

## Participants

**Kirk Andrews**, CFO at NRG Energy ([NRG](#))

**Nate Abercrombie**, [The Stock Podcast](#)

## Interview Transcript

**Nate:** Kirk Andrews, thank you so very much for coming onto the podcast. I've really been looking forward to talking about your business and the outlook and just all things NRG. So, sincere thanks for coming on, it means a lot.

**Kirk:** My pleasure Nate, no problem.

**Nate:** So if you don't mind, let's start with your background. What were the factors that led you to NRG and what were you doing before NRG?

**Kirk:** As I often say, admittedly tongue in cheek, I am a recovering banker, specifically investment banker. And there is maybe a twelve step program there, I'm not sure which one I'm on, but I originally started out in investment banking on Wall Street, not actually in the power industry. I was in mergers and acquisitions originally, going all the way back when there were names like Solomon brothers, which is one of the predecessors I worked for. It evolved up through all of the consolidations and banking stayed the same place. Over the course of my career I've been in M&A, I from time to time supported the power practice and the energy practice. So I began to get my exposure to the power markets in the companies both utilities, really from the banking side, really from the mergers and acquisitions side and ultimately I was offered a role to actually run the investment banking practice for power. First at Citi and then later at Villager bank.

**Kirk:** During that part of my tenure I came to know NRG more obviously as a client and when the CFO at NRG was moving on in 2011 I got a call from the company asking me if I would come and be the CFO. I had never thought about, at that point making an immediate move to the corporate side, but one of the nice things about NRG for me was if I was going to do so, and if I had to list a hand full of companies I would even consider, I would certainly think that NRG was among them. And primarily just because it was in the competitive part of the market. Not to take anything away from the regulated utilities, but a lot more bread than depth of transactions, interesting structures, MNA and the like. So it was a long-winded way of saying it was the right opportunity at the right time to leave a career in investment banking that I admittedly had enjoyed quite a lot.

**Nate:** Could you talk about the history of NRG? So you talked about the competitive nature and you mentioned the other side of the utility fence which is regulated utilities. Could you just maybe provide us with the longer dated history of NRG? It was owned by Xcel Energy correct?

**Kirk:** Yes, owned by Xcel Energy as a subsidiary of Xcel. Xcel Energy was a like a lot of, what we would think about as regulated utilities under the old model of regulation. In the early days in absence of deregulation, a lot of those companies like Xcel had formed subsidiaries that owned deregulated power plants in the increasing number of deregulated markets. So Xcel originally had looked to take NRG public. I think they did take NRG public maybe as far back as 1999. I think they bought it back in at some point. A short time thereafter NRG

like a lot of IPPs in the early days of deregulation went through a bankruptcy process and so the company that we know at it's core as NRG today obviously no longer Minnesota, that was one of the things that brought NRG to Princeton, New Jersey which is where we are headquartered now, is post the emergence from bankruptcy. So that was basically now NRG came to be the public company it is today. It was really an emergence from bankruptcy as a public company. It existed previously for a short time as a public company, albeit a subsidiary of Xcel energy.

Nate: What were the circumstances that led to NRG's bankruptcy back in the mid 2000's?

Kirk: It is tied to the catalyst that really formed NRG in the first place, albeit as a subsidiary of Xcel and that was really the early days of deregulation in the power market. Those that are familiar with deregulation of quasi or full monopolized industries, and history of the united states telecom comes to mind, airlines comes to mind and obviously power is one of them. And in the 1990's, really I think 1992 they had the original natural energy policy act that began the process towards deregulating parts of the power market into more of a competitive market structure. The idea behind that obviously as I know you are aware, was that monopolistic industries don't tend to innovate quite sufficiently, don't tend to control cost. Competition obviously drives prices down and there was an eye towards, what you might imagine as a benefit to the consumer.

Kirk: Originally this was largely the case, in any of this type of situation. It was really more driven by the industrial users of power more so than the consumer. But the ultimate rationalization I think was that the consumer would benefit by moving as much as possible what we think about as power, our electricity, our electricity bills for a more competitive market. With the idea being that the ultimate benefit of that would go to the customer. Any time you go through a deregulation you have a lot of what you call "teething pains" or what have you.

Kirk: In the advent of ads in 1990's and going in the 2000's, that basically was deregulating power which is largely deregulating the power plant part of it, not the poles and the wires. It's hard to have redundant poles and wires systems competing with each other, it's just not logistically possible. When that took place it really entailed taking the power generation assets out from what we used to call the regulated utilities. And when that was originally done, the value of those power plants was then going to be based on the price of power in the open market. The value of those plants was actually lower at that time because largely natural gas prices which drive the price of power, because that's kind of the feed stock for a lot of the power plants. Or at least the one that set what we called the "marginal price of power". The value of those power plants was actually in most cases lower than the original capital that was put into them by the regulated utilities and so the utilities were kind of provided an ability to recover the difference in what they had invested in the plants and what they were now worth.

Kirk: Both with some of the painful lessons learned in what to do in terms of deregulation of power. California suffered probably the brunt of that in the 2000's as well as natural gas prices began to increase. First of all an increase, it had kind of a whip saw price of power. In the early days a lot of companies like NRG had been capitalized on the basis of where then the profit margins were. As those margins began to erode and for companies like NRG, when natural gas prices are low, you don't own natural gas powered power plants, your profit rises and falls with the cost of natural gas. What we used to say is, because NRG was originally was more of a coal-fired generating business than anything else. And so what that means is, what we used to say is "We sell coal at natural gas prices". Right? Because if natural gas sets the price of power and if natural gas is really, really high, the higher it goes the price of coal stays relatively steady, your profit margin gets bigger.

