Participants

Kirk Andrews, CFO of NRG Energy (NRG)

Nate Abercrombie, The Stock Podcast

Interview Transcript

Nate: Kirk, thank you very much for coming back onto the program. It's always a pleasure to have you on the Stock Podcast, so thanks a million for coming back on for a follow-up interview.

Kirk: You bet. Nate, happy to join you.

Nate: For listeners who maybe haven't heard the first Kirk Andrews interview, could you provide us with just a very brief overview of what NRG does and who you are by the way?

Kirk: Sure, absolutely. First of all, I'm Kirk Andrews the chief financial officer at NRG Energy whose ticker is NRG. I've been chief financial officer here for the last eight years actually and NRG in a nutshell we are a power company, but that always tends to make people think of utilities and the distinction there is in some parts of the country the price of electricity, the price you pay on your power bill is completely regulated by the state that you live in. In other parts of the country, like in particular the Northeast and Texas where is the predominance of our business, power is deregulated. Which means the only charge on your bill that is regulated by the state is the charge for the owner of the poles and the wires and that's basically what we would still refer to as the utility. Everything else, the generation, the power plants are all privately owned by different companies, including ourselves, sometimes private investors, sometime public companies, and the right to sell power to end use customers, which we refer to as retail is also deregulated, so if you lived in one of those states, you may have seen advertisements for soliciting you to consider changing your electricity provider and that means you're not changing off the utility in that state, which because there's only one owner of the poles and the wires, but you are changing who you're getting the electricity from.

Kirk: NRG is in both ends of that value chain. We are in the deregulated power plant business and we have a large retail business. The power plant business, the price of wholesale electricity as we call it is determined by what the marginal cost of the next unit that needs to be incented to turn its plant on in order to supply the next megawatt of demand and the retail price of electricity is really completely driven by market forces that can be set by individual retailers and it is a truly competitive market on that end.

Nate: Yeah, thanks for that explanation. For many years NRG and a few other companies were known as the IPPs or the independent power producers and I believe it was you guys at NRG who really started kicking off... well, you've created this new business model, which is an integrated power producer, which really focuses on those elements that you just described but I'm curious how over the past couple of years now, how have those conversations been going with investors. Is it hard for them to wrap their heads around what you guys are today compared to what you guys were before, whatever it was, 2016, 2015? I mean you were the same company but it was this new message that you were getting out and I'm curious if it's hard for investors to wrap their head around.

Kirk: Yup, but what makes that challenging where investors are concerned are twofold. Number one, NRG and other companies like it, we generate a significant amount of excess free cash flow. That's the cash that our business generates above and beyond what's necessary to kind of keep the existing business afloat, if you will, which gives us a lot of degrees of freedom and in the past we call that capital allocation, i.e. what are we going to do with those dollars? Those dollars were invested in all sorts of different early stage evolving technologies and very difficult to get your head around the business model and where the capital was going. That was one challenge we faced that I think we've largely remediated in sort of refocusing on our core competencies, which I'm happy to go into. The other challenge about that is you mentioned IPP or independent power producers. NRG and companies like it didn't start out in both the power and the retail business. We were simply in the power generation business and when that's the case, as I mentioned in response to your earlier question, since the price of electricity rises and falls with whatever the marginal costs of the next megawatt that has to switch on in order to supply the demand, the wholesale price of electricity can be relatively volatile.

Kirk: It tends to be the case that the, what we call the marginal unit or the next megawatt of power plant that needs to turn on in the past and that's still largely true today tends to be a power plant that's fueled by natural gas and when that's the case, that means the price that that power plant or the cost of that power plant to generate that megawatt is simply what is the price of natural gas and how many BTUs of natural gas does that power plant need in order to produce a megawatt of electricity. Which means that since the price of power is a derivative of natural gas, then the price of power rises and falls with natural gas prices, and there's also a supply and demand and a weather element of that obviously, but it produces when you simply are in the power plant business, a business that's very much commodity cyclical and I think a lot of investors remember the days where the price of electricity rise and fall and so it is also the profitability of the underlying company.

Kirk: What makes that different in today's world is we talked about retail. Starting in about 2009 we were a first mover and beginning to acquire retail businesses. We've built up a retail franchise that especially within our core market and that's Texas, we are almost perfectly matched between the amount of megawatts of power plants that we own on the ones hand and the number of customers or load and that's megawatt hours that we serve in that same market, and while the underlying price of electricity can still rise and fall, the price to the end use customer is a lot less volatile, right the retail price of electricity. That means in days where the price of electricity is relatively high, the power plant side of the business tends to show a high degree of profitability and because you're not necessarily going to pass through every single change day to day in the power price onto your customers, that means the revenue rates on the retail side of our business stay relatively flat and you get a little bit less profitability out of the retail business.

