KGEN POWER CORPORATION

ANNUAL REPORT

For the Fiscal Year Ended June 30, 2008

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TABLE OF CONTENTS

PART I

Number 1.	Business	4
Number 1A.	Risk Factors	12
Number 2.	Properties	21
Number 3.	Legal Proceedings	21

PART II

Number 4.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	21
Number 5.	Selected Financial Data	22
Number 6.	Management's Discussion and Analysis of Financial Condition and Results of Operation	23
Number 7.	Quantitative and Qualitative Disclosures about Market Risk	33
Number 8.	Financial Statements and Supplementary Data	35

PART III

Number 9.	Directors, Executive Officers and Corporate Governance	61
Number 10.	Certain Relationships and Related Transactions, and Director Independence	64

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

The discussion in this report contains certain forward-looking statements that involve risks and uncertainties. We have based these forward-looking statements on our current expectations and assumptions about future events. In some cases, you can identify forward-looking statements by terminology, such as "may," "should," "could," "predict," "potential," "continue," "expect," "anticipate," "future," "intend," "plan," "believe," "estimate," "forecast" and similar expressions (or the negative of such expressions). Forward-looking statements include statements concerning known and unknown risks, uncertainties and other important factors that could cause actual results, performance or achievements of KGen and its subsidiaries to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Forward-looking statements are based on our beliefs as well as assumptions based on information currently available to us, including financial and operational information, current competitive conditions, and anticipated demand for electricity. As a result, these statements are subject to various risks and uncertainties. For a discussion of material risks and uncertainties that the Company faces, see "Number 1A. *Risk Factors*" in this Annual Report. Important factors that could cause actual results to differ materially include, but are not limited to, the following:

- the Company's exploration of strategic alternatives;
- the timing and extent of changes in commodity prices, particularly natural gas;
- the liquidity and competitiveness of wholesale markets for electricity;
- economic slowdowns and cooler-than-expected weather during our peak operating months that can adversely affect consumption of electricity by businesses and consumers;
- uncertainties that actual costs may be higher than estimated;
- uncertainties that actual sources may be lower and actual uses may be higher than estimated;
- refusal by or inability of our current or potential counterparties or vendors to enter into transactions with us or fulfill their obligations to us;
- effectiveness of our risk management policies and procedures;
- our ability to obtain credit or capital in desired amounts and/or on favorable terms;
- our ability to operate our power plants efficiently, manage capital expenditures and costs tightly, and generate earnings and cash flow from our asset-based businesses;
- present and possible future claims, litigation and enforcement actions;
- effects of the application of regulations, including changes in regulations or the interpretation thereof;
- disruptions in the transmission and distribution of power;
- availability of fuel and fuel transportation; and
- catastrophic events such as fires, hurricanes, explosions, floods, lightning strikes, terrorist attacks or other similar occurrences to our facilities or to facilities upon which we depend.

Part I

Number 1. ***Business***

Overview

We own and operate electric power generation plants and sell electricity and electrical generation capacity in the United States. We sell power and related products to wholesale purchasers such as retail electric providers, power trading organizations, municipal utilities, electric power cooperatives and other power generation companies. As of June 30, 2008, our portfolio consisted of five operational and fully permitted power plants, or the Plants, located in the southeastern United States with state-of-the-art General Electric 7FA and 7EA gas turbines having an aggregate capacity of 3,030 megawatts, or MW. The Plants include four combined-cycle plants (Murray I, Murray II, Hot Spring and Hinds) and one simple-cycle plant (Sandersville). We acquired the Plants from an affiliate of MatlinPatterson Global Advisors LLC, or MatlinPatterson, on February 8, 2007. Although our operations commenced with our acquisition of the Plants on February 8, 2007, the Plants were operated in the same manner and substantially all of the management team for the Plants transferred to us with the assets acquired. For ease of reference, we present operating and financial information for the Plants as owned by MatlinPatterson and by us on a combined basis in "Number 6. *Management's Discussion and Analysis of Financial Condition and Results of Operations*."

All of our Plants are located in the southeastern United States. Under the current market conditions in the southeastern United States region, where regional utilities control the dispatching order, our combined-cycle facilities historically have run between 10% and 35% annual capacity. We expect the electric power market in the southeastern United States region to return to equilibrium in the 2010-2014 timeframe as the electricity demand growth in the region continues. We believe this demand growth and the advent of more transparent and economic dispatch of regional system assets should result in increasing capacity demand, dispatch profile and improved profitability for the Plants.

Four of the Plants currently operate as merchant power providers. The remaining plant, the Murray I combined-cycle plant, benefits from a fixed-price long-term power purchase agreement, or the GPC PPA, for all of its 630 MW of capacity with Georgia Power, a subsidiary of The Southern Company. The GPC PPA, which continues through May 2012, provides for fixed capacity payments, which have provided stable cash flow. The Company recognized $49.8 million and $15.7 million related to capacity sales on the GPC PPA for the year ended June 30, 2008 and for the period February 8, 2007 through June 30, 2007, respectively. In June 2008, KGen Sandersville LLC executed a power purchase agreement with Southern Power Company that commences in June 2011 and continues through December 2015.

Our Strategy

Our strategy includes the following elements:

- ***Disciplined and opportunistic commercial strategy.*** We plan to sell energy and capacity into markets when pricing is most attractive. We currently sell and deliver our merchant energy primarily in the short-term, day-ahead or real-time markets to maintain our flexibility and to be able to participate in the anticipated continuing market recovery. We are pursuing potential transactions for longer terms in instances where the pricing of such transactions would enable us to increase the value of our assets and is consistent with our views of the anticipated market recovery.

- ***Focus on operational efficiency and excellence.*** We focus on maintaining and enhancing our plant availability and operational reliability to take advantage of market opportunities. We are committed to operating the Plants in a safe, reliable and environmentally-compliant manner. We maintain lean staffing at our corporate and plant levels and employ strategic outsource partners to enhance our energy marketing, gas supply, plant operations and maintenance functions and to increase the

economic efficiency of our operations and benefit from our partners' scale, experience and credibility. We seek to align the interests of our outsource partners through proper incentives.

Exploration of Strategic Alternatives

On April 11, 2008, the Board announced that it had retained Credit Suisse to evaluate all of the Company's options for enhancing shareholder value going forward including the sale of the Company, sale of individual assets, potential business combinations, and continuing to enhance the value of our existing assets. On May 6, 2008, our Board announced that it is committed to exploring any and all strategic alternatives to maximize the value of the Company. Our process of exploring strategic alternatives is ongoing.

Our Power Plants

KGen Plants

Plant	Location	Turbines	Heat Rate(1)	Total Capacity (MW)(2)	Commercial Operation Date
Combined-Cycle Plants					
Murray I	Murray County, Georgia	7FA	7,250	630	June 2002
Murray II	Murray County, Georgia	7FA	7,250	620	June 2002
Hot Spring	Hot Spring County, Arkansas	7FA	7,150	620	June 2002
Hinds	Hinds County, Mississippi	7FA	7,000	520	May 2001
Simple-Cycle Plant					
Sandersville	Washington County, Georgia	7EA	12,150	640	June 2002
Total				3,030	

(1) Approximate heat rate at full-load summer operation without supplemental firing.

(2) Nominal operating capacity.

The Plants are strategically located within SERC such that, with a market recovery, they should be able to take advantage of their locations to generate high financial returns. They are also located with strategic access to the natural gas system, providing broad access to suppliers. In addition, the Plants have access, via wheeling, to other regional markets.

Our Operations

Our management includes a core group of industry veterans who direct and implement our strategy. We have leveraged the capabilities of this core team by using third-party outsource providers to manage and maintain our facilities and to assist in marketing our capacity and energy.

The Plants are operated pursuant to operation and maintenance agreements with Duke Energy Generation Services, or DEGS. DEGS provides operations, certain accounting, human resources, engineering, environmental, health and safety compliance, and other services for the Plants. Many of the DEGS personnel at the Plants have worked there since the Plants commenced operations. DEGS utilizes its own personnel, supplemented by outside contractors on an as-needed basis, to perform such services. DEGS also provides, when requested, technical and commercial services, health and safety services, and human resources support for plant employees. We also engage various entities for the maintenance and transportation of our natural gas supplies.

The energy management services for the power and capacity of the Plants are provided by Fortis Energy Marketing & Trading GP, or Fortis. The services provided by Fortis include seeking purchasers for our merchant power sales and handling our natural gas purchases to meet operating needs for electricity placed through Fortis and providing administrative services for the tracking of power sales and gas purchases. Our natural gas needs under the GPC PPA are arranged by Sequent Energy Management L.P., or Sequent, under a long-term agreement. Under our energy management arrangements with Fortis, we are able to use Fortis' balance sheet through back-to-back sales which streamlines our sales process and allows us to enter into transactions that we might not otherwise be able to enter.

All of the Plants began operations in May 2001 or June 2002. Since inception our combined-cycle plants have been maintained pursuant to long-term service agreements, or LTSA's, with General Electric International, or GEI. Average availability at the Plants was 91.2% for the year ended June 30, 2008. The Plants are fully operational with all required permits, transmission interconnections, and gas transportation access. In addition, the use of standardized equipment in the Plants creates economies of scale with respect to operations and maintenance, spare parts, and capital equipment inventory.

Effects of Seasonality

The electric power industry is highly seasonal. In the summer months, especially in the southeastern United States, demand for electricity is usually much higher as a result of increased use of air conditioning. The Company's results of operations are subject to seasonal variations since demand for electricity, and thus production capacity, varies with weather conditions. Four of the plants operate on a merchant basis without long-term purchase agreements, and therefore are exposed to significant volatility in prices and generation demand. The Company earns the majority of its annual revenues in the five summer months, May through September. The shoulder periods, months other than the peak summer months, historically have not been profitable for the Company and are the months during which the Company seeks to perform scheduled maintenance related activities.

Principal Customers

Currently, Georgia Power is our most significant customer, with payments by it under the GPC PPA accounting for approximately 31.0% and 40.0% of our revenues for the years ended June 30, 2008 and 2007, respectively. Most of our remaining sales are merchant sales made through Fortis on a back-to-back basis, which are approved by us. Entergy Services and The Southern Company represent the principal ultimate customers of merchant sales made through Fortis, representing more than 75% of such merchant sales.

Power Transmission

Our Murray I facility is interconnected to the Georgia Integrated Transmission System, or GITS, at the Conasauga 500 kilovolt, or kV, substation pursuant to a long-term interconnection agreement with Georgia Power. Murray II interconnects at the 230 kV Loopers Farm switching station with (i) the GITS pursuant to a long-term interconnection agreement with Dalton Utilities and (ii) the Tennessee Valley Authority, or the TVA, transmission system pursuant to a long-term interconnection agreement with TVA.

Our Hinds facility is interconnected to Entergy Services' transmission system at the 230 kV Lakeover substation pursuant to a long-term interconnection agreement with Entergy Mississippi.

Our Hot Spring facility is interconnected to Entergy Services' transmission system at the 500 kV Etta substation pursuant to a long-term interconnection agreement with Entergy Arkansas.

Our Sandersville facility is interconnected to the GITS at the 500 kV Warthen substation pursuant to a long-term interconnection agreement with Georgia Power.

Gas Supply

Our source of fuel to generate electricity is natural gas and we purchase gas generally on a short-term basis, primarily on a day-ahead basis. Even when we have entered into longer term gas purchase agreements of up to 30 days, we generally have had pricing that is based on the spot natural gas price index. In this way, we seek to match our electricity pricing exposure, as our sales are generally made on a day-ahead basis.

One major committed source of natural gas is an agreement with Sequent, which provides natural gas supplies to our Murray I plant and provides us the benefit of the Sequent's credit in connection with such purchases. Our fuel supply agreement with Sequent has a term ending May 31, 2012, the date on which the GPC PPA terminates. To minimize risk, the gas price from Sequent is a day-ahead gas price calculated using an index formula similar in basis to gas pricing under the GPC PPA. Sequent provides firm gas supply sufficient to supply the requirements for Murray I. Sequent delivers natural gas to a pipeline receipt point from which we have firm long-term contracts with East Tennessee Natural Gas Company sufficient for all deliveries from Sequent to Murray I.

Natural gas is delivered to our Hinds facility through a 2.5-mile pipeline interconnected to Texas Eastern Transmission Corporation, or TETCO. We have gas transportation contracts with TETCO, subject to evergreen renewals every two years, unless a notice of cancellation is provided by either party, that provide firm capacity of 80,000 decatherms per day, or Dth/day, in our summer peak period and lesser amounts in the other parts of the year and provide interruptible capacity of 100,000 Dth/day year round.

At our Hot Spring facility, natural gas is delivered through a lateral pipeline interconnected to CenterPoint, a subsidiary of CenterPoint Energy, Inc. We have long-term pipeline transport contracts with CenterPoint that provide firm capacity of 98,000 Dth/day in our summer peak period and 50,000 Dth/day in the other parts of the year and provide interruptible capacity of 50,000 Dth/day for the year round.

We do not have any firm pipeline transport contracts in place for our Sandersville facility. We can have natural gas delivered to Sandersville through an interconnection with Southern Natural Gas Company, a subsidiary of El Paso Gas Company, with which we have secured monthly interruptible transportation services.

Competition

Since our Murray I plant is subject to a long-term unit contingent contract with Georgia Power and is a designated network resource to Georgia Power, we will not face substantial competition with respect to the sale of the Murray I plant's capacity until termination of the contract, or 2012. The remaining plants in our portfolio currently operate on a merchant basis. As a result, we face competition from the power generation plants operated by The Southern Company, Entergy Services, other utilities and from other merchant generators within the SERC region and outside the SERC region for electricity orders. Furthermore, competitive conditions may be substantially affected by various forms of energy legislation and/or regulation considered from time to time by the government of the United States. However, it is not possible to predict the nature of any such legislation or regulation that may ultimately be adopted or its effects upon our future operations.

Employees

As of June 30, 2008, we employed 18 people all of whom are located at our corporate office in Houston, Texas.

Regulatory Matters

Overview

We are subject to U.S. federal, state, and local energy and environmental laws and regulations applicable to the development, ownership and operation of the Plants. Federal laws and regulations govern, among other things, types of fuel used, the type of energy produced, power plant ownership, the rates, terms and conditions of wholesale electricity sales and corporate transactions involving entities that engage in wholesale sales and interstate transmission of electricity. State energy laws govern, among other things, utility rates, terms of retail sales, determinations of need for new facilities, land use and local permitting. Power projects also are subject to laws and regulations governing environmental emissions and other substances produced by a plant, along with the geographical location, zoning, land use and operation of a plant. Applicable federal environmental laws typically have state and local enforcement and implementation provisions. These environmental laws and regulations generally require that a wide variety of permits and other approvals be obtained before construction or operation of a power plant commences and that the facility operate in compliance therewith.

Federal Regulation and the Federal Energy Regulatory Commission

FERC is an independent regulatory commission within the Department of Energy that, among other things, regulates the transmission and wholesale sale of electricity in interstate commerce under the authority of the Federal Power Act, or FPA. Each of our subsidiary generating companies makes wholesale sales of electricity and is a "public utility" under the FPA, subject to regulation by the FERC. In addition, FERC determines whether a company that owns or operates a generation facility qualifies for Exempt Wholesale Generator, or EWG, status under the Public Utility Holding Company Act of 2005, or PUHCA of 2005. Each of the Plants is owned through subsidiaries that have been determined to be EWGs. This permits us to be exempt from most regulation as a holding company under PUHCA of 2005. The scope of holding company regulation was changed by passage of the Energy Policy Act of 2005, or EPAct.