- Kirk: But when natural gas prices started to fall, the profit margins of those plants and obviously the capital structure they were based upon came under stress and that always results ultimately in acute situations like it was in the case of NRG and many others in a restructuring context, obviously here in the course of bankruptcy. But as you well know, most if not all of the early day IPP's, because of that same circumstance I just described, went through their own restructuring. NRG was probably one of the first ones out, probably went through a quicker bankruptcy process so they were able to get off with a healthy capital structure, I think it was around 2003. And that's the company at its core that exists today, is the one that emerged from that bankruptcy coming out of the early days of deregulation from circumstances I talked about earlier, to the company we know today.
- Kirk: Obviously we built up from that from a lot of acquisitions, but I'm sure we'll go into that a little bit in our conversation.
- Nate: Just a quick question on retail, and I know we're going to talk about that just a little bit more in depth later on in the conversation. But, did NRG or did any of the other competitive power producers have a retail business back in the early 2000's?
- Kirk: No, the retail business was the other part of electric generation that was deregulated. So if you think about it, what we used to think about as being utilities, as I think about it, it's really three parts. It's the physical interaction and sale of the product to the customer and that's what you were just referring to as retail. There's the delivery of that product and is what we see driving down the highway every day, the poles and the wires, and there's the actual manufacturer, if you want to use that term, of the product. And that's the generation.
- Kirk: In the early days the generation was in one box, companies like NRG, or what we refer to as IPP's, independent power producers and the retail part of the business was either hived off from the original utility and increasingly in a subject to competition as other retailers sold the power to the customers. That's the power of choice. That's ultimately the idea behind deregulation, is you can choose your power provider. And your power provider isn't necessarily the one that makes the power and certainly not the one that delivers the power. In some ways it's a lot more complex in obvious ways. With the right process you can hang out your shingle and sell power to customers. Now, you've got to acquire that power if you don't own the power plant. That's the part of the business we used to refer to as retail electric providers, or some people call reps or REPs and that's what exists today. Probably the best less of how that worked was in deregulation of one of the markets we exist in now is obviously the Texas market, ERCOT.
- Nate: Back in the early 2000's was it just a fluctuation in natural gas prices, or were there other factors at play? There's always this concern around retirements and new build. I guess not a concern around retirements, it's more of a concern around new build. And excitement around retirements because for a power producer that would mean less supply assuming if demand stays constant our prices should go up. Were there other factors at play back in the early 2000's that maybe you could discuss that led to sort of the issues that the IPP's had encountered and led to bankruptcy?
- Kirk: I would say two in particular come to mind, one of which you're complicity eluding to. Back in the days where I refer to, in the early days of deregulation. Let's call this kind of the mid 80's, into the 90's, into 2000. Which is that year I think of as being a key inflection point in the evolution of the power markets we know today. And as I mentioned before, that was the period of time where natural gas prices were in a relatively low

state. That's what led to the scenario that I talked about, is being the value of the power plants, in some cases being less than what the utilities paid for them. But when the price of natural gas is low, that means at least the natural gas power plants, their feed stock is also low. That and relatively cheap capital combined with what was obviously a deregulated market. Deregulated in a sense that, the market is deregulated, it's no longer the case that the regulated monopoly or the utility has to go to the regulator and say "Hey I want to build a new power plant". The decisions to build new power plants are based on the market conditions. And the combination of key capital and low feed stock, led to a lot of bullying of a lot of new gas lands.

Kirk: And as you were eluding to before, the laws of economics, the power industry is not immune to those. And so when you build more natural gas powered power plants, you just add more supply to the various markets that are deregulated. Obviously the demand side of the equation doesn't work the way a lot of other industries work. The demand side of the equation is really more of a macroeconomic driven demand, right? It's population growth on the upside and obviously industrial and commercial growth, economic growth on that side of the equation. The head wind sometimes is efficiency. When you think about the efficiency of cars, the efficiency of heating and everything else. That basically governs the growth of demand. And we basically had sort of a bubble if you will on the supply side off the back of, as I said before, cheap capital and low feed stock for natural gas. There was a glut of natural gas powered plants that were built. And when supply grows faster than demand, the price is the victim and that also is part of what went into driving the price of power down for a lot of the participants. That was a critical cause.

Kirk: The other aspect that was somewhat unique to the California market which was kind of a little bit of a first mover in terms of deregulation. As I've said before some of the teething pains were that people had the ability to manipulate markets if you don't regulate them correctly. And there were a lot of bad actors in California that realized that in the early days the way the market was set up was, participants got compensated if there were constraints on delivering power from one place to the other. And what people forgot is, if that same entity, and Enron was a great example of that, has the ability to profit from when the price of power goes higher because it's difficult to get the power through one wire going from one area to the other, if you have ability to control that wire, then you can control the profit that you make from it. And there was a lot of that that went on that led to what a lot of people referred to as the California energy or the California power crisis. That was a big part of it, obviously more acute in California.

Kirk: But both of those two, especially the over build of gas plants kind of attributed to the early days of what I call "teething pains" and with deregulated markets and the victims of that were a lot of the first of the IPP's to come out of deregulation. We weren't prepared both from an advent of deregulation and more importantly from a capital structure standpoint to withstand that high volatility and prices that results from all of the circumstance we just talked about.

Nate: Did renewables play much of a role in terms of the fluctuation commodity prices back in the early 2000's?

Kirk: No, not to any appreciable degree. As I think about that was really the driver largely. There were two drivers over the course of the ensuing next decade. When I say next decade, let's just talk about getting beyond what people were refer to as the "Ots", the 2000 to 2010 period. That was largely driven, the power price fluctuation there was largely driven by natural gas and the over building of gas plants. First you started out with low natural gas prices and you ended up towards the end of the decade, 2008 probably being the peak high natural gas prices. So it's kind of a whip saw effect.

