Participants

Curt Morgan, President and CEO of Vistra Energy (VST)

Nate Abercrombie, The Stock Podcast

Interview Transcript

Nate: Curt Morgan thank you very much for coming on to the IwtB podcast it's gonna be a pleasure talking about your business.

Curt: Thanks Nate and appreciate the opportunity to join you on your podcast. Look forward to the questions you have and providing as many answers as I possibly can. So, it's great to be here.

Nate: Oh thanks, yeah, so could we first start out talking about your background. How did you get into the power business.

Curt: That's a good question, I've spent roughly 35 years in the broader energy industry. You know I was with Amoco corporation for I don't know, maybe almost 14 years and I was in the upstream and the downstream and also chemical business so I kind of saw a lot of the, you know the energy business. And then I was recruited out of that company at Amoco to go to what was then called Huston Industries that became Reliant and we were the integrated utility when I started at Huston Industries. So we would and the wires business became center point and then the ... we spun off the competitive generation and retail business into what was known as Reliant which has now become part of NRG. And that's how I got into the power business and that was just a little over 20 years ago so, I've been in the power business since then and more in the competitive side. A little bit of time with the regulated utility but mostly on the competitive generation side. But, also with power generation and retail business.

Curt: So, I have a pretty broad historical background working on both generation, wholesale, you know training and marketing as well as the retail business.

Nate: And you spent some time at Energy Capital Partners, is that correct?

Curt: I did, I spent about, I guess it was almost 10 years with Energy Capital Partners and when the bought, when they did their first investment actually, I knew a guy names Doug Kimlemen who many people know in the broader energy industries, their senior partner. And when they acquired some assets from Northeast Utilities which now is I think Eversource, they asked me to come in and be the CEO. That company was formed and then it's called First Light, we sold that to what was now at the time Genie of Suez which is now Engie and then I stayed with them after we sold that and we built another company called Equipower which interestingly we sold most of that to Dynegy so a lot of the assets that we had at Equipower, was almost a 10 thousand megawatt company, a lot of those assets came back to us when we acquired Dynegy recently.

Curt: So I'm very familiar with a lot of the assets that we acquired.

Nate: Yeah, yeah, it was the second to last interview that I had with Steve Newby and he's got a relationship with Energy Capital Partners and I had the opportunity to meet some of those guys while I was on the buyside side and I've just got a lot of respect for those guys and their ability to see value and act on it so.

Curt: Yeah, it's a good group of guys, they're smart and by the way, just so you know, Steve I was on the board of Summit throughout the beginning and then I left when I came here. I just didn't have the time be on a public company board but, so I guess you would say I'm a bit of a mentor of sorts to Steve when in his early years being a CEO, but we're very good friends. So, I'm glad ... I heard that he joined you on your podcast.

Nate: Oh really.

Curt: Which I'm glad that he was able to do that.

Nate: Yeah, yeah that was a great interview and I didn't realize you guys had that relationship so.

Curt: Yep.

Nate: So could you provide us with a little history of Vistra? So, I don't know if our listeners are familiar with the, at the time was one of the largest leverage buyouts in history of energy future holdings and I just think the history there is fascinating and if you wouldn't mind just sharing a little bit of it from your perspective, I'd love to hear it.

Curt: Yeah, this is a company that has been around a long time and most people probably recognize you know Texas Utilities, TXU actually goes back to Dallas Power and Light. Reliant had basically the Huston area of Texas, this particular company has its roots in the greater Dallas area of Texas and they were the two really predominant regulated utilities for years. You may know that John Wilder became the CEO of what was TXU at the time and then sold that as you said to TPG, KKR, Goldman Sachs in a huge leverage buyout transaction and at that time Nate, you may remember this but, gas was about $8 an mmbtu. They put on, as far out as they could, they put on I think almost five years of hedges on gas but, as you well know the shell formation explosion occurred, gas prices went down with a two handle on them and they couldn't hedge out so, it was kind of a long march into bankruptcy and then I think it was maybe the largest bankruptcy in US history.

Curt: Where we came from all that is there were some complications in getting Oncor, the regulated part of energy future holdings not out of bankruptcy but, we were able to spend, we were spun out of the EFH bankruptcy and we were called at the time TCEH, Texas Competitive Energy Holdings and then we changed our name to Vistra which I'll talk about here in a minute. But, anyway we were the generation and we were the retail TXU energy component of the FH and we were able to get a head start, get out into the market place back in October of 2016.

Curt: The name Vistra which was already developed before I got here so I can't lay claim to it, got its origins in, sort of vision meaning people thinking hey, we're coming out of bankruptcy so we wanna think about the future but, not forget about the tradition of the past so, it's you know VIS is for vision, future and then the TRA is for the tradition and then we formed it for Vistra, one of those concocted names. I actually, I've grown to like it but, that's where Vistra came from and of course now after the Dynegy transaction we've changed yet again. But, we came out of the bankruptcy of energy future holdings.

Nate: Yeah, I didn't know the history behind the name, that's really interesting to learn so thanks for that story. Could you talk about Vistra's assets, so you've got a generation business in a retail business, could you just provide kind of an overview of your generation fleet and where your retail business exists today?

