



NRG Energy (NYSE: NRG)

Buy Pitch

Real Assets Group

Analysts: Aleem Virji, Garrick Bracken, Amy Dong, Edward Liu, Benjamin Lee, Gage Burchall

Researchers: Alyssa Choi, Claudio Cericola, Emily Kim, Joshua Rovner, Nick Liu, Quentin Kehm

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WESTERN INVESTMENT CLUB

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The Opportunity: Extremely Attractive Risk/Reward

With a stable FCF-generating business with high dividend yield and returning value to shareholders, NRG is a quality company awaiting street rerating as the business shifts its fundamentals

- **NRG's business in generation wholesale has been strategically reduced from 2017**
- Avoiding wholesale volatility by strategically acquiring retail companies will lead to continued margin improvement
- **Divesting these assets and exiting the wholesale business was the primary goal**
- The idea is to match generation capacity to reach the needs of the retail base, without participating in the less attractive wholesale market
- **Street has failed to react to business transformation**
- Despite improving economics in the business model and increasing FCF to shareholders, street continues to value NRG like its old self and generation-focused peers
- **Opportunity for cross-selling not fully appreciated by street**
- Captive single product customers are likely to be converted to dual fuel with little additional investment
- **Growth into an all-in-one offering may have potential to drive additional service revenues**
- Investment in adjacent services increases stickiness of existing offering and retention in the future
- **Risk/Reward is extremely attractive to due stable cash flows and high dedication to returning capital**
- Dividends and share buybacks ensure a minimum level of returned value that improves the risk-reward profile from a full share price change alternative

Buy NRG at \$ 37.99 for a 87.9% upside and 13.4% 5-year IRR



01

Business Overview

Business Overview

NRG Energy is a leading energy company that is transitioning from energy generation to retail supplier

Company Overview

- NRG Energy is a leading American integrated energy company that generates power and provides energy and related products to homes and businesses
- NRG generates 14 GW of power from 33 power plants across the U.S. and serves 6 million retail customers
- Shifting towards a focus on customer-centric energy provision (to retail customers and businesses) from its original business model of pure power generation

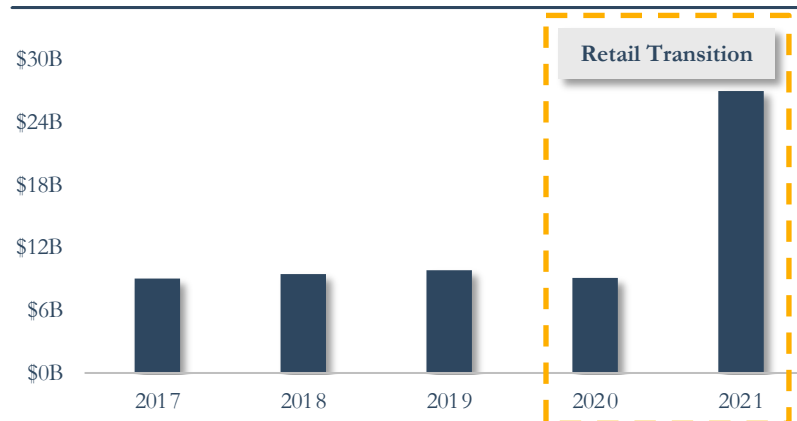
Key Statistics

Ticker	NYSE: NRG
Share Price	\$37.99
52 Week Low-High	\$31.94 – \$46.10
Enterprise Value	\$17.06B
Market Capitalization	\$9.26B
LTM EV / EBITDA	3.51x
Dividend Yield	3.7%

52 Week Stock Chart



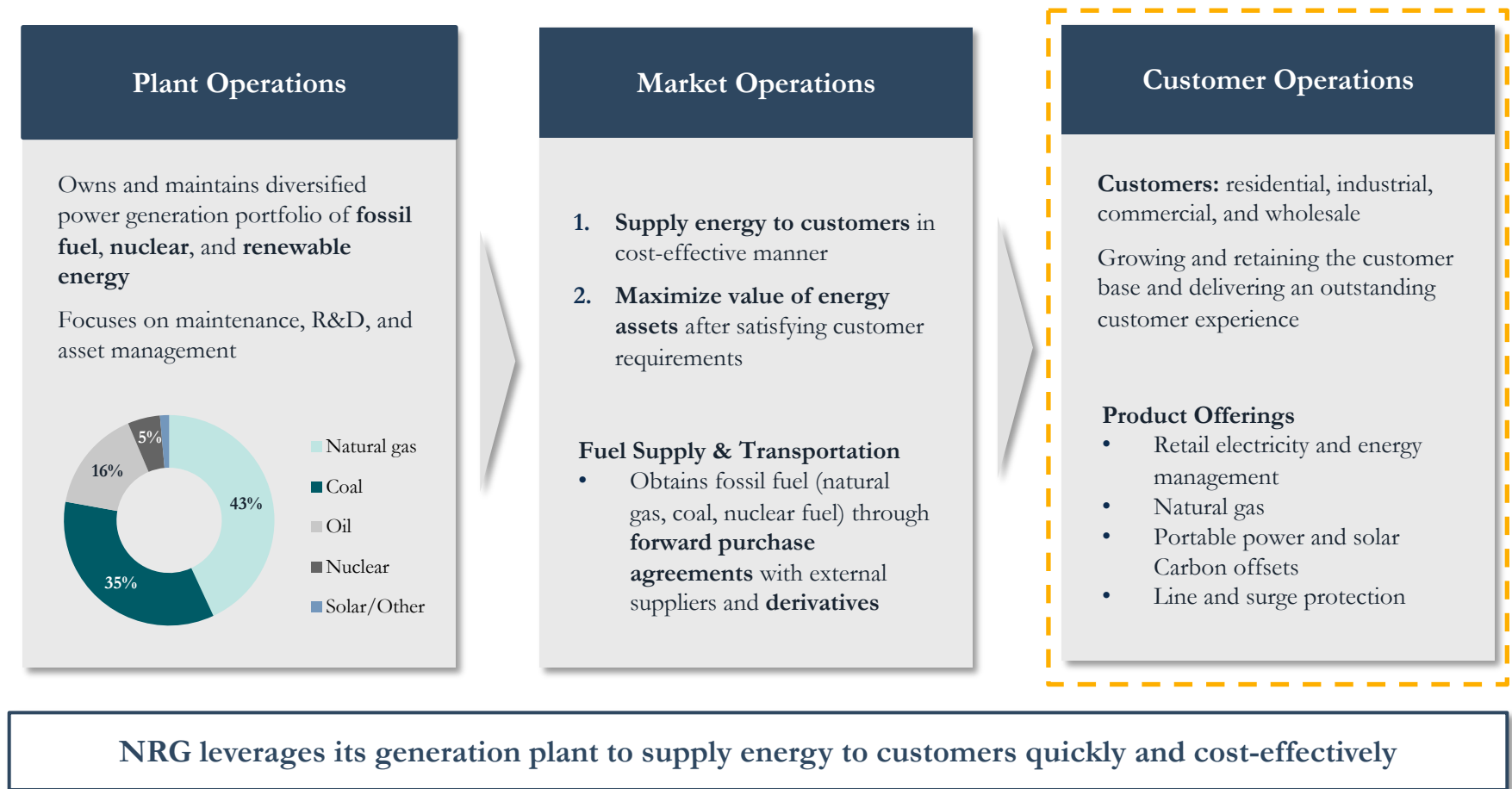
Total Revenue



Business Overview: Integrated Business Model

NRG's combined business model of retail energy and power generation is self-supporting

Integrated Power Offerings



Annotated Stock Chart

Rallying after facing significant losses from Uri, NRG presents a strong buy opportunity

52-Week Annotated Stock Chart



1 Mar 17, 2021

Update states Winter Storm Uri will have a “significant impact on 2021 results”, at ~\$750M loss

2 May 6, 2021

Q1 earnings call reports a \$967M loss due to Winter Storm Uri, higher than previous estimates

3 Aug 5, 2021

Compared to 2Q20, adjusted EBITDA is up 14.3%, driven by working synergies with Direct Energy

4 Nov 4, 2021

Supply chain and coal cost concerns lower guidance by \$100M; revenue up only 2% over 3Q21

