NRG Energy Inc.

Framing the Risk-Reward in Free Cash Flow

Equities

Americas
Electric Utilities

12-month rating	Buy
12m price target	US$20.00
	Prior: US$23.00
Price	US$16.40

RIC: NRG.N **BBG:** NRG US

Trading data and key metrics

52-wk range	US$33.72-16.40
Market cap.	US$5.51bn
Shares o/s	336m (COM)
Free float	100%
Avg. daily volume ('000)	1,192
Avg. daily value (m)	US$24.4
Common s/h equity (12/15E)	US$11.8bn
P/BV (12/15E)	0.4x
Net debt / EBITDA (12/15E)	5.2x

EPS (UBS, diluted) (US$)

	12/15E			
	From	To	% ch	Cons.
Q1	(0.40)	(0.41)	-2.21	(0.37)
Q2	(0.15)	(0.06)	61.11	(0.06)
Q3E	1.25	1.29	2.52	0.62
Q4E	1.53	1.25	-18.67	0.06
12/15E	2.31	2.13	-7.92	0.70
12/16E	1.56	1.56	-0.09	0.54
12/17E	1.39	1.48	6.99	(0.07)

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More buybacks coming but does the Street care at present?

We've thoroughly updated our model expectations, reflecting all of mgmt's latest capital updates, including an assumption of $250Mn/yr in further buybacks (ex asset sales). We see shares as now trading at an implied 23% yield across the 4-year avg, making any head turn to ask how sustainable is FCF? We say yes despite long-term pressures. Admittedly the calendar is tough into year end (see our pro's/con's below), the question remains when is the downturn reflected? Upside remains tied to growing asymmetric risk on solar execution/announcement of a partnership (which could meaningfully address executional issues), Texas power market expectations & scarcity, and even cont'd robust Retail performance. Lastly, cont'd reduction in capex spend in '16 should help 'realize' the FCF (pre-growth) capex delineated by mgmt.

Pruning the portfolio with PJM asset sales – focus on lower-quality assets

Management expects ~$500Mn of divestiture proceeds in 2016 from its asset review which is focusing on PJM. Few additional clues were provided but NRG indicated that the assets had relatively minimal EBITDA while also requiring capex. Not only would this free-up additional repurchase latitude but could also improve the future FCF profile.

NYLD drop more accretive than expect but no real surprises with NRG Yield

NRG offered a ~$50Mn concession to NRG Yield to boost the CAFD Yield to 10% on its latest drop-down, better than our expectations. We recently lowered our 2015-2018E DPS growth rate to 14% [details here] as we assume that management will throttle down growth to enable a smoother growth profile for 2019+.

Valuation: Reduce PT to $20 from $23 – good update, despite expectations

Friday's update actually exceeded our expectations, with cost cuts a real benefit alongside solar partnership. In contrast, we suspect investors may have been looking for a firmer headline number of on immediate repurchases and a more definitive exit to Home Solar. Lastly, PJM cleared quantities may be slightly underwhelming given just 14.2GW out of 17.4GW ("~85%"). Our valuation remains based on 2017 SOTP. Our expectation of $3.0-3.2Bn in '16 EBITDA guidance is inline w/ Streetexpectations, set to be released with 3Q. This should no longer be a concern for investors.

Highlights (US$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenues	8,422	11,295	15,868	16,255	16,029	15,925	16,072	16,285
EBIT (UBS)	969	1,380	1,605	2,135	1,872	1,788	1,910	2,120
Net earnings (UBS)	579	274	262	669	489	466	610	881
EPS (UBS, diluted) (US$)	2.47	0.85	0.78	2.13	1.56	1.48	1.94	2.80
DPS (US$)	0.18	0.48	0.54	0.58	0.58	0.58	0.58	0.58
Net (debt) / cash	(14,042)	(14,812)	(18,568)	(17,133)	(16,033)	(14,627)	(13,064)	(10,841)

Profitability/valuation	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
EBIT margin %	11.5	12.2	10.1	13.1	11.7	11.2	11.9	13.0
ROIC (EBIT) %	6.5	7.4	7.9	10.3	9.4	9.4	10.7	12.9
EV/EBITDA (core) x	6.2	6.3	6.2	4.2	4.2	3.9	3.2	2.3
P/E (UBS, diluted) x	7.5	31.3	39.6	7.7	10.5	11.1	8.4	5.9
Equity FCF (UBS) yield %	(50.4)	(9.1)	5.9	14.9	9.8	15.3	18.2	30.2
Net dividend yield %	0.9	1.8	1.7	3.5	3.5	3.5	3.5	3.5