Federal Power Act. The FPA gives FERC exclusive rate-making jurisdiction over wholesale sales of electricity and transmission of electricity in interstate commerce. Under the FPA, FERC, with certain exceptions, regulates entities that engage in wholesale sales of electricity and transmission of electricity in interstate commerce as "public utilities." Public utilities under the FPA are required to obtain FERC's acceptance, pursuant to Section 205 of the FPA, of their rate schedules and tariffs under which they sell electricity at wholesale. FERC has granted each of our generating companies the authority to sell electricity at market-based rates. FERC's orders that grant our generating companies market-based rate authority reserve the right to revoke or revise that authority if FERC subsequently determines that we can exercise market power in transmission or generation, create barriers to entry or engage in abusive affiliate transactions. As a condition to the orders granting our generating companies market based rate authority, every three years we are required to file a market power update to show that the companies continue to meet FERC's standards with respect to generation market power and other criteria used to evaluate whether entities qualify for market-based rates. Our generating companies will be filing their next market power update with FERC in December 2008. We are also required to report to FERC any material change in status that would reflect a departure from the characteristics that FERC relied upon when it granted our various generating companies' market-based rates, and our generating companies are required to make quarterly electronic filings with FERC providing information on sales of electric power.

The market-based rate sales made by our generating companies are subject to certain market behavior rules. The market behavior rules make it unlawful for any entity involved directly or indirectly in a FERC jurisdictional transaction to intentionally defraud, make untrue statements or omit material facts. If any of our generating companies were deemed to have violated one of those rules, they could be subject to potential civil or criminal penalties, disgorgement of profits associated with the violation and/or suspension or revocation of their market-based rate authority.

If our generating companies were to lose their market-based rate authority, such companies would be required to obtain FERC's acceptance to sell power at cost-based rates. Our company then would become subject to the accounting, record-keeping and reporting requirements that are imposed on utilities with cost-based rate schedules.

In addition, Section 204 of the FPA gives FERC jurisdiction over a public utility's issuance of securities or assumption of liabilities. However, FERC typically grants blanket approval for future securities issuances or assumptions of liabilities to entities with market-based rate authority. FERC granted such blanket authority to our generating companies. In the event that one of our public utility generating companies were to lose its market-based rate authority, such company's future securities issuances or assumptions of liabilities could require prior approval of the FERC.

The FPA also gives FERC jurisdiction to review certain corporate transactions and numerous other activities of public utilities, including mergers or consolidations involving public utilities, certain transfers of public utility and electric generation facilities, certain purchases by a public utility of the securities of another public utility, and certain public utility holding company purchases of securities and direct or indirect mergers and consolidations. FERC will grant approval under FPA Section 203 if it finds that the proposed transaction will be consistent with the public interest and does not raise concerns with respect to cross-subsidization involving a traditional public utility that has captive customers which receive services at cost-based rates.

In compliance with Section 215 of the EPAct, FERC has approved the North American Reliability Corporation, or NERC, as the national Electric Reliability Organization, or ERO. As the ERO, NERC is responsible for the development and enforcement of mandatory electric reliability standards for the wholesale electric power system. Our subsidiary generating companies are responsible for complying with the standards in the regions in which they operate. The ERO can assess civil penalties for non-compliance with the standards.

Public Utility Holding Company Act of 2005. The PUHCA of 2005 permits FERC access to the books and records of holding companies if necessary for determining jurisdictional rates. FERC has also implemented the PUHCA of 2005 rules governing accounting, record retention and reporting, as required by EPAct. Because we are a holding company under the PUHCA of 2005 solely as the result of owning one or more EWGs, we and our subsidiary generating companies are exempt from FERC access to books and records under the PUHCA of 2005. However, FERC has asserted independent authority under the FPA granting it access to the books and records of public utilities and holding companies. Moreover, state regulatory authorities have a parallel authority under the PUHCA of 2005 concerning access to books and records of holding companies if necessary for determining jurisdictional rates. Our subsidiary companies' EWG status does not exempt them or us from such state authority.

Environmental Regulation

The construction and operation of power projects are subject to extensive environmental protection and land use laws and regulations in the United States. Environmental laws and regulations that apply to us primarily involve emissions into the air, discharges to surface waters and the use of water, but often also include wetlands preservation, endangered species preservation, waste disposal and noise abatement. These laws and regulations often require us to follow lengthy and complex procedures to obtain licenses, permits and approvals for the Plants and operations from federal, state and local agencies. Based on current trends, we expect that environmental and land use laws and regulations will continue to change and become more stringent with time. If such laws and regulations or the terms of our licenses, permits or approvals are changed and our facilities are not grandfathered or excluded from these changes, we may need to make significant capital expenditures for modifications to project technologies and facilities to maintain compliance. We do not anticipate incurring material capital expenditures related to environmental compliance in 2008 or 2009.

Clean Air Act. There are three parts of the Clean Air Act that are particularly relevant to electricity generation facilities: Title I—National Ambient Air Quality Standards; Title IV—Acid Deposition Control; and Title V—The Clean Air Act Permit Program. Most of the permit and regulatory requirements that apply to the Plants arise under Titles IV and V. Title IV affects all fossil fuel-fired generation facilities and requires covered sources to generate or obtain annual credits for sulfur dioxide, or SO_2, emissions. Title V affects all emission sources, including gas-fired electricity generation facilities. Title V requires that we obtain comprehensive air emission control permits for the Plants that are classified as major sources under the Clean Air Act. In cases where the Plants are subject to Title V permitting program, we have applied for and obtained Title V permits for our operations.

Under Title I of the federal Clean Air Act, if National Ambient Air Quality Standards, or NAAQS, are violated in a region, that area is designated as a non-attainment area by the United States Environmental Protection Agency, or EPA, and is given a deadline for reaching compliance. The relevant state is required to submit a state implementation plan, or SIP, detailing how regional attainment will be achieved within the prescribed time limit. In response to SIP requirements, 19 states in the eastern United States (including seven states in the SERC region—Alabama, Illinois, Kentucky, North Carolina, South Carolina, Virginia and Tennessee) have established a seasonal nitrogen oxide, or NO_x, cap and trade program, whereby seasonal NO_x reductions are achieved using market mechanisms. Most of the nation's non-attainment areas are located within these states. The EPA requires most of the regions covered by this program to demonstrate attainment by 2009 to 2010.

During 2005 the USEPA adopted the Clean Air Interstate Rule, or CAIR, to control and mitigate transportation of nitrogen oxides, or NO_X, emissions across the eastern United States, including Arkansas, Georgia, and Mississippi. The Plants would have been subject to the CAIR program, which was to take effect in 2009; however, the United States Court of Appeals for the District of Columbia Circuit, or the Court, decided on July 11, 2008 to vacate CAIR in response to petitions for review challenging various aspects of CAIR. Because the Court found more than several fatal flaws in CAIR and the USEPA adopted CAIR as one, integral action, the Court vacated CAIR and its associated Federal Implementation Plan in its entirety and remanded both to the USEPA to promulgate a rule that is consistent with the Court's opinion. The specific changes to the rule to be made by USEPA and associated schedule for such changes as well as the future applicability of such changes to the Plants are not known at the present time.

Proposed and Recently Adopted Air Quality Regulations. On March 10, 2005, the EPA promulgated final regulations for the Clean Air Interstate Rule, or CAIR, which expands the NO_x and SO_2 cap and trade programs established for states in the eastern and southeastern United States under the 1998 federal NO_x SIP Call Rule. CAIR is a two-phase program with declining compliance caps for NO_x in 2009 and 2015 and for SO_2 in 2010 and 2015. On August 24, 2005, the EPA published a proposed Federal Implementation Plan, or FIP, to ensure that power generators affected by CAIR reduce emissions on schedule. In parallel actions in late 2005, the EPA proposed the second phase of the 8-hour ozone NAAQS rule relating to NO_x emissions and signed proposed revisions to address attainment of NAAQS for "fine particulates," or "PM2.5," which will require affected states to implement further rules to address SO_2 and NO_x emissions.

Numerous environmental groups, states and industry organizations challenged aspects of the CAIR. The challenges were consolidated into the proceeding titled *South Coast Air Quality Management District v. EPA.* In December 2006, the U.S. Circuit Court for the D.C. Circuit overturned portions of the EPA's Phase I CAIR implementation rule for the new 8-hour ozone standard holding that the EPA could revoke the existing one-hour standard as long as there was no "backsliding" from more stringent control measures. This ruling may result in the imposition of fees under Section 185 of the Clean Air Act on facilities with volatile organic hydrocarbon, or VOC, and NO_x emissions in severe ozone non-attainment areas. CAIR and its associated FIP were both vacated in their entirety and remanded to EPA by the U.S. Court of Appeals for the District of Columbia Circuit in its decision in *North Carolina v. EPA et.al* issued July 11, 2008.

Prior the the action by the U.S. Court of Appeals for the District of Columbia Circuit vacating CAIR, the states where we operate were in the process of modifying the relevant state SIPs to implement reductions in NO_x and SO_2 emissions as mandated by CAIR. Although the impact of the Circuit Court ruling and future CAIR rules in unclear, future CAIR regulations could affect our power generation operations by requiring that we generate or obtain through the emission trading market credits for NO_x and SO_2 emissions from the Plants or that we modify the Plants to further reduce emissions. As the allowable caps on NO_x and SO_2 emissions decrease, we anticipate that the cost to acquire emission credits will increase. If we were unable to satisfy some or all of our environmental commitments with emissions allowances, either because of regulatory changes or an inability to obtain emissions allowances, we could be required to take alternative actions, which may include reduced plant operation or shutdown or additional capital expenditures to comply with the Clean Air Act.

There is a growing consensus in the U.S. and globally that emissions of greenhouse gases ("GHGs"), are linked to global climate change and this consensus may lead to more stringent regulation of GHGs in the future. Increased public concern and mounting political pressure may result in regional and/or federal requirements to reduce or mitigate the effects of GHGs. For example, the EPA issued an Advance Notice of Proposed Rule making on July 11, 2008 for a request for public comment on how to respond to the U.S. Supreme Court's decision in *Massachusetts v. EPA* in which the Supreme Court ruled that the Clean Air Act authorizes regulation of greenhouse gases. Regional initiatives and proposed federal GHG legislation seek to establish a "cap and trade" system for regulation of the primary GHG, carbon dioxide or CO_2. Regulation of CO_2 at the federal level or in the states or regions where we operate could impact our operations by requiring that we acquire credits for each ton of CO_2 produced. It is uncertain whether allowances will awarded to existing emitters or will be required to be purchased. Our power generation operations primarily use natural gas and therefore emit less CO_2 than coal-fired generation facilities.

Site Remediation Liability. Certain federal and state environmental laws impose joint and several liability without regard to fault for costs required to clean up and restore sites where hazardous substances have been or could be released. We could be responsible under these laws for liabilities associated with the environmental condition of power generation plants that we own or operate or locations where we have arranged for the disposal of hazardous substances. We are also subject to environmental laws and regulations that require us to report and respond to spills and releases that may occur as a result of our operations. We are not currently subject to material liabilities or obligations to investigate, clean-up or monitor on-site or off-site environmental contamination under these environmental laws.

Insurance

We carry insurance coverage consistent with companies engaged in similar commercial operations with similar properties, including business interruption insurance for our combined-cycle facilities. However, our insurance policies are subject to certain limits and deductibles as well as policy exclusions. Adequate insurance coverage in the future may be more expensive or may not be available on commercially reasonable terms. Also, the insurance proceeds received for any loss of or any damage to any of our generation facilities may not be sufficient to restore the loss or damage without negative impact on our financial condition, results of operations or cash flows.

Available Information

Our principal offices are at Four Oaks Place, 1330 Post Oak Blvd., Suite 1500, Houston, TX 77056. Our phone number is (713) 979-1900. Our investor relations department will provide without charge, upon the written request of a holder of our common stock or a prospective investor, our annual reports, quarterly reports, and any amendments to these reports. Certain of these reports and other communication are also available on our website at *www.kgenpower.com*. We are not an SEC registrant and therefore none of these reports have been filed with the Securities and Exchange Commission.

Number 1A. *Risk Factors*

Risks Related to Our Exploration of Strategic Alternatives

Our exploration of strategic alternatives may not result in any transaction and may create uncertainties that could affect our business.

On April 11, 2008, the Board announced that it had retained Credit Suisse to evaluate all of the Company's options for enhancing shareholder value going forward including the sale of the Company, sale of individual assets, potential business combinations, and continuing to enhance the value of our existing assets. On May 6, 2008, our Board announced that it is committed to exploring any and all strategic alternatives to maximize the value of the Company. Our process of exploring strategic alternatives is ongoing. We have not determined whether we will elect to pursue any of the strategic alternatives that may be available to us, or what impact any particular strategic alternative will have on our operations or stock price if pursued.

In addition, there are various uncertainties and risks relating to our exploration of strategic alternatives, including:

- The exploration of strategic alternatives may distract management and disrupt operations, which could have a material adverse effect on our operating results;
- We may not be able to successfully achieve the benefits of any strategic alternative undertaken by us;
- The process of exploring strategic alternatives may be time consuming and expensive; and
- Perceived uncertainties as to our future direction may result in the loss of employees or business opportunities.

Risks Related to Our Industry

The operation of power generation plants involves significant risks that could result in unplanned power outages or reduced output, which would adversely affect our results of operations, financial condition or cash flows.

We are subject to significant risks associated with operating power generation plants, any of which could adversely affect our revenues, costs, results of operations, financial condition or cash flows. These risks include:

- operating performance below expected levels of output or efficiency;
- failure of equipment or processes, operator or maintenance errors or other events resulting in power outages or reduced output;
- availability of fuel and fuel transportation;
- disruptions in the transmission or distribution of power; and
- catastrophic events such as fires, hurricanes, explosions, floods, lightning strikes, terrorist attacks or other similar occurrences to our facilities or to facilities upon which we depend.

Unplanned outages of generation units, including extensions of scheduled outages due to mechanical failures or other problems occur from time to time and are an inherent risk of our business. Unplanned outages typically increase our operation and maintenance expenses. In addition, an unplanned outage may reduce our revenues as a result of selling fewer mega-watt hour, or MWh, or require us to incur significant additional costs as a result of running one of our higher cost units or obtaining replacement power from third parties in the open market to satisfy our power sales obligations. In particular, at times we have

substituted power generated by our Sandersville and Murray II plants at significantly lower margins for power from Murray I that is supplied under the GPC PPA when Murray I has had an unplanned outage. Georgia Power, in each case, must agree to the replacement transmission delivery point. If Georgia Power does not approve the alternate delivery point, the revenues paid to us under the GPC PPA may be reduced. As a result, if any one unit were to experience an unexpected failure or unplanned outage, especially during our peak summer season, it may have a material adverse effect on our revenues from operations or our costs of operations.

The cost of repairing damage to the Plants due to storms, lightning strikes, natural disasters and other catastrophic events may adversely affect our results of operations, financial condition or cash flows. These events and future events of this kind could damage the Plants and disrupt our fuel supply and transmission capability. Such events could also result in adverse changes in the insurance markets or other operating costs and disruptions of power and fuel markets. In addition, our power generation plants, fuel supply, fuel transport and transmission capability could be directly or indirectly harmed by future terrorist activity or acts of war. Strategic targets, such as energy-related facilities, may be at greater risk of future terrorist activities than other domestic targets. The occurrence or risk of occurrence of future terrorist attacks or related acts of war could result in increased securities and insurance costs, adversely affect the U.S. economy or otherwise impact our results of operations and financial condition in unpredictable ways.

Our operations are subject to hazards customary to the power generation industry. We may not have adequate insurance to cover all of these hazards.

