billion return to shareholders through dividends and share repurchases and $4 billion for opportunistic growth. We have earmarked $2 billion to achieve the $520 million incremental EBITDA detailed on the prior slide. The remaining $2 billion is available to be allocated to the maximum return opportunity, whether it be growth investments or share repurchases.

In summary, we outlined a compelling value proposition anchored by a portfolio of favored brands serving nearly 6 million customers. We are positioned to grow and leverage our existing operating platform to achieve higher margins and longer tenure customers. We have the financial flexibility to invest capital at attractive returns while returning significant capital to shareholders. And we have the right people and the right platform to create sustainable value for all stakeholders.

So with that, I want to welcome Alberto Fornaro to the call and provide a brief introduction. Alberto joined NRG on June 1, following an extensive CFO search. Alberto is a seasoned finance expert who brings over 30 years of experience and a unique combination of consumer, technology, manufacturing and risk management experience. I believe Alberto's expertise is the ideal fit to enhance our transition into a consumer services company.

Alberto, welcome. And I will turn it over to you for the financial review.

Alberto Fornaro

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

Thank you, Mauricio, for your kind words and good morning, everyone. I am excited to be with you this morning and to join NRG during its transformation to become a consumer services company. Now, more than ever, customer experience and engagement are key priorities for leading companies. And I feel fortunate to be part of an organization that is completely focusing on the customer to continue to grow. I look forward to the dialog with our analysts and the investment community over the months to come. Hopefully, we will be able to meet in person sometime in the near future.

Moving to the quarterly results, I will now turn to slide 9 for a brief review of our financials. For the quarter, NRG delivered $656 million in adjusted EBITDA or $82 million higher than the second quarter of last year. The increase in consolidated earnings was driven by the acquisition of Direct Energy and the related addition of synergies achieved in Q2.

Specifically by region, the East benefited from the expected contribution from the Direct Energy acquisition. In addition, favorable weather resulted in outperformance by both our electric and natural gas businesses. Finally, we enjoyed favorable intra-year timing of demand response revenues.

Next, our Texas region partially offset these benefits due to lower residential demand, driven by milder weather and return to work trends, as well as to higher retail supply costs. As a reminder, we benefited last year from exceptionally low market power prices realized during the start of the COVID-driven economic shutdown. On a year-to-date basis, our progress in terms of incremental profitability was even more significant. It demonstrates the value of our diversified consumer services platform and its ability to absorb the possible impact of headwinds such as the current forced outage we are dealing with at Limestone Unit 1 which will extend until year end.

Our expectation for the net impact from Winter Storm Uri remains at $500 million to $700 million, with an $85 million increase in onetime costs offset by a similar increase in the range of expected mitigants. This is primarily due to the positive development of the Texas securitization legislation during the quarter. The total negative cash impact is still expected to be $350 million to $550 million in 2021 and $150 million in 2022 due to the estimated bill credits owed to large commercial and industrial customers.

Now turning to Direct Energy integration, we are confirming our goal to achieve a run rate of $300 million synergies by 2023. We are on track to achieve $135 million of synergies for 2021 with $89 million realized year-to-date. Synergy expectations as well as synergies achieved so far are fully embedded respectively in our 2021 guidance and year-to-date actuals.

Overall, we are off to a great start in the first half of the year, and we are reaffirming guidance at $2.4 billion to $2.6 billion for adjusted EBITDA and $1.44 billion to $1.64 billion for free cash flow before growth.

I will now turn to slide 10 where we are updating our planned 2021 capital location. As in the past, our practice on this slide is to highlight changes from last quarter in blue. Starting from the left, on the third column, the net capital required for the Direct Energy acquisition was increased by $35 million based on the latest estimate of the post-closing working capital adjustments. We anticipate finalizing the working capital adjustment during the third quarter.

Moving on the next column and as discussed on the previous slide, the midpoint for net estimated cash impact from Winter Storm Uri remains at $450 million. This includes the increase of $85 million for onetime cost in 2021 and similar increase in expected mitigants driven primarily by the latest Texas legislation. As you are aware, the much anticipated securitization bills HB4492 and SB1580 have been approved and are being finalized by ERCOT and PUCT. Clarity about the expected completion should come later this year.