Curt: Yeah, so after the Dynegy merger we've got almost, I guess 42 thousand megawatts and I think it might be useful to kind of talk about the evolution of the company that went into bankruptcy and then came out of bankruptcy and where we are today because I think it gives it a good Segway into kind of where we're trying to take the company. So, and we can talk about that.

Nate: Yeah, that'd be great.

Curt: But this was a company that was predominately coal, I think we had, at one point in time we had roughly one percent gas and then we had gas peekers and were a coal company, and you may remember that John Wilder went on a big coal build in the state of Texas, which created a huge fervor in this state but, it was a company very much you know steeped in coal, we were a coal mining company as well as a coal power producer, and we had a significant amount of mines, which was rare, I mean very few power companies had that but, that's the complexion of the company. We did have the big nuclear facility Comanche Peak, which is the lowest cost nuclear plant in the country but there wasn't much gas and then we purchased 3000 megawatts natural gas combined cycles, state-of-the-art plants from Nextera.

Curt: That began the revolution of the change, and we acquired a thousand megawatts Odessa plant and then in the Dynegy transaction we got over 3000 megawatts of combined cycle gas. And then if you combine that with the 4200 megawatts of coal retirements we took a company that was one percent gas with a lot of old and aging coal plants to a company now that is you know over 50% gas and then if you take, you know we added 180 megawatt Upton II solar facility in a 10 megawatt battery system, which we can talk about if you like later, you know we're over, we're around 53% gas and renewables, 37% coal, and the remaining coal is really advantaged coal. In particular Oak Grove plant has single digit, sort of mid single digit cost or fuel.

Curt: So it is a really strong asset and so we've got this company that has now become renewables and become gas heavy with advantaged coal and then also with the nuclear plant that I mentioned that is lowest cost in the country, and we're actually going through an exercise through our operation performance initiative that we're doing with Mackenzie, we're doing that at Comanche Peak, which is actually gonna reduce their cost to do business. So, we like what we've done in the complexion of what have in [ERCOT 00:09:23] and of course we love the retail business. It is by far the best brand in Texas, it's the largest residential retail business, we have the strongest margins. In the ERCOT market we have reduced our attrition rates to you know less than one percent. Significantly less than one percent.

Curt: And we have a team here that is a true retail marketing company that's very innovative and has done a tremendous job so, when we put all that together, we have a really great set of assets and when you think about our company too, you know in ERCOT, our EBITDA by market is around 50 to 60% depending on where energy prices are in any given year so, we're still highly leveraged to ERCOT, and the ERCOT market right now we believe is in really good shape, and we think it will continue to be that way. We're also about 24% PJM and 12% ISO of New England. Those are our core markets. We're diversified now to with the addition of Dynegy we have picked up between retail, which is very stable and our capacity payments, that's roughly 50% of our EBITDA. Coming from those relatively stable revenue streams.

Curt: And then if you take a look at our ability to hedge, and we have the balance sheet to do it, at any given time, you know we're significantly hedged as a company, which creates this more stable earnings stream, which is what we're trying to accomplish.

Nate: Yeah, thanks for that explanation. Could you provide us with a summary of the motivations and the rational for the Dynegy acquisition late last year and for listeners who aren't aware, Dynegy was one of the four publicly traded IPP, or merchant generators that were publicly traded last year. Could you just provide us with the rational on the Vistra's side of the fence? And also your thoughts on diversification of the generation fleet, your generation fleet.

Curt: Yeah, I that there was, you know we saw value first and foremost, there was a substantial amount of value in the synergies and the operational performance improvements that we were able to put in place. I think you know that we've announced now up to 500 million dollars of Synergies in operational performance initiative. And we think there's upside from there. You know no matter what your evaluation metric is, whether you use a free cash flow yield or you use a multiple, that is substantial value creation that we could not do on our. There's just no way and we saw that value in the Dynegy fleet and then if you add the fact that in Ercot we wanted to get around 4000 megawatts of additional gas fired, state-of-the-art power plants we were able to do that between the Odessa acquisition and the Dynegy acquisition.

Curt: So, we created what we wanted in ERCOT and then this exposure to capacity markets was something we were very interested in and it was important to us and we wanted to get into the two best markets. If you really look at and I know this is probably, not a lot of people think this but, when you really get into it and you look at PJM and you look at Ice of New England and who had the best combined cycle fleet in the country, it was by far Dynegy. And conventional wisdom may have lead you to Calpine and I think that's probably true if you wanna included California but, California's not a market we're interested in. But, when you look specifically at PJM and Ice of New England, the best fleet, set of assets including the combined cycle plants was Dynegy's.

Curt: So we were able to get into those markets and then the last thing is it gave us a nice beachhead, you know starting point for our retail business outside of ERCOT. And so they had their retail business, it's a nice retail business but, we have obviously visions of expanding our retail business outside of ERCOT and we have the supply base to do that now and so for all those reasons we felt strongly that this was the right deal. We looked at a lot of different things, I mean when I say that Nate, we looked at midstream, we looked at waste to coal, we looked at our capabilities broadly and said, "What is the right thing to do as a company?" And we kept coming back to the best thing for us, our core capabilities are in the power business, in the retail business, and so then we said, "What's the best company for us?" And we believed it was Dynegy.

Curt: And, then it doesn't hurt by the fact that you know Dynegy had gone from $35 a share in 2015 even in the early 2016 I believe and at the time when we started discussions they were trading around $7 a share.