- Kirk: The advent of renewables I think about as being kind of a, obviously it started slightly before then, kind of a 2010, in this particular decade, the latter portion of which we find ourselves in today.
- Nate: Could you talk about the evolution of capacity markets? If you could frame up for the listeners, just how capacity markets came in to being where they are and what were the factors that may or may not have been influenced by the bankrupt sys over the past 15 years?
- Kirk: The best way to think about capacity markets as I think about it is in the current construct or in the relatively low natural gas price construct that exists today. Because it tends to be the case, and this was more back in the prior decade leading into this one, that coal fired plans, which we a lot of times...coal and nuclear, let's call those two together. Tend to be baseload. They run all the time for two reasons. Especially more acutely with nuclear. Nuclear is very cheap, or intended to be relatively cheap, relatively steady cost. And both nuclear and to a larger extent, coal, don't really have the ability to do what we call cycle either. So not only at that point in time were they relatively the lower cost power plants, they were also the power plants that were least able to turn on and off, to take up the demand as it grows.
- Kirk: So if you think about early in the morning on a given weekday as the sun gets hotter in the summer time and obviously it's hotter and air conditioning starts turning on and there is a fixed number of power plants on. Those tend to be coal and nuclear and that type of thing in the early part of the day and they tend to increasingly more and more gas plants turn on. How you get those gas plants to turn on is the price of power goes up to obviously meet and exceed the cost that it takes to convert natural gas in this particular case into power. That power price is also a signal in a deregulated market just like any price signal in any deregulated market as we think about it for new entrance to what will come in right?
- Kirk: It's like if you think about the demand for cell phones for example. If you've bilked out all the manufacturing necessary to crank out enough cell phones to meet the existing demand, the next cell phone demand that comes at the margin, you got to build another manufacturing plant. Well power plants are the same way. And power plants look at the price of power to determine whether or not it's justified to build a power plant. That's what we talked about before in the early days with those gas plants being built.
- Kirk: But when natural gas is relatively low, you've got a situation where the marginal price of power is also low. Which means the profit margin for any would be builder of a power plant is also low. So that price signal is not high enough to signal somebody to build a new power plant. So you say to yourself "So what". Well at the end of the day it isn't like you managed power the way I talked about managing cell phones right? I've got to have exactly enough manufacturing capacity to meet exactly what the demand is going to be.
- Kirk: Well demand is also less predictable just like leather is less predictable, so the deregulated markets have to make sure there is surplus demand. And because power is not a luxury good, it's an essential part of our life, and to keep the lights on, especially where the situations of when the weather gets super hot. You've got to make sure that not only the expected demand can be met, but if things get really hot, the demand at the peak gets met and then some, a little bit of a cushion. The markets tend to call that reserve margin, which basically is a fancy way of saying "I have slightly more power plants available than the demand, that way I know even in the high, worse case scenario, there is enough power plants to turn on so the lights don't go off". Well if the price signal is not there for somebody to go out and build a power plant, and you're nearing that point you don't have enough cushion, there's a reliability problem, that the markets, the people that say grace over those markets have to worry about.

Kirk: The capacity markets were really designed and created to what I often refer to is "Provide the missing money". So I'm just going to make this up to make it simple. If I was looking to build a power plant and say "Hey, I've got to make sure that my profit margin is, I'm making this up, 10 dollars a megawatt hour in order for me to cover my fixed cost of my debt and provide a reasonable return to my equity holders and I've got to have 10 dollars a megawatt hour for that to happen and the price of power is only 5 dollars per megawatt hour, well nobody's building. Capacity prices are designed to give an added incentive beyond on the power price to fill in that blank so that there is an incentive above and beyond that, largely for reliability purposes to ensure that new builds happen. So that you manage the market so that ideally the price signal is right there just enough, you've filled in enough of that missing money that the new build keeps up with the demand so you've always got that reasonable cushion, that cushion I refer to as being reserve margin. Slightly more power plants online than you think within reason, you're probably going to meet need. That way just in case it's super hot or one of those power plants don't work, the lights don't go off.

Kirk: Capacity markets were created in markets where the price signal wasn't there. There was as concern about reliability and as I said before, they were designed to provide that missing money that was necessary for that price signal for that next power plant to get built. Because that's the only way to do that in a deregulated market. You've got to have the right price signal.

Nate: Was that the first step that the different deregulated markets took to incentivize the construction of capacity that is sufficient for their particular footprint to have a sufficient reserve margin?

Kirk: Well there's all sorts of different permutations and variations around that and you're testing the limits of my granular knowledge of the history of at least the consecutive evolution of those things, but suffice to say as I think you know there are a number of other elements beyond just the energy price, or the price of power that are designed to do that. The one thing about the power market as you well know is, I don't think this is by intention, but the result is just the same. The terms, the acronyms are not intuitive when you look at them. So when I make reference to things, you say capacity confuses the reader and I understand that. But some of the other examples of that is there is a market for what they call ancillary services, which is basically another price signal in the market that compensates different types of power plants for their unique characteristics. So for example a gas powered power plant that has the ability to run at a minimum, it's called a spinning reserve. In the moment that the weather gets really hot on a moment's notice, you need that power plant to be available on a moments notice, so for power plants to have the ability to keep the turbines spinning even though it's not running a generator, well that costs money for that power plant to do that. And if you're not actually pushing the next button and attaching it to the generator, you're not providing the power to generate what we would traditionally call revenue. So there's other revenue models that are designed to provide additional incentives to those types of plants, largely gas powered plants, a lot of times that's called spinning reserve. And it's literally like what it sounds like.

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Kirk: I think about it like pushing the clutch in on your car. If I push the clutch in on the car, just like when I push the clutch in on the power plant, I'm still burning gas, I'm still burning fuel, but the car's not going anywhere in the car analogy. And in the power plant analogy, the power plant's not selling power, but it's still costing the power plant money, but you want them to do that because when you pull the clutch out on the power plant, instantaneously you've got power and you can immediately ... Pulling the clutch out is nothing more than engaging the generator.