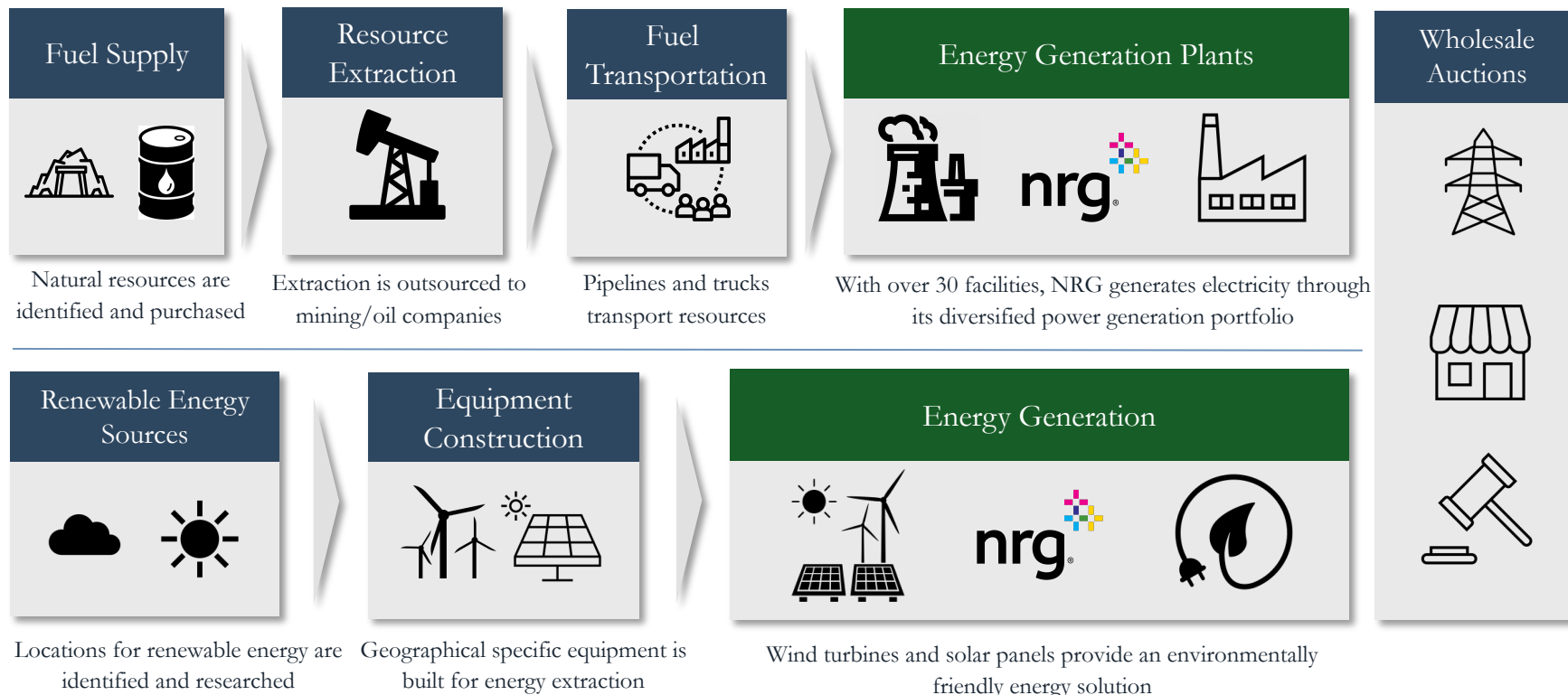
5 Feb 24, 2022

Cost of Uri reduced to \$380M; closed sale of 4.8 GW of fossil generating assets and \$500M debt reduction

Business Overview: Power Generation Value Chain

NRG's power generation business is powered through both fossil fuels and renewable sources

Value Chain

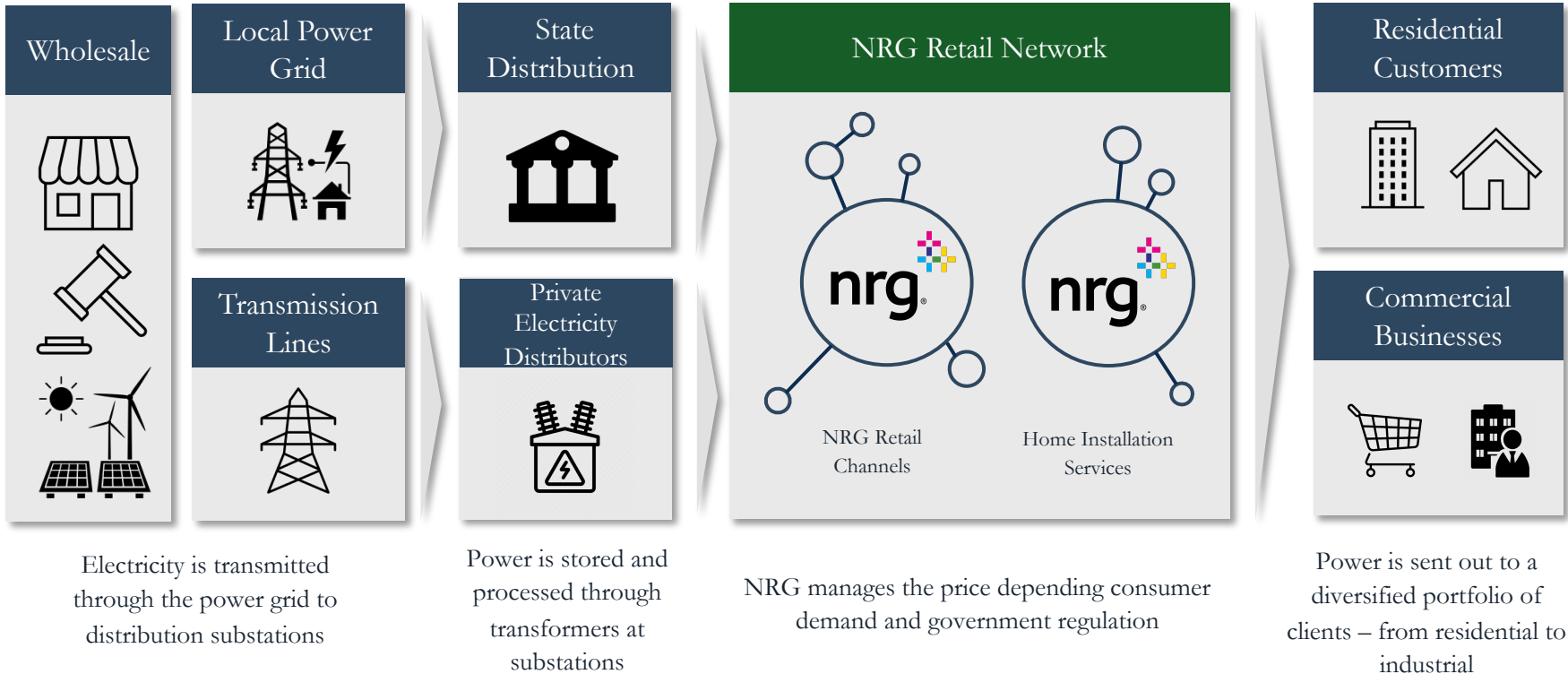


NRG leverages its diverse energy generation sources for flexibility and scale

Business Overview: Retail Power Value Chain

NRG has the leverage to set prices for electricity with their integration with power generation

Value Chain



NRG's competitive edge lies in its integration with power generation

02

Internal Analysis

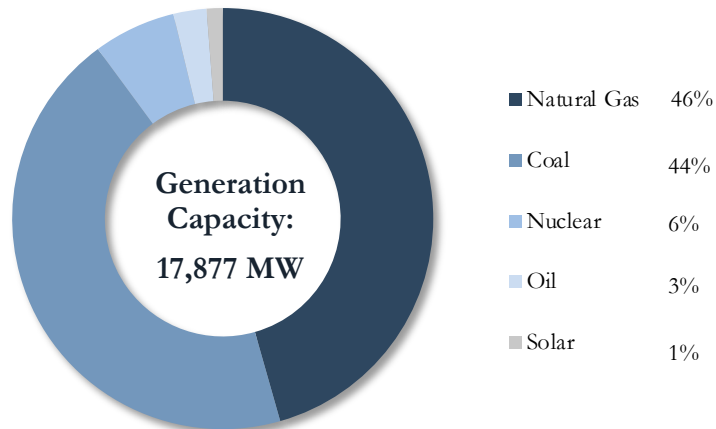
Internal Analysis: Revenue Breakdown

NRG's transition into consumer-facing retail market creates opportunity for rapid revenue growth

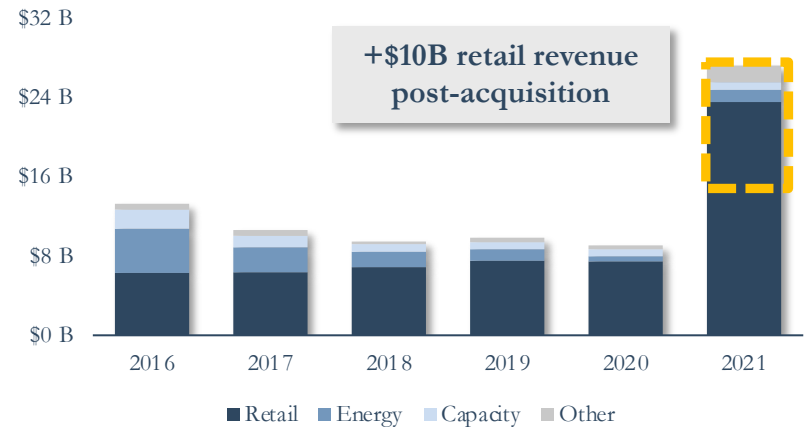
Overview

- NRG's acquisition of Direct Energy has enabled the company to expand its national presence into the retail energy market, growing revenue by +196.9% Y/Y
- Steady growth of retail revenues as a result of NRG's pricing power and ability to mitigate effects of rising energy costs
- Generation capacity has decreased from 23kMW to 18kMW in the past year to lower fixed costs and direct capital towards retail power