Source: Company accounts, Thomson Reuters, UBS estimates. UBS adjusted EPS is stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement. Valuations: based on an average share price that year, (E): based on a share price of US$16.40 on 21 Sep 2015 19:37 EDT

More buybacks coming and more capital announced for Home Solar

Investor expectations were particularly high around a repositioning of the balance sheet and ending capital dependency of Home Solar, shifting towards both share repurchases and debt paydown. Looking to 2016+ the combination of cost cuts ($150Mn run-rate), cancelled coal-to-gas conversions ($100Mn), and incremental project finance debt through modest specific re-leveraging ($250Mn) is expected to free-up $500Mn of capital (we assume ~$250 Mn for remainder fo 2015 and a similar figure in 2016 in repo's). This is incremental to the organic FCF of the business which we estimate at ~$800Mn With respect to Home Solar the segment will be moved into a new 'GreenCo' along with EVgo and uncommitted renewables. This segment will be given a further $125Mn revolver as mgmt looks to cap the drag from Home Solar (EVgo is also expected to have negative FCF in 2016), likely a key negative distraction for most post the call. We look for 3Q updates on a Solar sale/spin; a partnership is clearly the most likely avenue, with the bias likely to resolve execution install issues (no IPO appears possible, taking this investor concern of a failed push off the table).

What do we think of shares now?

We are maintaining our Buy rating with shares at a three-year low.

After shedding another 9% on Monday, NRG is now at its lowest point since June 2012, the last significant bottom in commodity prices and equity market expectations. This is in spite of a significant investment in the interim, with forward expectations in commodity prices seemingly reaching comparable lows.

We maintain our Buy rating but suspect the story could take some time to play-out with few clear further drivers to the story. Our average FCF yield implied on shares has improved from reflecting both the cost cuts and the latest PJM uplift as well as the obvious deterioration in shares **to an avg yield of 23% over the 4–year period**. That said, we notch down our IPP multiple to reflect our latest 'peak' cycle expectations, applying an 8x EV/EBITDA to the group. We see an argument for higher multiple applied to the Texas portfolio, whereas our comments on peaking in the cycle principally apply to the Northeast. While we expect net new additions in PJM through ~2018, we see the outlines of the cycle in Texas as already turning with a clear stemming of investment preparing the next up cycle.

What's the reaction to the Green solution? We think management held off in part on explaining the merits of the new structure, giving those who doubt fuel to their concerns of continued spend (-$125 Mn); add to this, management confirmed (the obvious) that an IPO would likely be quite challenging. **Overall, we expect a partner to drive improved execution deployment more than leads**. We suspect a partnership structure could well meaningfully accelerate deployments. Further, a partnership structure could be structures such that NRG retail is increasingly formally compensated for its retail endeavors, providing a more explicit form of income. We expect updates with 3Q here – which could well prove incrementally positive.

We caution investors that a strategy that enables continued YieldCo access is likely key. Ideally the partnership would quickly 'solve' the install backlog issues – and turn the business around without forgoing the 'upside' that would otherwise be involved in an outright sale. We wouldn't necessarily count NRG as 'out' on Home solar – and still see a path towards some eventual value.

What about the conventional portfolio? We see the refocusing back on the wholesale business as clearly constructive, with management pro-actively addressing the portfolio through the latest pruning exercise. While the latest actions should drive value on the margin ($150 Mn/yr in cost cuts is worth ~$4/sh fully capitalized), we suspect the wider investing community may yet remain on the sidelines given lack of confidence in the power trade.

So what's the formula here? While discrete management actions make sense – and are headed in the right direction, the macro outlook remains challenged on both wholesale power price trends – and for residential solar. While we see a need to continue to invest in growth businesses to feed (at least nominally) the NYLD growth prospects, we appreciate investor desires to see FCF translate into a combination of both (following a multi-year hiatus on share repo's). We emphasize NRG will principally dictate its future, with datapoints with 3Q on guidance and future resi solar strategy key to the story turnaround. Rather, the commodity headwinds remain alive and well, with shares once more *resuming* their downward commodity spiral only after the balance sheet was known. We attribute recent pressure as more a function of contined pressure on valuations – than necessarily a strong negative reaction to the latest conf call update.