Nate: Yeah.

Curt: We had to pay a premium to get them but, still when you look at the overall price point, it was rather low and so we liked where we were able to also acquire the assets. We thought it was a very good opportunity to buy at the bottom of the cycle.

Nate: Yeah, thanks for that explanation. I am curious whether or not you could provide us with a description of the cyclicality, when you keep your eyes on the space you can see when you know evaluations just don't make any sense whatsoever and you just described Dynegy's fleet as having the premier CCGT assets in those PJM and ISO-New England, why did the stock price drop so low? Why is there so much volatility in the IPP space?

Curt: So, anyhow, look this is something that is core to our strategy that I think created a lot of the volatility in the stock. Of course there's commodity price cycles and that creates some of it but, what I think might be interesting to people is that the all in contribution to gross margin and PJM and Ice of New England when you take capacity payments and energy payments has ranged between $9 and roughly I think it's $12 a KW a month between those two regions and, it's been relatively stable. So you say to yourself, wait a minute, if commodity prices are volatile, that doesn't seem like a great deal of volatility, and it's partly because the capacity markets have moved around quite a bit but, it's still a relatively stable stream and that's another reason we liked this.

Curt: I think a lot of people think that Ice of New England and PJM are out of favor, but the reality is they have a much more steady contribution to EBITDA than for example ERCOT has over the past because ERCOT's been more of a feast of famine because there's no capacity market. But, to get to your direct question I think the biggest contributor has been when there has been bad news or there has been a view that commodity prices are coming off, what has happened is the stocks have come under pressure, but the amount of leverage that the companies were carrying, there's no way that this industry should've been carrying six or seven times debt to EBITDA.

Curt: It's a competitive commodity based capital intensive business and so I like to say there was this actually, fairly good, fundamental business wrapped with too much debt and that debt created the squeeze on the stocks because there wasn't a lot of room to move when people thought when the commodity prices were gonna drop, there wasn't a lot of room to move before you got into distress. So I think the industry created a lot of its own volatility and then that fed on itself and what happened, and there's nothing wrong with this by the way but, you know a lot of hedge funds took positions in these businesses, and they were short termed owners, and they were trading it either it was a proxy for gas or whether they just liked the stock volatility of the business, and the long investors left because there was so much value destruction that went on.

Curt: And I've also mentioned that part of the volatility too was that it wasn't a really good and consistent return of capital approach in this business, all the money was going to pay off this excessive debt just to stay alive but, the investments were done at the high of the cycle when people thought they had money because there stock price was up because the cycle was up but in reality the really didn't have that money because when the bottom dropped out they over paid for assets. So, a lot of value destruction occurred, people over payed for assets.

Curt: All of that went to creating a sector that was highly volatile and out of favor and I think we did most of it to ourselves. I think the fundamentals of our business are pretty sound. We've got an irreplaceable product, it's not a fast grower. I mean there's no doubt about it at least in the near term. It may in the longer term but it's not today but, it's fairly inelastic from a demand standpoint so if you can get your leverage down, you can get your cost down. And you have to have your cost as low as it can possibly be.

Curt: This particular business generates a tremendous amount of cash and also the last thing is you need to have a strong retail business. Because retail business converts about 90% of the EBITDA to free cash flow. But, if you can do that and this is why I came to this company, big retail business, strong asset base, and an ability to reduce cost. If you can do all those things and keep your leverage low because when we came out of bankruptcy we had very low leverage, that's a winning formula and there's actually a very good business underlying that type of strategy.

Curt: So the volatility in my mind was created mainly by the strategies of companies and that began with just carrying way too much leverage.

Nate: Yeah, thanks, yeah I think you're ... you hit the nail on the head there and since you just sort of, you basically outlined your strategy but, if you could possibly talk about or at least highlight the key components of Vistra's strategy, explaining what are the benefits of having a really strong retain business and a really solid fleet of generation assets?

Curt: Yeah so, and you know it all begins in my mind it begins and ends with financial discipline and having a strong balance sheet. As I said before I think when you're in a capital intensive commodities based business, you have no business having the kind of leverage that this sector has carried and that financial discipline also translates not only into balance sheet strength and liquidity but, it also translates into.

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Curt: ... liquidity, but it also translates into investment discipline. If you're going to invest in this business, one, it absolutely has to be at the right time in the cycle, and two, you have to be patient. Your strategy can't get out in front of good, investment practices. I think that happened a bit. Everybody was so excited about growing a business that the strategy got in front of whether it was a really good deal or not. So that's key. Low-cost operations, especially as it relates to the power side of our business, is table stakes. You must do that. We're going through that right now and finding a tremendous amount of value.

Curt: These are generally fleets that were owned historically by regulated utilities. Many of them have not gone through the kind of diagnostic that we can go through, and they still have a lot of opportunity to improve the operations of the plants. But it's something you have to do and we will definitely get there. Diversification, as I already talked to you about was very important, and then the retail platform is really important. I'll expand a little bit on that. Not only is it important because of the conversion from EBITDA to pre-cash flow, but there's true transactional and also collateral efficiencies in between wholesale and retail.