Kirk: Now, obviously if the power price falls, the opposite holds, right, you've got less profitability, what we call the generation side of the business, and you've got expansion in your margin holding that price constant to the end use retail customer, so that really retail in essence, a lot of people talk about retail being a hedge to wholesale and it is in a way, it's really a volatility mitigant and the challenge that we've had is helping our investors understand how our fortunes from a profitability standpoint, unlike the IPP model of the past don't necessarily rise and fall financially one-to-one with the price of electricity. They are a lot more steady, a lot more predictable and a lot more resilient than if it was the case as we were in many of our competitors were in the past simply an owner of electric generation or power plants.

Nate: Yeah, thanks for that. If there's one thing that I miss about being back at Janus, it's having the opportunity to sit down in some of these conferences where you explain it because you do a really good job of explaining it but I guess that's also because you have so much practice.

Kirk: I was going to say, I get you. You took the words out of my mouth. We do get a lot of practice obviously.

Nate: Yeah. I would like to hear about just changes over the past 12 months or since the last time you came onto the podcast, but you mentioned core competencies and I would like to hear you just highlight what NRGs core competencies are.

Kirk: Sure, and they speak directly to the two pieces of our business, which we tend to, still externally the way I just did in response to your question have to talk about wholesale or power generation of a power plant side of the business on the one hand and the retail side of the business on the other hand but internally we tend to operate on a much more integrated basis and if you think about it in a nutshell, the input cost is hey, what are the efficiencies of all my plants? What is the fuel costs and how much of that I can manage and fortunately those prices and costs are relatively steady and what price am I charging to my end use customer? Everything that happens in the middle, right, between the wholesale business and the retail business is really not as impactful to the bottom line or the performance of the business and as we often say we are sourced agnostic as to some years more of our profitability is going to be from what you call the retail business and less of it from the wholesale, in other years the opposite is true but we're focused on delivering the bottom line performance of the consolidated profitability and the core competencies that allow us to do that are really two fold.

Kirk: I am 100% confident saying we are best in class on the retail side of the business. First of all I mentioned before we were the first mover into the retail business. We have acquired retail businesses that are complimentary and we pursue a model where we market power complemented by other products and services to end use customers through what we call a multi-brand multichannel strategy. We don't market everything under reliant, we don't market everything just under NRG. We have multiple brands that appeal to different consumers preferences as you would in any consumer product type business and through multiple channels, right. We don't just solicit things over the phone. Sometimes we sell door to door. Sometimes we generate a lot of customer leads through our relationships with the NFL. For example, NRG stadium is where the Houston Texans play, so we have multiple channels and multiple products through which to sell the retail side and we are the best in the business in terms of how to manage that and how to serve our customers well. Our number one goal around NRG, aside from safety, which is always number one once you move beyond that, our number one operational goal is being customer focused and I think we're the best in the business on that. I also believe because we have a breadth of experience in managing the power plant business, we operate power plants of practically every fuel type, whether that's nuclear, coal, oil, natural gas, renewables, experience in all of those different things and our operational excellence in managing those plants both safely and reliably is also best in class. Our core competencies and our competitive advantages speak directly to what strengths you have to have in order to manage effectively both sides of that total value equation.

Nate: Yeah, thanks for that. Now, could you just... it's been, I don't know, it's been more than 12 months, but I'd like to hear if there are any important operational or industry changes that have happened that you'd like to highlight or talk about during this interview.

Kirk: Sure. Well as I tend to think about it, I'm going to focus what seems like a little bit around the power plant side of the business, but it also has an impact certainly as it always does on the retail side of the business and as with a lot of industries, the primary changes that we're continuing to see both operational or industry as you put it, are on the regulatory side of things. I mentioned in the earlier part of conversation, power is deregulated, but that doesn't mean we don't have any regulation that oversees that. It is less so than in a traditional regulated utility, as I mentioned at the outset and the other one is the evolving pace of change from a technological standpoint and where those two things tend to intersect is it really in the area of renewables? Regulatory changes can either be environmental regulations, which regulate the amount of emissions that you have as a power generator and we've seen some of that. The pace of that change is quieted down currently with under the current administration but we have to prepare for obviously the future and the other one is, even though we exist in deregulated markets, the way in which those markets operate is still overseen by a couple of jurisdictions. One, regionally and the other federally and that means the different markets, whether that's the Northeast on the one hand or Texas on the other hand, which tends to be our two biggest deregulated markets. Those are regulated by both the states to a certain extent and also the interstate commerce part of that for wholesale electricity is regulated by the FERC or the Federal Energy Regulatory Commission. Both of those two important changes have given rise to a couple of things and primarily that's been the continued acceleration of, in particular renewables and we've seen some of that even in our biggest market and that's Texas and our challenge and our opportunity is being responsive to that pace of change because it has an impact on the type of products we can offer our customers and it also has an impact on the price of electricity.