- Kirk: And that's an important reliability measure to make sure that the plant's that are technologically necessary to, on a moments notice, be available to actually supply power, they need to be compensated for spinning in reserve or holding their clutch in place. And all of those things are elements that exists, were originally thought of, and some of them, like ancillary services, exist today.
- Nate: Yeah, no I appreciate that explanation, and I do apologize to you and listeners that I'm focusing so much on capacity markets. It was just one of those things that having covered NRG for quite a while, capacity market, the results from capacity market auctions, they resulted in such massive swings and the equity values for the power producers. I don't think it's as relevant any longer, but I think it's helpful, especially for somebody who maybe has had a little bit of experience with the IPP's, to just sort of wrap their head around, what were the important data points in the market? And I also mention it because I think it's important to talk about the transition from focusing on capacity markets to the new, fully integrated power model that we'll get to in just a second; but I do really appreciate the explanation.
- Kirk: No, it's totally understandable. That's one of the challenges that we face as an industry. And as I was going through that, you sometimes govern yourself to feel like, "I don't want to be too pedantic in describing this," but this has its roots in what you asked me at the very beginning of this conversation. I didn't originally come from the power industry, and as I began the early stages of my career to start to do more and more, obviously from an M&A perspective, merging and acquisitions around the power industry. Said more succinct, one sympathizes because it is a daunting task to understand all of these elements, which are obviously necessary if you're going to feel comfortable making an investment decision about a company like NRG, or any other IPP that competes in this particular industry. I get it.
- Nate: Yeah, I still would like to go through just a little bit more of NRG's history if you don't mind. Could you talk about 2010 to 2014, the renewable energy growth story, the NYLD IPO, just anything you think is worth mentioning that kind of has led us to, or has led your company to where it is today?
- Kirk: Sure, well there's a couple of interesting off shoots to that where NRG is concerned. Starting with the story we began with the creation of NRG coming out of first the spinoff, or the IPO, and then resulting ultimately in the bankruptcy, and the emergence thereof. At that time, NRG had, I'm just going to call it a smattering of power plants, largely centered along the northeastern part of the United States. Up in New York, there were different things that NRG has since sold at that time, but the interesting thing about NRG is, there are very few of those power plants from those early days that still exist today at NRG. They're not zero, but there's very few of them left, and the ones that are left, some of them are struggling. And that is the nature of the power markets.
- Kirk: Now, the reason I highlight that is not underselling the value proposition of NRG, because we are a lot more than the legacy plants and then some, but it is because of the acquisitive nature that we've evolved through, that has its underspendings in the evolutions of the markets, that we are where we are today. And two examples of that are, aside from acquiring more generation, which was a part of it, retail, and then ultimately renewables. But let me start with the generation side of the equation.
- Kirk: And I mentioned earlier when you were asking about de-regulation in retail, the Texas market. The Texas market is probably the best test case to explain to anyone what a de-regulated market truly looks like. We talk about utilities as being the predecessor of the de-regulated entities today. Well Houston for example had a utility, that was Houston Power and Light. And going back to the description I gave about the three

pieces of utility business, Houston Power and Light had those three pieces. They had the customers, they had the poles and the wires, and they had the generations.

Kirk: Well, Texas was one of the markets that went through a de-regulation, and probably more acutely than just about any other part of the country. So, what happened to the old Houston Power and Light? It basically became, in essence, three companies. It became what was then called Texas Genco, which owned the old power plants, part of the old utility, Houston Power and Light. It owned the poles and the wires, and it owned obviously the customers. Those three businesses, as a consequence of de-regulation, were broken into three distinct businesses.

Kirk: Two of those businesses stayed behind at the company that was the successor company to Houston Power and Light. And the third, the retail business, was spun off by that company into a company called Reliant. That company was designed to own all of the power plants that now the de-regulated company that owned the Texas business, owned outside of Texas. And it also owned all the customer business, the REP, the retail electric provider called Reliant. So that was spun off, literally created in another power company.

Kirk: What was left is the poles and the wires business, which was then called Center Point, still is today, and Texas Genco. Back when natural gas prices were a little lower at the middle part of the last decade called the mid-2000's, Center Point made a decision to sell its stake in Texas Genco, literally sell the power plants, leaving Center Point only with the poles and the wires. NRG had the benefit of acquiring that. So in about 2006 or 2007, NRG purchased the power plants that were part of the old utility in Houston, Texas, HLP. That was called Texas Genco.

Kirk: A few years later, in act in 2009, so about three years later, the company that I mentioned earlier, Reliant, which was the spin off company that owned the non-Texas power plants and the retail part of the old utility in Houston, that company was under its own financial stress. And as a consequence, made a decision to sell the retail business. NRG actually bought that retail business, and the reason I'm telling this story is, I'm a big fan. A lot of times I use movie quotes to describe things. And here where I'll use one. One of the things they used to say in the movie "The Blues Brothers," were, "putting the band back together."

Kirk: Well that, in essence, through those two acquisitions, which were both NRG acquisitions, first in 2006/2007, Texas Genco, the power plants. And then following that in 2009, Reliant, which was the retail part of the old Houston business. We kind of put the band back together. We put the customers and the retail business back together with the power plants, which is just the two ends of the old regulated utility in Houston. So NRG today owns completely, if you will, all of the elements of the old utility in Houston that were de-regulated. Obviously the exception being the poles and the wires, because that's still a regulated business owned by Center Point.

Kirk: That was an important inflection point that changed not only for NRG, but in terms of the recognition of the importance of retail along with generation for a competitive power provider, what we used to call an IPP, an independent power producer.

Nate: Yeah, what's funny for me. I think back to my days at my former firm and there was this discussion for quite some time around ESG, or environmental and social governance. People pointed at NRG and said, "Oh my gosh, they just produce so much electricity with coal powered generation." NRG had one of the largest renewable energy portfolios in the United States. Am I wrong?



- Kirk: We did, and actually we still do. As you know, and maybe the folks who listen to this may be aware, we're in the process of monetizing or selling that, but you're correct. But that was as much a by-product of social change, which was certainly catalyzed by that because our CEO at the time who was at the helm, at the advent of our foray into renewables, saw that social imperative. What's worth doing for the right social reasons in a public company context, is also only worth doing for economic reasons.
- Kirk: So what I would say is through those twin motivations, NRG was the beneficiary of what I would say a little bit of a first mover status. Back in, we'll call it the last decade, call it like 2009/2008, both under the oversight of the Obama Administration, the Department of Energy, as well as the state of California, there was a push to try and sent evolving our power supply in the United States towards more renewable energy. And the problem with anytime you want to incent or motivate a change in that direction, it needs to be grounded certainly in economics.
- Kirk: And any time you're talking about a technology like renewables, and when I say renewables, I'm talking about mostly solar and wind. In the early days, just because of the impact of economies of scale, or lack thereof, it's difficult for newer technologies to compete with older technologies. Part of it is scale, part of it is just using new technology. So solar and wind, going back to what I talked about before, is incenting somebody to buy the new regular power plant. Well, solar and wind are even more difficult because there are costs for every megawatt that they supplied back then, and a little less so today, were higher. So they needed even higher power prices to motivate them to do that.
- Kirk: Well, if you've got de-railing markets, there's only so much you can do. So from the fact that California put in place standards that required a certain amount of renewables, combined with the fact that the federal government provided significant tax incentives, call it an order of magnitude of about 30 cents on the dollar that the government was providing, and various tax incentives, either just directly in cash, or tax deductions. That was designed to help reduce the cost and make those more competitive.
- Kirk: And because all those new solar and wind plants, a lot of the ones we were looking at for solar, they were all under long term contracts out in California because of the state of California mandating that the utilities buy their power from more renewable sources. NRG took advantage of that to a larger extent. We acquired an anchor core of some really large projects out in California that were all under long-term contracts in utilities, so there was no fluctuation in the revenue. It's obviously a long story, but the upshot of that is that NRG took advantage and acquired, or developed a lot of those early, especially solar plants, large ones, that were all under fixed price, long-term contracts. All those incentives I talked about before.
- Kirk: That allowed us to finance those relatively efficiently with relatively minimal NRG dollars. We borrowed money against those, almost like mortgages, and we were able to build out a pretty significant renewable presence that you referred to before. But it was catalyzed by those twin events, both federal and state, particularly California, back in kind of late 2000's, early 2010 type time.
- Nate: Yeah, just so you know, I also like to explain things in terms of movie quotes. I don't know if you listened to the Mike Garland interview, I've got a little Doc Brown quote in there that I was really proud of. You'll have to listen to it.
- Kirk: Oh good, I'll have to listen to that.