Power generation involves hazardous activities, including acquiring, transporting and unloading fuel, operating large pieces of rotating equipment and delivering electricity to transmission and distribution systems. In addition to natural risks such as earthquake, flood, lightning strikes, hurricane and wind, other hazards, such as fire, explosion, structural collapse and machinery failure are inherent risks in our operations. These and other hazards can cause significant personal injury or loss of life, severe damage to and destruction of property, plant and equipment, contamination of, or damage to, the environment and suspension of operations. The occurrence of any one of these events may result in our being named as a defendant in lawsuits asserting claims for substantial damages, including for environmental cleanup costs, personal injury and property damage and fines and/or penalties. We maintain an amount of insurance protection that we consider adequate, but we cannot assure you that our insurance will be sufficient or effective under all circumstances and against all hazards or liabilities to which we may be subject. A successful claim for which we are not fully insured could hurt our financial results and materially harm our financial condition. Further, due to rising insurance costs and changes in the insurance markets, we cannot assure you that insurance coverage will continue to be available at all or at rates or on terms similar to those presently available to us. Any losses not covered by insurance could have a material adverse effect on our financial condition, results of operations or cash flows.

Our revenues and results of operations from the sale of electric power and generation capacity may be adversely impacted by market risks that are beyond our control.

We have not sought FERC approval to sell electric energy and capacity from our generation facilities at cost-based rates. Rather, we sell electric generation capacity and energy on a merchant basis to wholesale purchasers at prices determined by the market. As a result, we are not guaranteed any rate of return on our capital investments through mandated rates, and our revenues and results of operations depend upon current and forward market prices for power. Unlike most other commodities, large quantities of electricity cannot be economically stored and therefore must be produced concurrently with its use. As a result, wholesale power markets are subject to significant price volatility from supply and demand imbalances, especially in the day-ahead and spot markets. Long-term and short-term power prices may also fluctuate substantially due to other factors outside of our control, including:

- oversupply or undersupply of generation capacity;

- changes in power transmission or fuel transportation capacity constraints or inefficiencies;
- electric supply disruptions, including plant outages and transmission disruptions;
- seasonality;
- demand changes due to changes in the macro-economic environment;
- weather conditions;
- availability and market prices for natural gas;
- changes in demand for power or patterns of power usage;
- additional supplies of power from existing competitors or new market entrants as a result of the development of new generation plants, expansion of existing plants, the revitalization of non-operating plants or additional transmission capacity;
- development of new fuels and new technologies for the production of power;
- availability of competitively priced alternative power sources;
- changes in the relationship between the prices of natural gas and coal;
- natural disasters, wars, embargoes, terrorist attacks and other catastrophic events;
- regulations and actions of regulatory bodies; and
- federal and state power market and environmental regulation and legislation.

Our business is subject to substantial governmental regulation and may be adversely affected by liability under, or any future inability to comply with, existing or future regulations or requirements.

Our business is subject to extensive federal, state and local laws and regulation. Compliance with the requirements under these various regulatory regimes may cause us to incur significant additional costs and failure to comply with such requirements could result in the shutdown of the non-complying facility, the imposition of liens, fines and/or civil or criminal liability. The EPAct is likely to have several long-term impacts on the energy sector. Among the impacts are strong financial incentives for investment in transmission and generation, federal pre-eminence over state authority, which may remove some obstacles to improved transmission, and changes to the Public Utility Regulatory Policies Act of 1978, or PURPA, that increase the importance of analyzing economic viability of certain merchant generation projects. Many of the provisions of the EPAct require implementation by FERC. FERC has not completed all of its rulemakings and certain of its regulations may face requests for rehearing, appeals or litigation. The effects on our business are uncertain and could adversely affect our business and financial results.

We are also affected by changes to market rules, tariffs, changes in market structures, changes in administrative fee allocations and changes in market bidding rules. Although the Plants are not currently located within an Independent System Operator, or ISO, or Regional Transmission Operator, or RTO, we may in the future be subject to an ISO or RTO and we may sell some of our energy into ISOs or RTOs. The ISOs or RTOs that oversee most of the wholesale power markets impose, and in the future may continue to impose, price limitations, offer caps and other mechanisms to address some of the volatility and the potential exercise of market power in these markets. These types of price limitations and other regulatory mechanisms may adversely affect the profitability of our generation facilities that sell energy and capacity into the wholesale power markets. In addition, the regulatory and legislative changes that have recently been enacted at the federal level and in a number of states in an effort to promote competition are novel and untested in many respects. These new approaches to the sale of electric power have very short operating histories, and it is not yet clear how they will operate in times of market stress or pressure, given the extreme volatility and lack of meaningful long-term price history in many of these markets and the imposition of price limitations by ISOs or RTOs. Additionally, Entergy Services, on behalf

of various affiliated operating companies, has established the Independent Coordinator of Transmission, or ICT, to oversee its transmission system. The establishment of ICT is largely seen as a step towards improving transparency in granting transmission and non-discriminatory transmission access to Entergy Services' system. However, the introduction of the ICT into the Entergy sub-region may have a materially different impact from the impact of an ISO or RTO and may not be beneficial and therefore could have a material adverse effect on our operating results.

We are subject to environmental laws and regulations that impose extensive and increasingly stringent requirements and liabilities on our operations that could adversely impact our results of operations, financial condition and cash flows.

Our business is subject to the environmental laws and regulations of federal, state and local authorities. We must comply with these laws and regulations and obtain numerous governmental permits and approvals to operate our power projects. If we fail to comply with environmental requirements applicable to our operations, we could be subject to administrative, civil and/or criminal liability and fines, and regulatory agencies could take other actions to limit or curtail our operations. We are also subject to liability for environmental contamination at our operating facilities or third-party locations where our operations have sent wastes. In addition, new environmental requirements that take effect or changes to or reinterpretation of existing environmental requirements or enforcement policies could adversely affect our business, results of operations, financial condition and cash flows. See "Number 1. *Business—Regulatory Matters—Environmental Regulation*."

Competition in wholesale power markets may have a material adverse effect on our results of operations, cash flows and the market value of our assets.

We have numerous competitors in all aspects of our business, and additional competitors may enter the industry.

Other companies with which we compete may have greater liquidity, access to credit and other financial resources, lower cost structures, more effective risk management policies and procedures, greater ability to incur losses, longer standing relationships with customers, greater potential for profitability from ancillary services or greater flexibility in the timing of their sale of generation capacity and ancillary services than we do.

Our competitors may be able to respond more quickly to new laws or regulations or emerging technologies, or to devote greater resources to the construction, expansion or refurbishment of their power generation facilities than we can. In addition, current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties. Accordingly, it is possible that new competitors or alliances among current and new competitors may emerge and rapidly gain significant market share.

Our competitors include the power generation capabilities of Entergy Services, The Southern Company and TVA, utilities that have historically dominated their respective geographic regions in SERC and that have significant influence over the markets in which we compete and over the state regulatory bodies that regulate them. These utilities have the ability to charge rates based upon their cost of generation and thus may be able to dispatch their generation facilities instead of purchasing energy from merchant generators even though the price charged by the merchant generators may be lower than the utilities' cost of generation. Entergy Services has purchased merchant generation facilities and placed such facilities into its rate base. These purchases and any similar purchases in the future may significantly reduce the demand for energy and capacity from the Plants. In addition, Entergy Services and The Southern Company are also our principal customers. There can be no assurance that we will be able to compete successfully against current and future competitors, and any failure to do so would have a material adverse effect on our business, financial condition, results of operations and cash flow.

Changes in technology may impair the value of the Plants.

Research and development activities are ongoing to provide alternative and more efficient technologies to produce power, including fuel cells, clean coal and coal gasification, micro-turbines, photovoltaic (solar) cells and improvements in traditional technologies and equipment, such as more efficient gas turbines, cleaner and safer nuclear or coal power plants, and coal-fired integrated gasification combined-cycle power plants, among others. Advances in these or other technologies could reduce the costs of power production to a level below what we have currently forecasted, which could adversely affect our revenues, results of operations or competitive position. Improvements in transmission technology may reduce transmission constraints but may also improve access of competitors to our markets. Renewable resource technologies receive assistance in commercial implementation through regulatory requirements, subsidies and tax incentives that may adversely affect demand for the output of the Plants and their values.

Risks Related to Our Business

Most of the Plants currently operate without long-term power purchase agreements and if we are unable to find purchasers for our power or capacity or to find purchasers at attractive pricing, it would have a material adverse effect on our financial condition and cash flows.

Four of the Plants currently operate as merchant facilities without long-term power purchase agreements, and therefore are exposed to significant price volatility from the supply and demand imbalances in the day-ahead and spot markets. Without the benefit of long-term power purchase agreements for these assets, we cannot be sure that we will be able to sell any or all of the capacity available or power generated by these facilities at commercially attractive rates or that these facilities will be able to generate revenues or operate profitably. If long-term power purchase agreements at attractive prices become available, we may not have sufficient credit standing to take advantage of such opportunities.

Revenue may be reduced significantly upon expiration or termination of the GPC PPA.

The GPC PPA generates a substantial portion of our operating margin. The pricing of the GPC PPA exceeds current pricing structures for comparable facilities in our markets. The GPC PPA expires in May 2012 and contains termination provisions standard to contracts in our industry such as performance or payment default or prolonged events of force majeure. If we are not able to enter into an agreement or agreements with Georgia Power or other third parties with respect to the Murray I plant on similarly favorable terms to the GPC PPA upon its termination or expiration, it may have a material adverse effect on our results of operations, financial condition and cash flows.

The anticipated development of nuclear and coal-fired generation facilities within the SERC region and the resulting production of electricity with lower marginal costs may adversely affect our revenues, results of operations, cash flow or competitive position.

Nuclear and coal-fired generation facilities, which are generally used as base load power sources in an electric energy grid, have lower fuel costs and as a result have lower marginal costs of power production as compared to our combined-cycle facilities, which are generally used in load-following roles, and our simple-cycle plant, which is generally used as a peaking power source. In the southeastern United States region, coal-fired capacity is currently under construction or in different stages of development, and is projected to be operational by 2009. While a significant portion of this base load capacity will not be available in the near term, the expected increase in base load capacity could lower demand for load-following and peaker plants such as ours, which could adversely impact our revenues, results of operations and cash flow. Several utilities in the southeastern United States region have announced that they are considering the commissioning of new nuclear generation facilities. Although no firm commitments have been made, the construction of new nuclear generation facilities may have a similar impact on the markets as new base load coal-fired generation facilities.

We rely on power transmission facilities that we do not own or control and are subject to transmission constraints within our core regions. If these facilities fail to provide us with adequate transmission capacity, we may be restricted in our ability to deliver wholesale electric power to our customers and we may either incur additional costs or forego revenues.

We depend on transmission facilities owned and operated by others to deliver the wholesale power we sell from the Plants to our customers. The Southern Company and Entergy Services control the transmission infrastructure in our primary regions of operations within SERC.

Additionally, if transmission is unavailable or disrupted, or if the transmission capacity infrastructure is inadequate, our ability to sell and deliver wholesale power may be adversely impacted. If a region's power transmission infrastructure is inadequate, our recovery of wholesale costs and profits may be limited. If restrictive transmission price regulation is imposed, the transmission companies may not have sufficient incentive to invest in expansion of transmission infrastructure. We also cannot predict whether transmission facilities will be expanded in specific markets to accommodate competitive access to those markets.

Our costs, results of operations, financial condition and cash flows could be adversely impacted by disruption of our fuel supplies.

We rely on natural gas to fuel the Plants. Delivery of fuel to the Plants is dependent upon the continuing financial viability of contractual counterparties as well as upon the infrastructure (particularly natural gas pipelines) available to serve each plant. As a result, we are subject to the risks of disruptions or curtailments in the production of power at the Plants if a counter party fails to perform or if there is a disruption in the fuel delivery infrastructure.

We buy significant amounts of fuel on a short-term or spot market basis. Prices for our fuel fluctuate, sometimes rising or falling significantly over a short period. The price we can obtain for the sale of electric energy may not rise at the same rate, or may not rise at all, to match a rise in fuel or fuel delivery costs. This may have a material adverse effect on our financial performance. Changes in market prices for natural gas may result from the following:

- weather conditions;
- seasonality;
- demand for energy commodities and general economic conditions;

- disruption of gas transportation, infrastructure or other constraints or inefficiencies;
- changes in FERC-approved gas transport tariff rates;
- additional generation capacity;
- outages resulting from maintenance;
- availability of competitively priced alternative energy sources;
- availability and levels of storage and inventory for fuel stocks;
- natural gas production levels;
- the creditworthiness or bankruptcy or other financial distress of market participants;
- changes in market liquidity;
- natural disasters, wars, embargoes, acts of terrorism and other catastrophic events; and
- federal, state and foreign governmental regulation and legislation.

We obtain supplies of natural gas through firm and interruptible pipeline transport agreements. The transport prices we pay are regulated under tariffs approved by FERC. Certain tariffs apply to gas supplies taken over a fixed period of time. As the Plants are generally dispatched intermittently, we do not need gas at a steady rate over a long period of time but in compressed periods. Unless the gas transporter has flexible operations or cooperates with us, a requirement to take a minimum amount of gas over an extended period or face penalties related to the pressure in the pipeline and other contract requirements can make it uneconomical to operate a plant under certain conditions. In particular, we obtain natural gas for our Hot Spring plant through CenterPoint, which has enforced its tariffs from time to time in a manner that has resulted in us not dispatching the Hot Spring plant even when such could be done at a positive margin. Failure to adopt flexible pipeline operations that recognize the needs of modern energy grids and merchant generation facilities could have an adverse affect on our revenues, results of operations and cash flows.

Failure to achieve favorable operating results could have an effect on our financial condition.

Our inability to operate the Plants efficiently, manage capital expenditures and costs, and generate earnings and cash flow from our asset-based businesses in relation to our debt and other obligations could have a material adverse effect on our results of operations, financial condition or cash flows.

We depend on our management for our future success.

Our future success in operating the Plants is largely dependent on the skills, experience and efforts of our senior management and certain key personnel with critical skills. While our Chief Executive Officer and certain other members of our management are subject to employment agreements, these employment agreements may be terminated at will by the employees and the loss of the services of any such individual or other key personnel could have a material adverse impact upon on our business and results of operations.

Our operations have not been profitable and if we are unable to generate net income, the price of our common stock will be adversely affected.

For the year ended June 30, 2008 and from December 4, 2006 (Date of Inception) to June 30, 2007, we had losses of $103.9 million and $22.6 million, respectively, before income taxes. We expect to continue to operate in a difficult merchant power market in the SERC region in the near term.

We have only two significant customers with which we have a direct contractual relationship for our power so our credit risk is concentrated. If either customer were to experience financial difficulties, we could be subject to a material and adverse effect on our financial condition and results of operations.

Our only two significant customers with which we currently have a direct contractual relationship were Georgia Power and Fortis. We benefit from Fortis' credit through back-to-back sales of merchant power and capacity to our ultimate customers (of which Entergy Services and The Southern Company represent over 75% of such merchant sales). Changes in economic, regulatory or other factors could have a significant effect on these customers or our contractual relationships. If either Fortis or Georgia Power failed to pay us or were delayed in their payments under our contracts, we would be adversely affected to the extent that we were unable to find other customers at the same level of contract profitability.

In the past, our predecessor has identified material weaknesses in its internal controls over financial reporting. We have succeeded to their internal controls and our failure to achieve and maintain effective internal controls could have a material adverse effect on our business in the future and on our access to the capital markets.