For additional context, please refer links to relevant recent reports below:

9/15/15 Taking the Other Side of the Debate [Evaluating the Capital Deployment Debate]
9/4/15 NYLD: Between a Rock and a Hard Place
8/13/15 Addressing the Slide [NDR Takeaways]
8/5/15 Buy-Into the Free Cash Flow Yield Story
8/4/15 Lack of Wind Hits Results
5/15/15 Let the Summer of Repurchases Commence
2/27/15 Splitting The YieldCo
1/20/15 Picking Apart The Solar Opportunity
1/16/15 Daring to Dream

Putting the slide in context

NRG is approaching its ten-year low set in April 2012 and is now off 55% from its June 2014 high. The recent sell-off has been the sharpest since 2008 and aside from value investors stepping-in to buy the health free cash flow yield, we see little on the horizon in the near-term to right the ship. The recently announced share repurchase authorization could help to stabilize shares, with our expectations for buybacks to drive $250Mn…

Why the slide?
1) Few (positive) catalysts
2) Commodity doubts on long-dated gas
3) PJM auction 'came and went'

Figure 1: NRG Energy- The Past Ten Months have been painful…

Source: FactSet

Framing the Positive and Negative Near-Term Power Catalysts

We present below the key datapoints to the power sector. The sector, despite the high FCF yield offers little by way of positive catalysts to drive a turnaround, hence the complete capitulation in shares.

Power positives:

- ERCOT: Finalization of EPA's Regional Haze regulations in 4Q
- Nuclear plant retirement announcements: For both Illinois and New York markets likely in 4Q
- Energy Price Formation: Latest round of reforms at FERC.

Power negatives:

- Renewables front and center: *upside* to Street expectations on deployments.
- PJM: Negative demand revisions to forecast in ~December.
- Continued new entry reaching in-service: Principally in 2016+ onward

Below we present takeaways from management's call Friday:

Wholesale/Retail:

- **PJM Capacity Auction:** NRG cleared 14,200MW out of its 17,400 available (as of 12/31/14) with management commenting that it cleared 85% of the portfolio. For the transition auctions the uplift was lower than expected with only 3.9GW clearing as Capacity Performance in 2016/2017 ($105Mn revenue improvement). For 2017/2018 9.7GW cleared, contributing ~$125Mn incremental revenue.

  We believe almost all of NRG's assets in the ComEd (predominantly EME assets) cleared as CP for the 16/17 transition auction. Additionally, we assume GenOn's RTO assets cleared CP for both the 17/18 transition auction and the 18/19 base auction, however, we do not expect its ATSI assets to clear the 18/19 base auction. Furthermore, we assume EMAAC assets are cleared as CP for both the 17/18 transition auction and the 18/19 base auction; but believe GenOn's MAAC assets cleared partially as CP for the 17/18 transition auction. We expect NRG's generation assets located in the SWMAAC cleared as CP for the 18/19 base auction.

- **Coal-to-Gas Conversion plans:** As part of its asset review NRG reweighed all capital opportunities against repurchasing its own stock and has adjusted its fuel conversion plans. *The scaled back plans will reduce capex by ~$100 Mn.*

  - The 638MW Avon Lake 9 (ATSI) planned gas conversion. While Avon will continue to operate *without* conversion, complying with the MATS rules principally with lower-sulfur coal (we suspect PRB) and back-end emissions controls (likely ESP retrofits, consistent with other Ohio plants). We understand citing issues for the ~$40Mn pipeline lateral may have been the root cause of the shift. The previous gas conversion was premised on a new 20-mile gas pipeline but NRG has faced a slow process at the Ohio Power Siting Board and landowners along the proposed pipeline route.

Figure 2: NRG Net Capacity

Summary	
PJM	17,391
ERCOT	10,559
CAISO	7,571
MISO	4,734
NYISO	4,207
ISO-NE	2,665
FRCC	463
WECC	46
Total	47,636

Source: Company Filings (As of 12/31/14)

- 401MW Portland (MAAC) oil conversion plans cancelled. The Portland plant will seemingly be retired, adding to Eastern (EMAAC) congestion seen in the last auction

- New York conversion plan is NPV positive for balance of the portfolio

Management also confirmed that Huntley will be retired in March 2016 but back-stepped from earlier comments about ceasing operations at Dunkirk following the Entergy litigation. We estimate that the conversion and additional gas pipeline lateral will cost ~$85Mn and are still in NRG's capex plan. The Further detail on Huntley and Dunkirk are available in our recent analysis of the New York market **'Taking Down Coal in the Empire State'**.

- **Asset divestiture process:** NRG has begun a process to potentially sell a number of assets to raise $500Mn. The assets included in the process have minimal EBITDA while also requiring modest ongoing capex. We suspect this could include several of the units continuing to see investment for fuel conversions (most are contemplated for completion by May, 2016).

  Proceeds would be used ~equally for repurchases and debt paydowns *but* if GenOn assets are divested the proceeds would likely see a larger percentage earmarked for debt reduction purposes. Management has framed this as 'trimming' the portfolio that is now over 40GW following the latest acquisitions.