Nate: You mentioned the social motivations, as well as the economic motivations for doing what NRG did. Obviously you had a different CEO at the time, but at a certain point, the market was overreacting to some of the volatility in commodity prices, and the market wasn't rewarding NRG for the shareholder return story, it wasn't rewarding NRG for a lot of the different efforts that you were making to sort of simplify business. And then there was a change in management, and then there was a new emphasis, which was reduce cost, improve margins, reduce debt. Could you talk about kind of that catalyst, and then if you would like to talk about the activist investor.

Kirk: Sure, what you're referring to is first of all, with that pretty significant success we had from an [owner magnitude 00:36:15] standpoint, largely around those large renewable projects that I referred to before. Those types of projects, because of their different return profile, they aren't exposed to the fluctuations and commodity prices, they have a different valuation multiple associated with them for good reason. They were good value and they still are. But the multiple that they command, that is perfectly justified from a value standpoint, is higher than the way the typical investor in a commodity exposed company like a traditional independent power producer like NRG still was, and is at it's core commands.

Kirk: And what happens when that takes place is, markets tend to apply more or less a one size fits all value to the whole company. So if I've got a certain part of the business that should be valued at a 10, or 11, or a 12 multiple, but the average investor, understandably, thinks about me as being an industry that's a seven to eight times multiple. Then if my whole company is given a seven to eight times multiple, I'm not realizing the value for that big piece of the company. And that big piece of the company was the renewables business.

Kirk: We took an interim step to try to remediate that by taking that part of the business public to a company called NRG Yield. That helped, but didn't solve the issue because we also hadn't had the one you referred to before, which is lower commodity prices on the rest of the business, placing greater pressure on the company. So after the CEO change in 2015, the new CEO and I saw a light about picking some of the low hanging fruit and addressed some of those issues, got out in 2016, beginning to reduce our costs, beginning to simplify our balance sheet.

Kirk: I say simplify because even through that period of time, I think we managed the balance sheet very well. But we did take advantage and do what I call "leave no doubt," to do some additional de-levering to improve our balance sheet ratios so our investors had greater confidence. We did that over the course of the first year after the change in the CEO. And I would say we were kind of in the middle innings of that game, focusing on streamlining the cost, doing away with some of the cost structure that was designed to go after a lot of different initiatives and different businesses that were addressing where the power markets were going, and focusing more on the core business.

Kirk: And then in the throws of that, as you referred to, as is often the case for a company that's going through an evolutionary change, and has pressure on its stock price, and some things that aren't resonating in the stock price, like the renewables business I spoke about before. It was around that time that we found ourselves, like a lot of companies in that situation, with an activist investor in our stock. And fortunately for us, I would say that, that activist investor was both well timed and had the right perspectives to bring about a relatively swift and relatively amicable resolution, and that was, we agreed to continue down the path that we were going down. And that was simplifying the company, streamlining the cost, but it allowed us to step on the accelerator in that process.

Kirk: So what you're referring to is, in early 2017, off the backup after the first year we'd gotten through after the regime change, we announced as a part of our settlement, if you recall that with the activist; that the next phase of our approach to that simplification was significantly selling off those businesses whose value was not resonating in the whole company along the lines of what I described before. Continuing down the path towards reducing costs, and also improving even further, the margins of our retail business, which had its beginnings in that Reliant acquisition that I spoke about earlier.

Nate: Yeah, and all this resulted in something that you called "The Transformation Plan" back in mid 2017. So you mentioned high level, selling off assets whose value isn't being recognized in the NRG share price, and reducing costs, and improving margins with the retail business. Could you talk about the asset sale number, what you plan on doing in order to achieve cost reductions? And I'll just leave it there for right now.

Kirk: Sure. So, and this has evolved since that breakdown, but I will go back through the entire history. The cornerstone of that three prong transformation plan, that you correctly referred, to was the asset sale piece. The other two component pieces being cost savings and improving the margins of the retail business. We are in the middle to kind of late innings of an asset divestiture program that, in total, amounts to about a little more than three billion dollars worth of asset sales. About half of that number is the sale of our renewables platform, which is what created those big renewable projects I referred to before. And in our remain stake in the renewable plants that we own today, that we'd previously taken public like I referred to that before.

Kirk: Because that IPO of that company helped highlight the differentiated value of that business I often refer to. It was necessary, but not sufficient to solve the problem. So we concluded that the best way to solve that problem was to sell it completely and turn it into cash. If the market price is not giving you the fair price, then if the third party asset sale market does, you can take that capital and deploy it elsewhere to benefit the shareholders.

Nate: Yeah.

Kirk: That, I would say, is the cornerstone of that asset sale program. And about half of that three billion plus is that business, and then it's rounded out by some other businesses that conform to the same definition, but it's anchored by that part of the business. That basically puts us on a path to almost three billion dollars plus. That's a lot of capital for a company. To put that in perspective, that's 10 dollars a share for a company basically is recently, at the end of 2015, at a share price of less than 10 dollars a share, just to put it in perspective.

Kirk: We're turning a part, but certainly by no means all of our business, into cash. It's about 10 dollars a share. That gives you a lot of degrees of freedom to either return that cash back to the shareholders, because it's obviously their money, or to find ways to acquire that cash to create more value than just 10 dollars a share. So that's really the cornerstone of that program.