We are not subject to the requirements of Section 404 of the Sarbanes-Oxley Act of 2002. During the preparation of our predecessor's fiscal year 2006 financial statements, material weaknesses were identified pertaining to (a) internal controls over supervisory and management review sufficient to detect errors in initiation, recording, processing and reporting of financial data (b) the absence of a process or formal policy in place to provide supervisory review or approval of procedures for recognition of month end accrued liabilities and (c) the absence of a process or formal policy, supervisory review or approval procedures for recognition and valuation of derivative instruments. We have succeeded to our predecessor's internal controls and have the same employees working on our control systems.

Although we have taken measures to remediate the prior weaknesses, including building out our accounting department by acquiring contract resources, these remediation steps and others we may undertake in the future may not be effective in successfully remediating these material weaknesses or in preventing or identifying the same or additional material weaknesses in our internal control over financial reporting in the future. In addition, even if we are successful in identifying the same or additional material weaknesses in the future, we may not successfully remediate such material weaknesses quickly or at all. Any failure to maintain adequate internal control over financial reporting or to implement required, new or improved controls, or difficulties encountered in their implementation, could cause us to report material weaknesses or other deficiencies in our internal control over financial reporting and could result in a more than remote possibility of errors or misstatements in our consolidated financial statements that would be material. If our management or our independent registered public accounting firm were to conclude that our internal control over financial reporting was not effective, investors could lose confidence in our reported financial information and the value of our shares of common stock could be adversely impacted. Our failure to achieve and maintain effective internal controls could have a material adverse effect on our business in the future and on our access to the capital markets. We will continue to operate at a relatively small staffing level. Our control procedures have been designed with this staffing level in mind; however, they are highly dependent on each individual's performance of controls in the required manner. The loss of accounting personnel, particularly our chief financial officer or our chief accounting officer and controller, would adversely impact the effectiveness of our control environment and our internal controls, including our internal control over financial reporting.

Other Risks

We rely extensively on third-party service providers for the operation and maintenance of the Plants and for certain marketing of our electricity, and if such service providers cease to perform such services or fail to perform such services adequately, it could adversely affect our results of operations and cash flows.

We currently have few employees of our own and are dependent on contractual arrangements with third parties for the operation and maintenance of the Plants. All of the Plants are operated by DEGS under operating and maintenance agreements. In addition, GEI provides maintenance services to our combined-cycle plants under LTSAs. Fortis acts as commercial marketer for the power produced by four of the Plants other than the Murray I plant. Currently, Fortis and Sequent provide significant credit to us which allows us to transact without providing additional financial collateral. In the event that their credit policies toward us change or these agreements terminate, we may be unable to obtain an agreement with another energy service provider on similarly favorable terms and this could have a significant impact on our ability to procure fuel and meet our power generation targets. While we believe that such contractual arrangements allow us to leverage our management team and have allowed us to operate more effectively and efficiently, in the event we have a significant disagreement with DEGS, GEI, Sequent or Fortis that interrupts one of their services or one of them experiences financial difficulties that adversely affect their ability to provide services, our results of operations, financial condition and cash flows may be adversely affected. In this regard, DEGS and Fortis both have the right to terminate their agreements with us at their convenience. In addition, although we seek to align our interests contractually, there may be conflicts of interest and one of these parties may take actions that are not in our best interests. We do not have the internal operating capability to perform the services that we outsource, and to develop such capabilities would be time consuming and expensive.

In connection with the operations of the Plants, all energy management services consisting of sales of power and procurement of fuel for the Plants, except for sales under the GPC PPA for Murray I and natural gas supply from Sequent for Murray I and II, are provided by Fortis. It is our intent that Fortis passes through the actual price of power and costs of fuel that it receives from its counterparties through mirroring back-to-back transactions and not make any additional revenues by inserting an additional margin on these transactions. However, not all transactions are totally transparent (particularly when sales or purchases are made to and from Fortis' own trading book), and although we have the ultimate authority for all transactions, the possibility exists that our future sales margins may be materially reduced by Fortis' pricing.

There has been only limited trading in our common stock, so our stockholders may find it difficult to dispose of their investment.

Our common stock is not traded on any established trading market. Although institutional investors do occasionally trade our common stock, this trading activity is very limited and does not occur on a regular basis. As such, investors who own or purchase our common stock will find that the liquidity or transferability of the common stock is limited. Accordingly, stockholders may find it difficult to dispose of, or obtain accurate quotations as to the market value, of our common stock.

Number 2. *Properties*

Our corporate headquarters are located in Houston, Texas. As of June 30, 2008, we lease approximately 20,200 square feet of office space. In addition, we own and lease various real property and facilities relating to our power generation business. We believe we have satisfactory title to the Plants and our facilities in accordance with standards generally accepted in the electric power industry, subject to exceptions that, in our opinion, should not have a material adverse effect on the use or value of our portfolio. Our properties are as follows:

Site Name	Location	Owned/Leased
Corporate Office	Houston, TX	Leased
Murray	Dalton, GA	Leased(1)(2)
Hinds	Jackson, MS	Leased
Hot Spring	Malvern, AR	Leased(2)
Sandersville	Warthen, GA	Leased(2)

(1) Real property is leased but the generation assets are owned

(2) Generation assets and real property are leased in relation to the Industrial Revenue Bonds mentioned in Note 9 to our audited financial statements, or Notes. There is a bargain purchase option whereby we can acquire the asset at the end of the lease for a nominal price.

Number 3. *Legal Proceedings*

Hinds Property Tax

KGen Hinds LLC is a complainant in civil action relating to the payments in lieu of taxes on the real and personal property of KGen Hinds for 2006. The civil action of KGen Hinds is in the Circuit Court of Hinds County, Mississippi, and is against Hinds County, the City of Jackson and the Hinds County tax assessor and collector. KGen Hinds is disputing the defendant's claim that KGen Hinds owes approximately $1.6 million for payments in lieu of taxes for 2006. We have also disputed the County assessment for the 2007 property tax.

Part II

Number 4. *Market for the Company's Common Equity, Related Stockholder Matters and Company Purchases of Equity Securities*

Our common stock shares are not traded on a public exchange. In connection with our private placement in December 2006 we agreed to affect a shelf registration of the shares that were sold so that they could be publicly offered and sold. On November 9, 2007, we filed Form S-1 registration statement with the Securities and Exchange Commission, and subsequently amended such statement. The registration statement has not been declared effective. On February 21, 2008, the Company's Board of Directors suspended the process for completion of the shelf registration.

The payment of dividends is subject to the restrictions described in Note 6 to the Notes and discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations. We have not paid any dividends on our common stock and do not have any present intention to do so.

Number 5. *Selected Financial Data*

	Year Ended June 30, 2008	Period December 4, 2006 through June 30, 2007	Predecessor Information Period July 1, 2006 through February 7, 2007	Predecessor Information Year Ended June 30, 2006	Predecessor Information Period August 5, 2004 through June 30, 2005
	(in thousands)	(in thousands)	(in thousands)	(in thousands)	(in thousands)
Operating Results Data:					
Revenues:					
Energy sales	$ 308,605	$ 87,396	$141,080	$264,576	$ 75,026
Capacity sales	51,416	15,737	34,501	51,688	16,511
Total revenues	360,021	103,133	175,581	316,264	91,537
Operating expenses:					
Cost of fuel	268,978	78,127	115,076	222,325	67,208
Operating and maintenance	52,065	9,722	11,549	18,919	30,081
Gas transportation	16,382	6,279	9,674	15,893	13,919
Selling, general and administrative	29,418	11,777	10,436	14,247	13,613
Acquistion contract termination loss	37,190	—	—	—	—
Depreciation	24,068	9,164	7,614	12,895	12,956
Auxiliary power	8,437	2,649	4,187	6,905	5,355
Insurance	3,177	1,531	2,039	3,657	3,375
Total operating expenses	439,715	119,249	160,575	294,841	146,507
Operating (loss) profit	(79,694)	(16,116)	15,006	21,423	(54,970)
Other income (expenses)					
Interest expense	(16,513)	(7,153)	(30,231)	(43,762)	(36,691)
Debt extinguishment loss	—	—	—	—	(33,099)
Gain on sale of assets	—	—	110,109	11,393	—
Taxes, other than income taxes	(3,457)	(1,161)	(3,106)	(5,821)	(5,391)
Interest income	2,796	879	3,834	2,361	713
Other	(7,065)	912	(3,536)	(900)	(2,637)
Total other income (expenses)	(24,239)	(6,523)	77,070	(36,729)	(77,105)
Net (loss) income before income taxes	(103,933)	(22,639)	92,076	(15,306)	(132,075)
Income tax benefit	—	3,602	—	—	—
Net (loss) income after income taxes	$(103,933)	$(19,037)	$ 92,076	$(15,306)	$(132,075)
Net loss per share—basic and diluted(1)	$ (1.86)	$ (0.39)	N/A	N/A	N/A
Weighted average shares outstanding—basic and diluted(1)	55,949	48,603	N/A	N/A	N/A
Balance Sheet Data:					
Total property, plant, and equipment, net	$ 671,114	$693,295	$336,935	$324,799	$ 422,781
Total assets	870,722	948,767	560,211	546,356	566,956
Total current liabilities	39,457	20,589	12,492	19,803	29,234
Long-term debt	195,000	197,000	409,327	479,342	473,501
Stockholders'/Member's equity	$ 615,805	$711,741	$119,695	$ 27,619	$ 42,925

(1) KGen Power Corporation was formed December 4, 2006. Its predecessor was a partnership, therefore there is no common stock issuance to account for in the predecessor periods.

Number 6. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion is intended to assist you in understanding our business and the results of operations together with our present financial condition. This section should be read in conjunction with our Consolidated Financial Statements and the accompanying notes included in this Annual Report for the fiscal year ended June 30, 2008. Unless the context otherwise requires or indicates, references to "KGen," "Company," "we," "our," and "us" refer to KGen Power Corporation and its subsidiaries and to the business of our predecessor KGen Partners LLC, or KGLLC, all of the equity interests of which we purchased on February 8, 2007 pursuant to a purchase agreement, or the KGLLC Purchase Agreement.

Statements in our discussion may be forward-looking. These forward-looking statements involve risk and uncertainties. We caution that a number of factors could cause future results to differ materially from our expectations. Please see "Number 1A. *Risk Factors*" of Part II of our Annual Report for the fiscal year ended June 30, 2008 regarding certain risk factors related to the Company.

Business Overview

We own and operate electric power generation plants and sell electricity and electrical generation capacity in the United States. We sell power and related products to wholesale purchasers such as retail electric providers, power trading organizations, municipal utilities, electric power cooperatives and other power generation companies. We believe our assets have the potential for increases in their earning power and asset value from the anticipated continuing recovery of the United States energy market. As of June 30, 2008, our portfolio of facilities consists of five operational and fully permitted power plants, or the Plants, located in the southeastern United States with General Electric 7FA and 7EA gas turbines having an aggregate capacity of 3,030 megawatts, or MW. The Plants include four combined-cycle plants (Murray I, Murray II, Hot Spring and Hinds) and one simple-cycle plant (Sandersville). We acquired the Plants from an affiliate of MatlinPatterson Global Advisors LLC, or MatlinPatterson, on February 8, 2007.

Although our operations commenced with our acquisition of the Plants on February 8, 2007, the Plants were operated in the same manner and substantially all of the management team for the Plants, transferred to us with the assets acquired. For ease of reference, we present operating and financial information for the Plants as owned by MatlinPatterson and by us on a combined basis.

All of our Plants are located in the southeastern United States. Under the current market conditions in the southeastern United States region, where regional utilities control the dispatching order, our combined-cycle facilities historically have run between 10% and 35% annual capacity. We expect the electric power market in the southeastern United States region to return to equilibrium in the 2010-2014 timeframe as the electricity demand growth in the region continues. We believe this demand growth and the advent of more transparent and economic dispatch of regional system assets should result in increasing capacity demand, dispatch profile and improved profitability for the Plants.

Four of the Plants currently operate as merchant power providers. The remaining plant, the Murray I combined cycle plant, benefits from a fixed-price long-term power purchase agreement, or the GPC PPA, for all of its 630 MW of capacity with Georgia Power, a subsidiary of the Southern Company. The GPC PPA, which continues through May 2012, provides for fixed capacity payments which provides stable cash flow. On June 6, 2008, the Sandersville simple cycle plant entered into a power purchase agreement, or the Sandersville PPA, for a unit contingent 250 to 280 MW of capacity and associated energy with Southern Power Company. The Sandersville PPA commences on June 1, 2011 and continues through December 31, 2015.

Recent Events

Changes to the Board and Management

On February 21, 2008, the Board unanimously nominated and elected Daniel Hudson and William Rockford to the Board. The election of Mr. Hudson and Mr. Rockford to the Board was effected after holders of over a majority of the outstanding shares of the Company indicated to the Company their support for their election.

On April 18, 2008, a written consent executed on behalf of holders of approximately 62.8% of the shares of our outstanding shares was delivered to the Company (a) removing Gerald Lindner, Ramon Betolaza, and Joseph Piazza from the Board, (b) electing Thomas B. White to serve as a director and (c) strongly recommending that the Board remove Mr. Lindner as Chief Executive Officer of the Company. Subsequent to the delivery of the written consent, stockholders holding an additional 12.8%, for a total of 75.6%, of our shares delivered proxies supporting these actions. The removal of Mr. Linder, Mr. Betolaza and Mr. Piazza as directors and the election of Mr. White as a director was confirmed by Delaware's Court of Chancery on April 24, 2008 in a stipulated final order and judgment.

Subsequently, on May 2, 2008, the Board unanimously nominated and elected James P. Jenkins and Jeffrey S. Stein to the Board. Following this election, William Grealis, Harrison Wellford, and William Rockford resigned from the Board. Thereafter, on May 5, 2008, the Board unanimously nominated and elected Gerald J. Stalun as a director. The election of Mr. Jenkins, Mr. Stein, and Mr. Stalun to the Board was effected after holders of over 60% of our outstanding shares indicated to the Company their support for their election. Mr. Jenkins, Mr. Stein, Mr. Stalun, and Mr. White have agreed to serve as directors without compensation from the Company, other than reimbursement of their out-of-pocket expenses.

Daniel Hudson, a director of the Company since February 2008, has been elected by the Board to serve as its Chairman. In recognition of Mr. Hudson's increased duties and responsibilities, the board has approved the payment to Mr. Hudson of annual cash compensation of $200,000 for his services as Chairman, in addition to reimbursement of his out-of-pocket expenses. Mr. Hudson was also granted options for 100,000 shares with an exercise price of $19.50 per share.

The employment of Gerald Lindner, our former Chairman and Chief Executive Officer and his executive assistant was terminated on May 6, 2008. The employment of Donald Boyd, our former Chief Operating Officer and Executive Vice President, was terminated on May 23, 2008. The Company is currently in negotiations with each regarding the amounts due to them under their respective agreements with the Company. We have estimated the termination liability for these employees under their agreements to be $3.9 million which was accrued as of June 30, 2008. The terminated employees have, however, claimed an additional $1.3 million in termination payments. Because this represents a contingent liability and an uncertainty, actual settlement amounts could differ from those amounts accrued.

Richard McLean, the Chief Financial Officer of the Company, has been named as Chief Executive Officer. Mr. McLean will also continue in his position as Chief Financial Officer. Charles Holland, who has been with the Company since 2004, has been promoted to Senior Vice President, Operations.

Exploration of Strategic Alternatives

We are in the process of reviewing strategic opportunities that are available to the Company and its shareholders and that may enhance shareholder value. In this regard, we have retained Credit Suisse to evaluate all of our options for enhancing shareholder value including the sale of the Company, the sale of individual assets, and potential business combinations.