Moving to the next column. To achieve a 3.0 net debt to adjusted EBITDA ratio, we expect to deleverage by $255 million, plus early redemption fee of $9 million, totaling $264 million of capital to be allocated. This leaves $461 million of remaining capital available for allocation. A large portion of this capital is dependent on the successful conclusion of the ERCOT securitization processes.

Finally, as a reminder, today our capital allocation waterfall does include the impact from our pending 4.8 gigawatt asset sale which is expected to close in the fourth quarter. Net cash proceeds will be utilized partly for debt reduction, $500 million to maintain leverage neutrality. And the remaining $100 million to $150 million after purchase price adjustments to be available for general capital allocation.

Finally, on slide 11, after reducing our corporate debt balance for the expected 2021 debt reimbursement and for the minimum cash, our 2021 net debt balance will be approximately $7.9 billion which when based at the midpoint of the adjusted EBITDA implies a ratio of 3.0 net debt to adjusted EBITDA. As discussed during the Investor Day, given our growth profile, we have revised our time line to achieve investment grade metrics of 2.5 to 2.75 times net debt to adjusted EBITDA ratio. We plan on achieving a stronger 3.0 ratio by year end 2021, and growing into our longer term targets of 2.5 to 2.75 ratio by 2023, primarily through the full realization of Direct Energy run-rate earnings.

We remain committed to a strong balance sheet and to achieve credit metrics aligned with an investment grade rating. We are very comfortable in achieving our target and are continuing to maintain a constructive dialog with the rating agencies. Back to you, Mauricio.

Mauricio Gutierrez

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

Thank you, Alberto. Turning to slide 13, I want to provide a few closing thoughts on today's presentation. During the quarter, we made significant progress on our priorities, integrating Direct Energy, perfecting and growing our platform and executing disciplined capital allocation. NRG has never been stronger. We have the stability and financial flexibility to thrive and take advantage of opportunities through all market cycles. At our Investor Day, we outlined for you the tremendous opportunity to deliver value for shareholders, and I have never been more excited about the future of this company. I look forward to updating you on our progress along the way.

So with that, Rei, we'll open the line for questions.

QUESTION AND ANSWER SECTION

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

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

Hey. Good morning, team. Thanks for the opportunity. Just in brief you can comment on nuclear piece – federal nuclear efforts perhaps if that's been defined. If you can comment on that just in brief. And what that might mean for your specific opportunities, if you don't mind?

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

I'm sorry, Julien. You were breaking up a little bit. Are you talking about the nuclear PTC?

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

Exactly. Indeed. And what that might be at the federal level for your assets.

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

Right. Well, I mean, the – so first, let me just say that in terms of regional or market specific, out-of-market subsidies, whether it's for nuclear or any other technology, we'd rather see competitive incentives in our respective markets. Now, having said that, if there is a national PTC, obviously that changes our perspective. We will look at participating in that through our South Texas Project facility down in Texas. And obviously, that has a positive impact on our – on that particular asset. So that's how I would think about the national PTC. But I need to highlight the national aspect of it. I mean, I think if it's just regional, it creates a lot of dynamics intra-market that are not necessarily in the best interest of competitive markets.

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

Indeed. Just wanted to get your perspective on that. And if you don't mind, perhaps a bigger picture question here. Can you comment on the commodity backdrop here? I mean, I just – there's been a lot of movement in the various forward curves. Obviously, your position is not always obvious from a net short or net long perspective depending on the specific market. Can you comment a little bit on the overall position today as you think about the later-dated years and just how that positions you against the targets you articulated earlier?

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

Sure, Julien. I mean, as I tried to highlight in the past, our integrated platform really has reduced exposure to the underlying commodity prices, whether it is increasing in natural gas which we have seen or increasing in power prices. These tends to affect all market participants, all retail providers, so to some extent all these increasing commodity prices can be passed through to customers. It's not that it's just affecting us or affecting somebody else.

I will say that given the addition of the natural gas business with the acquisition of Direct Energy, that actually have been very complementary, and it highlights the strength of our diversified portfolio. I mean, in the East, if you look at it, it's actually even more noticeable. If gas prices are increasing, perhaps that has some impact on – in the near-term on our power business, but it has actually a benefit on our natural gas business which is incredibly sizable.

So that's why I think investors need to think about our business somewhat insulated from increases in commodity prices.

Now I don't know, Chris, if you have any comments around just the direction of the price move and what to expect as I – I think I already addressed the impact on our portfolio.