Curt: If you are a long wholesale generator or you're a short retailer, you have to transact in the wholesale market. When you do that, you're transacting with bigger players, better balance sheets, and they are always going to get the better of the bid-ask spread. Then also, if you're selling to those folks or you're buying from them, they're going to require you to post collateral, because you're sub-investment grade and they're invest grade and because they can get away with it. At the end of the day, we estimate that to be three to ... and NRG has a similar number. We estimate that to about $3 to $4 a megawatt hour of value that leaks out with sort of long generators and retailers but stays within our integrated business.

Curt: Those are huge, huge numbers, and that's important. The other thing is that because of that, if you have multiple channels to sell into, as a long generator, and part of those channels are retail channels, you also have the prospect of earning more margin. So you're going to get a higher ... Not only are you going to not have the transaction in collateral inefficiencies, but you're also going to add on top of that a margin. The question really around retail growth is, can you do it economically? Meaning, what's the cost that you have to spend to acquire customers? It's my view that, and I think our view that organic growth is the most economic growth, but it takes more time to do it.

Curt: Then acquisitions are a little harder to do because you have to pay up, you have to pay a premium, and frankly, you're not always certain what you're really getting. Retail players in our industry are very inconsistent in terms of their performance. So, we like the organic growth. But that's really the big drivers. The other thing that you have is asset quality. We call it in the money fleet. The difference between us and maybe other large generators that you'll know is that some of those guys, they're more capacity plays. They get most of their value from the capacity market. And people say, "Well you're exposed to energy."

Curt: Well we get capacity payments too. We like being exposed to energy. That means our assets are in the money. So having a fleet that has the kind of heat rates and cost structure that allow us to make money on the energy side is really important to us. So, the quality of asset is important. The last thing, you have to have a team of people that can commercialize those assets. That long generation position. That can construct a realized price curve that is above settled prices through using the volatility and forward markets, and opportunistically hedging two to three years out and creating not only risk management, but also creating value through doing that type of strategy.

Curt: Those are the key elements of our business model and they, going forward, I think our focus is really more around the retail growth, and we'll be speaking more about that in the near future. We have to go over our retail strategy with the board. But that's really the focus for us when you think about growth in the company. Then also, we're going to play, in a modest way, and in a deliberate way, we will be a participant in renewables in the battery business. I think you're also going to see more about that in the near future in terms of how we're going to do it.

Curt: But the one thing we're not going to do, you know, I've learned the lessons of the past. We're not going to over extend ourselves into flagellant technologies so that we can wave the flag that we're a big renewable player. We're going to do it because it has economics and that it makes sense for our retail business and it makes sense for the company to do that. We have the balance sheet to be able to do that and we have to cash flow to be able to do it. Then of course, another big part of our strategy is we are going to return capital to share holders.

Curt: We have enough cash flow in the future that it is likely at some point in time we'll institute a recurring dividend, and we will still even be able to buy back our shares given the amount of cash that we generate and also the amount of capital we think we need to put into growth. So, I think that's a long story, but that's really the essence of our strategy and who we are and where we're going to take our company.

Nate: No. I appreciate that very much. Could you talk about how ... So the stability of the new integrated power model is something that I've been keeping my eyes on since I've been covering ... Well I covered this space or this sector for quite some time. But you know it much better than me. One of the things that I've tried to explain in previous podcast, so let's just focus on ERCOT. You have a big retail business. You have a big generation fleet, and the market has tightened. At least the supply side of the market has tightened in ERCOT due to some of your retirements and the failure to build new generation assets in the ERCOT region just due to delays and everything else.

Nate: Power prices ... I just saw a Bloomberg energy finance notice this morning that showed how the forward curve for the month of August has come down quite a bit over the next few years relative to where it was trading a couple months ago. But it's still really high relative to historical forward curves for that month. Assuming that power prices spike and they come close to hitting the $9,000 per megawatt hour price cap, what is the dynamic for Vistra? Do you lose some money on the retail side but then earn a lot more of that back on the generation side? How does that dynamic work? If you could, just describe how that provides Vistra with a lot more stability just in terms of cash flows.

Curt: All right. So yeah. There's a lot to that, and I'll try to attack that question in a number of different ways. So, as I mentioned earlier, ERCOT's going to see more volatility than most markets because there's no capacity payment. However, it has the highest upside. We're seeing sort of a renaissance, if you will, in the ERCOT market, because frankly, we were disciplined in terms of the economics of our plants and made some decisions and the market tightened. Plus, this is a market where you're still seeing 2% growth.

Curt: If you come to Dallas or Houston, you'll see it. You know, the tremendous amount of growth in this state, as well as Austin, Texas. So it's a growing state, which that bodes well, and then also there's been a ... On the supply side, there's been some retirements. It wasn't just us. There were others that did some retirements, as well. That was because the market was at an all-time low. Going back to 2017, our around-the-clock power prices were in roughly $21-$22 range. So the ERCOT market is a bit, you could argue in some cases, a bit of a feast-or-famine market.

Curt: The reason I like where we are today is because the reason that we had such a drop off in pricing after 2011, when prices really got strong and then also 2014 really, is that we had, in my mind, some inexplicable new build in this market that really weren't justified where the forwards were at the time. People were placing bets with other people's money. One was a strategic that built 2,000 megawatts and should never have done it, but they did it on the backs of their balance sheet. The other one somehow they were able to get people to put equity into it.