Nate: It's always been meaningful, maybe erroneously so, but FERC and PJM and capacity markets and what's happening up there always seems to be kind of a gray cloud for the power producers and there's a lot of stuff going on right now and I would love to just hear your thoughts on the dynamics, what's at stake and what does it mean for NRG longer term?

Kirk: Sure. First of all that's a good example of regulation, if you will, of work. There's a distinction between regulation in terms of a regulated utility and regulation that you still face as a competitive power producer but nonetheless, what you're talking about is PJM or Pennsylvania, New Jersey and Maryland. That's the jurisdiction or the independent system operator that governs the wholesale market in the Northeast for the most part where we certainly have power plants. There's a capacity market in addition to the price of electricity and the capacity market basically is designed to compensate generators that aren't necessarily making enough or all of their money that's necessary to keep the power plants in place off the back of where the prices are but that's designed to keep them there in order to ensure the reliability of the system and the rules that govern the capacity markets are incredibly complicated. They're determined and signed off on by FERC and we're at an inflection point where how those prices get determined especially in one of the subset markets of PJM and that's the ComEd region which is out near Illinois.

Kirk: There's a lot of issues in doubt and I won't get into the details here, but suffice to say, there are different outcomes there that affect what the future prices of capacity are and therefore the future profitability of our plants in particular. Our plants in PJM for the most part, earn most of their dollars off of capacity prices. They aren't high power generating plants, they're there to provide almost an insurance product and obviously the changes that might take place from the FERC and the PJM where future capacity prices are concerned have an impact on that, but it is always the case context matters. Our four power plants in the Midwestern part of PJM in that ComEd region, and this is publicly disclosed earn about a hundred million dollars or about 5% of our consolidated EBITDA. We believe there is strong reason to believe that the outcome of where those capacity price changes will continue to be supportive of competitive markets, which means good prospects of those prices continue to be as robust or nearly as robust as we've seen in the past. There are other outcomes where those prices might be less robust, but we see no scenario where that is as draconian as even close to that entire $100 million or 5% of our consolidated EBITDA being at risk.

Kirk: It is fractional at best if you look at the more conservative or draconian outcomes out of that process. We're certainly mindful of it and focused on it as everyone is but in the context of NRG, I think it's important to understand what the order of magnitude might be in the realm of the possible in the totality of the NRG enterprise.

Nate: Yeah, so that ties in nicely with what you said previously about consumer preferences within the retail business and also changes over the past 12 months. Are you seeing... I mean, is it a gradual increase or is it a pretty significant increase in the appetite for consumers to have more renewables in Texas?

Kirk: Sure. I think the consumer preference side of things as with any industry, we've got more terms of art that require translation than you could shake a stick at. We tend to refer to the residential part of our business that's like you and me, individual consumers of electricity as the mass, M-A-S-S business. In the mass business that's been relatively steady and that's where we're fortunate, going back to my answer, where your previous questions in this multichannel, multi-product strategy. One of our businesses that we own and our brands is Green Mountain Energy. Green Mountain markets solely renewable electricity so we can ensure for that customer who's interested in that, that 100%, if that's their preference, of the power that is sourced to supply the needs of the home in this particular case is sourced 100% from renewables and that pace of change or the demand for that type of product is certainly growing. We've also seen, I think this has been more acute on what we call the commercial industrial side of things. The larger commercial or in some cases very large industrial customers, increasingly they are interested in their own because of their own sustainability challenges and objectives is making sure that they are environmentally friendly, for lack of a better term in the power that they procure.

Kirk: We've recently introduced a product out of the commercial/industrial side of our retail business that is renewable select that in much the same way as I described, Green Mountain Energy allows that end use customer if it's commercial or industrial without necessarily constructing solar panels on the roof of the manufacturing plant to still nonetheless source their power needs increasingly from renewable electricity and that's really driven a lot of demand for us and it also means that we have to ensure we have access to renewable electricity and there with the pace of change, and this is more economic because solar let's use that for example, has increasingly been driven down in terms of the cost to install, and the more that cost to install solar has been driven down, the more competitive it has become with the overriding price of electricity, right.

Kirk: I mentioned before, in order to be profitable you've got to make sure that the price of power is sufficient to compensate you for the capital that you put in place and increasingly, that is the case with solar and in some cases that's even above and beyond needing to have a government subsidies, tax subsidies and the like and when we've seen in Texas for example, the pace of new build on solar begin to grow rather than buying that solar or being the one to invest or build that solar power plant, we've simply signed long-term contracts to off take some of that solar power and then are marketing and sending that through to our end use customers. One, that allows us to supply that increasing demand from that part of our customer base and two, it allows us to do that in a way that's not as capital intensive for us. We have a very strong balance sheet. We're a good counterparty for those entrepreneurs that are building those new solar plants and we feel in the current context, that's a better means by which for us to get access to those renewables so that we can continue to meet the demands of our customer base where the renewable product is concerned.