Sandersville PPA

On June 6, 2008, KGen Sandersville LLC entered into a power purchase agreement with Southern Power Company ("Sandersville PPA") expiring on December 31, 2015. Under the terms of the Sandersville PPA, KGen Sandersville LLC will sell a unit contingent 250 to 280 MW of capacity and associated energy to Southern Power Company. The capacity price under the contract escalates annually. The PPA commences on June 1, 2011, and therefore, no capacity revenues were recognized for the year ended June 30, 2008.

Results of Operations

The results of operations for the year ended June 30, 2008 are presented below. The acquisition of KGLLC closed on February 8, 2007 and prior to the acquisition closing, KGen did not have operations or expenses. In addition and as a result, we have limited financial information from our 2007 fiscal year for comparison purposes as KGLLC's results of operations are only included in our consolidated results of operations from February 8, 2007. However, in order to facilitate management's discussion and analysis, we have presented the results of operations for the year ended June 30, 2007 of our predecessor, KGLLC, combined with KGen for the period from February 8, 2007 through June 30, 2007. As a result of the acquisition, the assets and liabilities of KGLLC were restated to fair value as required under FAS 141, *Business Combinations* and we entered into a new Credit Facility.

For a number of reasons, the historical results of operations of our predecessor are not comparable to our results of operations after the KGLLC acquisition. In connection with the KGLLC acquisition, we substantially changed the capital structure of KGen as compared to that of KGLLC prior to our acquisition. The following discussion identifies and summarizes these and certain other factors that impair the comparability of results between the Company and our predecessor.

- Capitalization—Prior to the acquisition of KGLLC, we completed a private placement of 55,476,784 shares at $14.00 per share, which generated net proceeds to us of $722.0 million. Our predecessor was owned by funds associated with a private equity firm that focused operations on cash flows from our assets, including through sales of non-operating power plants.

- Assets held for sale—On January 1, 2006, our predecessor determined to sell certain assets. During the year ended June 30, 2007, our predecessor closed sales on these assets, resulting in net gains on the sale of assets of $110.1 million. The results of operations for these assets were included in results of operations through the respective sales dates.

- Effects of the KGLLC Acquisition—In connection with the KGLLC acquisition, the purchase price for the member interests of $927.3 million was allocated to the acquired assets. As a result, our asset and intangible values were revalued and are substantially higher than the book values of our predecessor. Additionally, the asset lives were re-determined. These revaluations led to significantly increased levels of depreciation and amortization expense.
- Interest expense—In connection with the KGLLC acquisition, our predecessor repaid in full $413.8 million of secured indebtedness under its credit agreement. To finance the KGLLC acquisition, we entered into a credit agreement for a $200.0 million seven-year term loan. See Note 6, *Long Term Debt,* in the notes to the consolidated financial statements for further discussion of our existing credit agreement. As a result of the replacement of the old credit facility, which had significantly higher debt levels and interest rates, with the new credit facility, we have significantly lower interest expense.
- Taxes—Our predecessor was a limited liability company and, as such was treated as a partnership for federal and state income tax purposes. KGen is a taxable corporation and is subject to federal and state income tax on our taxable earnings.
- Share based payments—In connection with our equity offering and the KGLLC acquisition, certain employees were granted options to purchase common stock under our equity incentive plan. See Note 11, *Share-Based Payments*, in the notes to the consolidated financial statements for further discussion of the options outstanding. As a result, we have implemented SFAS 123(R) and are recognizing compensation expense related to the stock options outstanding. Our predecessor had no share-based payment transactions.

Our results of operations are subject to seasonal variations since demand for electricity, and thus, production capacity, varies with weather conditions. For our merchant plants, we earn the majority of our revenues in the months of May through September. Months other than the peak summer months historically have not been profitable for KGen and are the months during which we seek to perform scheduled maintenance-related activities.

Consolidated Results of Operations of KGen for the Year Ended June 30, 2008 compared to the combined period from July 1, 2006 through February 7, 2007 of our Predecessor and February 8, 2007 through June 30, 2007 of KGen.

The following table sets forth our results of operations for the year ended June 30, 2008, and the results of operations for the combined period from July 1, 2006 through February 7, 2007 of our

predecessor and February 8, 2007 through June 30, 2007 of KGen, respectively, which are expressed in thousands of dollars, except per share amounts:

	KGen	Predecessor & KGen		
	For the Year Ended June 30, 2008	For the Year Ended June 30, 2007	Change	% Change
Revenues:				
Energy sales	$ 308,605	$228,477	$ 80,128	35%
Capacity sales	51,416	50,238	1,178	2%
Total revenues	360,021	278,715	81,306	29%
Operating expenses:				
Cost of fuel	268,978	193,203	75,775	39%
Operating and maintenance	52,065	21,271	30,794	145%
Gas transportation	16,382	15,952	430	3%
Selling, general, and administrative	29,418	22,212	7,206	32%
Acquistion contract termination loss	37,190	—	37,190	100%
Depreciation	24,068	16,778	7,290	43%
Auxiliary power	8,437	6,836	1,601	23%
Insurance	3,177	3,570	(393)	−11%
Total operating expenses	439,715	279,822	159,893	57%
Operating loss	(79,694)	(1,107)	(78,587)	7099%
Other income (expenses):				
Net gain on sale of assets	—	110,109	(110,109)	−100%
Interest expense	(16,513)	(37,384)	20,871	−56%
Taxes, other than income taxes	(3,457)	(4,267)	810	−19%
Interest income	2,796	4,713	(1,917)	−41%
Other	(7,065)	(2,625)	(4,440)	169%
Total other income (expenses)	(24,239)	70,546	(94,785)	−134%
Net (loss) income before taxes	(103,933)	69,439	(173,372)	−250%
Income tax benefit	—	3,602	(3,602)	−100%
Net (loss) income after taxes	$(103,933)	$ 73,041	$(176,974)	−242%

Selected Operating and Business Metrics

		1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
Selected Financial and Operating Data						
Total generation (GWh)	FY 2007	1,702	472	435	1,007	3,616
	FY 2008	2,003	743	779	900	4,425
	change	301	271	344	(107)	809
	change %	18%	57%	79%	−11%	22%
Merchant generation (GWh)	FY 2007	1,327	431	379	794	2,931
	FY 2008	1,428	637	721	684	3,470
	change	101	206	342	(110)	539
	change %	8%	48%	90%	−14%	18%
Merchant energy gross margin (in thousands)	FY 2007	$19,631	$3,498	$2,895	$8,620	$34,644
	FY 2008	$22,429	$5,752	$3,966	$8,457	$40,604
	change	$ 2,798	$2,254	$1,071	$ (163)	$ 5,960
	change %	14%	64%	37%	−2%	17%
Merchant energy gross margin/merchant generation ($/MWh)	FY 2007	$ 14.79	$ 8.12	$ 7.64	$10.86	$ 11.82
	FY 2008	$ 15.71	$ 9.03	$ 5.50	$12.36	$ 11.70
	change	$ 0.92	$ 0.91	$(2.14)	$ 1.50	$ (0.12)
	change %	6%	11%	−28%	14%	−1%
Selected Market Data						
Average on-peak market power price—Entergy ($/MWh)	FY 2007	$ 58.82	$49.59	$53.96	$59.98	$ 55.58
	FY 2008	$ 57.11	$52.31	$63.99	$79.88	$ 63.27
	change	$ (1.71)	$ 2.72	$10.03	$19.90	$ 7.69
	change %	−3%	5%	19%	33%	14%
Average on-peak market power price—Southern ($/MWh)	FY 2007	$ 59.21	$47.13	$51.75	$60.00	$ 54.52
	FY 2008	$ 60.36	$52.17	$62.60	$79.87	$ 63.71
	change	$ 1.15	$ 5.04	$10.85	$19.87	$ 9.19
	change %	2%	11%	21%	33%	17%
Average Henry Hub gas price ($/MMbtu)	FY 2007	$ 6.09	$ 6.59	$ 7.13	$ 7.54	$ 6.83
	FY 2008	$ 6.17	$ 6.92	$ 8.58	$11.32	$ 8.24
	change	$ 0.08	$ 0.33	$ 1.45	$ 3.78	$ 1.41
	change %	1%	5%	20%	50%	21%
Selected Weather Data						
Actual CDDs(1)	FY 2007	4,074	236	—	2,155	6,465
	FY 2008	4,329	431	—	2,019	6,779
	change	255	195	—	(136)	314
	change %	6%	83%	—	−6%	5%
Normal CDDs	FY 2007	3,699	62	—	1,517	5,278
	FY 2008	3,699	62	—	1,517	5,278
	change	—	—	—	—	—
	change %	0%	0%	—	0%	0%
Actual HDDs (2)	FY 2007	—	2,716	4,209	—	6,925
	FY 2008	—	2,495	4,621	—	7,116
	change	—	(221)	412	—	191
	change %	—	−8%	10%	—	3%
Normal HDDs	FY 2007	—	3,087	4,828	—	7,915
	FY 2008	—	3,087	4,899	—	7,986
	change	—	—	71	—	71
	change %	—	0%	1%	—	1%

Notes:

(1) CDD represents the number of degrees that the mean temperature for a particular day is above 65 degrees Fahrenheit. The CDDs are then accumulated for a given period.

(2) HDD represents the number of degrees that the mean temperature for a particular day is below 65 degrees Fahrenheit. The HDDs are then accumulated for a given period.

GAAP to Non-GAAP Reconciliation

Energy Gross Margin and Merchant Energy Gross Margin

	KGen	Predecessor & KGen
	For the Year Ended June 30, 2008	For the Year Ended June 30, 2007
	(in thousands)	
Energy sales	$308,605	$228,477
Cost of fuel	268,978	193,203
Energy gross margin	39,627	35,274
Less: Murray I energy sales	62,617	43,093
Add: Murray I fuel	63,594	42,463
Merchant energy gross margin	$ 40,604	$ 34,644

Historical Results of Operations for the Year ended June 30, 2008 compared to the combined period from July 1, 2006 through February 7, 2007 of our Predecessor and February 8, 2007 through June 30, 2007 of KGen.

We analyze our results of operations related to energy sales according to energy gross margin. We define energy gross margin as energy sales less the related cost of fuel. This metric is one measure of our efficiency in converting natural gas expense into revenues. We consider our merchant plants to be Hinds, Hot Spring, Murray II, and Sandersville because they are not currently subject to long-term sales agreements. Our Murray I plant operates under the long-term GPC PPA.

Energy gross margin increased $4.4 million to $39.6 million for the year ended June 30, 2008 compared to the same period in the previous year due to a $6.0 million increase in merchant energy gross margin offset by a $1.6 million decrease in energy gross margin from our Murray I plant. The $6.0 million merchant energy gross margin increase resulted from increased merchant generation. Merchant generation increased by 539 GWh, or 18%, to 3,470 GWh for the year ended June 30, 2008 and implied merchant spark spread decreased by $0.12/MWh, or 1%, to $11.70/MWh for the year ended June 30, 2008. A contributing factor of the increase in merchant generation and the decrease in implied merchant spark spread was due to the large increase, 90% , in merchant generation for the three months ended March 31, 2008 at a lower spark spread as a result of two awarded month long sales contracts for the Hot Spring facility in January and February 2008. The terms of these two contracts provided for Hot Spring to operate on 16-hour schedules for 60 consecutive days. The $1.6 million decrease in energy gross margin from the Murray I plant resulted, in part, from increased amortization expense, which reduces energy sales, due to the revaluation of the intangible contracts from the KGLLC acquisition. Net amortization expense increased to $8.1 million for the year ended June 30, 2008 as compared to $4.8 million for the year ended June 30, 2007. Excluding noncash amortization expense, energy gross margin for our Murray I plant increased $1.7 million during the period. This $1.7 million increase is largely due to an increase in Murray I generation of 270 GWh, or 39%, to 955 GWh for the year ended June 30, 2008.

Operating expenses, excluding cost of fuel, for the year ended June 30, 2008 were $170.7 million, compared to $86.6 million for the year ended June 30, 2007. This $84.1 million increase includes, but is not solely derived from, a $30.8 million increase in operating and maintenance expenses, a $7.2 million increase in selling, general, and administrative expenses, $37.2 million in expenses associated with the CEH acquisition, which includes a $35.0 million payment for the termination thereof, a $7.3 million increase in depreciation expense, and a $1.6 million increase in auxiliary power. The operating and maintenance expense increase was primarily related to $16.5 million and $14.0 million in charges in connection with the scheduled major maintenance outages at the Hot Spring and Murray facilities, respectively. The increase in selling, general, and administrative expenses for the year ended June 30, 2008 primarily related to a $6.0 million increase in noncash option expenses and a $3.9 million termination accrual recorded offset by

a decrease of $2.4 million in employee bonuses. The increase in depreciation expense resulted from the revaluation of the fixed assets from the KGLLC acquisition and redetermination of asset lives as prescribed by FAS 141, *Business Combinations*. The increase in auxiliary power for the year ended June 30, 2008 of $1.6 million related to a $0.4 million water settlement with the City of Jackson for the Hinds facility and the remaining related to a 15% rate increase in auxiliary power for the Murray facilities as well as an increase in the peak demand fee during the months where there were no starts.

As a result of the foregoing, we incurred an operating loss of $79.7 million for the year ended June 30, 2008 compared to an operating loss of $1.1 million for the year ended June 30, 2007.

Other income (expense) was a $24.2 million expense and $70.5 million of income for the year ended June 30, 2008 and 2007, respectively. The primary components of other income (expense) are as follows:

- Our predecessor realized a $110.1 million net gain on sale of assets during the period from July 1, 2006 through February 7, 2007. These assets were not purchased as part of the KGLLC acquisition.
- Interest expense for the year ended June 30, 2008 was $16.5 million as compared to $37.4 million for the same year ended in 2007. The decrease in interest expense relates to a significant reduction in outstanding debt and interest rates compared to our predecessor.
- Other expense for the year ended June 30, 2008 and 2007 was $7.1 million and $2.6 million, respectively. The expense at June 30, 2008 primarily represented the losses on derivatives associated with our interest rate hedging due to the change of the fair value and the cash settlements on our swaps and caps. The expense at June 30, 2007 represented $0.8 million of gain on derivatives, $2.4 million due to potential state tax liabilities relating to the assets that were sold, and $1.0 million of letter of credit fees.

As a result of the foregoing, we incurred a net loss of $103.9 million for the year ended June 30, 2008 compared to a net income of $73.0 million for the year ended June 30, 2007.

Liquidity and Capital Resources

Liquidity Position

We expect that cash on hand, cash flow provided by operations, and cash available under our working capital facility will satisfy our short-term liquidity needs with respect to our current portfolio of working capital assets over the next twelve months. Our liquidity is comprised of the following at June 30, 2008 (in millions of dollars):

Unrestricted cash and cash equivalents	$ 51,493
Working capital revolver and synthetic letter of credit facility (net of letters of credit issued thereunder)	87,540
Total	$139,033

Our principal sources of funds are cash flows from operations and borrowings under our Credit Facility. Our principal use of funds consists of operating expenditures, payments of principal and interest on our Credit Facility, and capital expenditures. On June 30, 2008 we had approximately $87.5 million available under the revolving working capital and synthetic letter of credit facilities of our Credit Facility for activities related to our current facilities and cash on hand of $51.5 million, of which $40.5 million is not subject to lien of the Credit Agreement. Management believes that these amounts and cash flows from operations will be adequate to fund capital expenditures and other liquidity commitments.