Curt: But I don't see that, Nate, happening again soon. So the idea that there's some big CCGTs showing up in ERCOT over the next two to three years, I just don't see it, because the economics are not compelling. And by the way, the market expects that to happen. And so, the curve is backward dated, but what that does is it almost assures that it doesn't happen because you can't hedge four or five years out, which is what you need to actually get financing in ERCOT. You can't do that. That's why I believe this market is going to stay tighter longer than it has in the past.

Curt: Now anything can happen. But that's our view of the market itself. We believe there's probably going to be ... I think it's 8,000 roughly megawatts of wind and solar come in over the next four years or so. But when you look at that and then you look at the roughly 1,500 megawatts a year of growth due to 2% growth, they kind of offset each other. So our own estimates just using the CDR numbers, which are overstated in terms of thermal new build, fossil fuel new build is still less than 10% reserve margins. That's even with, like I said, some combined cycle plants being built. So we feel pretty good about where retail is.

Curt: Now, let's get to the other question, which is probably the most important question for us, is how do we do in the ERCOT market? How do we do in a strong market on whole wholesale side? How do we do in a weak market? The good news for us is that we actually can win in almost every market with our retail and wholesale business. So we're still long generation. And so, a tight wholesale is net-net very good for our company. So even, let's just say, that our margins get squeezed a little bit on the retail side. We're going to more than offset that with the length on the wholesale side. So, we're in a very good position in that regard.

Curt: Probably our weakest position is when the wholesale proves are very low, and for a sustained period of time, like we just came out of. Our retail business does very well in that environment. But because we're long generation, we make less money. We're not in that market environment now. We're in a strong wholesale market position. Even if prices spike, and the cost to serve incremental load in the summer is greater on the marginal volumes that we have to supply to our customers, even if that happens, and on that we lose some money, we more than make it up on the whole sale side.

Curt: But what's really important is that because we don't increase our prices immediately, and the other retailers have to, what happens is we get more customers coming to us and our existing customers are more sticky. So in the times where we've seen increased pricing in retail in the summers, we've actually came out of it better. We've actually increased not only our volumes and numbers of customer but our margins coming out of a spiky summer. So, we like that position in ERCOT. It's a very resilient position. And especially where things are lined up eight now, this is the best market environment for our company right now.

Nate: Yeah, no, that's great to hear. That's encouraging to hear, especially from the perspective of a shareholder. You mentioned renewables. Could you talk a little bit about what your renewable strategy is? Is it purely returns based? Or is there maybe call it a social or an environmental influence or motivation there as well?

Curt: I would say it's 90% economics and 10% social. I mean, look, I'm not going to be in my job very long if I'm running my business based on social norms.

Nate: Yeah.

Curt: We have the asset base we do, we have to make money doing it, and we have to protect it and do the things that are important to do that. That doesn't mean though that we can't economically find ways to move into newer technologies that are likely to be the technologies of the future. That doesn't mean that we're not going to do that more and maybe even at a more accelerated pace in the future. But you can pretty much take the bank that when we do do it, it will be based mainly on economics. Those economics do exist. You can find ways to do it. The ones that we've done so far have very good economics.

Curt: The one thing we bring to the table, and it's somewhat limited but it's still real, is that with our retail business, there are a number of customers that are willing to pay very good margins to have green products. One of our best-selling products is Free Nights & Solar Days. With our Upton 2, we can provide the solar, and then we have PPAs also on wind, and which we also provide a product around that. Then we're able to buy cheap power overnight to supply the Free Nights, because powers are roughly zero bucks. So that product is a great seller.

Curt: And so, the margin we can get by providing solar to that product, the integrated margin is significant. If we were just a wholesale generator, a developer trying to develop that same solar farm, we couldn't make it work because it would be outpriced in the market. But we can make it work on an integrated basis. That's a really important feature. You know, having that retail business allows us, because on the retail side, we're able to get significant margins, because people are willing to pay for it.

Nate: Which one's more attractive today? Is it solar? Is it wind? Is it some sort of combination with battery storage?

Curt: Yeah, I think solar, right now, just the cost curves on that, you know, amazing. But solar is the most economic in our modeling. Then I'd say wind is behind that. Combined cycles are even further out. Obviously, coal and nuclear are way out. But it's really wind and solar. That's interesting. The thing about it though at ERCOT ... and I think Patter Energy talked about this. But in ERCOT, the wind play is beginning to fizzle out a bit because of the congestion in the Panhandle. So, it makes it harder. I don't see ... The state of Texas is not going to spend another five to six billion dollars on CREZ too.

Curt: There is no appetite in this state to do it. So I think that slows that down. The economic of a solar plant, as I said, just on a pure, merchant, wholesale basis, is still difficult even in this pricing to make happen. I think the only way you really get those done is either you have an integrated business like us or you're able to do it by selling the offtake to an Austin Energy or CPS in San Antonio, which is where most of this has been backstopped. It's been through PPAs with some of the continuing regulated entities in the state of Texas.

Curt: But we actually assume, again, effectively, merchant, solar and wind come in at roughly 8,000 megawatts over the next four years. If that doesn't show up, obviously, this thing is going to be tighter. I do believe that that will happen. I think people will find a way to build more solar, and to some extent, more wind. But that's kind of the hierarchy of what would come in. When I talk about gas-fired plants too, combine cycle really would be ... They're still out of the money, but they would be next. Then simple cycle, without a capacity thing that to build a simple cycle gas plant in ERCOT, I just can't see that happening.