Nate: Are there positive returns for NRG to sign a PPA? I mean is it... one might think that there's a pass through, but do you sometimes or oftentimes or all the time earn a return on a consolidated basis? Within the context of retail, I guess is what I'm trying to say.

Kirk: Yeah. There we always have to look at, and in this case we're not talking about building a power plant. We're talking about contracting for the product of that power plant or what we call it offtake or a power purchase agreement. We have to look at the price that we're signing up over a longer period of time, sometimes seven, sometimes 10 years for that power relative to where we see the price of wholesale electricity and fortunately we've seen myriad opportunities to lock in under a long-term contract, a price of electricity that we fundamentally believe is below where the prevailing price of electricity is going to be over that period of time. That gives us a competitive advantage in cost of goods sold, coupled with the fact that that's a renewable product that we have a growing demand for and those listening might say, well why in the world are you getting the opportunity to buy power below where it's priced? It has to do with financing and liquidity at the end of the day. It's very difficult to lock that price of power in the financial markets. There's just not enough buyers, especially over the long period of time to financially, if you will, hedge, if you're building a solar plant so you need an off-taker like NRG for example, to sign that long- term contract and it's in our interest to do so because we have an obligation to serve our customers with that power but it gives... because NRGs balance sheet and our credit ratings are increasingly improving, we are a source of steady cashflow for that power developer or that entity that's building that new solar plant.

Kirk: The stronger the quality and the reliability of those cash flows gives that developer an opportunity to lower their cost of capital and reduce the capital cost necessary to put that in place. They can borrow more against that stream of cash flows and perhaps they're willing to give up a little bit of that discount, if you will, to where the forward price is in exchange for getting certainty of cash flows and that's where our interest, our strength of our balance sheet and the interest on the part of the developers of the solar are kind of symbiotic in that sense. Right? They want to levelize reliable set of cash flows from a high quality off-taker. We want electricity that we feel like we're getting in at least slightly advantaged price and one that's reliable and one that's renewable and the intersection of those two things creates what I think is a little bit of a win-win situation, especially in Texas where new megawatts are necessary because the demand in Texas is growing every single year to require new megawatts to be put in place in order to make sure that that system is reliable, that there's enough power to satisfy all of that demand.

Nate: Because we're on power prices, would like to hear your thoughts on the curve especially as it relates to street estimates. Just to explain myself a little bit more here. One of the things that I thought was really interesting about sell-side estimates is that they usually just take the forward curve and apply it to different businesses like your own that are exposed to commodity prices and oftentimes the forward... well, I say oftentimes. Nearly all the time the forward curve is wrong and I would love to hear perspective on how the sell-side or how Wall Street analysts come up with their estimates for cash flows for your business, especially several years out using a forward curve that may or may not be accurate and what were the actuals at the end of the day. Fast forward a couple of years from whenever a sell-side report comes out or a Wall Street analyst report comes out that says your EBITDA's going to be declining into perpetuity because power just keeps getting cheaper and that's oftentimes not the case because power prices are super volatile.

Kirk: All true, and I would say that that dynamic that you just accurately described exists for two reasons but before I go into those two reasons, I would say you're correct. It tends to be the case generally speaking, that the sell-side analysts will just take the price of power in the forward curve and push that through their model. Well, what are they modeling in that particular context? They're modeling the generation side of the business. How profitable does that imply the generation business will be over time, and if you're taking a forward curve, if you will, or the forward prices for power in a given market and that market is what we call backwardated or the prices are declining over time, obviously that shows a declining profit stream, but it also ignores the other side of the business.

Kirk: As I talked about when we talked about at the beginning of this conversation, we are also in equal magnitude, especially in Texas in the retail business, which means that declining power price curve even if you take it at face value is declining cost of goods sold on the retail side of the business where the price of electricity to the end use retail customers tends to be a lot steadier. It doesn't necessarily follow the forward curve. In one sense that only tells half the story and then the other sense there's you always have to be hesitant when you hear somebody say don't believe the forward curve, but I think where power prices are concerned and I'll take our core market, which is Texas, which is where the bulk of our profitability comes from as an example. The price of electricity in the forward curve is a function of two things. One in combination, what the future prospects of supply and demand are. There's economics 101 for you and the other is liquidity, which means how many bids and asks or how deep is that market? If I was looking to buy power off of that forward curve three years from now or in 2023 are there a lot of buyers and sellers behind that particular forward curve? And it tends to be the case that that answer is an unequivocal no and the reason is relatively simple. Who is that marginal buyer? Who is the demand side of that forward curve?