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

Yeah. The only thing I would add is, I mean, look gas has been strong because there's a lot of increased demand out there, right? LNG is going crazy overseas with Europe on bid against Asia. That's driving things up. I think that the US just recently became the largest exporter of LNG in the world, passing Australia, which is a hell of a thing. Haven't seen that before. Storage is low right now.

So yeah, we're in a bit of an upcycle right here. But like Mauricio said, it's something that we can price in, right? So if we're pricing to our customers off of the curves that we see and we're covering it off of the curves as they happen or off of our generation, we're in a good spot where we tack on the margin, move on our merry way. So I think Mauricio's right. The integrated platform is a great way to play this whether it's an upcycle or downcycle.

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

Right. And just last quick clarification, if you don't mind. Are you confident with respect to the transition? I know we're still early right after your Analyst Day here, but just with respect to some of the early indications on a strategic pivot on the retail side, any level of confidence or comments you can offer? I know it's, we're getting at it a little bit early here.

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

Okay. Julien, I want to understand your question. I mean, any confidence on our people to...

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

Just early planning as you think about executing against the full $700 million uplift.

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

Oh, okay. Got it. So, I mean, we are – we're very confident on that. And actually, we have already started a number of initiatives both on power services and home services. But as I said, I mean our number one priority right now, and I want to be unequivocal about it, is integrating Direct Energy and achieving the $300 million of synergies.

That's the least path resistance to value. And we're focused on that. Then we're going to look at the low-hanging fruit opportunities like optimizing our dual fuel customers. We have good visibility on them. We want our power customers to buy natural gas, and we want our natural gas customers to buy power. So the cost of acquisition is actually pretty compelling.

And then – and I think that would be the focus for the rest of 2021 and in 2022. You need to think about those other – those opportunities on power and home services as we are testing and learning right now. And if we think that the opportunity is very attractive, then we will accelerate the scale-up. If it's not, then we will kill it quickly. But I expect that most of that investment will happen in the second half of our planning period towards, let's say, 2023 and beyond.

But we're very, very excited. We actually have a pilot program right now on Home Solar which is very exciting. And we're learning a lot about what customers want. So, we are waiting – we're not waiting, we're starting these initiatives. We're very small – deploying very little capital, but we're learning a whole lot.

Julien Dumoulin-Smith
Analyst, BofA Securities, Inc.

Q

Excellent. I'll leave it there. Best of luck.

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

A

Thank you, Julien.

Operator: Your next question comes from the line of Shar Pourreza from Guggenheim Partners. Your line is now open.

James Kennedy
Analyst, Guggenheim Securities LLC

Q

Hey, guys. Good morning. It's actually James for Shar. Congrats on results.

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

A

Hey. Good morning. How are you?

James Kennedy
Analyst, Guggenheim Securities LLC

Q

Good. How's it going? I just had a few housekeeping questions on the quarter. Can we just unpack the February impact just a little bit more? It looks like the buckets moved around $85 million. On the gross side, what's the breakdown there between resettlement and bad debt? And then just on the mitigation side, is that entirely securitization recovery assumption?

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

A

Yes. So, as Alberto mentioned, buckets moved a little, on a gross basis it moved by $85 million. I mean, the majority of it is just resettlements. And I would say 70% – 70%, 30% between resettlements and then 30% bad debt. So we feel very confident with the – now with the clarity that we have around securitization that we're going to be able to offset that.

So, net-net, there is no change in the impact of the – of Winter Storm Uri. Although as I mentioned before, I mean, things are going to move a little bit up and down. It just happened also in this quarter. But we have the upcoming 180-day settlement and just in a – in a couple of weeks and we're monitoring that. But I actually think that that's going to be very small. But nonetheless, I mean, I expect things to move in just a little bit whether it's up or down. But now that we have this visibility on the securitization, it just gives me a lot of comfort to maintain the range that we have.

James Kennedy
Analyst, Guggenheim Securities LLC

Q

Got you. And then just on the PJM strategic review, could you provide any guidance on the time line for the balance of the fleet?