Curt: Now the other thing you've mentioned, which is interesting, is the battery side. There is some opportunity. It's limited. But there is some opportunity to put batteries in. I'll just tell you. Our battery, which I was surprised, is 10 megawatts and it's the seventh largest battery installation, which was shocking to me. But nevertheless, that was built on the back the fact that we had excess power coming off of Upton 2, and we were able to clip that excess power and actually charge the battery. There's not a big, you know, that so-called duck curve they have in California. There's not that that type of opportunity in Texas.

Curt: But there is an opportunity given the morning and afternoon peaks to bring the battery on, especially when we're using excess power to charge it. That has very unique economics. I would not say that those economics are replicable to others. And so, I don't foresee just a plethora of batteries coming in. But nevertheless, there are certain instances where batteries could be interesting. The place where batteries are more interesting and where we're in a really prime position to play, is in California. We have two sites that are probably the two best sites in all of PG&E's territory to put in battery.

Curt: Batteries are really needed California given the enormous amount of renewables that have come into the market. They have that duck curve, where when the solar facilities go down, they need something to come on quickly. The most economical thing there ... Because they don't want thermal assets added in California. So in their mind, the best thing is a battery. We're working with parties to look for ways to do battery installations on our sites. We think we'll do that and that could be a pretty interesting little business that nobody was counting on.

Curt: I know we weren't counting on it when we bought the Dynegy assets. But it could be a little good little moneymaker for us, and it's a good place for us to learn that business.

Nate: Do you think that there's a ... and maybe this is a little bit outside of your wheelhouse. And if so, that's perfectly fine. Is there a particular type of technology, battery technology that you think is going to win out in the long term? Or is it just the lithium-ion, big storage facilities, the Tesla batteries that are going to ultimately, just because of its cost-competitive nature, because of its economies of scale, will eventually win out? Or is there something else that you're keeping your eye on?

Curt: I wouldn't say I'm an expert on it. We're getting better at it. But there are a couple of what I'd say nascent, sort of, other technologies that are trying to make their way. Lithium-ion though right now is the absolute clear winner. Now, within the lithium-ion world, I would not say that there you can distinguish significantly among the manufacturers. So, it's really about pricing.

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Curt: ... among the manufacturers. So it's really about pricing, about warranties, I think pricing is pretty close, pretty fiercely competitive. If you do a large installation you can get really good pricing. But I would never say, Nate, because one, I don't know. And secondly, the world changes so fast. Technology is just so rapid, and that's why we're not to get too wrapped up in any one technology. But having said that, right now for us, clearly the winner on this is lithium-ion, and I think pricing we're getting is compelling. And so we're comfortable going that route. Could it change in 5 to 10 years? It is certainly possible.

Nate: I appreciate the insight. So, if you wouldn't mind shifting a little bit towards the financials and just talking about the balance sheet.

Curt: Yeah, sure. So I'll just talk broadly on capital allocation 'cause I think that should touch on it.

Nate: Okay.

Curt: If that's okay that's where I'll talk about.

Curt: But we did increase to a higher level even though we did a stock for stock deal because Dynegy was, I don't know, six times levered or whatever. We went up to just a little bit below four times. We told the market that we would not do a deal much over four times and that we wanted to be able to get down to our target within two years of doing a transaction. So we are on target to do that.

Curt: So we've already started that, we took out I think it was like $850 million dollars in Dynegy’s bonds already. And then we have, I think, but I think there's another roughly two and a half billion dollars in bonds that we expect to payoff between now and the end of 2019 and we have the cash to do that.

Curt: And then we're also generating based on our estimates and we're out there hedging and trying to lock all this in but we believe we can generate somewhere around a billion dollars of excess cash even while bringing our debt down to two and a half times net EBITDA and I'll talk about that in a minute 'cause I think that's an important point to make.

Curt: So in between now and 2018 through the cash generation of the company we're gonna be able to in total take debt down by $3.6 billion dollars and have another billion to allocate.

Curt: We have already earmarked, and we're in the middle of executing on this, we've already earmarked a half a billion dollars for share repurchases. We think our stock is a really good buy right now and so we're out executing against that but we're gonna be opportunistic on that. That should leave us, probably more, a '19 opportunity but that should leave us with another half a billion dollars or so for some sort of capital allocation. I think we may institute at every current dividend and start that in '19, we had always thought it was a more of a 2020 issue but maybe we do that a little earlier. Or if our stock is still a very good buy we might do that and then if there was some kind of a growth opportunity, which I think is last and probably least in terms of priority, but those are the things we can do.

Curt: Longer term, if we say that $3 billion dollars plus is what we can generate from EBITDA and 60% of that can be converted, that's $1.8 billion. In fact, though, the numbers we provide to the market show from 2020 to 2022 we think that our free cash flow is gonna be around $6.1 billion so that tells you right there it's over $2 billion dollars, not the $1.8. If you have a dividend, even with a dividend, a recurring dividend of $4-500 million dollars, that's another billion and a half dollars of excess cash that we have.

Curt: And so that's a high price problem to have, but what that tells me is, you know, and we're not, there's no way, Nate, we're gonna spend that kinda money on a big acquisition or something like that. I just do not see it. So that tells me there's gonna be other things we're gonna do whether that's share buybacks, you know, special dividends, we probably do share buybacks before special dividends but who knows.