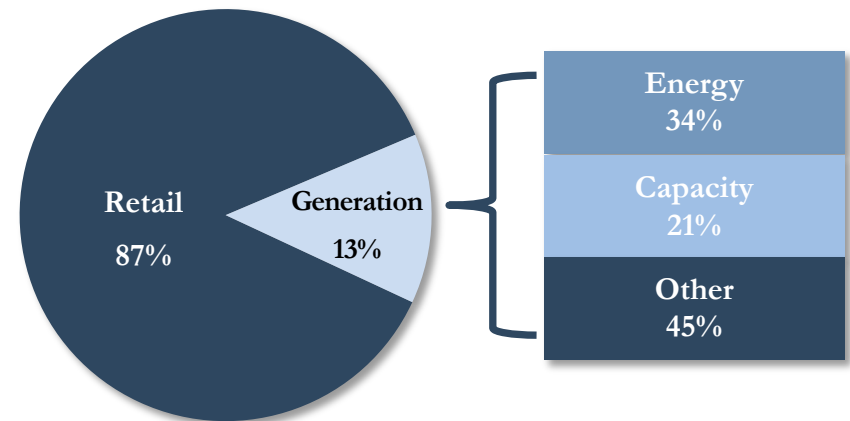
Resource Generation Capacity



Segment Revenue Breakdown



Segment Distribution



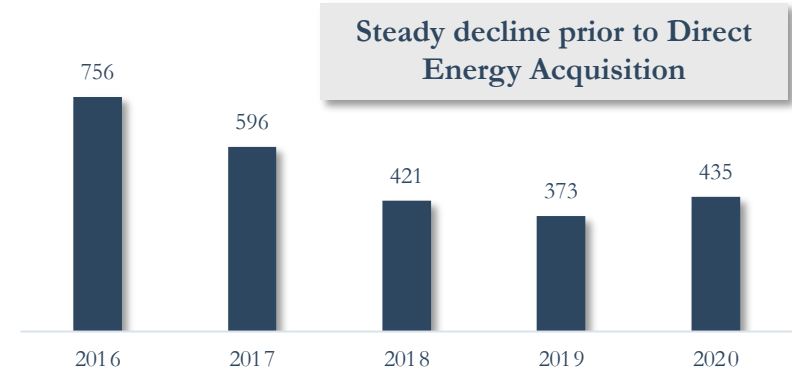
Internal Analysis: Cost Summary

Pivot towards retail business sees strong cost margin growth due to price control

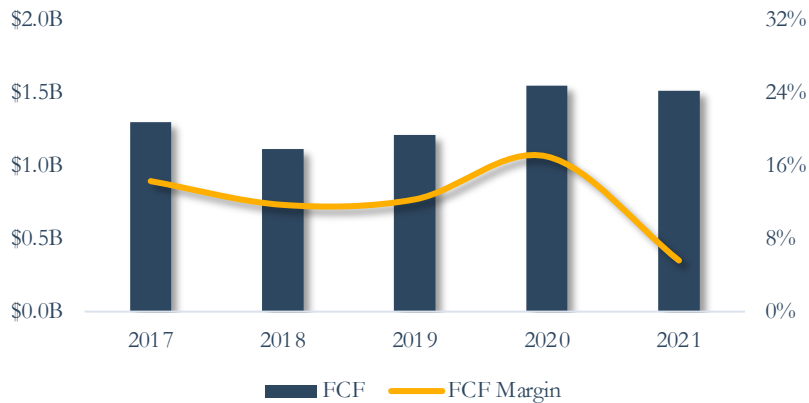
Cost Analysis

- Strategic movement into retail energy market has reduced fixed-costs of storing energy and optimized profit margins
- Acquisition of Direct Energy allows NRG to pass more costs onto consumers, acting as a hedge against future inflationary pressures
- Although 2021 margins are down due to storm winter Uri, NRG is positioned to capitalize off strong future margin expansion due to less competitive retail market

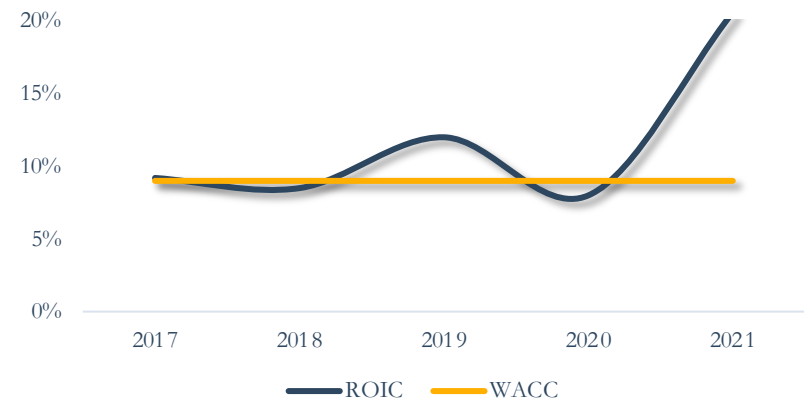
Depreciation



Free Cash Flow



ROIC vs WACC



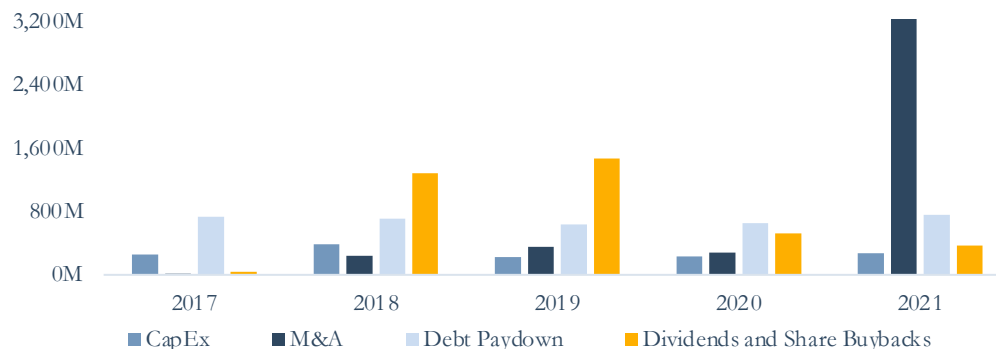
Internal Analysis: Capital Utilization

NRG exercises a strong capital allocation strategy to drive growth and considerable shareholder value

Financial Summary

- NRG's robust FCF margins ensure consistent capital to maintain CapEx and expand operations
- With growth driven by inorganic expansion, NRG has the capital to finance debt and M&A
- Nearly half of all FCF is distributed back to shareholders via dividends and buybacks

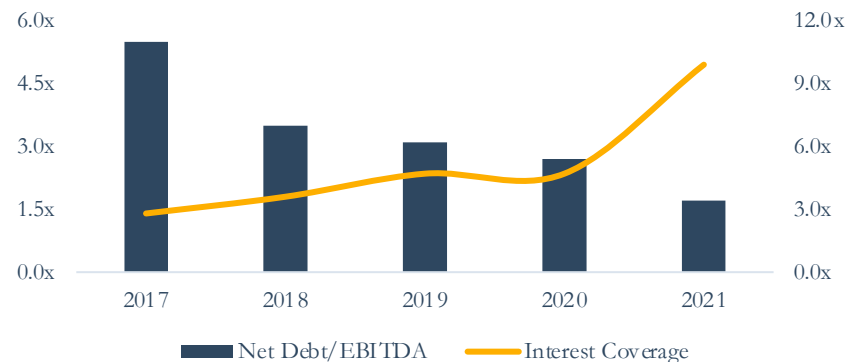
Capital Allocation



Acquisition Criteria

- ✓ Scalable and advantaged operations
- ✓ High retention platforms to aid consolidation
- ✓ Retail competitors with attractive growth
- ✓ Accretive deal opportunities
- ✓ Opportunities to expand retail sales
- ✓ Tuck-ins with high strategic synergy

Interest Coverage and Leverage History



Internal Analysis: Recent M&A History

NRG's recent acquisitions aid in consolidation and entrance into the retail segment

Select Transactions

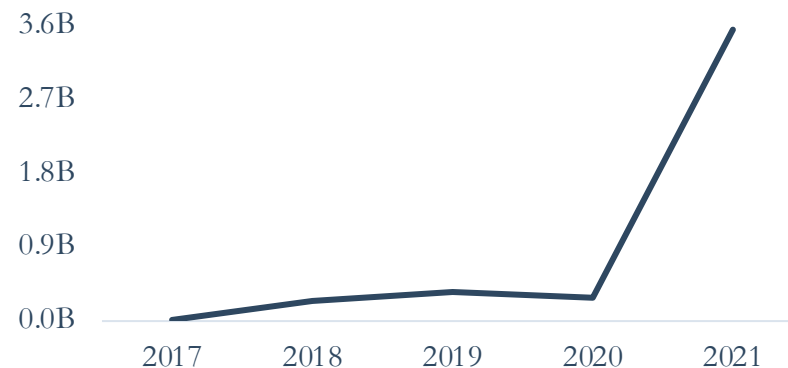


- May 2019
- \$3.6B; 100% stake all cash deal
- Leading US retail energy company acquired, forming NRG as a leading integrated energy and home services offering