Kirk: Well, in markets where power is deregulated, why would someone have the reason to buy wholesale electricity? Because they're in the retail business like we are, but very few of the retail customers other than the large commercial and industrial customer that I mentioned before, tend to lock in or sign up a contract for power longer than a couple of years which means if I'm looking to hedge or lock in the power that I've obligated to sell to end use customers, I haven't locked in the revenue side of that equation quite yet. There's a dearth of demand when you go out the curve and that influences tremendously the shape of that curve. The other is I mentioned supply and demand and economics. Texas is a very tight market. What do I mean by tight? On the highest peak demand day relative to the amount of megawatts in the system, there's less than a 10% premium on megawatts available to supply demand and expected demand itself. That means if you get a swing in a hot day, which means everybody's not going to turn their air conditioners off, you've got very little cushion before you run out of megawatts. That's a long winded way of saying is there needs to be in that dynamic, more megawatts added to the system in order to keep up with the pace of demand and when you start to prognosticate how many megawatts are coming into the system, when you begin to start to prognosticate, a lot of megawatts coming into the system outpacing the pace of demand that can create a pessimistic view of where the power prices are, but of course reality has to intersect and say, even if I spreadsheet that number of megawatts coming into the system, does that mean those number of megawatts are going to show up on that particular timeline? And that amount of uncertainty also tends to influence the conservatism or the downward sloping expectation around prices.

Kirk: Both of those two dynamics tend to underrepresent reality. One, meaning that supply and demand and the liquidity challenge of the forward market and the other being, even if you accepted that at face value, you're ignoring the other half of the equation, which is the retail business where that's the cost of goods sold, if you will.

Nate: Yeah. Could you go into the retail business just a little bit more? I know that over the past several years companies like yourself and Vistra and some previously public companies have acquired retail businesses and so there's been a lot of consolidation in the space and I guess a lot is a relative term, but I would just love to hear what your sort of high level thoughts are and what you think would be important to share to listeners about retail consolidation and what NRG's plans are within the retail space.

Kirk: Sure. Yes, we have been as have been our competitors relatively opportunistic in taking advantage of opportunities that arise out of the consolidation trend. We have about a 30% market share in our home market in Texas. We're not prohibited from going higher, but it takes increasingly large acquisitions to move the needle in terms of that particular market share and it's tended to be the case that most of the consolidation opportunities have either been very, very small or relatively medium sized acquisitions and in medium size in this case, I mean less than a half a billion dollars and we've seen that in a number of cases over the years. I think a lot of the 'would be' consolidation candidates have been in fact just that consolidated. There are other potential larger competitors out there that may or may not decide to put themselves up for sale, but so also more often than not, we'll expect to see smaller opportunities and I don't mean necessarily consolidation from an M&A opportunity, but we see opportunities practically every single year to buy just small books of customers from relatively small retailers. You might ask yourself why a small retailer's doing that? They're basically just monetizing some of their customers to raise capital. Could be because they need capital to post collateral and because they've got a hedge their power price position if they don't own generation but all of that has contributed to some of the consolidation. The consolidation is taking place in traditional M&A and it's also taking place in the context of what we call SBAs or small book acquisitions, which sounds like what it is. Just acquiring small books of customers from relatively smaller retailers who are raising capital through monetizing those customers and we take advantage of both.

Nate: Yeah. Is there kind of a rough estimate for the number of retail providers in Texas, for example? I mean, is it hundreds across the United States? Is it thousands?

Kirk: I don't know that it approaches thousands, although it may be, but it's certainly in the hundreds when you look. Now, some of those are really, really, really small. The 80, 20 rule tends to apply. There are three relatively large competitors and then it tails off from there and I'm talking about that not only in Texas but also in the Northeast.

Nate: Yeah and how has the consolidation affected just consumer dynamics, customer acquisition and retention?

Kirk: There I think the customer acquisition retention has been relatively steady, I think where that's benefited the consumer, maybe not necessarily in an absolutely tangible way this five minutes, but smaller retailers, less well capitalized retailers are less capable of withstanding where there is volatility in the underlying price of power. They've got to do what I call hedge expected load, which means, hey, what do I think my customer base is going to need? And I've got to go out into the market because I don't own power plants and tends to be the case that small retailers don't. I've got to transact for those megawatts financially and I got to make sure that not only am I transacting for the megawatts that I think will show up if the weather is relatively normal or I don't get a extreme event but I've also got a hedge the tail risk at the end of the day. And that's increasingly challenging for a relatively small retailer, which don't tend to have high credit ratings and high access to capital credit lines and the like and so consolidating some of those smaller retailers into larger, more well-capitalized, better balance sheet entities like NRG ensures that those customers that are being served by that entity are served by one that can withstand or manage the volatility. Part of that we do through our balance sheet and a big part of that we do because in fact we are fortunate enough to own physically the megawatts necessary to supply that demand.