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

A

Well, I mean, just to take a little bit of a step back because I think this – context is important here. So when you look at the PJM fleet, you're really talking about the Midwest Generation fleet. I mean that's the lion's share of it. And as we have quantified for you in the past, I mean, that's about 5% of our earnings. So it's important just to put that context and the magnitude of that. I think everybody has seen the auction results. They were very disappointing. That basically resulted in the announcement of 50% of our coal fleet, the retirement – the announced retirements of 50% of our coal fleet. I think given the changes in capacity prices in PJM, it's just prudent that we do a deep dive review of the rest of the portfolio. It's ongoing at this point and we're looking at everything in terms of reliability – if they're needed for reliability, what are the development prospects. I mean, we're looking at just about everything for that on that strategic review. And I'll – as we progress I'll keep you all updated. But that's where we are.

James Kennedy
Analyst, Guggenheim Securities LLC

Q

Got you. That's all I had. Thanks. Congrats again. And welcome, Alberto.

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

A

Hey. Thank you, James.

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

A

Thank you.

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

Michael Lapides
Analyst, Goldman Sachs & Co. LLC

Q

Hey, guys. Thank you for taking my questions. Couple of things. First of all, the biggest investor concern about NRG is your short position in Texas, meaning, the fact that you don't have as much generation as you might have retail load. How do you anticipate changing your disclosures going forward to help get people comfortable with the short position? Meaning whether you'll outline PPAs you have, or tolling agreements or the hedging of future demand, simply because while I doubt there's going to be another Uri, I'm not so – I'm not a weatherman, so I can't predict it, but I kind of doubt it. But there will be weather events, summer and winter down the road. Maybe not as violent as Uri, but they'll happen. The grid, just a couple of weeks ago was actually forecasting one in Texas. And clearly, the short exposure is the single biggest risk outstanding for NRG. So, how do you plan on changing your disclosure going forward about your long or short position as a mix of contracting physical assets and other hedging?

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

Right. Well, good morning, Michael. And let me just be clear here. NRG doesn't have a short position. When I talk about running an integrated model, every megawatt that we are selling to our customers we're back to backing. Whether it is with owned generation or whether it is contracting generation in the market or just buying on the open wholesale market. So, I want to be clear, Michael. Because I think that is a misconception of NRG. We are not short of electricity, we're not short of products that we're selling to our customers. We back to back them all. So, that would be the first point.

The second point is, we don't have to own every single megawatt that we have. I mean that is – we can actually achieve the same attributes of owning generation by contracting them. We have a number of renewable PPAs that we have. We contract with other counterparties, and whether it is a tolling deal or some physical transaction, we can actually buy in the open market in the forward. So I mean, there is a number of things I would say that the biggest lesson coming from Winter Storm Uri is the diversification of our supply. If I owned one big power plant and you would basically say, okay, well, now they're not short, that one power plant will be a single point of failure. That's what we're trying to avoid.

That was the big lesson from Winter Storm Uri. So I actually feel a lot more comfortable that we have a best-in-class commercial team that is looking at sourcing those megawatts from our power plants, from other people's power plants and from the open market. That is the best strategy that we have.

And if we can do it in a capital-light way that frees up our cash and maintains the strong free cash flow to EBITDA ratio that we have, the better. So that's how I think about it, Michael. But this notion that you're describing that somehow the biggest risk is the short position of NRG. I just don't share that same view.

Michael Lapides
Analyst, Goldman Sachs & Co. LLC
Q

Right. But can I follow up on that real quick. Just – I'm going to try and keep it simple. Do you have enough megawatt hours of your own generation or under multiyear contracts to meet expected peak demands, summer and winter?

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

I mean, every – we do. That's what is balancing – running a balanced portfolio is. Now, I expect the commercial team when we go into the shorter term to position the – our – to adjust our position based on their – sometimes based on their commodity, based on weather, based on prices. But you're talking about optimization around the edge not necessarily a position going forward. So, I mean, if you're asking me do we have enough megawatts, I would say yes. On a nameplate capacity, our portfolio is sufficient to cover just as much of the megawatts that we sell, but that's not what we're trying to do. What we're trying to do is optimize our supply to make sure that we put the position – we have the company positioned in the best possible way given where we think the market is.

Michael Lapides
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Okay. Thank you, guys. Much appreciated. I'll follow up offline.

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

A

No problem, Michael.

Operator: Your next question comes from the line of Keith Stanley with Wolfe Research. Your line is open.