Debt and Credit Facility

Our only debt for borrowed money is evidenced by our Credit Facility, which consists of:

- a $200.0 million term loan facility, or the Term Loan Facility;
- a $80.0 million working capital facility for letters of credit and other liquidity needs, the Working Capital Facility; and
- a $120.0 million synthetic letter of credit facility to support the collateral requirements under the project documents related to the facilities, or the Collateral Credit Facility.

Borrowings under the Term Loan Facility were made by KGen LLC, our subsidiary, and were used to refinance existing indebtedness of KGen LLC, pay fees and expenses relating to the Credit Facility, and fund required reserves. Future borrowings under the Credit Facility are subject to the satisfaction of customary conditions.

Interest Rate. Borrowings under the Credit Facility bear interest at a spread above LIBOR-based loans. The $200.0 million Term Loan Facility bears interest at LIBOR plus 175 basis points. Please refer to "Number 7. *Quantitative and Qualitative Disclosures About Market Risk*." The $80.0 million Working Capital Facility bears interest at 200 basis points.

Fees. We pay a 50 basis point fee on the unused portion of commitments and all un-drawn letters of credit under the Working Capital Facility and a 191 basis point fee on the $120.0 million amount of the Collateral Credit Facility.

Maturity Date. The maturity date of the Credit Facility is February 8, 2014, except that the maturity date of the Working Capital Facility is February 8, 2012.

Security. Borrowings under the Credit Facility are secured by substantially all of the assets of our subsidiaries, which constitute all of our operating assets and generate substantially all of our operating cash flows. Our only significant asset not subject to the lien of the Credit Agreement was a cash balance of $40.5 million at June 30, 2008 that was held at our parent company level.

The Credit Facility and related financing documents contain various affirmative and negative covenants, including financial covenants, limitations on KGen LLC's ability to pay dividends and restrictions on the use of available cash for operations, except as required for debt service payments and an event of default in the event of a change in control of KGen. At June 30, 2008, we were in compliance with the covenants contained within our Credit Facility.

Contractual Obligations

Our contractual obligations consist of principal and interest payments on term debt, obligations under firm gas transportation agreements, and leasehold payments. We intend to fund our contractual obligations through our internally generated cash flows from operations as well as from available borrowing under our revolving Working Capital Facility under our Credit Facility. We believe that our sources of liquidity will be sufficient to meet our contractual obligations. The $200.0 million term debt was funded on February 8,

2007. The following table sets forth our contractual obligations as of June 30, 2008 (in thousands of dollars):

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Term debt(1)	197,000	2,000	4,000	4,000	187,000
Pipeline payments	178,741	13,576	40,187	38,976	86,003
LTSA	9,940	1,007	3,161	3,384	2,388
Other	6,360	766	1,524	1,502	2,568
Total	392,042	17,348	48,872	47,862	277,959

(1) Future interest obligations under our term debt are uncertain due to the variable interest rate. The term debt bears interest at an adjusted rate of LIBOR plus 175 basis points, or 4.5% at June 30, 2008. Based on a 4.5% interest rate at June 30, 2008, $8.8 million, $17.4 million, $17.0 million and $4.2 million would be due under the term debt facility in less than one year, one to three years, three to five years and more than five years, respectively.

Capital Expenditures and Major Maintenance

Total capital expenditures for the year ended June 30, 2008 and for the period from February 8, 2007 to June 30, 2007 were $1.9 million and $0.4 million, respectively.

We incur costs for major maintenance on the Plants which is expensed in the period incurred. We expect to incur major maintenance expenditures in the first and third quarters of fiscal 2009 in the amount of $17.2 million.

Cash Flow Analysis

The following table summarizes our changes in cash (in thousands of dollars):

	For Year Ended June 30, 2008	From December 4, 2006 (date of inception) to June 30, 2007
Statement of Cash Flow Data:		
Cash flows provided by (used in):		
Operating activities	$(53,165)	$ (15,683)
Investing activities	16,343	(811,789)
Financing activities	(2,000)	917,787
(Decrease) Increase in cash and cash equivalents	(38,822)	90,315
Cash and cash equivalents at beginning of period	90,315	—
Cash and cash equivalents at end of period	$ 51,493	$ 90,315

Cash Flows from Operating Activities. Our cash flows used in operations were $53.2 million for the year ended June 30, 2008, primarily related to our net loss of $103.9 million which included $37.2 million of expenses related to the CEH transaction, offset somewhat by collections of accounts receivable. We also incurred $15.7 million of cash interest during the year based on our outstanding credit facility.

Cash Flows from Investing Activities. Our cash flow from investing activities for the year ended June 30, 2008 were $16.4 million and primarily related to the use of restricted cash requirements for major maintenance. We also incurred $1.9 million in property, plant, and equipment additions, $1.4 million related to general plant additions, and the remaining $0.5 million related to leasehold improvements to the

corporate office space. This was offset by the redemption of a short- term investment in the amount of $2.0 million in May 2008.

Cash Flows from Financing Activities. Our cash flow from financing activities for the year ended June 30, 2008 was $2.0 million and represented the quarterly principal payments of long term debt as required by the Credit Facility.

Off-Balance Sheet Arrangements

The Company did not participate in or have any off-balance sheet arrangements for the year ended June 30, 2008 or for the period from December 4, 2006 (Date of Inception) to June 30, 2007.

Discussion of Critical Accounting Policies

In preparing our consolidated financial statements in accordance with accounting principles generally accepted in the United States, KGen is required to use its judgment in making estimates and assumptions that affect the amounts reported in its financial statements and related notes. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Many of our critical accounting policies are those subject to significant judgments and uncertainties which could potentially result in materially different results under different conditions and assumptions. Future events rarely develop exactly as forecast, and the best estimates routinely require adjustment.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, or SFAS No. 157. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. Rather, its application will be made pursuant to other accounting pronouncements that require or permit fair value measurements. SFAS No.157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. We will adopt SFAS No. 157 effective July 1, 2008. The provisions of SFAS No. 157 are to be applied prospectively upon adoption, except for limited specified exceptions. The Company is evaluating the requirements of SFAS No. 157 and does not expect the adoption to have a material impact on its Balance Sheet or Statement of Operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, or SFAS No. 159, which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. We will adopt SFAS 159 effective July 1, 2008. The Company is evaluating the requirements of SFAS No. 159 and does not expect the adoption to have a material impact on its Balance Sheet or Statement of Operations.

Number 7. ***Quantitative and Qualitative Disclosures About Market Risk***

Interest Rate Risks

Our primary market risk is the potential impact of changes in interest rates on our variable rate borrowings. The terms of our new Credit Facility require us to maintain interest hedge arrangements to reduce our exposure to market risk from changes in the interest rate. As a result, we have entered into interest rate swaps and caps in order to mitigate the risk associated with the variable rate borrowings.

KGen LLC had two interest rate option contracts, or Caps, that were accounted for at fair value. Both contracts expired on September 30, 2007.

Additionally KGen LLC has five current interest rate swap agreements. These interest rate swaps are intended to hedge the risk associated with variable interest rates. For each of the interest rate swaps, the Company pays its counterparty the equivalent of a fixed interest payment on a predetermined notional value, and we receive the equivalent of a floating interest payment based on three-month LIBOR rate calculated on the same notional value. These payments are made on a quarterly basis. While the notional value of each of the swaps does not vary over time, the swaps are designed to mature sequentially. The total notional amount of the swaps is $165.0 million with an average interest rate payable to KGen of 5.1%. The following is a summary of the swaps:

	Maturity Date	Notional Amount	Fair Value at June 30, 2008	Fixed Rate
		(in millions)		
Contract #1	3-31-2008	$33.0	$ —	5.250%
Contract #2	3-31-2009	$33.0	$ (493,062)	5.172%
Contract #3	3-31-2010	$33.0	$ (941,875)	5.113%
Contract #4	3-31-2011	$33.0	$(1,183,557)	5.115%
Contract #5	3-31-2012	$33.0	$(1,340,481)	5.138%
Contract #6	3-31-2013	$33.0	$(1,480,385)	5.169%

As of June 30, 2008, the majority of our outstanding variable rate debt has been converted to a fixed rate through the swap agreements. We are exposed to credit related losses in the event of non-performance by the counterparty to the interest rate swaps, however our counterparty is a major financial institution and we consider such risk of loss to be minimal. We will continue to monitor the creditworthiness of our counterparty in light of the current unfavorable financial markets.

Number 8. ***Financial Statements and Supplementary Data***

KGen Power Corporation

Consolidated Financial Statements

For the Year Ended June 30, 2008 and For the Period From December 4, 2006 (Date of Inception) to June 30, 2007

Contents

Report of Independent Registered Public Accounting Firm 36

Consolidated Financial Statements

Consolidated Balance Sheets 37
Consolidated Statements of Operations 38
Consolidated Statements of Stockholders' Equity 39
Consolidated Statements of Cash Flows 40
Notes to Consolidated Financial Statements 41

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of KGen Power Corporation

We have audited the accompanying consolidated balance sheets of KGen Power Corporation and subsidiaries as of June 30, 2008 and 2007, and the related consolidated statements of operations and stockholders' equity and cash flows for the year ended June 30, 2008 and for the period from December 4, 2006 (Date of Inception) through June 30, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of KGen Power Corporation and subsidiaries at June 30, 2008 and 2007, and the consolidated results of their operations and their cash flows for the year ended June 30, 2008 and for the period from December 4, 2006 (Date of Inception) through June 30, 2007, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Houston, Texas
September 26, 2008

KGen Power Corporation

Consolidated Balance Sheets

(in thousands, except per share amounts)

	June 30, 2008	June 30, 2007
Assets		
Current assets:		
Cash and cash equivalents	**$ 51,493**	$ 90,315
Restricted cash and cash equivalents	**24,325**	40,205
Short-term investments	**2,199**	4,240
Accounts receivable	**36,763**	24,951
Spare parts inventories	**7,409**	7,074
Prepaid expenses and other current assets	**1,272**	1,012
Total current assets	**123,461**	167,797
Property, plant, and equipment	**704,343**	702,459
Less: accumulated depreciation	**33,229**	9,164
Total property, plant, and equipment	**671,114**	693,295
Contract-based intangibles (net of $14,842 and $4,186 of accumulated amortization, respectively)	**68,700**	79,356
Deferred charge	**2,101**	589
Deferred financing fees (net of $1,243 and $348 of accumulated amortization, respectively)	**5,021**	5,916
Other noncurrent assets	**325**	1,814
Total assets	**$ 870,722**	$948,767
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable and accrued liabilities	**$ 37,457**	$ 18,589
Current portion of long-term debt	**2,000**	2,000
Total current liabilities	**39,457**	20,589
Long-term debt	**195,000**	197,000
Contract-based intangibles (net of $2,243 and $731 of accumulated amortization, respectively)	**17,925**	19,437
Other noncurrent liabilities	**2,535**	—
Commitments and Contingencies (Note 8)	**—**	—
Stockholders' equity:		
Common stock (par value $.01; 150,000 shares authorized; 55,963 and 55,945 shares issued and outstanding at June 30, 2008 and 2007, respectively)	**560**	559
Additional paid in capital	**738,215**	730,219
Accumulated deficit	**(122,970)**	(19,037)
Total stockholders' equity	**615,805**	711,741
Total liabilities and stockholders' equity	**$ 870,722**	$948,767

The accompanying notes are an integral part of these financial statements.

KGen Power Corporation

Consolidated Statements of Operations

(in thousands, except per share amounts)

	For the Year Ended June 30, 2008	From December 4, 2006 (Date of Inception) to June 30, 2007
Revenues:		
Energy sales	**$ 308,605**	$ 87,396
Capacity sales	**51,416**	15,737
Total revenues	**360,021**	103,133
Operating expenses:		
Cost of fuel	**268,978**	78,127
Operating and maintenance	**52,065**	9,722
Gas transportation	**16,382**	6,279
Selling, general, and administrative	**29,418**	11,777
Acquisition contract termination loss (Note 8)	**37,190**	—
Depreciation	**24,068**	9,164
Auxiliary power	**8,437**	2,649
Insurance	**3,177**	1,531
Total operating expenses	**439,715**	119,249
Operating loss	**(79,694)**	(16,116)
Other income (expenses):		
Interest expense	**(16,513)**	(7,153)
Taxes, other than income taxes	**(3,457)**	(1,161)
Interest income	**2,796**	879
Other	**(7,065)**	912
Total other expenses	**(24,239)**	(6,523)
Net loss before taxes	**(103,933)**	(22,639)
Income tax benefit	**—**	3,602
Net loss after taxes	**$(103,933)**	$(19,037)
Net loss per share—basic and diluted	**$ (1.86)**	$ (0.39)
Weighted average shares outstanding—basic and diluted	**55,949**	48,603

The accompanying notes are an integral part of these financial statements.

KGen Power Corporation

Consolidated Statements of Stockholders' Equity

(in thousands)

For the Year Ended June 30, 2008 and from December 4, 2006 (Date of Inception) to June 30, 2007

	Common Stock		Additional Paid in Capital	Accumulated Deficit	Total
	Shares	Amount			
Balance at December 4, 2006 (Date of Inception)	—	$ —	$ —	$ —	$ —
Common shares issued—Private Equity Offering	55,634	556	724,495	—	725,051
Common shares issued—KGLLC Acquisition	308	3	4,007	—	4,010
Stock-based compensation expense	3	—	1,717	—	1,717
Net loss	—	—	—	(19,037)	(19,037)
Balance at June 30, 2007	**55,945**	**$559**	**$730,219**	**$ (19,037)**	**$ 711,741**
Stock-based compensation expense	**18**	**—**	**7,997**	**—**	**7,997**
Net loss	**—**	**—**	**—**	**(103,933)**	**(103,933)**
Balance at June 30, 2008	**55,963**	**559**	**738,216**	**(122,970)**	**615,805**

The accompanying notes are an integral part of these financial statements.

KGen Power Corporation

Consolidated Statements of Cash Flows

(in thousands)

	For the Year Ended June 30, 2008	From December 4, 2006 (Date of Inception) to June 30, 2007
Cash flows from operating activities		
Net loss	$(103,933)	$ (19,037)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	24,068	9,164
Deferred income taxes	—	(2,155)
Amortization of deferred financing fees	895	348
Amortization of contract-based intangibles	9,144	3,455
Change in fair value of derivative instruments	6,588	(1,113)
Stock compensation expense	7,997	1,717
Write off of short-term investment	—	35
Changes in operating assets and liabilities:		
Accounts receivable	(11,812)	(20,077)
Spare parts inventories	(335)	145
Prepaid expenses and other current assets	(919)	1,332
Other noncurrent assets	691	(770)
Deferred charge	(1,512)	(589)
Accounts payable and accrued liabilities	15,928	11,862
Other noncurrent liabilities	35	—
Net cash used in operating activities	(53,165)	(15,683)
Cash flows from investing activities		
Purchase of KGLLC, net of cash acquired	—	(773,858)
Purchase of property, plant, and equipment	(1,887)	(396)
Proceeds from settlement of derivative instruments	309	704
Short-term investment	2,041	1,966
Use of (Investment in) restricted cash and cash equivalents	15,880	(40,205)
Net cash provided by (used in) investing activities	16,343	(811,789)
Cash flows from financing activities		
Net proceeds from sale of common stock	—	725,051
Net proceeds from debt borrowings	—	193,736
Repayment of debt	(2,000)	(1,000)
Net cash (used in) provided by financing activities	(2,000)	917,787
(Decrease) Increase in cash and cash equivalents	(38,822)	90,315
Cash and cash equivalents at beginning of period	90,315	—
Cash and cash equivalents at end of period	$ 51,493	$ 90,315
Cash paid for		
Income taxes	$ —	$ —
Interest	$ 15,713	$ 6,710
Non-cash transactions		
Grant of shares for Board fees	$ 310	$ 50
Grant of shares in exchange for an ownership interest of KGen Partners LLC	$ —	$ 4,010

The accompanying notes are an integral part of these financial statements.