- July 2017 + Ongoing Divesture
- \$1.6B equity lost in restructuring + commitment to divest \$4B in bad power generation assets in coming years
- NRG ceded 100% of equity in GenOn following chapter 11 restructuring, spurring a business transformation plan to divest bad generation assets and free up capital to shift towards the retail power segment

Cash Acquisitions



Acquisition Rationale

- NRG acquires attractive assets in the US energy space to expand their footprint in the deregulated space and assist with expansion into new segments
- The company's considerable FCF generation enables to fund a majority of their deals through 100% cash transactions
- NRG's successful M&A history contributes to their strong market positioning and fast onboarding for cash acquisitions

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External Analysis

External Analysis: Retail Sales

The deregulated retail segment remains a highly attractive market compared to energy generation

Segment Overview

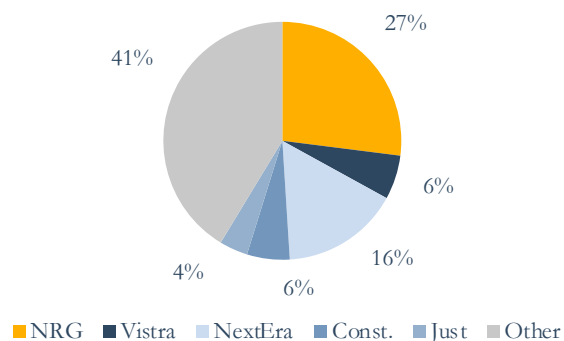
- Retail energy companies purchase energy at wholesale prices and sell it to consumers who can choose from multiple providers
- Attractive margin stability despite “uncertainty” in the deregulated market
- Competition in the space remains a concern for investors however, customer stability remains high driven by reliable offerings from the largest providers

Contract Dynamics

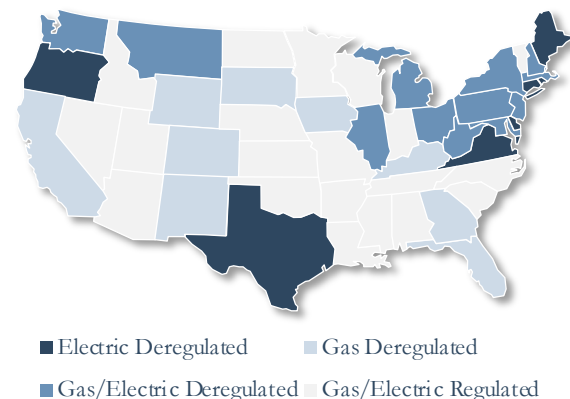
Location	Gas	Electricity
Contract Renewal Rate (%)	85%	75%
Average Customer Lifespan	9 Years	6 Years

Contract dynamic in unregulated sector is much more attractive than regulated utility provider

US Electricity Market Share (2020)



US Deregulated vs Regulated Power Regions



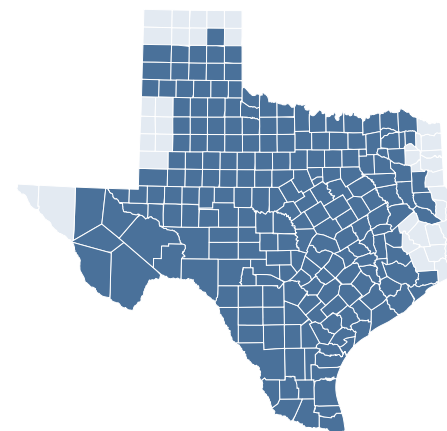
ERCOT Dynamic Analysis

ERCOT places immense stress on Texas energy suppliers through their volatile pricing scheme

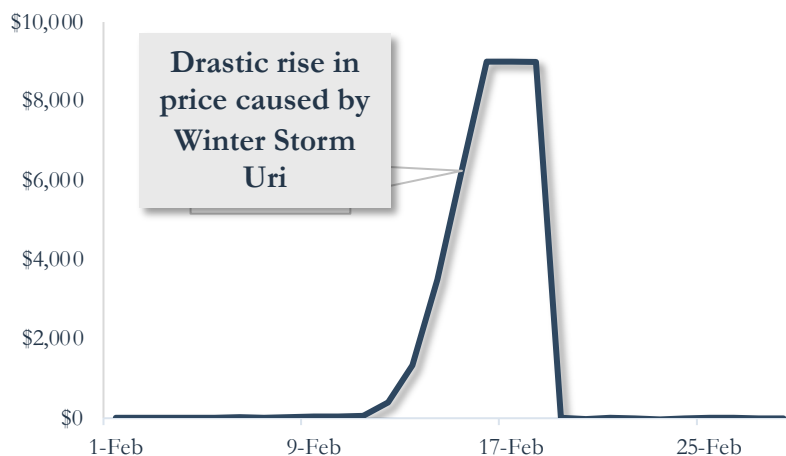
Company Profile

- The Electric Reliability Council of Texas (ERCOT) manages the flow of electric power to ~90% of the state's electric load
- The independent system operator schedules power on an electric grid that connects more than 46,500 miles of transmission lines and 710+ generation units
- ERCOT performs financial settlement for the competitive wholesale bulk-power market and administers retail switching for ~8 million premises

ERCOT Energy Coverage



ERCOT Power Price Volatility (\$/MWh)



Legal Issues

- Following the bankruptcy protection filing from Brazos Electric, ERCOT is under legal pressure
- Brazos Electric argued that ERCOT mismanaged the electric grid, therefore all costs incurred by Brazos and other energy providers should be reversed
- Former ERCOT CEO Bill Magness stated that the decision made by ERCOT was under immense pressure from Texas Gov. Greg Abbott



04

Investment Thesis

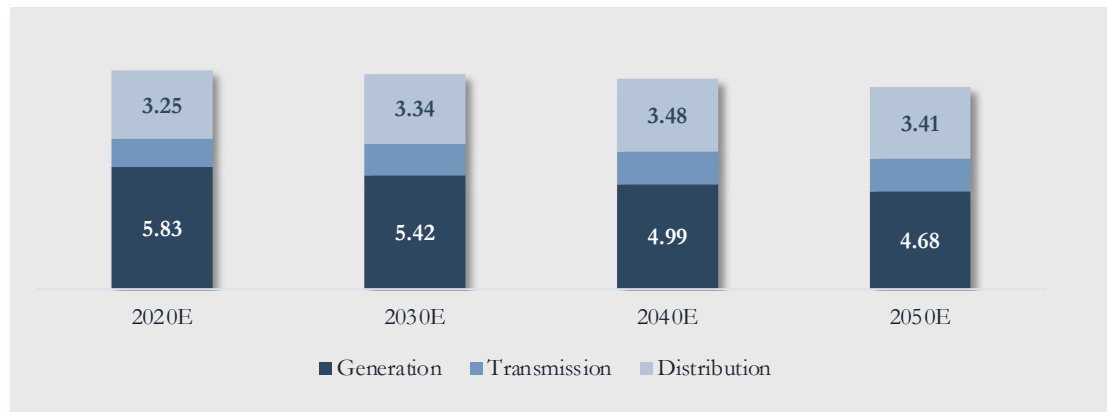
What's Attractive In The Deregulated Energy Sector?

Deregulated power dynamics have shifted, resulting in a riskier generation business if one lacks proper assets

Power Market Dynamics: Generation vs Retail



Price of Electricity Projections (per KWH)



Price of generation expected to be the **main** contributor to electricity price **decreases**, resulting is **lower margins** compared to retail

NRG Energy's "Big Shift"

NRG has been completing their transformation strategy which involves a shift from wholesale generation to the higher margin retail sales

NRG's Transformation

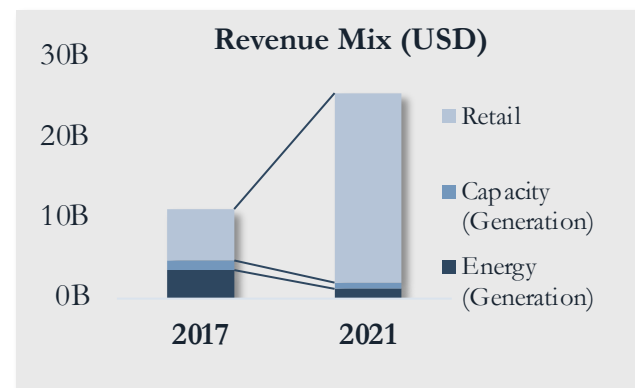
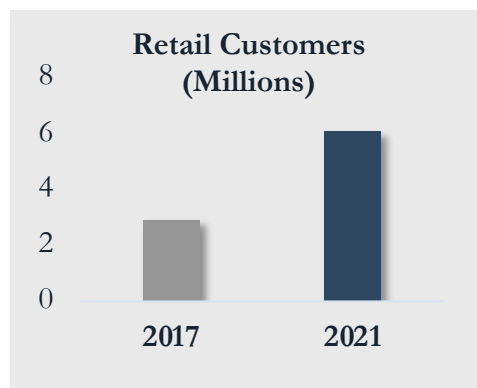
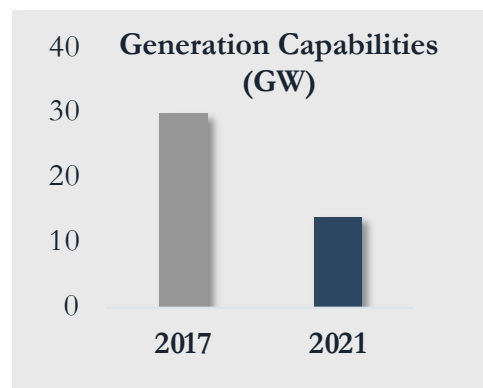
- **NRG's business in generation wholesale has been strategically reduced from 2017**
- The wholesale market boasts volatility and high fixed costs surrounding older assets
- Inefficient legacy generation assets (primarily coal, 27% of portfolio) were getting priced out of auctions, leading to high fixed costs and idling assets