Nate: Yeah and how did the volatility in or the price spikes in Texas affect some of those smaller retailers out there who-

Kirk: Yeah. There, it's a little too early to tell. I mean, what you're talking about is a relatively recent dynamic whereas I mentioned before, Texas is a market where it is relatively tight in terms of the amount of supply versus the growing amount of demand and in order to do that, when the supply and demand reaches a certain inflection point, and this is where regulation comes into play, regulation allows the price of power to move to what we call scarcity pricing and outside of the band of what is it actually necessary to incent the next generator to turn on and more towards, we need to have more transparency into really high power prices because we need to incent the next developer to come in and actually say, "Hey, this is worth building a new power plant."

Kirk: That volatility, if you get caught short, right, where you've got a high demand day as a small retailer, the price of power in Texas can actually go to $9,000 a megawatt hour. It's kind of like a game of musical chairs. That's a pretty big chair missing from the table if you haven't hedged that megawatt that you've got to go out in the market and buy at $9,000 and I think what you're implying, which is correct is shouldn't that result in some capitulation or dislocation if people get caught short, certainly it should. It's too early to tell whether that's been the case. A lot of these smaller retailers tend to transact with banks or other hedge counterparties to sort of mitigate their risk and it all depends on how those hedge counterparties respond when that producer winds up being short, if they in fact do. We haven't seen a lot of tangible or empirical evidence that those situations are taking place but it certainly raises the specter of possibility that those types of opportunities might be in the offing if we can continue to see the pace of volatility and the price of power in markets like Texas as we have, especially over the course of last summer.

Nate: Yeah and there was some scarcity pricing over this past summer which I only know because I'm a huge dork and I pay attention to the ERCOT, real time pricing map and I saw some huge price spikes and I'm curious though, whether or not there was feedback from... not feedback, but after you reported results, was there investor disappointment that maybe you guys didn't make as much money as maybe some people were expecting when it came to this past summer because of those really high price levels? Or did they, I mean for you guys, was it kind of something that really highlighted the fact that as a business you guys are much more stable than investors give you credit for?

Kirk: Yeah, there I think you're onto the answer your question and I think we've done a good job, and I've talked about this at the outset of our conversation about what are some of the challenges in helping people understand how a wholesale and retail company works in tandem. We've been very careful to highlight to our investors that even though if you run a sensitivity analysis and say, okay, the price of power is currently X, and if the price of power goes to Y, wow, that's a lot more profitable situation for the generation business and maybe they've got more of their power plants that are actually turned on and they're actually getting increases in volume along with that increase in price. That dynamic is completely true on the wholesale side of our house, but we've actually been unapologetic about saying don't necessarily believe that 100% of that theoretical upside is going to drop to the bottom line because in order for that to take place, I have to hold the line on the expected profitability of my retail business and if I've got a rising cost of goods sold, the only way for me to hold the same profitability on the retail business is to pass 100% of that increase in power prices right onto my customers, and that might work in a given year but we're in a long-term customer relationship business.

Kirk: Part of our job is mitigating that volatility for our customer, so we weren't passing that through 100 cents on the dollar and the practice in doing that goes back to the term of art I used in our earlier part of conversation. We're really focused on being source agnostic and more focused on delivering the bottom line number that we've told our investors to expect and increasingly we focus on the cash flow, free cash flow side and what that means is we will forgo some of that upside on the wholesale business in order to maintain the resiliency of our retail business and that's just fine and sometimes better, especially in an instance where we're still able through the combination of those two things to deliver the aggregate number and at the end of the day, that's the most important thing is the profitability of the overall enterprise, not necessarily how the individual parts work.

Nate: Since we're talking about financials, maybe it's a good point to transition and I'd love to give you the opportunity to highlight your new capital allocation and shareholder return strategy for NRG shareholders.

Kirk: Well, first of all, as I mentioned in the earlier part of our conversation, we are fortunate enough through the complementary nature of our wholesale and retail business to have an enterprise that delivers a far more reliable and resilient stream of cash flows and a magnitude of cash flows that's far in excess of that which is necessary to operate those two businesses or the combination of those two businesses and that means we're stewards of that capital for our shareholders. We also in the context of 2019, are through the bulk of what failed a couple of years ago we turned our transformation plan. We redoubled our efforts on cost savings, improved the balance sheet metrics and exited a number of non-core businesses. The last part of that allowed us to raise a significant amount of capital, about $3 billion worth but as we get through that and as we approach the steady state or the benefits of that transformation plan, we're now focused on making sure that our capital allocation approach reflects more completely the end state and that is a reliable, predictable stream of cash flows through the cycle. Up until this point, because of the transformation we've been through and the significant magnitude of capital, especially those non core assets sales produces, we'd been disproportionately focused on share repurchases hopefully for understandable reasons but in 2020... sorry, go ahead. You're going to ask a question?