Keith Stanley
Analyst, Wolfe Research LLC

Q

Hi. Good morning. First, on capital allocation, would you expect the $461 million of cash available from the slide to be fully allocated this year, or is it more likely a good chunk of that gets pushed to next year just because you need the cash back from the Uri offset still?

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

A

Yes. Good morning, Keith. I think – I mean, I'll – well, first of all, we allocate capital when we actually have the cash available to us. So while we have created some financial flexibility given the changes that we did on the glide path to achieve our investment-grade credit metrics, they are still underpinned by when we're going to receive the money from the Uri mitigation plan, and then secondly, from the sale of our East and California assets. So those are the two big triggers. As soon as we have that excess cash, I am going to apply our capital allocation principles. I expect to provide all of you another update on the third quarter call, and I expect this money to start coming in towards the fourth quarter.

So as we have always done in the past, and I don't think this should be a surprise to anybody, we allocate that excess cash when we actually have the cash. And that's how I – that's how you should think about just in terms of timing, Keith.

Keith Stanley
Analyst, Wolfe Research LLC

Q

Got it. The second question just – can you give an update, curious how retail margins sort of ignoring the changes in power prices, if you can isolate it, just how retail margins are tracking after the shakeout from the winter storm. Are you seeing less competition in the Texas market given the volatility event or just any comment on trends and margins.

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

A

No, I think margins have been relatively stable as we – even though the winter storm was pretty impactful particularly on the regulated side, but also on the unregulated. Many of the retail providers have either credit sleeves or back to back. So, we saw just a handful of people being exposed to the open market. And I think, they fell through the process, but they were the minimum number of participants. I wouldn't say that there was a big number of participants that were under tremendous stress on the retail side. So, margins have been relatively stable. The competition is still out there, similar to what we have seen in the past.

Keith Stanley
Analyst, Wolfe Research LLC

Q

Thank you.

Operator: Your next question comes from the line of Jonathan Arnold from Vertical Research. Your line is now open.

Jonathan Philip Arnold
Analyst, Vertical Research Partners LLC

Q

Good morning, guys.

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

A

Good morning, Jonathan.

Jonathan Philip Arnold
Analyst, Vertical Research Partners LLC

Q

Can I just ask on the mitigation Storm Uri? Did, has any of that been realized already or is it all still to come?

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

A

Most of it will still to come. I mean, as you know, the securitization process is still ongoing, while they pass the law, what we expect is in August to – we're going to have a hearing. And then in October, we need to have an order that is going to define how they're going to allocate that money. So, I expect that by October we'll have even more line of sight in terms of the allocation methodology.

And so that would be on the securitization. And then on the other two, the bad debt is a continuous process. And then I think everybody knows that in the heat recall option that we had, I mean that's going to take a little bit more time given the legal route that we're taking.

Jonathan Philip Arnold
Analyst, Vertical Research Partners LLC

Q

Okay. Great. Thank you for that. And then I'm just – on a – looking forward and just thinking about some of the new targets in the strategy laid out at the Analyst Day, should we anticipate that you will start to provide sort of more disclosure around – sort of the granularity between different types of customers, you have single fuel, dual fuel, et cetera, and just some ways to start tracking your performance on that plan over time? And if so, when do you think we might start to see some of that kind of incremental disclosure?

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

A

Yes. No, that's an excellent point, Jonathan. As I said to you before, we're going to be increasing our disclosures. We're actually working on it right now given the strategic update that we provided to all of you in just a month ago. So, I think what you should expect to see is transparency and visibility in terms of how we go from the margin that we have today to the margin that we want to have in 2025, the steps that we're taking. We're going to have conversations around the different initiatives to deploy the $2 billion of capital. We're in the test and learn period right now. But as we start scaling up in any of these initiatives, we will have a conversation with all of you ahead of time in terms of what the opportunity, quantifying the opportunity, what is the capital that is required and what is the EBITDA associated to it.

So, there is a lot more disclosures to come both in terms of the $2 billion of capital deployment that we expect and the opportunity that that represents, but also the makeup of our portfolio around customers, what we're seeing around the longevity of these customers in our portfolio.

Jonathan Philip Arnold
Analyst, Vertical Research Partners LLC
Q

Mauricio, do you see that as something that'll be sort of part of the regular kind of quarterly cycle when you get to that or more something you'll do once a year or something like that?