- **Divesting these assets and exiting the wholesale business was the primary goal**
- The idea was to match generation capacity to reach the needs of the retail base, without participating in the less attractive wholesale market



Result: An asset-light, fully integrated retail power business less susceptible to price shocks and wholesale auctions

Generation to Retail

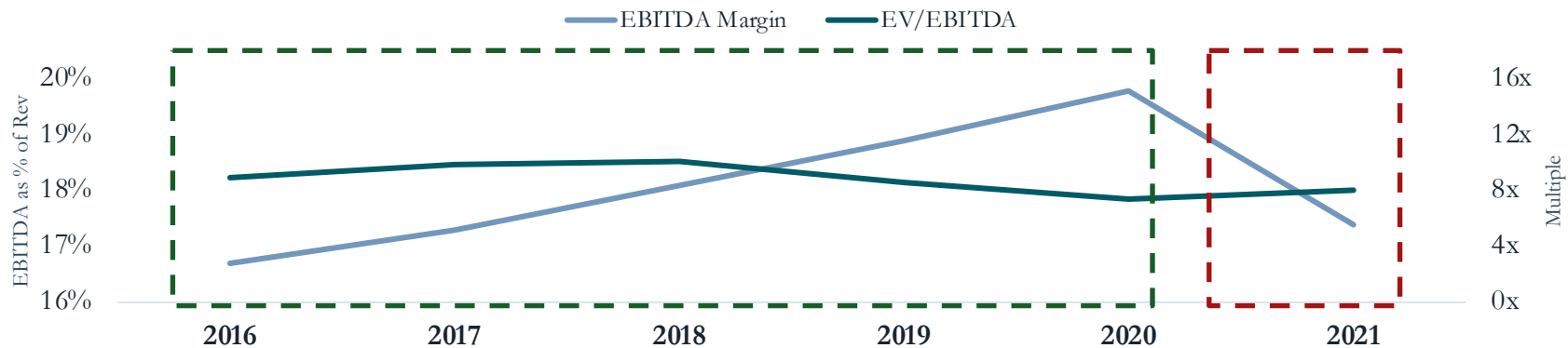


Perfect Storm Shrouds Attractive Business Transformation



This fundamental shift in business structure is yet to receive appropriate multiple rerate

Underappreciated Economic Transformation of Business



Shift Increases Margins

Margins increase as the business shifts from generation to retail, with no apparent reward to its stock; likely due to concerns with a successful transformation

Street continues to treat NRG as a generation wholesale business

Winter Storm Uri Strikes Texas

Storm Uri was an unprecedented winter storm in February 2021 that affected several regions across the US, particularly Texas

The storm resulted in a hit to EBITDA of roughly 400M USD

Coal-Related Supply Chain Costs

With unexpected rise in NG prices during the year, forced a one-time flex up on coal generation to bridge generation gaps

Result is a 100M one-time hit to EBITDA

40% of this effect is expected to be divested by the end of 2022 even if this is not temporary

Bottom Line: NRG's transformation from generation to retail has been largely unappreciated by street primarily due to several one-time costs that have clouded the underlying margin and FCF improvements. Although multiples should **not** be at a **regulated utility's**, positive rerate is expected



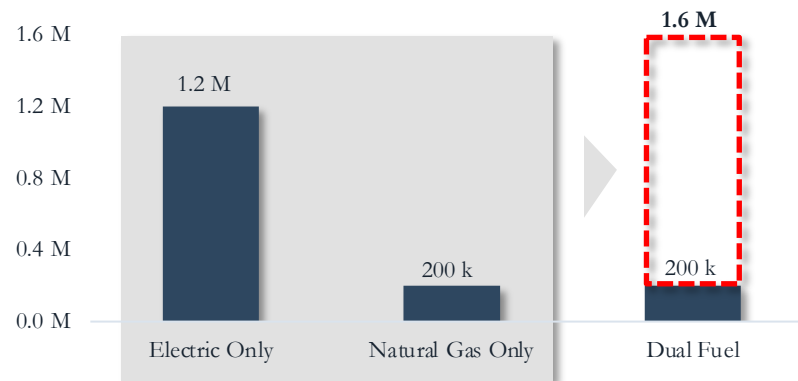
Cross-selling Opportunity is Undersold

Direct Energy acquisition is an underrated opportunity to grow core business within current clients

Direct Energy Acquisition

- True cost and cross-selling synergies potential have not been realized by investors due to one-time events:
 - Coal production issues
 - Storm Uri
 - Change in revenue recognition policy
- Estimated to double percentage of integrated customer share by 2025

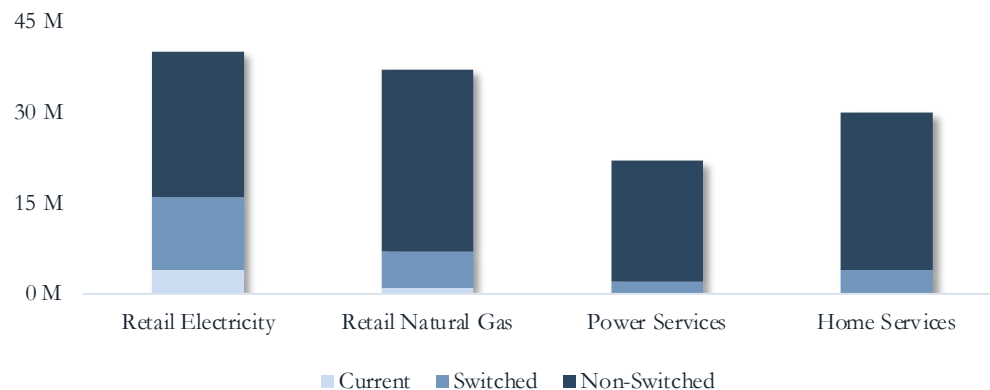
Dual Fuel Opportunity in Existing Customers



Penetration in Core Offerings

Superior Net Promoter Score (NPS) indicates strong likelihood of success in expanding Direct Energy's market share in the East:

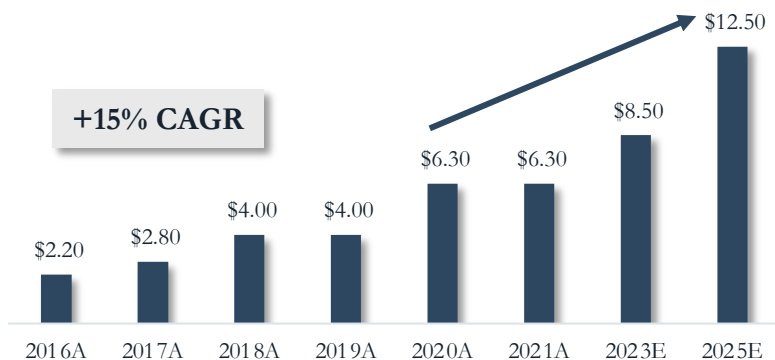
- NRG Home brands: **45-70**
- Leading regulated utility: **10-15**



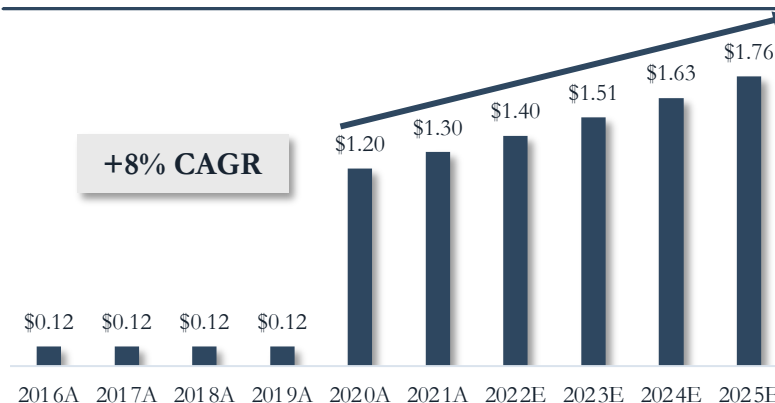
Free Cash Flow Use Reframes Risk

Dividends and share buybacks improve the risk-reward profile of holding NRG in the long-term