Nate: So your target was somewhere between two and a half and four billion dollars in asset sale proceeds. And you hit the mid point, and now with an equity value of call it roughly 10 billion dollars, 30 percent of that is coming back in cash, which is pretty phenomenal. Could you talk about the balance sheet as well? So, in a previous episode, having Mike Garland on the program to talk about investor concerns around leverage

levels and the total amount of debt. By divesting the renewables business, you're shedding a lot of debt off of the balance sheet, correct?

Kirk: That's correct, and since you mentioned Mike Garland, Mike's company has an element of this, more or less exclusive to the challenge that we face that was a part of our challenge from a balance sheet standpoint. I mentioned before that the renewables business that we had, most all of our renewables assets were all under long-term contract. They were all selling their output over, in many cases, as much as 20 years plus over the long run.

Kirk: That's a pretty levelized stream of cash flow that just allows itself to be financed at the individual project level at a pretty high order of magnitude, and at a pretty low cost, because low risk means low cost to the debt. So think of that just as a bunch of, almost like mortgages, each one of which is right next to that power plant, the renewable power plant, and it's generating all those cash flows. That's a great benefit. It allows you to generate a lot of equity return. The downside of that is, that level of debt, relative to the EBITDA, is a high level of debt, and understandably so because that cash flow is not fluctuating around, so it naturally lends itself to higher levels of leverage.

Kirk: So, we really face two challenges, one of which we probably had some degree in common with Mike Garland, but I won't certainly speak for him in that regard. And that was, on the face of our balance sheet, which included all of those highly levered, albeit, highly contracted, low volatility in cash flow, power plants; as well as the traditional debt we had on the balance sheet to finance the traditional part of the company. When you looked at that relative to the cash flow of the overall company, it looked disproportionately high.

Kirk: Now obviously you'd understand that, that was true if you unpacked that a little further, but the average investor only had so much time. And as we often said, "On the face of the Bloomberg screen, we looked like we had way too much debt." It didn't matter whether you got down below that and you could explain why that was there. Sometimes you have to recognize that perception is reality. So, part of that divestiture, aside from generating the three billion plus in cash, the other benefit of it is, it solves a good part of that face of the Bloomberg problem, right?

Nate: Yeah.

Kirk: If you're selling off all the assets that have a higher degree of leverage that is impairing the optics, for lack of a better term, of the company, that takes you a long way towards the average investor understanding the capital structure better. And that took us a big step in the right direction. And in addition, off of the back of two things: one as I said, leave no doubt as to the integrity of the balance sheet. We elected to take an incremental step to ...

PART 2 OF 3 ENDS [00:46:04]

Kirk: The integrity of the balance sheet, we elected to take an incremental step to even further de-lever by taking Sullivan, for example, that three billion dollars worth of cash and reducing our debt. One, that reduces our overall debt, makes us look less financially and makes us be less financially risky. But of equal importance, we at NRG, we have a lot of net operating losses, or tax shield that we can use. Which means we're not making the most of the interest deduction that we generate from all that debt. So our debt is less valuable to us as a company that doesn't currently pay taxes. So that was another motivation behind reducing our

target leverage ratio which is now only three times as a ratio of our net debt, which is our total debt minus our cash divided by our EBITDA, which is basically just a proxy for our cashflow.

Kirk: So, our debt, net of our cash in representing no more than three times our annual cash flow, that's simplified ratio.

Nate: Yeah and so at the peak, debt was what? 23 billion? And the debt will be close to eight billion by the end of the year?

Kirk: It's actually lower than that, it should be under six by the end of this year.

Nate: So, if I were to just summarize at a very high level, and probably butcher it, but early 2000s, there was a lot of supply in the market, commodity prices were low, there were bankruptcies, there was probably concern around the viability of the business model. NRG comes out of bankruptcy, there are, as we said, social and economic motivations that led to call it a renewable build-out. You acquired more generation. You acquired some retail assets. Then, capacity markets also come along, stabilize the business a little bit, but then there's all this concern around renewables, the returns for renewable growth, investments that NRG was making. Everyone's concerned about- so again, going back to capacity markets, commodity prices, the economics for renewables- you had these targets to reduce cost and to improve the balance sheet. Could you talk a little bit about the one missing piece, which is stable business model, so in terms of cash flows, revenues. How is the business different today versus, just call it, early 2000s, mid 2000s?

Kirk: I would say, aside from the simplicity and the enhanced integrity of the balance sheet, which we just talked about. Focusing on the business model itself, I think that the biggest different is A, I think from a power generation part of the business, we are in the right markets that we would like to be in going forward. And that's primarily, obviously, Texas for the Ercot market. Reason for that is, the Ercot market is probably one of the tightest markets if not the tightest market in the country in terms of supply and demand. That means robust prices and also is the one market for power in the United States whose demand is still growing. So those are both good fundamental dynamics and we're fortunate enough to have a pretty significant presence there, which we're pleased with. Partially for those fundamental reasons, and partially because most of our three million retail customers, and I'll go the back of the story I told much earlier is, they're also in Texas. So we have the generation that supplies our retail business. That's important.

Kirk: And the rest of our power clients in the North East and we have, what I call, an insurgent presence in the North East from a retail perspective, but we have aspirations to grow. Number one, that's a much easier to tell, much more simplified, much more focused investment story. And one of the things you always have to be mindful of as a public company is your elevator speech. It can't take a hundred story building to tell it and I think we've gotten this down to a manageable number of floors on the elevator to tell our story.

Kirk: The benefit of that, also, in addition to simplicity is, the right level of retail. Because, even though retail power prices are certainly tied to the underlying cost of the commodity you're selling, which is subject to fluctuations. Retail margins themselves, the difference between revenues and costs have proved to be relatively stable and there's a myriad of reasons why that's the case. That means the retail part of our business, in addition to being a natural sales channel, for our gross product, which is, we make electricity, provides a really stable base. It's a big component of our earnings, more than 60 percent.