  Bottom line? We think the timing of the asset sales is well aligned with our broader view that the PJM market in particular may be peaking. We see the desire to cut capital spend as further playing into desires articulated by many investors to see additional capital return to shareholders.

- **Raising incremental ~$250 Mn in project finance too?** We understand the company will also seek to *raise* incremental project debt in lieu of asset monetization. While unclear *which* assets this would include, we suspect this could yet include some of the remaining renewable assets – as well as some of the core profitable assets. We see this trend towards corporate leverage as a trend we've seen elsewhere with NEE and EXC seemingly pursuing comparable strategies

- **Retail Customers:** The total retail customer count decreased marginally as of August 30th due to attrition from Dominion East but there was modest growth in the rest of the fleet to offset lost customers.

- **Carbon 360:** The carbon capture investment is being "wound-down" and only has $117Mn of capex obligations beyond this year. This appears to precisely the type of area that will be targeted in the corporate overhead cost reduction plan.

- **Focus could shift back to Texas shortly:** We flag the core ERCOT fleet could yet see focus return to this segment in coming months as the EPA is set to finalize Regional Haze regulations in Texas. We flag the proposed rules had included the Limestone unit, suggesting finalization could yet require full wet scrubbers to achieve stated SO_2 targets. The question is whether any compromise deal can be reached – or to what extent modifications on the units can enable SO_2 compliance with any final target. *Overall, given the distress in this market, we could well see NRG poised to refocus its efforts on reviewing the portfolio here for seasonally mothballing portions of its portfolio.* W

Could NRG move to rationalize the Texas portfolio – and/or see Haze pressure?

Finalization of Haze regs could be a pos. push for mrkt confidence

GreenCo:

The draw on the revolver will be disclosed quarterly and is expected to peak in the summer of 2016

- **Creating new subsidiary with additional discipline:** The new customer-facing subsidiary will hold NRG Home Solar, EVgo, and other renewables business excluding utility-scale and other assets currently committed to NRG Yield already. Management has established a $125Mn revolver indicating that this will be the maximum financial reliance that the segment will have going forward, excluding the $85Mn obligated to EVgo in California. Skeptical investors have characterized this as guidance for 2016 negative FCF. Beyond the $125Mn, the GreenCo is not able to sustain itself, it will have to find alternative capital and/or reduce operations. Such a solution could be finding strategic partners such as potentially Sunrun or Clean Power Finance. Alternatively we read the disclosures as NRG effectively admitting that an alternative strategic owner may see more value in the 'green' businesses and seeking a sale or spin in the future.

  Few details have been provided about EVgo outside the Analyst Day where management disclosed $29Mn losses for 2013/2014 with an objective of breaking-even in 2017 based upon a 50% market share for eVgo and annual sales of electric vehicles double from 2014. Electric vehicle sales data in 2015 has had disappointing datapoints such as Nissan Leaf sales and resale prices. Nissan is one of eVgo's partners.

- **Home Solar booking vs installations:** According to the chart outlining the 2015 residential solar customer headcount presented in management's presentation, it appears like the recent lag between bookings and installations/ deployments for NRG is in the 4-5 month range for the Home Solar business. In comparison, SCTY noted that their lag is ~60-90 days. Two keys here are the location of the majority of NRG's residential customers, along with operational inefficiencies at the company in relation to the Home Solar business. First, we have heard from many industry participants that NJ (one of NRG Home Solar's target states) has some of the highest permitting costs and longest processes in the country. This is the main caveat when comparing NRG to other players from a total portfolio lag perspective. SCTY's lag naturally compares favorable in more efficient markets, CA in particular. Having said that, data compiled via New Jersey's Clean Energy Program suggests that NRG have an installation time well over the state average. Please click here to review the data. Between 1Q14 and 1Q15, the average time between project 'acceptance' and 'completion' was 232 days for NRG Home Solar, compared to a state average of 181 days, 142 days for SCTY, and 194 days for VSLR. The largest player in NJ, Trinity Solar, has a state leading delta of 128 days.

  Potentially more critical though, is that the 'limited' investment into expanding the installation teams is creating a bottleneck between bookings and installations, as indicated by the incremental growth of the lag between bookings and installations as bookings have grown. As the back-end processes are not being invested in to match the rate of bookings, NRG Home Solar is not able to equal the delta between bookings and installations at the high growth/ high capex resi solar leaders in SCTY and VSLR. Given the financial limit of $125M that NRG is setting for the DG business for 2016, we don't anticipate the bottleneck will subside without a partnership or exit strategy.