FCF per Share Growth



Dividend Growth



Importance of FCF Changes

- Consistent dividends reduces investment risk for NRG
- Management has indicated **69%** of 2022 estimated capital will go solely to returning value to shareholders
- 50/50 strategy of opportunistic investment and return of capital which guarantees on top of dividends:
 - Investment at greater of **12-15%** unlevered pretax return and hurdle rate
 - Share repurchases

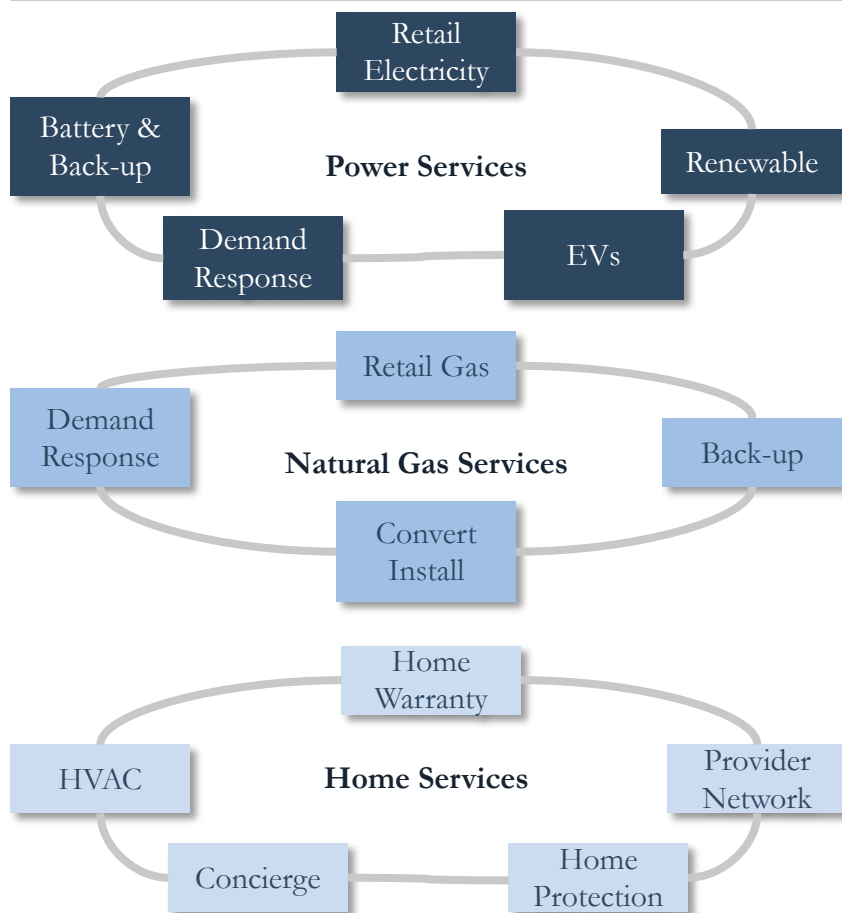
Reflection in Financial Performance

- Resistance to commodity price changes:
 - 2021 EBIT margins (**13%**) stayed consistent despite service disruption in Texas due to Storm Uri
 - Power prices increased an average of **595%** during this time
- Strong margins in relation to competitors:
 - 2021 EBIT margins drop to **-12%** during the same period for Vistra Corp

Product Offering Keeps FCF Thriving

Investment in product offering indicate that FCF conversion should stay stable long-term

Developing a One-Stop Product Offering



Evidence in Retention

- Durable customer relationships
 - Renewal win rate: **85%** (Gas) and **75%** (Power)
 - Average customer relationship: 9 yrs (Gas) and 6 yrs (Power)
- Upselling capabilities and their impact:
 - Add up to \$800 in value/customer on top of \$250/customer for new single product customers

Best-in-Class Execution

Support



- Flexible billing
- Individualized product offerings

Sales



- Sales close under 22s
- 80% renewals over 12 months

Experience



- 71% enrolled in online tools
- 50+ touchpoints

05

Valuation

Valuation: Multiples & DDM

Multiple valuation shows upside of 87.9% with 13.4% IRR

Multiples & DDM

EV/EBITDA			
	Bear	Base	Bull
2026 EBITDA	\$2,204	\$2,740	\$2,783
Multiple	7.0x	9.2x	11.0x
Enterprise Value	\$15,431	\$25,208	\$30,608
Net Debt	(\$7,716)	(\$7,716)	(\$7,716)
Equity Value	\$7,715	\$17,492	\$22,892
Shares	245	245	245
Value / Share	\$31.49	\$71.39	\$93.44
Implied Upside	(17.1%)	87.9%	146.0%
5-Year IRR	(3.7%)	13.4%	19.7%

DDM			
	Bear	Base	Bull
Terminal Value	\$14	\$92	\$95
Discounted Terminal Value	\$9	\$59	\$61
Implied Share Price	\$13	\$81	\$85
Discount/(Premium)	(65.8%)	114.5%	123.6%

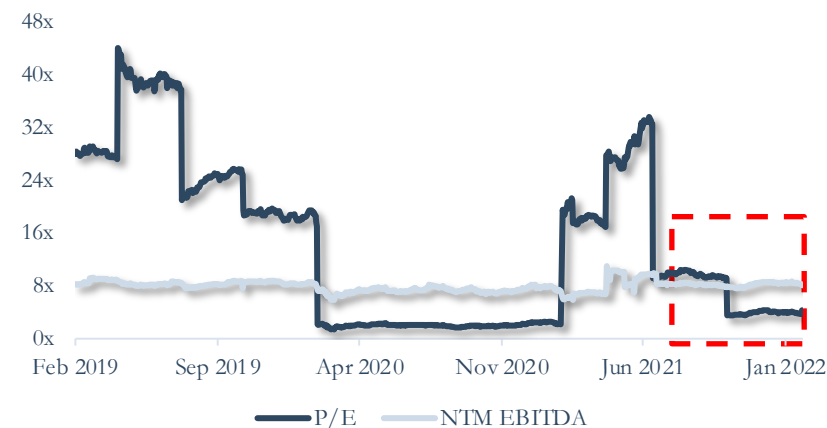
Risk / Reward	n/a	1.7x	1.9x
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Multiple valuation/DDM model projects favorable upside with attractive risk/reward profile. Multiple re-rate to NRG's pre-Storm Uri level is a conservative projection.

Key Assumptions

Key Driver Assumptions					
	2022E	2022E	2023E	2024E	2025E
Texas Power Price (\$/MWh)	\$ 103.75	\$ 103.75	\$ 104.00	\$ 104.00	\$ 104.00
<i>Rationale: After Storm Uri and spike in energy price in 2022, we are projecting power price to restabilize to pre-pandemic level around \$103-104/MWh level</i>					
Cost of Fuels As % Of Rev	30.9%	30.9%	30.0%	30.0%	30.0%
<i>Rationale: Superior margin for their retail segment in Texas is projected as their generation/retail hybrid model guarantees lower cost to meet the existing retail demand</i>					
West Retail Sales Vol Growth	7.6%	5.0%	5.0%	5.0%	5.0%
<i>Rationale: Recent geographic expansion to West region in NRG's retail business will foster top-line growth in their high-margin segment for the forecasted period</i>					

Multiple Contraction



Valuation: Illustrative Holding Period

Adjusting conservative dividend yield, investing in NRG reveals 23.6% IRR for 5-year holding period

Dividend-adjusted Illustrative IRR

5-Year Holding Period

	May-22	2023E	2024E	2025E	2026E	2027E
Outflows						
1 Share @ 37.99	(37.99)					
Inflows						
Dividends		\$ 5.28	\$ 5.28	\$ 5.69	\$ 6.10	\$ 6.51
Price at Sale						71.39
Net Change in Cash Flow	-	(37.99)	5.28	5.28	5.69	6.10
						77.90

IRR

26.86%

Returning Capital To Shareholder

- Due to the shift dynamic for NRG as generation/retail hybrid, less intensity in maintenance CapEx spend allowed NRG to actively return capital to shareholders
- Management has disclosed its initiative to resume buyback program with an allocated budget of \$1B for 2022
- Moving forward, the projection illustrates conservative dividend yield and models future share buyback that shows strong IRR

Dividend Build

	Dividend Build				
Fiscal Period ending weeks	Year 1 Feb-24	Year 2 Feb-24	Year 3 Feb-24	Year 4 Feb-24	Year 5 Feb-24
	52.1	52.1	52.3	52.1	52.1
Discount Factor	0.92	0.84	0.77	0.70	0.64
Revenue	19,916	20,676	21,367	22,289	23,263
EBIT	1,770	2,406	1,836	1,936	2,042
NOPAT					
Add: D&A	597	620	641	669	698
Less: Capital Expenditures	(239)	(248)	(256)	(267)	(279)
Less: Change in NWC	(624)	(326)	213	(16)	(16)
Unlevered Free Cash Flow	1,504	2,453	2,434	2,321	2,445
<u>Dividend</u>					
Dividend Per Share	\$ 5.3	\$ 5.3	\$ 5.7	\$ 6.1	\$ 6.5
Discounted Cash Flow	\$ 4.8	\$ 4.4	\$ 4.4	\$ 4.3	\$ 4.2