- Kirk: Then it's relatively stable, but still you get that stability at the core but on top of that, provided you're in the right markets with the right assets. For example, our biggest power plant presence in Ercot, and Ercot is a market that is poised for higher prices because you've got a growth and demand, you've got a relatively fixed amount of supply, the current power prices, even though they're higher than they were a year ago and much more so, still haven't gotten to the level that over the long run, they incent more supply coming in the markets. So in the near term, you've got the makings for robust prices and upsides. So, stability of cash flows from retail, supplemented by upside for the fundamentals in the markets are it. We think that's good recipe, which when buoyed with, as you pointed out, three billion dollars worth of excess capital, that gives you a lot of flexibility and you got that off the back of a now eaten, further improved, and simplified balance sheet. I think that's the right recipe for us as a public company to better appeal to our investors and deliver value. And I think it's really as simple as that.
- Nate: Yeah. No, that's a good way to frame it up. So with the amount of cash that you've been able to realize, or you will be able to realize from all of the asset sales, and because your company, just call it run rate of anywhere between 1 to 1.3 billion dollars of free cash flow over the next several years? You're going to generate an enormous amount of cash and I'm curious what you plan on doing with that cash.
- Kirk: Yup. So, what I'm telling you has been, and it's a relatively simple version, the numbers that you just described are, obviously, accurate. So, the asset sales and the cost improvements we're doing is really a program, it's kind of a three year program. 2018, 2019, 2020. So by 2020 we'll be through that phase of it. So, a little simple math will tel you, you're right about billion dollars plus, 1.3 is roughly the average. 1.3 billion is, through cash flow, supplemented by another 3 billion dollars of asset sales, even setting aside some of our fixed commitments, that's the sort of path could generate about 5 billion dollars of excess cash for 2020. And if you extrapolate that out a couple of years forward, it's not had to get to a number that approaches 8 billion.
- Kirk: Well, you know, that number, eight billion dollars of excess cash, is about 80 percent of NRG's market cap. In that there's few companies I can think of that you look at and say, "Do I get an 80 percent pay back over the next five years of my entire investment?" Which means everything's modular. You buy lunch here at stock, 80 percent of that cash I've just invested in stock comes back over the course of the next five years, that's a pretty compelling story. Now one way to make that manifest itself is just return all that cash to the shareholders, but you can return some of that cash to the shareholders and you apply the portion that you don't to buying assets for a dollar that are really worth \$1.10, then you can create even more value than 80 percent of your market cap. Either way you slice it, at a bare minimum, 80 percent is a pretty compelling number.
- Kirk: This is where I would say, for me as the CFO, the most compelling aspect of A, the regime change that went through and B, the discipline that we've catalyzed from our transformation plan, is our approach to what we call cap allocation. Which is the term of art we use to- how do we decide what we do with that five billion through 2020? And to me it's as simple as this, it's really a two part equation that really has three parts. The first one is, I want to make sure I've got the right balance sheet or I can tell you we've already gotten that there. That five billion through 2020 is after we've satisfied that. So now the question is, what are you going to do with that money? And the discipline is as simple as this, you need to find ways, if you're gonna reinvest that money, to reinvest it at a greater return than your investor expects.



Kirk: Now, you can do the math on the back of the envelope and figure out what your cost of capital is, and as I often put it, many times that's necessary and sufficient to make sure that you've found the right investments. But it isn't always sufficient. What makes it sufficient is, you also have to look at your own stock price. Said differently, if I'm going to say, "Hey, in order to create value for a shareholder off the back of what the calculator would tell me I'd need to invest at, I've gotta generate a 13 percent return pre-tax; un-levered." But if I look, I know my stock price, the total value of the company including the debt, and I know how much cash flow the company trims off. That's a simple equation to say, what does that imply the company itself, anchored by the stock prices return? And if that return is greater than that, call it 13 percent, then not only is that where I should really be thinking about putting the money, is that a more compelling investment than that hurdle rate?

Kirk: If I'm going to look at an investment, it not only has to beat that hurdle rate, it has to beat what I call the new hurdle rate, or the more important hurdle rate, which is whatever the return is implied by my stock, that's higher, say hello to your no hurdle rate. That's the approach that we're going to take. In other words, if we can't find, let's use that five billion, five billion dollars worth of investments that not only exceed our cost and capital, our hurdle rate, but the opportunity cost that's represented by our stock, then we're going to default to buying back the stock.

Kirk: And that's basically, where we are at this five minutes, because in the minds of investors, I think the right way to translate this for our internal discipline is, if the return on your stock price is as compelling as ours even is today, and you were choosing to invest that capital in a new investment, that might be the right decision, I'm not saying it's wrong, but you need to think about that decision on reinvestment, under those set of circumstances. Would I still make that investment if I had to raise stock to make it at the current stock price? Because if the answer to that question is no, you should not make the investment. Even if it meets your own internal purpose.

Nate: Yeah.

Kirk: Because there you're thinking like an owner, you're thinking like an investor. Because in substance, you have the opportunity to buy back that stock by choosing to take that capital and invest it elsewhere, it's in substance, that's the same thing as issuing stock. And that is the big difference, I think, in the discipline and the luxury that I have as the CFO because my CEO and I see alike on that discipline that I feel passionate about and so does our board. And I think the beneficiaries of that consistent discipline are our shareholders.

Nate: Yeah, so if you could indeed repurchase close to 80 percent of your shares over the next several years, clearly, the stock is under priced. Would you consider shopping the company to pull some of that value forward?

Kirk: Well, that is always, as you know from your experience, sometimes a dangerous question to ask and a more dangerous question to answer.

Nate: Yeah.

Kirk: The yearbook answer from anybody, I'm going to give it to you, is we don't speculate about M&A. We have not made a determination that now is the time to seek to sell the company, but we are always focused on doing the right and optimal thing by our shareholders. So, said differently, circumstances and facts matter, right? But if that circumstance is the best means to create value for shareholders, that's not something we

should ever look the other way at. But I would tell you right now in the current context, having said that, our focus is on driving our stock price higher so that it does represent the true fundamental value of the company. And to me, the best way of doing that is the path that we're on right now. When the market is not rewarding you for that fundamental value, you can create that reality by doing one thing which has two benefits.