Corporate/Other:

- **Targeting ~15% overhead cost cuts:** NRG is now targeting $150Mn/yr overhead cost cuts for run-rate 2016E from a 2015E base of $1,090Mn. Concrete details were not provided on the call (expected with 3Q15 results) but reductions will focus on less developmental opportunities and a "streamlined organizational structure". We look for details on how much of the savings are at GenOn.

$60Mn cost to achieve in 2015

This is the biggest positive surprise from disclosures

NRG Yield:

- **No equity activity planned:** As mentioned previously NRG Yield can achieve the low-end of its dividend per share growth target through 2018 without issuing equity. Management did not state that it will not issue equity before 2019 but affirmed that it does not need to as it can flex its dividend payout ratio.

Drop-down will be financed with cash on hand and is expected to close in upcoming weeks (4Q15)

- **Agreeing on a price for EME Wind drop-down:** NRG Yield will buy drop-down for $210Mn of cash with a total $452Mn enterprise value with a 10% equity yield. The economics could be further enhanced by additional NRG Yield corporate leverage but we do not anticipate further capital markets activity in the near-term. NRG Energy has previously guided to 8% equity yields on drop-downs and by opting for a 10% yield it sold the assets for $210Mn vs $263Mn in an attempt to make the transaction look more favorable to NRG Yield. The transaction has an 11x EV / EBITDA multiple and we now reflect this in our NRG Energy valuation for all remaining renewables in NRG Energy's portfolio.

  With a weighted-average contract life of only eleven years we see the repowering assumption as critical in the late 2020s. Based upon our wind mini-model for the transaction we calculate a **~10% IRR** based on ~$31 annual CAFD ($27/MWh merchant tail) for the remaining ten-year life beyond contract. That said, we caution that long-term merchant prices in renewable saturated markets/periods could yet see further pressure.

Updated EBITDA Estimates- Modest Uptick

Below we present our updated NRG Energy adjusted EBITDA estimates which shows significant increases beyond 2015 due to our incorporation of the PJM auction results (transition and Base Residual Auction) as well as the $150Mn cost-savings plan.

With 2016 Adj EBITDA guidance poised to be released with 3Q results, we initially anticipate a range of **$3.0-3.2 Bn.** While we expect backwardation to persist in the wholesale portfolio in Texas, we see potential upside on our Alt Energy/NYLD segment (timing of ramp-up of new assets is key) as well as Retail, given continued modest power price expectations. This could well prove >$600 Mn yet again.

Even in a downside scenario, we emphasize a distressed mid-$2 gas figure for Henry Hub would seemingly still produce a teens FCF yield on the equity, suggesting investors would still get 'paid' to wait out the cycle.

Figure 3: Updated NRG Energy Adjusted EBITDA Estimates – Revised up Modestl

EBITDA ($Mn)	2013A	2014A	2015E	2016E	2017E	2018E
NYMEX Assumption		*4.26*	*2.95*	*2.95*	*3.12*	*3.25*
Texas	502	302	416	195	88	56
Northeast	1,004	1,206	780	671	568	713
South Central	43	118	67	78	106	146
West	167	272	384	372	384	318
Alt Energy & NYLD	335	627	601	637	634	631
Guidance			690			
Retail Businesses	614	604	626	588	554	583
Guidance			575-650			
Corporate, Other, and Unallocated Synergie	(29)	(1)	393	467	537	537
NRG Adj. EBITDA (UBSe)	2,636	3,128	3,266	3,007	2,870	2,983
Prior EBITDA Est. (UBSe)		3,128	3,289	2,956	2,713	2,749
Consensus EBITDA Est.(9/21/15)	2,636	3,194	3,252	3,085	2,913	3,158
Guidance (1Q15)	2550-2600	$3,100-$3,200	$3,200-$3,400	UBSe: $3.0-3.2Bn		

Source: Company Filings, Fact Set, and UBS Estimates

Valuation: Reduce Price Target

Despite increasing our adjusted EBITDA estimates due to the combination of PJM results and the cost cut plan, we are reducing our valuation to $20 from $23 derived via our 2017 sum-of-the-parts analysis.

We emphasize our latest valuation ascribes an 8x EV/EBITDA on the conventional generation business and a 11x EV/EBITDA on the renewables assets outside of NYLD, reflecting the economics of the latest asset drop-down to NYLD.

We have adjusted our valuation for the following factors:

- **Conventional business to 8x from 9x previously**: The lower conventional multiple is now applied across our IPP/integrated valuations reflecting a multiple more indicative of the 'top' of the power cycle, particularly for PJM, amidst continued concerns over further commodity downside with new entry anticipated. We also further bifurcate and apply a -1x turn to both the PJM (Northeast) and California portfolios to illustrate risk to backwardation as these markets are seemingly the closest to peak. In contrast, we see an emerging argument to apply a yet premium multiple to ERCOT for any eventual recovery.