Comparable Companies Analysis

NRG currently trades in line with unregulated peers despite business transformation; steep discount remains compared to regulated utilities

Comparable Companies Analysis

Company	General			Trading		
	Share Price	Mkt Cap	EV	NTM EV/Rev	NTM EV/EBITDA	NTM P/E
Regulated Utilities						
The Southern Company (NYSE:SO)	\$65.0	\$68,957.1	\$127,351.1	5.57x	12.64x	18.36x
American Electric Power Company, Inc. (NasdaqGS:AEP)	\$89.5	\$45,106.8	\$81,889.6	4.85x	11.78x	17.98x
PG&E Corporation (NYSE:PCG)	\$11.4	\$22,553.8	\$68,682.8	3.22x	8.33x	10.34x
DTE Energy Company (NYSE:DTE)	\$122.0	\$23,627.3	\$41,858.3	3.08x	12.23x	20.59x
Duke Energy Corporation (NYSE:DUK)	\$100.2	\$77,069.2	\$148,741.2	5.66x	12.12x	18.34x
Exelon Corporation (NasdaqGS:EXC)	\$42.6	\$41,676.3	\$83,313.3	4.73x	11x	18.95x
Edison International (NYSE:EIX)	\$62.4	\$23,716.6	\$56,737.6	3.76x	9.84x	13.72x
Xcel Energy Inc. (NasdaqGS:XEL)	\$67.2	\$36,587.5	\$61,183.5	4.65x	12.47x	21.15x
Mean				4.4x	11.3x	17.4x
Median				4.7x	12.0x	18.4x
Unregulated Power						
Vistra Corp. (NYSE:VST)	\$21.9	\$10,569.5	\$22,096.5	1.34x	6.96x	14.5x
Entergy Corporation (NYSE:ETR)	\$105.6	\$21,396.1	\$48,323.2	4.19x	11.27x	16.65x
Mean				2.8x	9.1x	15.6x
Median				2.8x	9.1x	15.6x
NRG Energy, Inc. (NYSE:NRG)	\$38.0	\$9,199.4	\$17,236.4	0.81x	8.06x	9.12x

NRG currently trades **in line** with **unregulated** power companies, despite **shedding excess generation** assets that other peers continue to operate. NRG trades at a **steep discount** compared to **regulated peers**, although multiple gap may be undeserved given their business shift to an **integrated power model**, providing higher margins and greater stability, similar to regulated utilities.

06

Risks & Mitigations

Risks & Mitigations

Several risks could have adverse implications on the value and success of NRG

Details

Mitigation

High Debt Load

- NRG has about \$8.29B of debt due to their recent acquisition of Direct Energy which could have negative effects on its future growth

- NRG has been consistently paying down their debt. Their recent divesting efforts will free up substantial amounts of capital and be able to pay off its debt over time

Low Interest Coverage

- NRG has a current interest coverage ratio of 7.7x. Inability to cover their interest expenses in the future may put them in financial distress

- NRG has grown after expanding into retail, with revenue growing +196.9% YoY. Consistent revenue growth should position NRG to comfortably cover their interest expenses

Retail Segment Transfer Failure

- Failure to successfully integrate into the retail sector could heavily disrupt the company's future wellbeing, rendering its efforts futile

- Successful acquisition of Direct Energy has propelled NRG into the retail space, with 2/3 synergies already realized. Management should continue its trend of obtaining good acquisition and expansion opportunities

Environmental Concerns Over Current Generation Profile

- NRG's generation profile emitted 27,728,489 metric tons of CO₂ in 2020. Keeping their emissions levels consistent will risk them facing social backlash and consumer avoidance

- NRG's retail transition will increase its renewable energy output and lower its carbon emissions. NRG was a recipient at 2021 SEAL Business Sustainability Awards

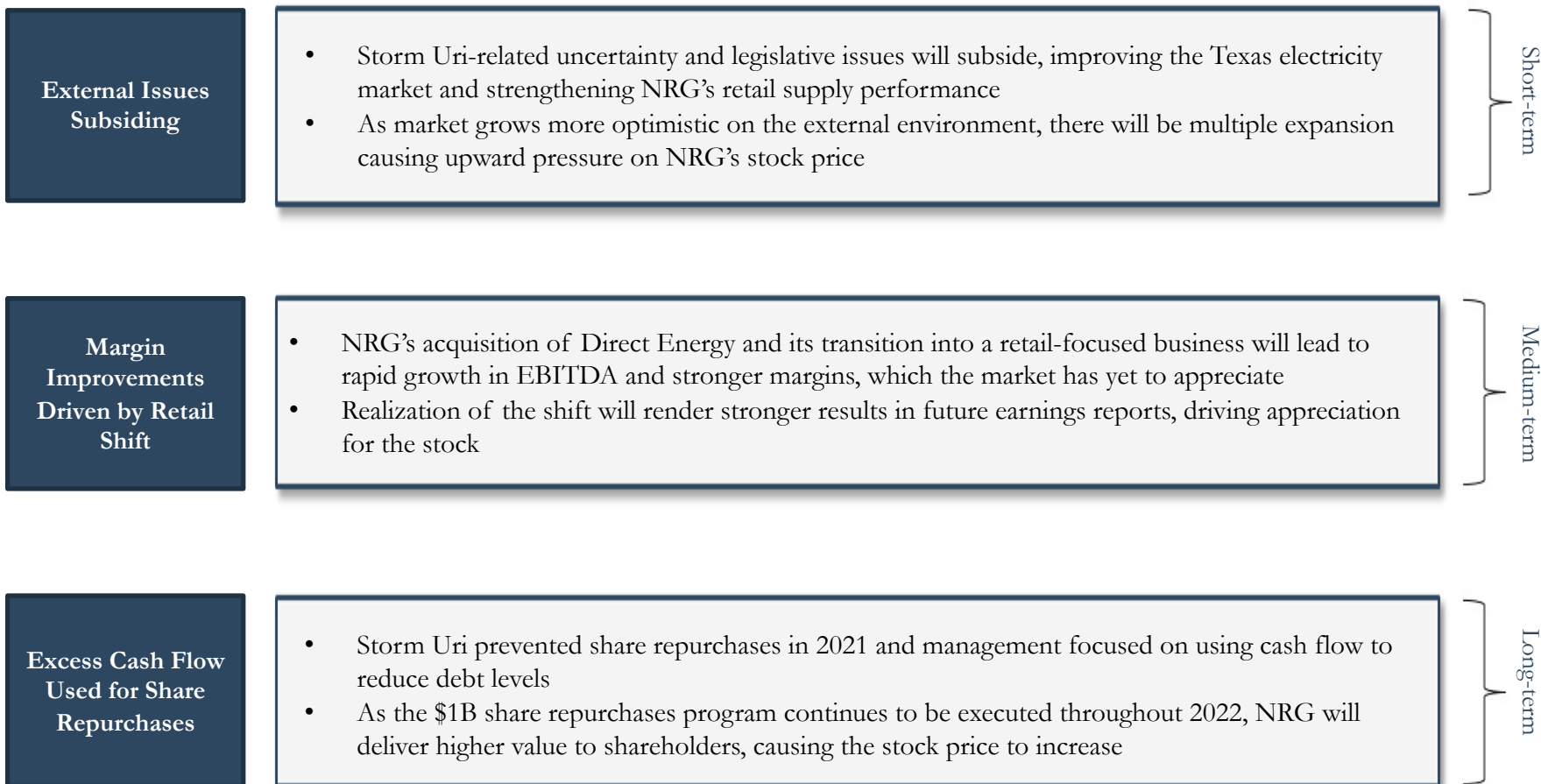


07

Catalysts

Catalysts

This realization will take place through external issues subsiding, multiple rerating, and share buyback program



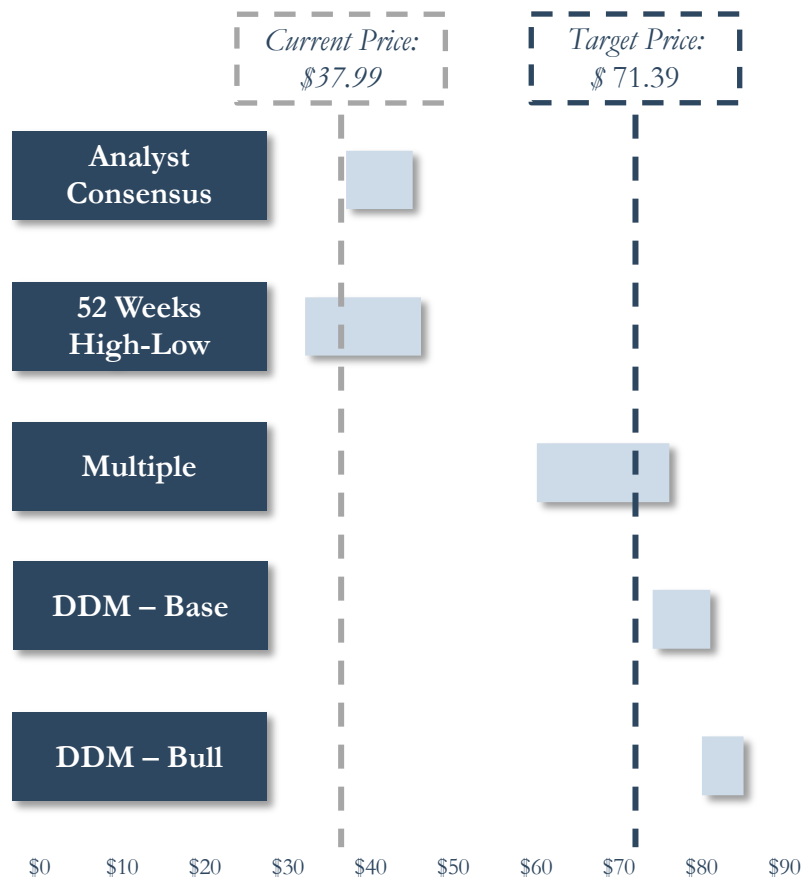
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Investment Summary