Nate: No, I was just saying yeah, with an emphatic yeah, because I think your stock is cheap so to see you guys buy back so many shares, it's just been... it's been awesome from a shareholder's perspective and just really impressive from somebody who pays attention to what management teams do-

Kirk: Sure.

Nate: ...with their cash.

Kirk: Well, the philosophy behind that element for us, or at least for me is a lot of times the old term about it is put your money where your mouth is. Well, when we came out with this transformation that we talked about, and I mentioned this before, cutting costs, exiting non-core businesses, raising capital, improving the balance sheet, we called that the [transformation plan] and as is understandably the case, announcing it is one thing, delivering on it is another, but we were confident enough in our ability to do the latter that even if our stock price lagged what we believed was going to be the case, our ability to execute on that and I think we've delivered and proven that we can. It's incumbent upon us to put our money where our plan is and that's basically what we've been doing in buying back the stock. But that's not to say we're off of repurchasing shares, but if you think about a levelized stream of cash flows, like the ones that we deliver well in excess of $1 billion, it's a $1.35B at the midpoint of our guidance in 2020. That is well enough capital to have, not only to reinvest in the business but to continuing to return capital shareholders and what we concluded it was the right inflection point to do was make a bigger portion of that more reliable, more directly translatable and we announced that we were going to increase the amount of cash we were paying out as a dividend, increasing that by 10 fold in fact. We had a small token dividend of 12 cents a share. We announced we're increasing that to a dollar 20 a share and we'd grow that at between seven and 9% annually, which means about 300 million or about little less than 25% of our 2020 cash flow is going to a dividend.

Kirk: We then send the remainder of what amounts to about half of that free cash flow. We're going to return that to shareholders as well. Complementing our dividend by continuing to repurchase shares. That means we've got about 1.35B of free cashflow. About half of that goes back to the shareholders. 50% of that in the form of the dividend, 50% of that in terms of continuing to repurchase shares and the other half of that is earmarked for finding ways to in continue to take advantage of the consolidation trend we see other ways to reinvest in the business to further drive growth in the top end and I think the important part of that equation is driving the top end growth through prudently reallocating that 50% of the capital and reducing prudently the denominator or the shares outstanding taking advantage of the dislocation of our stock price. The combination of those two drives the financial metrics of the company on a per share basis toward a more robust growth and a growth that can support and, in many cases, exceed the dividend growth aspirations we talk about. We think that's a powerful combination, especially in the context of the pace that we're on with our balance sheet. We've already taken our balance sheet metrics to about two and a half times net debt to EBITDA. We believe that that metric is consistent with investment grade and we're on a path on moving the agencies forward to align their rating agencies with the quality of the balance sheet metrics that we've already delivered and I think that is another catalyst for improving the performance of the underlying shares, the clarity on the capital allocation which I just described and translating that now strength and balance sheet into higher quality credit ratings.

Nate: Yeah, I really appreciate you describing the strategy and to your point about reducing share count while also growing the business. I did just reopen one of a sell-side analyst [report] who I think you think highly of and I certainly think very highly of Steve Fleishman where he talked about, Who Says the IPPs Can't Grow? and I think he has in there $12 in free cash flow per share in 2025 which is a 30%, 31% free cashflow yield for your stock, which is super impressive, especially as you guys transitioned to investment grade, which again, another one of the reasons why I think I'm a shareholder and I think your stock is extremely undervalued, but I wanted to talk just a little bit about what types of investment opportunities you're seeing today that meet your return threshold.

Kirk: Yeah. Well, first of all, our return thresholds are we have a relatively conservative and by design hurdle rates. We're targeting 12 to 15% unlevered pretax returns on investments. That's a relatively high bar. I mean if you translated that math, you'd find that that's higher than our after tax cost to capital and that's just ensures good financial discipline, which means that if the expected case generates a return in excessive of ROC, that means by definition you're building positive net present value when you're reinvesting those cash flows. Where our cash has gone towards opportunistic investments as I allude to in the earlier part of our conversation is primarily towards taking advantage of that consolidation trend in retail and I think we'll continue to do that. We've seen returns in excess of those numbers off the back of the two retail acquisitions we've announced in the last couple of years and I think there's ongoing opportunities to do that. Over time, not necessarily in the near term, but over time certainly that would probably include investments in generation, but with the same discipline applying. Because as we grow our retail business, we have to also grow the certainty that we have about our ability to have the amount of megawatts necessary to support that ongoing demand.