- **Renewables to 11x from 12x,** consistent with the latest drop to NYLD. Further details are available in our report 'Embedding the Auction Uplift'. With respect to the renewables segment after NRG offered a more attractive price to NRG Yield on its latest drop-down (11x EV/EBITDA or 10% equity yield)

  we now reflect this in our NRG Energy valuation for all remaining renewables in NRG Energy's portfolio.

- **Home Solar:** *An important valuation wildcard?* With our prior target embedding $4/sh, we reflect a substantially more modest valuation equal to **~$1/sh**, applied off a run-rate of 200MWs/yr using our generic $0.40/Watt generic margin garnered by asset monetization in a post ITC environment, with a 5x EBITDA Devco multiple applied to the business.

- **Cost savings effort:** is reflected in our Corporate & Other line-item, and valued at a 7x (-1x vs. IPP peer multiple) turn for the overall segment accounting for the wide amalgamation of cost synergies historically disclosed. We assume half of the synergies are achieved in 2016 at $75 Mn, with full year accuring in 2017 at $150 Mn. This could well prove conservative as well and provides upside to our 2016 EBITDA – and provides further latitude for which mgmt to hit Street estimates with 3Q guidance.

- **Additional repurchases:** We assume $250 Mn/yr, as the implied $500 Mn of capital latitude available post-"Reset" suggests there will be $249 Mn left for 2016 after the $251 Mn to be executed for 2015.

- Our Midwest Generation compliance plan capex has been reduced by $100Mn to account for the decision to convert fewer assets.

Figure 4: NRG Energy Valuation – Dropping our Target to $20/sh from $23/sh despite cost savings effort

All figures in US $ million except per share data	2017 EBITDAR	EV/EBITDA Multiple				Enterprise Value		
NRG Energy (Classic) and GenOn		Low	Prem/ Discount	Base	High	Low	Base	High
Base IPP Multiple =				8.0x				
Texas	88	7.0x	0.0x	8.0x	9.0x	616	704	792
Northeast	379	6.0x	-1.0x	7.0x	8.0x	2,273	2,652	3,031
GenOn Operating Leases	80	6.0x	-1.0x	7.0x	8.0x	480	560	640
South Central	106	7.0x	0.0x	8.0x	9.0x	742	848	954
West (ex-EME)	140	6.0x	-1.0x	7.0x	8.0x	840	980	1,120
Alt Energy (ex-NYLD and EME Portions)	162	10.0x	3.0x	11.0x	12.0x	1,616	1,777	1,939
Retail Businesses (Reliant, GM, E+, D)	554	4.0x	-3.0x	5.0x	6.0x	2,215	2,769	3,323
Edison Mission								
EME - MidWest Generation	159	7.0x	0.0x	8.0x	9.0x	1,112	1,271	1,430
EME - EMMT (Trading)	32	4.0x	-3.0x	5.0x	6.0x	126	158	189
EME - Other (Gas and Other)	74	7.0x	0.0x	8.0x	9.0x	518	592	666
Other, Corporate, and Unallocated Synergies	523	6.0x	-1.0x	7.0x	8.0x	3,135	3,658	4,180
Total / Implied	2,295	*6.0x*	*1.0x*	*7.0x*	*8.0x*	13,674	15,969	18,264
Net Debt and Other								
NRG Recourse Debt							(8,821)	
GenOn Non-Recourse Debt							(2,862)	
GenOn and EME PV Operating Leases							(1,184)	
Midwest Gen Compliance Plan							(445)	
Solar Non-Recourse Debt (Non-NYLD)							(1,699)	
PTCs?)							757	
Preferred Shares (2015E)							(310)	
Cash (2015E)							3,602	
EBITDA Devco Multiple							400	
NPV of Equity using Hedged EBITDA Methodology						3,112	5,408	7,703
Open Analysis								
Power Hedges	(149)	7.0x		8.0x	9.0x	(1,041)	(1,190)	(1,339)
Coal Hedges	4	7.0x		8.0x	9.0x	31	36	40
Total	(144)	7.0x		8.0x	9.0x	(1,010)	(1,154)	(1,299)
add NPV of Power Hedges							(7)	
add NPV of Coal Hedges							(25)	
NPV of Equity using Open EBITDA Methodology						2,070	4,221	6,372
NYLD Class A Current Share Price						9.68	14.68	27.00
NYLD Equity Value						827	1,254	2,306
$/share for NRG Energy (85Mn Shares Owned (B & D)]						2.75	4.17	7.67
Estimated 2017 Shares Outstanding						301	301	301
Equity value per share (using Avg of Open/Hedged)						$11.00	$20.00	$31.00