Recommendation

Buy recommendation for NRG at \$37.99 for an implied upside of 87.9%

Valuation Range



Base Case Sensitivity

WACC	Terminal Year Dividend Growth				
	1.0%	1.5%	2.0%	2.5%	3.0%
7.2%	\$98.2	\$105.2	\$113.5	\$123.6	\$136.1
8.2%	\$84.3	\$89.2	\$94.9	\$101.6	\$109.6
9.2%	\$73.7	\$77.3	\$81.5	\$86.2	\$91.7
10.2%	\$65.5	\$68.2	\$71.3	\$74.8	\$78.8
11.2%	\$58.9	\$61.0	\$63.4	\$66.1	\$69.0

WACC	Terminal Year Dividend Growth				
	1.0%	1.5%	2.0%	2.5%	3.0%
7.2%	\$98.2	\$105.2	\$113.5	\$123.6	\$136.1
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Recommendation

**Buy Recommendation for NRG Energy, Inc
(NYSE:NRG) at \$37.99**

Implied Upside: 87.9%



9

Appendix

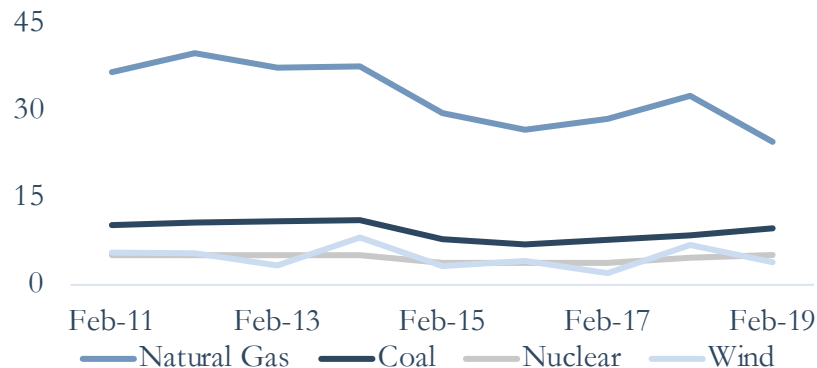
Appendix: Storm Uri

Extreme winter storms in February 2021 caused troubles for NRG's Texas business

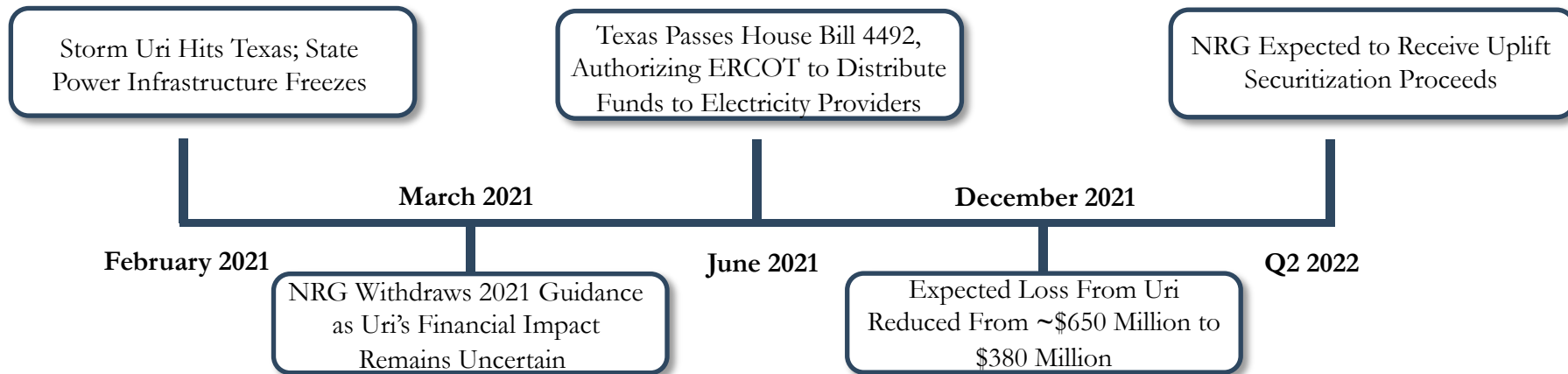
Overview

- In February 2021, a winter storm hit parts of North America and caused widespread failures of the power grid and water supply, particularly in Texas
- ERCOT had grossly underestimated the amount of electricity needed during the storm and major power sources were not equipped for the cold and icy conditions
- Between February 14-20, over two-thirds of Texans lost power at some point, contributing to 210 deaths

Power Generation in ERCOT Region (GWh)



Timeline



Appendix: Management Overview

Mauricio Gutierrez & Elizabeth Killinger lead NRG into a new retail era

Mauricio Gutierrez (President & CEO)

- Holds a bachelor's degree in industrial engineering from the Universidad Panamericana and two master's degrees - one in mineral economics from the Colorado School of Mines and one in petroleum economics from the French Petroleum Institute
- joined NRG in 2004 as a Portfolio Director before becoming a VP of Trading, Executive VP of Commercial Operations, the COO and eventually the CEO in 2015
- Mauricio has held several senior positions at energy merchant Dynegy and consulting firm DTP in Mexico City.

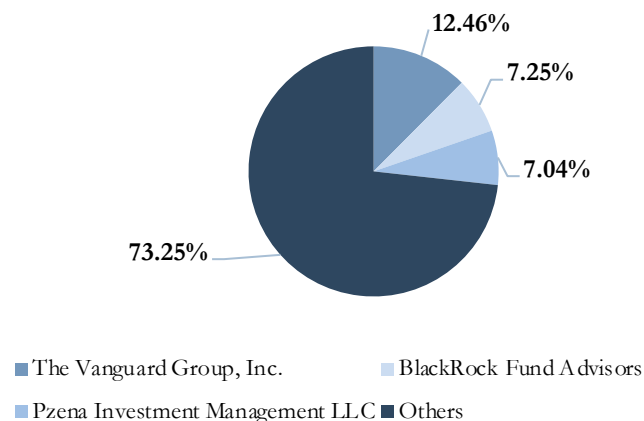
Elizabeth Killinger (EVP & NRG Home President)

- Graduated from University of Houston with a BBA in Management Information Systems
- Worked in oilfield services, software development, and management consulting before joining NRG in 2002
- Responsible for leading NRG's \$6 billion Customer division including Reliant Energy and NRG's other brands
- Played a key role in the company's "Era of Personal Power" and transition to competitive electricity markets with customer service at its core

Others in Senior Management

		
<u>Brian Curci</u>	<u>Chris Moser</u>	<u>Alberto Fornaro</u>
EVP, Legal and General Counsel	EVP, Operations	EVP and Chief Operating Officer

Main Shareholders



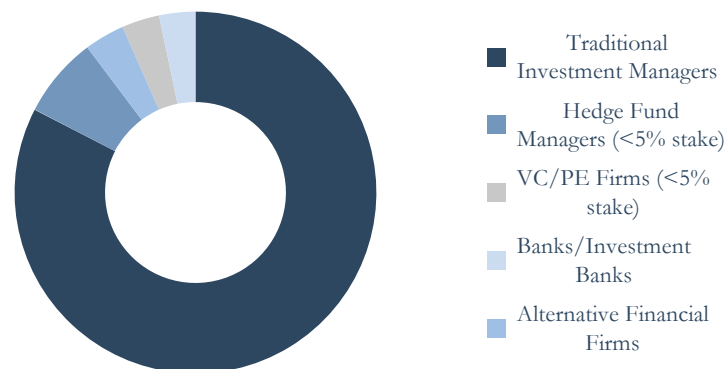
Appendix: Investor Profile

Large institutional investors continue to hold NRG Energy shares, and some have increased their portfolio

Ownership Summary

- Institutional ownership is over **98.9%**
- Individuals and Insider ownership sits at 0.284%
- State Owned Shares make up 0.04% of ownership
 - Large number of institutional owners means shareholder base is strong and investors are confident in the long-term performance of NRG Energy stock

Institutional Ownership



Current Top Holders Activity