Kirk: One, every time you buy a share of stock for less than what it's worth, the shareholders that don't sell back to you reap the benefit in that value being spread over a lower number of shares. That's value enhancement for those remaining shareholders and that should drive the stock price higher. But there's no substitute, right? There's one thing if I'm like every other CFO in the world saying, "My stock is cheap, my stock is cheap, my stock is cheap," right? Well that's just talk, at the end of the day. If I'm then taking the action to say, "Not only do I believe my stock is cheap, I'm gonna put my money where my mouth is." To me, that should instill confidence in the market above and beyond just that arithmetic benefit I talked about for demonstrating that by taking advantage of that opportunity that you're articulating. Those are the two things that we're focused on right now. We want to have the luxury, said differently, that when it comes to that capital allocation decision, that that hurdle rate increasingly becomes not only necessary but sufficient, and the only way that's gonna take place is if we get that stock price closer to fundamental value. So that's the mandate we're focused on in the near term. Never foreclosing any and all alternatives to bring that value forward.

Nate: Yeah. I appreciate that, especially from a current shareholder's perspective. If you were a potential NRG investor, what do you think you would need to do, because you know so much about the business, what do you think is most important for you to do to get more comfortable with the NRG investment thesis?

Kirk: Well, I think the most important thing is really self-imposed back on us and that is that, let's go back to that three billion dollars of asset tills. We've already signed the contracts for the vast majority, almost all of those have already been inked, we're just waiting for them to close. We need to close those asset tills because one of the ways to close that value gap, and I think one of the ways I would speculate is the reason why we haven't gotten all the way there yet, is simple. It's execution risk, right? And as an investor, I get it. I'm not willing to value 100 cents on the dollar of that three billion and so you've got it in your bank account. And the best way to erode that execution discount, if you will, is to turn those contracts into cash and that's what we're focused on right now. That not only benefits from the standpoint of- when I put the cash in the balance sheet, it's easier to value, but going back to what I said before, at least one of those asset tills meaningfully simplifies the face of the balance sheet, which I think is another issue.

Kirk: So, I think that's really incumbent upon us. And the other thing that I would say is, that gives us the ability to tell that more simplified story and as long as I believe, we continue to comport our actions from a capital allocations strategy standpoint, with our words that we've consistently articulated and most comprehensively articulated at an investor day presentation that we gave at the end of March. Then I think that that's the best means by which to instill confidence in our shareholders, because what I would say is, that's our credibility and credibility's a currency just like anything else. And just like any other currency, it's challenging enough to come by, but it's twice as challenging to get back once you've lost it.

Nate: No, I can appreciate that. So, very last question. A funny story, and this is something I try to ask all management teams, a funny story or question from a sell side conference or an investor meeting that you think is worth mentioning.

- Kirk: Well, I have no doubt that I'm probably forgetting, in the course of my almost seven years here, I've seen a lot come and go. But what comes to mind since I just mentioned investor day, it's both a lesson and a funny story.
- Kirk: But, we have these investor days, is where we sort of roll out the whole company and present the strategy, and all the different businesses, in a full day, at a far more detailed level than we do on a quarterly by quarterly basis. I mentioned we just did that at the end of March, the last time we'd done that is I think January of 2015. And it's not only the source of my anecdote, but it reinforces what I said before about the elevator speech, right? You need a reasonably simple and far less than a hundred story building to tell it.
- Kirk: Back in January 2015, we still had the platform, the complexity, the balance sheet, a lot more be all things to all people in terms of our different business initiatives. That takes a lot of story telling to get there and as is always the case, at investor day tends to be case at the financial part of the presentation comes last. That's me. And we had this investor day down in Houston and the investor day, I think, was scheduled to end at like, 1:00 or 2:00. Well, it's different if you have it in New York, it's not the same problem, it's not really a problem, but it's a lot more challenging in Houston, because what do you know, right? 95 percent of the investors that came down to see you speak don't live in Houston and when you tell them something's ending at 1:00 or 2:00, they're on the flight that they're able to get to.
- Kirk: And as I watched the time go by, we had well eked into the time that I was supposed to begin and so, not only was I past with telling the financial story behind this hundred story building, I had to tell it in about half the time. So I date myself by saying this, I feel like I was either a speed reader like that guy you see on the TV commercials, or in the literary context, I was, like, going to an Evelyn Wood class, that was the old speed reading course.
- Nate: Yeah.
- Kirk: And I felt, like, my mouth getting dry and trying to get through that as quickly as I can. I made it through and with good humor and I've gotten a lot of jokes about that after but I think people realize that wasn't by my choice. But I'm pleased not to have the experience to relive that again. I'm also happy to report I probably started a little early than scheduled on the last investor day and I think that's as it should be. It's a by-product and a benefit of the fact that our elevator speech was a whole lot easier to tell this go around.
- Nate: Yeah. That's a good sign. No, I remember that analyst day. That was at the Zaza hotel, right?
- Kirk: Yeah. Down in Houston, exactly.
- Nate: Yeah. I just remember seeing a lot of folks having their suitcases and everything ready and packing up and walking out while you were talking. And I was like, "What! This is one of the most important parts. Why in the hell are people leaving?"
- Kirk: Yeah.
- Nate: I didn't realize, yeah, the dynamic about flights, and having to get out.

Company: NRG Energy  
Ticker: NRG  
GICS Sector: Utilities  
Date: 4/12/2018

Market Cap: \$10.7B  
Cash & Equivalents: \$764M  
Total Debt: \$16.4B  
Enterprise Value: \$28.6B

Price: \$34.23  
2018 P/E: 11.7x  
2018 EV/EBITDA: 9.7x  
2018 Div Yield: 0.4%

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Kirk: Well, fortunate enough, I had the luxury of not taking it personally. One, because I wouldn't anyway. But our share boulevard investors, maybe you knew, probably know now, knew at the time, came up to me at one of the breaks and said to me, "Hey man, this thing looks like it's running over schedule. I've got a hard stop, I've gotta leave this and so I hope I get to see your presentation." So, that was the other reason why I scrambled to try to get all my words in, but I realized that as people started to walk out as we were getting towards the end. That's just a consequence. I get it, you gotta make that flight.

Nate: Yeah. Yeah, definitely. Well, hey Kirk, I know I've taken more time than you probably wanted to give, but sincerest thanks from me personally and IWTB. It's been a pleasure talking to you.

Kirk: Thank you, Dave, happy to do it.

Nate: Sincere thanks and good luck out there.

Kirk: No problem. Well, good luck with it.

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