KGen Power Corporation

Notes to Consolidated Financial Statements

For the Year ended June 30, 2008 and from December 4, 2006 (Date of Inception) to June 30, 2007

1. Nature of Business and Significant Accounting Policies

KGen Power Corporation (the "Company") was incorporated in Delaware on December 4, 2006, which is the date of inception. The Company owns and operates electric power generation plants and sell electricity and electrical generation capacity in the United States.

On December 28, 2006, the Company completed the initial placement of shares in a private equity offering (the "Offering"). The proceeds of the Offering were temporarily restricted and were to be used for the acquisition of KGen Partners LLC ("KGLLC") and certain of its subsidiaries. Concurrently with the Offering, on December 28, 2006, the Company's Board of Directors approved the acquisition of KGLLC and subsequently entered into a Membership Interest Purchase and Sale Agreement, whereby the Company agreed to acquire 100% of the member interests in KGLLC. On February 8, 2007, the acquisition was completed and the results of KGLLC's operations have been included in the consolidated financial statements since that date. The Company did not have operations prior to the acquisition of KGLLC. As a result of the acquisition completed on February 8, 2007, the period from inception through June 30, 2007 does not reflect a comparable period of operations compared to the year ended June 30, 2008.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and those of KGen Partners LLC, KGen Power Management Inc., KGen LLC, KGen Murray LLC, KGen Murray I and II LLC, KGen Hot Spring LLC, KGen Hinds LLC, KGen Sandersville LLC, and KGen Acquisition I LLC, all direct or indirect 100% owned subsidiaries, as well as any variable interest entities for which the Company is the primary beneficiary (since the acquisition of KGLLC). All significant intercompany balances and transactions have been eliminated in consolidation.

Reclassifications

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Such estimates include the fair value of acquired assets, estimated asset lives, recovery of investments in long-lived assets, utilization of deferred tax assets, and fair value determination of financial instruments and share-based compensation. Actual results could differ from these estimates.

Revenue Recognition

Revenues derived from electric power energy sales are recognized as power is delivered. Revenues derived from long-term capacity sales contracts are recognized based on the monthly minimum commitment component adjusted for seasonal and other factors as appropriate on a straight-line basis over the terms of the contracts.

1. Nature of Business and Significant Accounting Policies (Continued)

Effects of Seasonality

The electric power industry is highly seasonal. In the summer months, especially in the southeastern United States, demand for electricity is usually much higher as a result of increased use of air conditioning. The Company's results of operations are subject to seasonal variations since demand for electricity, and thus production capacity, varies with weather conditions. Four of the plants operate on a merchant basis without long-term purchase agreements, and therefore are exposed to significant volatility in prices and generation demand. The Company earns the majority of its annual revenues in the five summer months, May through September. The shoulder periods, months other than the peak summer months, historically have not been profitable for the Company and are the months during which the Company seeks to perform scheduled maintenance related activities.

Cash and Cash Equivalents and Restricted Cash and Cash Equivalents

Short-term investments, consisting of money market instruments with original maturities of three months or less, are considered to be cash equivalents and are recorded at cost, which approximates current market value.

Cash and cash equivalents that are contractually restricted for specific purposes are classified as restricted on the balance sheet. Such restricted funds are classified as current and noncurrent based upon the nature of the purpose for which the funds can be used and the expected timing of use of such funds.

Short-Term Investments

Short-term investments, consisting of money market instruments with original maturities of less than twelve months but more than three months, are considered to be short-term investments and are recorded at cost, which approximates current market value.

Spare Parts Inventories

Inventories consist primarily of various consumable spare parts and tools, which are valued at the weighted-average cost method, and are stated at the lower of cost or market.

Contract-Based Intangibles

Contract-based intangibles consist of the estimated fair value of contractual rights and obligations related to power purchase agreements and firm transportation contracts. The intangibles are being amortized using the straight-line method over the life of the specific contracts, and such amortization is reflected as an adjustment to the associated revenue or expense item. The contract-based intangibles are reviewed quarterly for impairment. No impairment was indicated at June 30, 2008 or 2007.

Property, Plant, and Equipment

Property, plant, and equipment is recorded at cost and is depreciated on a straight-line basis over the estimated useful life of the various classes of assets.

1. Nature of Business and Significant Accounting Policies (Continued)

Long-Lived Assets

The Company accounts for long-lived assets in accordance with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS No. 144"). Assets held for use are carried at cost less accumulated depreciation, unless recognition of impairment is necessary. For the year ended June 30, 2008 and period from December 4, 2006 (Date of Inception) to June 30, 2007, no events or changes in circumstances indicated the carrying value of long-lived assets held for use might not be fully recoverable.

Deferred Financing Fees

Included in deferred financing fees are capitalized costs associated with debt issuance. Costs incurred to secure debt were capitalized and are being amortized over the life of the borrowing.

Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and cash equivalents, restricted cash and cash equivalents, short-term investments, accounts receivable, accounts payable, debt instruments, and interest rate derivatives. The carrying value of cash and cash equivalents, restricted cash and cash equivalents, short-term investments, accounts receivable, and accounts payable are representative of their respective fair value due to the short-term nature of these instruments. The carrying value of interest rate derivative instruments represents the fair value, which is based on estimates using standard pricing models that take into account the present value of future cash flows as of the consolidated balance sheet date. The carrying value of the debt instruments approximates the fair value as the instruments bear a floating market-based interest rate.

Concentration of Credit Risk

The Company's only two customers as of June 30, 2008 are Georgia Power Company ("GPC") and Fortis Energy Marketing & Trading GP ("Fortis"). The Company does not believe these customers represent a significant credit risk. However, changes in economic, regulatory, or other factors could have a significant impact on the Company's contractual relationships (See Note 8). Operations of the facilities are dependent on the continued performance by customers and suppliers of their obligations under the relevant power sales contracts and operation and maintenance agreements. If a substantial portion of the Company's long-term power sales contract was modified or terminated, the Company could be adversely affected to the extent that it would be unable to find other customers at the same level of contract profitability. The Company does not believe these customers represent a significant credit risk due to their payment history and, therefore, does not require collateral for accounts receivable. However, the contracts do provide for the customers to post collateral upon certain defined credit-related events.

Repair and Maintenance

Costs incurred to repair and maintain the power plants, including major maintenance costs, are expensed as incurred.

1. Nature of Business and Significant Accounting Policies (Continued)

Contingencies

The Company, in the course of its operations, is subject to claims, lawsuits, and contingencies. Accruals are made in specific instances where it is probable that liabilities will be incurred and where such liabilities can be reasonably estimated.

Income Taxes

The Company accounts for income taxes using the asset and liability method. The asset and liability method requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of (i) temporary differences between financial statement carrying amounts of assets and liabilities and the basis of these assets and liabilities for tax purposes and (ii) operating loss and tax credit carry-forwards for tax purposes. Deferred tax assets are reduced by a valuation allowance when management concludes that it is more likely than not that a portion of the deferred tax assets will not be realized in a future period.

Loss Per Share

Basic loss per share is calculated by dividing net loss by the weighted average number of shares of common stock outstanding during the period. Fully diluted loss per share is computed on the same basis as basic loss per share as the inclusion of any other potential shares outstanding would be anti-dilutive.

	For the Year Ended June 30, 2008	Period from December 4, 2006 (Date of Inception) to June 30, 2007
Numerator:		
Net loss	$(103,933)	$(19,037)
Denominator:		
Weighted average shares outstanding	55,949	48,603
Loss per share—basic and diluted:	$ (1.86)	$ (0.39)

Other Comprehensive Income

The Company has no comprehensive income or loss other than net loss.

Business Segment Information

The Company's business, operation of electric power generation plants and sale of electricity and electrical generation capacity, constitutes a single reportable segment pursuant to SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

1. Nature of Business and Significant Accounting Policies (Continued)

New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. Rather, its application will be made pursuant to other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. The provisions of SFAS No. 157 are to be applied prospectively upon adoption, except for limited specified exceptions. SFAS No. 157 will be effective for the Company on July 1, 2008. The Company is evaluating the requirements of SFAS No. 157 and does not expect the adoption to have a material impact on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS No. 159") which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 will be effective for the Company on July 1, 2008. The Company is evaluating the requirements of SFAS No. 159 and does not expect the adoption to have a material impact on its consolidated financial statements.

2. Equity Offering

The Company was incorporated as a Delaware corporation on December 4, 2006 and was formed to raise equity from the private equity markets and to own and operate electric power generation plants and sell electricity and electrical generation capacity in the United States. The Offering was made in a private placement exempt from registration under the Securities Act of 1933, as amended (the "Securities Act"). The Company engaged the services of Friedman, Billings, Ramsey & Co., Inc. ("FBR") to serve as initial purchaser and placement agent for the Offering.

The initial placement was for 48,240,682 common shares at an offering price of $14.00 per share. The Company also granted FBR an option to purchase or place up to an additional 7,236,102 shares of common stock (the "Over Allotment") at the offering price less the initial purchasers discount within 30 days after closing of the Offering. On December 28, 2006, the Company completed the private placement pending the completion of certain conditions as described in the PSA and funds were deposited in an escrow account. On February 8, 2007, all the conditions of the PSA for the acquisition of KGLLC were satisfied and the funds being held in escrow were released and became available for use by the Company for the acquisition and payment of offering costs.

The Offering proceeds were $722.0 million, net of offering expenses of $53.8 million.

3. KGLLC Acquisition

On December 28, 2006, the Company entered into the PSA. The PSA provided for the acquisition by the Company of 100% of the outstanding member interests in KGLLC, repayment of all the outstanding amounts due under an existing KGLLC credit agreement, completion of a new term loan borrowing and certain entities ("MP Assets") that were not purchased by the Company were transferred to KGen Holdco LLC ("KGen Holdco), an entity controlled by the previous owners of KGLLC. On February 8,

3. KGLLC Acquisition (Continued)

2007, all conditions were satisfied and the acquisition of KGLLC was completed. The results of KGLLC's operations have been included in the consolidated financial statements since that date.

As a result of the acquisition, the Company acquired an indirect 100% interest in the entities holding the Hinds, Hot Spring, Murray I & II, and Sandersville power generating facilities.

Plant	State	Type	Output MW
Murray I	GA	Combined-Cycle	630(1)
Murray II	GA	Combined-Cycle	620
Hinds	MS	Combined-Cycle	520
Hot Spring	AR	Combined-Cycle	620
Sandersville	GA	Simple-Cycle	640

(1) Based upon the most recent performance test, current capacity is designated at 630 MW for the GPC PPA.

The purchase price was $927.3 million and was comprised of the following (in millions of dollars):

Cash	$921.6
Common stock issuance	4.0
Transaction costs	1.7
	$927.3

The $921.6 million cash acquisition payment was comprised of a payment to KGen Holdco of $507.8 million and a payment of $413.8 million to repay outstanding debt of KGLLC. The acquisition of KGLLC by the Company resulted in a change of control under KGLLC's previous financing that required KGLLC to prepay all outstanding debt obligations thereunder.

The Company issued 308,000 shares to GKL Capital LP, an entity controlled by the former Chairman and Chief Executive Officer of the Company, in exchange for its member interests in KGLLC. The $4.0 million value of the shares issued was determined by the market price of the Company's common shares on the date that the acquisition of KGLLC was completed, less applicable placement fees.

KGLLC owned several entities that were not acquired by the Company. Pursuant to the PSA, those entities were transferred to an entity owned by KGen Holdco, an entity controlled by the previous owners of KGLLC. KGen Power Management Inc. entered into a management services agreement with KGen Holdco whereby it agreed to assist KGen Holdco and such entity in the final dissolution of the MP Assets. The services agreement with KGen Holdco was terminated in May 2008.

Purchase Price Allocation

The KGLLC Acquisition was accounted for using the purchase method of accounting under the accounting standards established in SFAS No. 141, *Business Combinations* ("SFAS 141"). As a result, the assets and liabilities acquired by the Company are included in the Company's balance sheet as of June 30, 2007. The Company reflected the results of operations of the KGLLC acquisition beginning February 8,

3. KGLLC Acquisition (Continued)

2007. The Company recorded the estimated fair values of the assets acquired and liabilities assumed at the February 8, 2007 closing date, which are summarized in the following table (in thousands of dollars):

Final Purchase Price Allocation at February 8, 2007

Current assets	$170,470
Property, plant and equipment	699,908
Intangible assets subject to amortization (10.4 year weighted-average useful life):	
Power purchase agreement (5.3 year weighted average useful life)	43,264
Gas transportation agreements (15.8 year weighted-average useful life)	40,278
	83,542
Other assets	245
Total assets acquired	$954,165
Current liabilities	$ 6,727
Gas transportation agreements intangible liabilities subject to amortization (14.8 year weighted average useful life)	20,168
Total liabilities assumed	26,895
Net assets acquired	$927,270

The KGLLC purchase price was less than the estimate of fair value for the net assets acquired. The purchase price was allocated to property plant and equipment and intangible assets and liabilities based on the ratio of purchase price to fair value at the time of acquisition which was determined by appraisals. The purchase price allocation is final and no subsequent adjustments are expected.

Unaudited Pro Forma Results of Operations

The following table sets forth certain unaudited consolidated operating results for the year ended June 30, 2007, as if the KGLLC Acquisition and Offering were consummated as of the beginning of the applicable period. The KGLLC Acquisition was consummated on February 8, 2007. The pro forma information has been derived from the historical consolidated financial statements of the Company and the historical consolidated financial statements of KGLLC. For periods prior to the Company's inception, the results represent that of KGLLC. The pro forma results of operation are for illustrative purposes only. The financial results may have been different had the companies always been combined. You should not rely on the pro forma financial information as being indicative of the historical results that would have

3. KGLLC Acquisition (Continued)

been achieved had the merger occurred in the past or the future financial results that the Company will achieve after the merger (in thousands of dollars, except per share amounts):

	Unaudited Pro forma Resuts of Operations For the Year Ended June 30, 2007
Total operating loss	$ (7,547)
Net loss	(24,722)
Basic and diluted net loss per share:	
Net loss per share	$ (0.44)
Weighted average shares outstanding	55,942

4. Property, Plant, and Equipment

Property, plant, and equipment consists of the following (in thousands of dollars):

	Estimated Useful Life	June 30, 2008	June 30, 2007
Land	—	$ 4,201	$ 4,201
Buildings	40 years	28,612	28,612
Gas and steam turbines	30 years	235,985	235,985
Generators and auxiliaries	30 years	48,402	48,402
Transmission and fuel gas pipelines	30 years	57,191	57,191
Systems and equipment	5-30 years	122,611	122,550
Other plant	3-30 years	207,341	205,518
Total property, plant, and equipment		704,343	702,459
Less: accumulated depreciation		33,229	9,164
Net property, plant, and equipment		$671,114	$693,295

5. Contract-Based Intangibles

Contract-based intangibles net of accumulated amortization consist of the following (in thousands of dollars):

	Term	June 30, 2008	June 30, 2007
Assets			
Murray I Georgia Power contract	May 31, 2012	$31,965	$40,078
Murray firm transportation contracts	Various	36,735	39,278
Total assets		$68,700	$79,356
Liabilities			
Hinds firm transportation contract	March 31, 2011	$ 220	$ 443
Murray firm transportation contract	November 30, 2016	546	612
Hot Spring firm transportation contracts	Various	17,159	18,382
Total liabilities		$17,925	$19,437

For the year ended June 30, 2008, and from December 4, 2006 (Date of Inception) to June 30, 2007, amortization of contract-based power sales rights and obligations was $8.1 million and $3.2 million, respectively, and was recorded as a reduction of energy sales on the consolidated statements of operations. For the year ended June 30, 2008 and for the period from December 4, 2006 (Date of Inception) to June 30, 2007, amortization of contract-based natural gas transportation rights and obligations of $1.0 million and $0.3 million, respectively, was recorded as an increase of gas transportation expenses on the consolidated statements of operations.