Source: Company filings and UBSe

NRG's FCF Profile

We emphasize NRG's higher FCF yield is principally derived from its cash rich retail business, which we continue to value at a 5x EV/EBITDA multiple. We see the principle pushback on shares relating to the $500 Mn+ in future years on reinvestment back in the business in 2016/17 as limiting credibility of the FCF yield. We suspect some investors view skeptically the capex needed to reinvest *back* in assets to keep them open –as is the case with the bulk of the coal-to-gas fuel conversions. Further, the question remains how to think about and position the EPS profile of the aggregate business.

Figure 5: NRG FCF - Delivering a Shocking amount back in capital return

EBITDA to Cash Flow Analysis	2014	2015	2016	2017	2018	2019
NRG:						
EBITDA	3,128	3,266	3,007	2,870	2,983	3,161
Interest	(1119)	(1,152)	(1,126)	(1,099)	(1,069)	(933)
Income Tax	7	(40)	(40)	(40)	(40)	(40)
Collateral / Working Capital	(320)	248	(20)	17	(451)	(24)
Other / Deferred Taxes	(186)	-	-	-	-	-
Less: Home Solar	(65)	(175)				
CFO	1,445	2,062	1,758	1,707	1,365	2,022
Maintenance Capex	(254)	(495)	(475)	(375)	(375)	(375)
Enviro Capex	(254)	(320)	(250)	(5)	(15)	(20)
Pfd Div	(9)	(9)	(9)	(9)	(9)	(9)
FCF Pre-Growth Capex	928	1,238	1,024	1,318	966	1,618
Guidance		*1,100-1,300*				
CAFD from NYLD		(234)	(305)	(355)	(358)	(363)
Amortization Schedule - Non-NYLD						
Agua Caliente		28	29	30	31	31
CVSR		25	25	26	27	28
Viento		22	23	23	24	25
NRG Peaker		20	20	20	20	21
Cedro Hill		8	9	9	9	9
NRG - Other		19	19	20	21	21
Debt Amortization		121	124	128	132	135
Less: Non-Owned Distributable Cash flow from NYLD	(57)	(169)	(137)	(160)	(161)	(163)
Less: Other	15					
FCF net of NYLD and Debt Amortization	886	1,069	886	1,159	804	1,454
Plus: Non-Cash Lease Amortization		80	80	80	80	80
Less: Minimum Lease Payment		(166)	(211)	(207)	(196)	(195)
Adjusting for GenOn Leveraged Leases		(86)	(131)	(127)	(116)	(115)
Market Cap		5,455				
Less NYLD Stake		1,254				
Market Cap (ex-NYLD)		4,201				
FCF net of NYLD, Debt Amort, and Leveraged Leases		983	755	1,032	688	1,340
Implied FCF Yield (with NYLD)		18%	14%	19%	13%	25%
Implied FCF Yield (without NYLD)		23%	18%	25%	16%	32%
GenOn EBITDA		520	308	275	398	462
Interest Expense		(262)	(262)	(262)	(282)	(302)
Maintenance Capex		115	110	115	115	115
Environmental Capex		7	-	-	-	-
Total Capex		122	110	115	115	115
Free Cash Flow (Pre-Leveraged Lease)		136	(65)	(102)	1	44
Net Leveraged Lease Impact (Debt Amort)		(86)	(131)	(127)	(116)	(115)
Free Cash Flow (Pre-Leveraged Lease)		50	(196)	(229)	(115)	(71)
FCF net of NYLD, Debt Amortization and GenOn		1,205	822	1,057	805	1,499
FCF net of NYLD and Debt Amortization (without GenOn)		1,069	886	1,159	804	1,454
Uses						
Organic Growth Capital		900	500	500	-	-
Total Capex		1715	1,225	880	390	395
Assumed Share Repurchases		437	-	250	250	250
Projected Common Dividend		178	173	167	158	149
Remaining for Debt Paydown, etc.		(1,092)	(374)	21	167	824

Source: Company reports and UBSe

Forecast returns

Forecast price appreciation	+22.0%
Forecast dividend yield	3.5%
Forecast stock return	+25.5%
Market return assumption	5.7%
Forecast excess return	+19.8%

Statement of Risk

Risks to our investment thesis include but are not limited: 1) actual commodity prices differing significantly from our assumptions; 2) political and regulatory intervention to change the structure of competitive markets in response to high power prices and insufficient new build; 3) the current state of credit markets that has limited the companies' flexibility to return excess cash to shareholders; and 4) unknown impact from a potential carbon legislation (likely a modest negative). Other investment risks include abrupt changes in weather patterns, sharp slowdown in economic demand, interest rate risks, large renewable/transmission build-out across TX, declining valuation for NRG Yield investment, and disruption of trading activity in power markets.