Kirk: As we put it in a nutshell, they will be strategically consistent and by strategically consistent, we're in the generation business, we're in the retail business, and that's where we're going to stay and when we think about generation, we call that purposeful generation, which means we're not just agnostically interested in megawatts, we're interested in megawatts that locationally and technologically are ideally suited to support our growing retail business all wrapped around the discipline around capital allocation returns and positive NPV, which as I said, we are stewards of capital and we have to apply it as if it was our own.

Nate: Yeah, you mentioned in your 3Q call, you emphasize, and maybe it's just me who felt like you were emphasizing the word earn when it came to investment grade and I almost got the sense that maybe you felt like you guys were already investment grade, but you have to earn it within the eyes of Moody's and Fitch and S&P. I'm just kind of curious was there some sort of underlying meaning there or maybe I'm just reading way too much into that and then secondly-

Kirk: Yeah, no, no, you're not.

Nate: Okay and then just secondly, just what is it about the business and the leverage that might make you think NRG isn't recognized as investment grade within their eyes and what needs to happen?

Kirk: Sure. Well, a couple of things. We didn't just target investment grade metrics, which is the announcement we made towards getting to that roughly 2.5x net debt to EBITDA for its own sake. We did so for a reason and the reason is beyond the obvious, right? The better your credit rating and lower your cost of capital and access to capital and all that. All that's true but we also see a strong correlation between the manner in which our free cashflow is valued, whether you want to call that a free cash flow multiple on the one hand or free cashflow yield as some people like to think about it. That's the free cashflow of the company divided by the market cap, if you will. Right now, that number for us is still in the mid-teens. We do not think that reflects the relatively low risk proposition that our company deserves and there is a strong correlation between quality of credit rating and the robustness of, or lower free cashflow yield or higher free cashflow multiple. It was really with an eye towards the equity side that we embarked on this journey towards first investment grade metrics and later investment grade and there's a distinction between those two because the credit rating of any company is a function of two things, statistics and risk, right.

Kirk: The corollary there is like risk adjusted return. If I told you your return was 10% but the risk was five times the market, you wouldn't think that was a very good return so context matters. We believe that the metrics that we have put forth today anchored by that two and a half times is enough to deserve or earn investment grade rating, but our risk in the rating agency world is sort of translated into risk rating and it's really S&P, which is the best example of that. Right now our risk rating is about... is fair. F-A-I-R, which is basically the same risk rating we've had all the way back to the days when we were just a power producer. Because we've evolved the risk of our model, we believe we deserve a better risk rating to go along with that and we're sympathetic and understanding with the folks that the rating agency is that that doesn't happen overnight and in much the same way the mandate is the same on the equity side and as it is on the rating agency side. We have to continue to execute as we did this year as we fully expect to next year to demonstrate through performance that we in fact are delivering on that reliable stream of cash flows and I think that will come with time. The first step was getting the metrics where we think they ought to be. The next step is leaving no doubt in the minds of our investors in the rating agencies that in fact the lower risks of our businesses, we see them manifest as themselves in reality.

Nate: Yeah. I've got some closing questions here. Given the amount of free cash flow that your company generates and how undervalued in some people's minds, mine in particular thinks it is, what would you do different with the business or where would you make investments if you didn't have shareholders?

Kirk: Yeah. I think it is a great question. I think that the answer to that revolves a lot around the retail business. We have challenges in making decisions every single year about how much selling and marketing dollars we invest in that particular business and it's a function of where we see the opportunities, where we see the business going but if we're looking at allocating significant amounts of selling and marketing dollars, we can't ignore the fact that selling and marketing dollars flow through the P&L. They impact the near-term profitability of the business. I would say it's like any other public company, it's weighing the pros and the cons of perhaps sacrificing the near term profitability in part for the long-term health of the business because you know this as well, if not better than I do, is that there is a relatively short term natured bias of the public markets and that's not a criticism. It just is what it is. Sometimes the difficult challenge is you have to go out and say, yes, okay this year's performance is 5% less than where you think it ought to be because I'm reinvesting in the business and next year you're going to see the fruits of that labor. It's the challenge of balancing out the future of the business with the, what have you done for me lately approach and I think that's on us to be able to articulate that thesis appropriately so that people expect and understand why are those investments being made and obviously it's incumbent upon us to deliver on the benefits that they produce in future years but that's probably the biggest challenge in a public company context for us, I think.

Nate: Yeah. Well, Kirk, thank you very much for your time. It's always a pleasure talking to you and it's been an especially big pleasure this time because I get to give it to everybody else to listen to. Thank you so much for taking the time to talk.

Kirk: Nate. My pleasure. Happy to do so.