Curt: But I like this problem, I think it's a great problem to have. And then the stability of our earnings is directly a function of our ability to use the volatility and the curves and to hedge our long position at the right price points. We're looking for pricing above our point of view, we model every market, we have a point of view where it is, and then of course that point of view shapes our long-term forecast and if we can do it at or above that then we can hit our numbers and we think we can create a fairly steady earning stream. EBITDA stream, you know, relative to what it has been in the past and that's essentially the capital allocation story for this company as it stands today.

Nate: Yeah, so the ability to generate roughly 50% of your market cap over the next 4 years is a pretty compelling investment case, so, I'm curious what you think the market misunderstands or just doesn't see in the value and Vistra's stock price based on your outlook.

Curt: Yeah that's a very good question and one that we spent an inordinate amount of time talking about. But I'll tell ya there's one structural issue. And that is when we came out of bankruptcy 20 of our top shareholders owned 88% of our stock.

Nate: Wow.

Curt: That is a concentration level that is, maybe unprecedented. Here's what's happening in my mind. Every time we have some good news, our shareholders who don't wanna own the stock, and there's a number of 'em, right? Because they came out of bankruptcy and they're creditors. They're not the natural long-term holders. They look for the opportunity to sell into good news.

Curt: And so where we would've thought we'da got a good pop, by the way we still have almost doubled our share price, so mind you, in given that selling pressure we've still been able to incrementally move the stock price up. But it hasn't moved to where we think it should be and I just think it's because there's an overhang and that's gonna persist, I believe for probably another six months to a year. I think it's gonna get better over time as some of the large guys get out, but it is a structural issue for us.

Curt: The sector has underperformed so much in the past that people are lookin over their shoulders. They're saying, "okay, I hear this but I need more time. I need more time to see these guys execute, I like 'em, they're doin good job, they've done okay but you know what? You gotta show me a little bit." And I can understand that because the sector has underperformed, they have destroyed value for the most part, and we haven't been consistent in what we've done. And we haven't followed through on what we said we were gonna do.

Curt: And so I think there's a little bit of that. Then the last thing I'd say is, I'd say that the sector itself, because of all the news around renewables and batteries because it's so sensational I believe that some people look at it and say, "is there a tail risk on this stock that I need to take into account?" In our analyst day we spent a lot of time on that, we've done a lot of work.

Curt: Lot of people talk about it, I read some of the analysts reports and there's some people who just keep talking about it that, "I know it's gonna happen batteries are gonna come in" but when you really do the math and you truly sit back and say, "what is going to come into this market? How much can batteries really penetrate? How much wind can really go into PJM? How much offshore wind are people gonna allow in ISO New England and be subsidized?" When you do that kinda work these numbers are relatively low.

Curt: The only states where they're gonna be higher are states like New York and California where they're throwing a ton of money behind it and they have renewable portfolio standards. When we do that work our assets, which are the preemo assets in these markets, are still gonna do very well and our core market ERCOT, batteries are tough to do, wind is tough, rooftop solar is non-existent, and there is gonna be, it's a great state for solar but we've factored that in and we still have 10% reserve margins.

Curt: So you know, that's sort of the story on all that.

Nate: Yeah I really appreciate that. Could you talk about what you think the valid risks are? To your strategy and executing?

Curt: So I'm gonna say something that may sound like I'm schizophrenic but that doesn't mean that irrational investment and you know, chasing money with low return expectations can't result in somebody building in a market and creating-

Curt: We've seen it, right? That story has played out. So I always worry about, which is why I talk all the time on our earnings goal in any kind of form I can get into about the fact that we may be able to find one merchant combined cycle plant in the U.S. since the late 90s that's been built where the initial equity owners actually got a return.

Curt: I made a living at ECP buying everybody else's stuff that they've built and sometimes, then after the second bankruptcy, a third of what it cost to build.

Nate: Wow.

Curt: So I always worry about irrational build in markets because there's a lot of money world chasing something, and chasing the story and there's a lot of developers out there that can tell a good story and I feel like the financial community has no disciplined the development community the way they should in forcing them to get most of their economics just like every equity owner would. They get paid along with the equity owners.

Curt: And so I think there's a flawed model out there as well. So I do worry about that. The second thing I worry about is I worry about states and I worry about the federal government intervening in our business because they can't help themselves. It's electricity, it's intrinsic to everyday life, and they just can't keep their hands off it. And the law of unintended consequences is all over their hands because they don't, they think they know what they're doing but they don't. They don't understand the business, yet they have to do something because they wanna get voted in. And so they create enormous risk in our business.

Curt: The good news is, is that FERC has been a great referee on this. And I showed a slide to our analysts today that shows proof of that. We went from the the YCAP market in ISO New England to the forward capacity market to now pay for performance. All of those have increased capacity prices.

Nate: Yeah.

Curt: And we went from the ICAP market to the RPM market to the CP market in PJM. All of those have resulted in higher capacity markets. They've also, with mitigation measures, they started out with no mitigation measures in ISO New England and now have a very strong mitigation regime. We're getting ready, I believe, FERC's is gonna do something to mitigate ZECs and other renewables coming in to the PJM market. I think that's gonna happen.