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12-Month Rating	**Definition**	**Coverage**[1]	**IB Services**[2]
Buy	FSR is > 6% above the MRA.	45%	36%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	13%	20%
Short-Term Rating	**Definition**	**Coverage**[3]	**IB Services**[4]
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 June 2015.
1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
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UBS Securities LLC: Julien Dumoulin-Smith; Michael Weinstein; Paul Zimbardo.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
NRG Energy Inc.[16]	NRG.N	Buy	N/A	US$16.40	21 Sep 2015
NRG Yield[16]	NYLDa.N	Neutral	N/A	US$14.68	21 Sep 2015

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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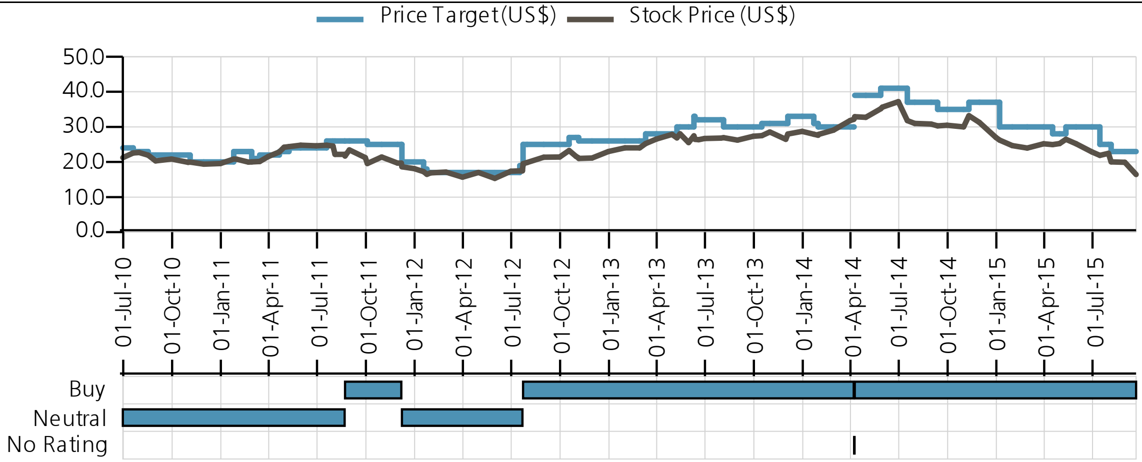
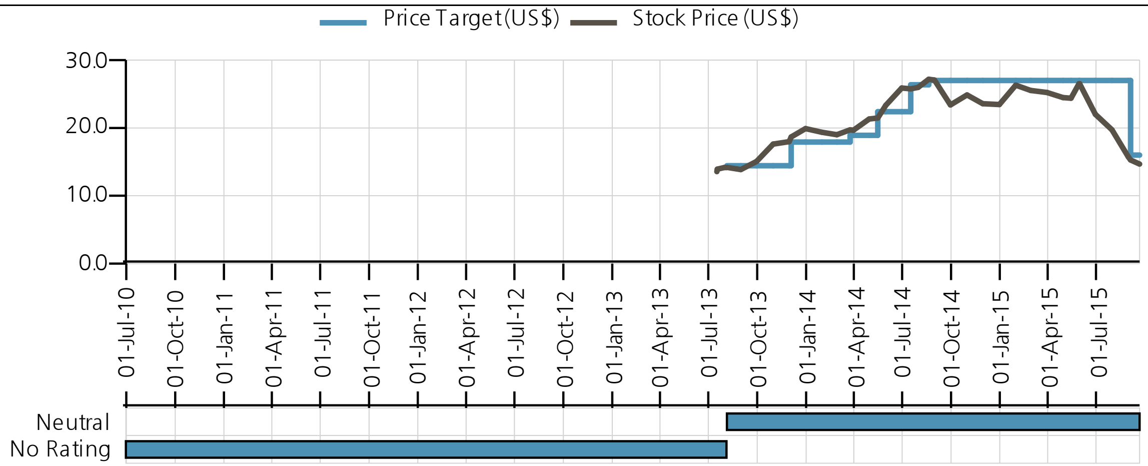
NRG Energy Inc. (US$)



Source: UBS; as of 21 Sep 2015

NRG Yield (US$)



Source: UBS; as of 21 Sep 2015

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