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

No, my goal will – we'll make it part of the quarterly updates. And I think that in earnest we'll come probably towards the end of the year and start the new year with fresh financials. We're already working on that now. And I think you should expect more disclosures as we go into 2022.

Jonathan Philip Arnold
Analyst, Vertical Research Partners LLC
Q

Okay. Thank you.

Operator: Our final question comes from the line of Angie Storozynski with Seaport Global. Your line is now open.

Angie Storozynski
Analyst, Seaport Global Securities LLC
Q

Thank you. I was actually about to ask a similar question about disclosures. It seems to me, at least, that the business has become a bit of a black box for all of us. I don't think that we really appreciate some exposure to gas margins and hence some increased seasonality of Direct Energy especially. So we would definitely appreciate the disclosures.

And again, I did hear Mauricio, your comments about the fact that you guys are not short power, I understand that, at least in the long term. But how can you reconcile the movement in forward power curves and the fact that you are relying on market-based purchases of power on your medium-term margins on the retail side? I mean, I understand that you match your contracts with – in the market purchases. But I don't think that it's possible to time it just right. So, again, directionally, explain how the move in forward curves should have impacted your retail margins.

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

A

Sure, Angie. So, I mean, I think you need to make the distinction between customers that are under fixed price. And the customers that are on their fixed price, we back to back that. So, the minute we sign a customer under fixed price, we have the supply, we lock in the margin. And that is very simple. I mean, we price every customer based on the forward curve.

So, I don't think that – that doesn't create any exposure. Perhaps, you're talking about the variable rates, the month-to-month and whether or not we can buy that. But keep in mind, I mean, a variable rate is exactly that. You have the ability to change the price if the underlying commodity price in the market changes. So that's why I was saying we have the ability to pass through some of these costs.

And we're not the only ones exposed to it. Every single retail energy provider – electric provider is exposed to these changes in power prices. So it's not like, this puts us in a disadvantage. I mean, it impacts the supply cost of all retail electric providers. So you would expect a similar – a move to offset that increase. That's why I say, I still don't understand this concept around why some investors or some of you think that we're short power. I mean, having a variable price customer allows us to change prices whether it's up or down, if prices are coming down, perhaps we can move the customers pricing down. But if prices rise, we can do the same. So in the medium term, when you're talking about the medium term, I'm assuming you're talking about 12 to 18 months. I mean that's plenty of time to take price actions. And that's what we have done in the past. We consistently see that. So that's how I think about the exposure. And on the fixed price, we always do it back to back. So I'm not concerned about fixed price customers that go multi-year particularly for C&I customers.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Okay. And then just one last follow-up on capital allocation. So I mean, I'm really glad to see that you will be restarting your share buyback program. Now is that in any way implicitly stating that your investment grade rating is sort of delayed inherently given the Uri storm, and as such, there is no point in trying to de-lever as quickly as possible. Hence, you have some more flexibility, because again I would have expected that you're going to try to go back to that say 2.5 to 2.75 net debt to EBITDA as quickly as possible. And clearly, buybacks are not going to help with that.

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

A

Well, I mean, I think what we said is we have adjusted our glide path to 2.5 to 2.75. We haven't changed our targets of the investment grade credit metrics. We changed the trajectory on how to get there. And that was informed by our conversations with rating agencies in the aftermath of Winter Storm Uri. So it's very consistent with the conversations that we've had with the rating agencies.

I don't control the credit rating timing. That's not on us. That's on the rating agencies. We believe that 3 times is a strong – a very strong balance sheet, but we still are targeting 2.5 to 2.75. But given this change in glide path, it has provided some financial flexibility to – if we have excess cash which we anticipate to have by the end of the year, then we will allocate that through the guidance and principles that are very transparent and that we have communicated to all of you. So that's how I expect to start allocating this excess cash, which include share buybacks toward the end of the year when we start having some excess cash. I mean, that's going to be contingent on when do we close the asset sale and when do we start seeing the money from the Uri mitigants.

Angie Storozynski
Analyst, Seaport Global Securities LLC

Q

Very good. Thank you.

Operator: That is all the time we have for questions. I will now pass the call over to Mauricio Gutierrez for closing remarks.

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

Great. Thank you. Well, thank you for your interest in NRG, and look forward to continue updating you in this exciting new opportunity and phase for NRG. Thank you, everyone.

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