Curt: So while I worry about it and I have to be worried about it, I also believe FERC has been very good at it but the thing I worry more about is when a President uses national security for something that really is not a national security issue, in my view. Or it's not the highest priority national security issue related to energy infrastructure.

Curt: But the good news on that front is I think it's gonna be really difficult because I think trying to implement it is messy and also, the other thing I'd say lastly is, between the DOE Secretary and the President who I think has been misled and ill-informed on this issue, by the way, but they're the only two that I can find that actually support this.

Curt: There isn't anybody else, FERC, PJM, ISO New England, legislatures on both sides of the isle, there's such an enormous amount of folks who say this is just not the right answer to this problem that I think it's gonna be hard to actually make happen. But it's the kinda thing that keeps me up at night. Because we can't control it, and that worries me.

Nate: Yeah. If you were a potential Vistra energy investor and knowing what you know about your business, what do you think the most important or key things are that you would need to do in order to get comfortable with a Vistra investment?

Curt: I would definitely wanna understand the long-term prospects in the industry. Because I think that's all about valuation. Long-term valuation. I'd wanna get to know the management team. Because I think when I was in private equity and I said it loud and clear when I was an operating partner with Energy Cap Partners, you can run all the models you want but you have to have a team that can execute that are honest and held accountable.

Curt: So I definitely would want to understand that. I'd wanna probe a little bit around the retail business to understand it. I think when people do that though, what they find out is that the retail business is probably the best part of our business. The one thing we do know, Nate, at the end of the day is that people need electricity. There's no other power source that we know of, and so our product is resilient in terms of it's demand. The question is how do ya make it? That's part of our business that I'd wanna know about and so that's the other piece of the story. Because everyone seems to know about the generation side. They think of it as a manufacturing plant, they can kinda understand it. It makes sense but the retail marketing business is one that people wanna understand.

Curt: And sorta the last thing is capital allocation and what are you guys gonna do? What's the history of this team? Have they given money back? I have to remind people all the time, we've already given a billion dollars special dividend back to our shareholders and we're doing a $500 million dollar share repurchase so we have done that.

Curt: But those are the key things. Course you wanna know the strategy, and all that but you really wanna see the actions of this team. What have they done since they came in from October to now? What have they told the market back on October and what did they execute on? What did they get done? 'Cause you know, this is an industry that has not done that. They have not earned the trust of the company, and then of course just understanding what their expectations are and what they're gonna do with you guys hard earned money as shareholders.

Curt: I am a shareholder, I'm not talkin about what I got from the company, I'm talkin about I'm a significant shareholder with my own money in this company and I think this model that we have is the right one and i think we can create a lot of value over the next few years.

Nate: Yeah, I appreciate that. So, very last question. Do you have a funny or interesting story from a sale side conference? Or just an investor meeting that you wouldn't mind sharing?

Curt: Yeah. So, I wish I had some kind of witty, funny thing to talk about, but I don't. But I've been to a lot of different venues and talked to a lot of people. I'd call it on the corny side of that question is, you know I will tell ya that we had a pretty good vision of what we wanted to do as a company but in sitting down with, in particular, long-term investors and trying to get them back into this sector, getting the sort of input from those folks and listening to what they looked for helped us shape. No doubt, helped us shape where we're taking our company.

Curt: And this particular instance, Nate, it was one of the big banks, they'll remain nameless, but we were in Boston and they, for whatever reason, they had us going from one side of Boston to the other multiple times. We did it like six times in one day. So Molly was really paranoid about us getting to the next meeting.

Curt: Molly is one of the best task masters that I know in terms of timing. And so she called the meeting over and the large investor who, does yield a lot of power, said "the meeting will be over when I say it's over." And I knew this individual and it wasn't surprising that the person said it. But I remember Molly because she was relatively new in the job, I mean she turned completely white.

Curt: Now that was a pretty interesting, that was interesting, that was more on the funny side of things.

Nate: Yeah, I imagine. Some of the characters out there, pretty funny and pretty interesting but I'll leave it at that. Well, Curt thank you so very, very much for coming onto the podcast. It's been a real treat, a real pleasure talking to you. So thank you so much.

Curt: Hey look, my pleasure. I really appreciate the time and you asking us to come on this. We're obviously very excited about our company. I have a lot of passion and I know the team does as well. I love to get the story out. The reality is, Nate, we would love to get a much larger retail base in our stock. This sector has really not been conducive to that. I think it actually is now. I'm hoping that we can get out to people through your podcast that may never really have been able to have that opportunity.

Curt: This is why I went on Mad Money a couple of times, because I know Jim Cramer has a good reach on that, too. But that's a priority for us. I know a lot of people don't spend a lot of time cultivating it but the nice thing about what you have here is that this is a way to get to many of those types of folks so it's a great form for us. And I'm a believer that the podcast world is gonna be the way of the future. And so I'm happy to be a part of this.

Nate: Well, thanks. I appreciate those encouraging words and yeah, I feel very strongly about podcasting. I mean, that's why I'm doing it but it's been a very fun challenge so far. And it's people like you who agree to come on to the podcast early on, before it's established and before it has a large number of people that follow it that I owe an enormous amount of gratitude and thanks to, so thank you so much Curt and thank you Molly for making all this happen.

Nate: It's been, again, it's been a pleasure.

Curt: Alright, Nate, take care.

Nate: Alright, you too!

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