6. Long-Term Debt

Long-term debt is summarized as follows (in thousands of dollars):

	Interest Rate	Maturity	June 30, 2008	June 30, 2007
Total debt outstanding	Variable	February 8, 2014	$197,000	$199,000
Less: current portion			2,000	2,000
Total long-term debt			$195,000	$197,000

On February 8, 2007, KGen LLC, a wholly owned subsidiary of the Company, entered into a credit agreement with Morgan Stanley (the "Credit Agreement") and related security deposit agreement (the "Security Deposit Agreement") with Union Bank of California, as collateral agent and The Bank of New York, as depository agent, to provide term debt in the amount of $200.0 million. The term debt bears interest at an adjusted rate based on the London Interbank Offered Rate ("LIBOR") plus 175 basis points, has a term of seven years and requires a $2.0 million principal payment per year made in quarterly installments. KGen LLC's obligations and indebtedness under the Credit Agreement are secured by a security interest in all of the assets and all of the membership interests of KGen LLC and its subsidiaries. The interest rate incurred on the term debt was 4.5% and 7.1% at June 30, 2008 and 2007, respectively.

6. Long-Term Debt (Continued)

The remaining future minimum principal payments subsequent to June 30, 2008, and thereafter are as follows (in thousands of dollars):

2009	$ 2,000
2010	2,000
2011	2,000
2012	2,000
2013	2,000
Thereafter	187,000
Total	$197,000

KGen LLC also entered into an $80.0 million working capital facility for other liquidity needs and a $120.0 million synthetic letter of credit facility to support the collateral requirements at the project level. The working capital facility bears interest at 200 basis points with a 50 basis point commitment fee for any unused portion and has a five-year term. Letters of credit have been issued under the working capital facility as of June 30, 2008 and 2007 for $12.5 million and $14.7 million, respectively. KGen LLC pays a fee of 191 basis points on the $120.0 million synthetic letter of credit facility. The facility has a seven-year term, and as of June 30, 2008, only a $100.0 million letter of credit had been issued under such facility.

The Credit Agreement and related financing documents contain various affirmative and negative covenants, including financial covenants, limitations on KGen LLC's ability to pay dividends and restrictions on the use of available cash for operations, except as required for debt service payments.

Under the terms of agreements governing indebtedness of certain subsidiaries of the Company, such subsidiaries are restricted from making dividend payments, loans or advances to the Company. These restrictions resulted in restricted net assets (as defined in Rule 4-04(e)(3) of Regulation S-X promulgated by the Securities and Exchange Commission) of the Company's subsidiaries exceeding 25% of the consolidated net assets of the Company and its subsidiaries. The amount of restricted net assets was $569.2 million at June 30, 2008, of which $38.1 million was restricted net current assets.

7. Restricted Cash and Cash Equivalents

The Credit Agreement requires KGen LLC to maintain six months of principal and interest payments reserve in cash. At June 30, 2008 and 2007, the restricted balance, in accordance with this requirement, was $7.0 million and $9.9 million, respectively.

Additionally, the Security Deposit Agreement requires KGen LLC reserve the most recent estimate of annual major maintenance expenses. At June 30, 2008 and 2007 the restricted balance, in accordance with this requirement, was $17.3 million and $30.3 million, respectively.

8. Commitments

KGen Murray I and II LLC has a power purchase agreement with GPC ("GPC PPA") expiring May 31, 2012. Under the terms of the GPC PPA, the Company sells a unit contingent 550 to 680 MW of capacity and associated energy to GPC. The capacity price under the GPC PPA escalates annually. The monthly minimum commitment of 550 MW is recognized separately for summer and non-summer months

8. Commitments (Continued)

as capacity revenue on a straight-line basis over the remaining term of the GPC PPA. Actual capacity revenue recognized for the year ended June 30, 2008 and the period from December 4, 2006 (Date of Inception) to June 30, 2007 was based on a 630 MW designation, which was in excess of the monthly minimum commitment.

The future minimum capacity sales payments (subject to the adjustments discussed below and based upon a capacity of 550 MW) to be recognized under the GPC PPA for the remaining years subsequent to June 30, 2008, are as follows (in thousands of dollars):

2009	43,046
2010	43,908
2011	44,785
2012	37,586
Total	$169,325

The Company recognized $49.8 million and $15.7 million, respectively, related to capacity sales on the GPC PPA for the year ended June 30, 2008 and for the period from December 4, 2006 (Date of Inception) to June 30, 2007. The Company recognized $1.5 million and $0.6 million in deferred charges for the year ended June 30, 2008 and for the period from December 4, 2006 (Date of Inception) to June 30, 2007, respectively, which consisted of the difference between the monthly minimum commitment calculated on a straight line-basis over the remaining term of the GPC PPA and actual minimum capacity sales payments due under the GPC PPA.

The price of the associated energy is calculated to approximate a pass-through of fuel and variable operations and maintenance costs. The Company recognized $67.2 million and $17.4 million, respectively, related to energy sales on the GPC PPA for the year ended June 30, 2008 and for the period from December 4, 2006 (Date of Inception) to June 30, 2007.

The GPC PPA is subject to seasonal and monthly availability adjustments (positive or negative) if available capacity differs from a specified availability level. These adjustments are recognized as capacity sales revenue as associated capacity is provided.

The amount receivable from the GPC PPA was $26.6 million and $19.6 million at June 30, 2008 and 2007, respectively.

Prior to the Company's acquisition of KGLLC, Duke Capital LLC (the "Duke Affiliate") was required under the GPC PPA to post a performance guarantee of $120.0 million through May 2008, $100.0 million from June 2008 through May 2010, $80.0 million from June 2010 through May 2011, and $40.0 million from June 2011 through May 2012. KGLLC reimbursed the Duke affiliate for the actual costs of maintaining the performance guarantee. In connection with the Company's acquisition of KGLLC, the GPC PPA was amended to allow KGen LLC to replace the Duke affiliate performance guarantee with the synthetic letter of credit issued pursuant to the Credit Agreement.

Fortis is the commercial marketer for all of the Company's facilities and Duke Energy Generating Services ("DEGS") is the operations and maintenance provider for all the Company's facilities. The Company compensates Fortis based on a percentage of gross margin not to be less than a minimum

8. Commitments (Continued)

management fee. For the year ended June 30, 2008 and for the period from December 4, 2006 (Date of Inception) to June 30, 2007, the Company paid Fortis $0.5 million and $0.3 million for energy management services and paid DEGS $19.9 million and $6.4 million for operations and maintenance services and fees, respectively. The net receivable from Fortis was $10.1 million and $5.0 million at June 30, 2008 and 2007, respectively.

The Company has a fuel supply agreement with Sequent Energy Management ("Sequent"), a subsidiary of AGL Resources, which supports the GPC PPA. This full requirements contract is for firm delivery of 85,106 decatherms per day ("Dth/day") and expires May 31, 2012, with evergreen annual renewals absent notice from either party. Sequent retains a continuing first priority lien on and security interest in the Company's energy payment receivables from GPC, to the extent of fuel costs owed. The fuel pricing is based on a combination of related gas price indices and other components similar to the pricing in the GPC PPA. Sequent delivers natural gas to several pipeline receipt points from which the Company has long-term gas transportation contracts with East Tennessee Natural Gas Company for 168,000 Dth/day of firm capacity.

The Company has long-term gas transportation contracts with Texas Eastern Transmission Corporation to deliver gas to the Hinds facility. The firm transport contract is subject to evergreen renewals every two years, unless a notice of cancellation is provided by either party and provides firm capacity of 80,000 Dth/day in the summer peak period and lesser amounts in the other parts of the year.

The Company has long-term gas transportation contracts with a subsidiary of CenterPoint Energy, Inc. to deliver gas to the Hot Spring facility. The contracts provide firm capacity of 98,000 Dth/day in the summer peak period and 50,000 Dth/day in the other parts of the year.

The Company entered into long-term service agreements with General Electric International ("GE") to provide maintenance services at the Hinds, Hot Spring, and Murray facilities. All maintenance costs paid to GE are expensed as incurred. The agreement terms vary based on the start date but end after the later of the second major inspection or attainment of specified aggregate factored hours or factored starts. Payments to GE are variable based on parts and work required, plant run time, or equivalent starts and stops.

The Company entered into standby letters of credit that support obligations to The Southern Company, Texas Eastern Transmission Company, GPC, Mississippi Power Company, and Tennessee Valley Authority. At June 30, 2008 and 2007, letters of credit were supported by $2.2 million and $4.2 million, respectively, of short-term investments as collateral.

The Company entered into a standby letter of credit that supports the lease of its executive offices. This letter of credit was supported with $100,000 of cash and cash equivalents as collateral. On April 9, 2008, this letter of credit expired and approximately $113,000 of principal and interest was redeemed to the Company.

8. Commitments (Continued)

For the period from December 4, 2006 (Date of Inception) to June 30, 2007, the Company had a three-year operating lease for its executive office space expiring September 30, 2007. On August 8, 2007, the company executed a new lease, which includes its current space of 10,800 square feet plus an additional 9,400 square feet. In addition, the lease term was extended through September 20, 2017. Rent expense under this lease was $0.4 million and $0.1 million, respectively, for the year ended June 30, 2008 and for the period from December 4, 2006 (Date of Inception) to June 30, 2007.

The future minimum lease payments for the five years subsequent to June 30, 2008, and thereafter are as follows (in thousands of dollars):

2009	$ 571
2010	571
2011	571
2012	571
2013	571
Thereafter	2,568
Total	$5,423

On June 18, 2007, the Company signed a purchase and sales agreement with affiliates of Complete Energy Holdings, LLC (“CEH”) to acquire 1,859 MW of capacity for $1.3 billion, plus working capital adjustments. During the year ended June 30, 2008, the Company entered into a termination and mutual release agreement with CEH and certain of its affiliates pursuant to which the Company made a $35.0 million payment to CEH in full settlement of its liabilities to CEH in connection with the purchase and sale agreement. In addition, the Company incurred $2.2 million in professional fees to certain third-party consultants and advisors that assisted with the evaluation and negotiation of the CEH acquisition. The expenses related to the CEH acquisition were recorded in acquisition contract termination loss on the consolidated statements of operations.

In April 2008, KGen Murray I and II LLC entered into a power and gas purchase agreement to supply 225 MW of capacity and associated energy and 40,000 Dth/day of fuel to Fortis. The agreement commenced on June 1, 2008 and continues through September 30, 2008. For the year ended June 30, 2008, total capacity sales recognized under this contract were $1.6 million.

On April 30, 2008, KGen Hinds LLC entered into a five-year water solutions agreement with GE Mobile Water, Inc. The agreement provides for the treatment and processing of water used at the Hinds facility. Agreement pricing is derived from a combination of a fixed base fee and a variable fee per thousand gallons of water processed. The fee will escalate annually based upon an agreed upon index.

On June 6, 2008, KGen Sandersville LLC entered into a power purchase agreement with Southern Power Company (“Sandersville PPA”) expiring on December 31, 2015. Under the terms of the Sandersville PPA, KGen Sandersville LLC will sell a unit contingent 250 to 280 MW of capacity and associated energy to Southern Power Company. The capacity price under the contract escalates annually. The PPA commences on June 1, 2011, and therefore, no capacity revenues were recognized for the year ended June 30, 2008.

8. Commitments (Continued)

The employment of Gerald Lindner, the former Chairman and Chief Executive Officer and his executive assistant was terminated on May 6, 2008. The employment of Donald Boyd, the former Chief Operating Officer and Executive Vice President, was terminated on May 23, 2008. The Company is currently in negotiations with each regarding the amounts due to them under their respective agreements with the Company. The termination liability for these employees under their agreements is estimated to be $3.9 million which was accrued as of June 30, 2008. The terminated employees have, however, claimed an additional $1.3 million in termination payments. Because this represents a contingent liability and an uncertainty, actual settlement amounts could differ from those amounts accrued.

In connection with the strategic review, the Company has executed retention agreements with its employees. Payments under these agreements are based on the continued employment of the recipient and are triggered only in the event of a sale of the Company, or in the case of certain employees, upon the sale of two or more of our generation facilities. The total amount payable under the retention agreements depends on the whether the transaction completed is a sale of the Company or a sale of two or more of our generation facilities as well as, in the case of the sale of the Company, the price per share received in the sale. The Company has not accrued any amounts related to these agreements.

9. Industrial Development Revenue Bonds

Construction of the Hot Spring, Murray, and Sandersville facilities was financed by various development authorities through the issuance of Industrial Development Revenue Bonds (the "Bonds"). Simultaneous with the Bonds' issuance, the facilities were leased to the project companies subsequently acquired by the Company by the development authority pursuant to either 20-year or 30-year lease agreements. As part of the bond agreements, the development authorities assigned the leases to the bond trustee to secure the Bonds in accordance with the terms of trust indentures. The lease payments are set exactly equal to the bond repayments and are the sole source of retirement for the Bonds. The Company is the sole holder of the Bonds.

The agreements executed in connection with the transfer of the Bonds permit the limited liability companies to make payments to the Company in the form of intercompany book entries without the actual transfer of cash. At June 30, 2008 and 2007, $775.4 million and $775.4 million, respectively, of the Bonds remained outstanding related to the Hot Spring, Sandersville, and Murray projects.

Upon expiration of the lease term or earlier termination of the lease by the repayment of the Bonds, the Company may purchase the properties for a nominal amount.

Under the terms of the Bonds and the related trust indentures and agreements, the Company has constructive ownership of the facilities, which are included in property, plant, and equipment in the accompanying consolidated financial statements. As the Company has the unilateral right to terminate the lease and trust indentures by repaying the Bonds to itself, the principal balance of the Bonds and the lease obligation have been presented net in the accompanying consolidated balance sheets. Additionally, the lease payments and the bond interest income have been presented net in the accompanying consolidated statements of operations.

10. Derivatives

The Company accounts for derivative instruments in accordance with the provisions of SFAS No. 133, A*ccounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 137, SFAS No. 138, and SFAS No. 149, ("SFAS No. 133"). SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. The statement requires an entity to recognize all derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. The ongoing effects are dependent on future market conditions.

The Company acquired two interest rate option contracts ("Caps") from KGLLC for purposes of reducing exposure to interest rate fluctuations as required under credit agreement terms. These contracts were accounted for at fair value and expired on September 30, 2007. The short-term portion of the Caps as of June 30, 2007 was $0.3 million and was recorded in other current assets. The change in fair value of the contracts and all related amounts in connection with settlement were recorded in other in other income and expense. The Caps had notional amounts of $162.5 million and $150.0 million at June 30, 2007, and paid KGen LLC if the LIBOR rate exceeded 4.5% and 5.5%, respectively.

On May 4, 2007, KGen LLC entered into six interest rate swap agreements ("Swaps") for the purposes of reducing exposure to interest rate fluctuations as required under credit agreement terms. Each of the six individual swap agreements has a notional amount of $33.0 million and has a term that expires in each consecutive year, beginning on March 31, 2008 continuing through March 31, 2013. The average interest rate payable to KGen was 5.1% at June 30, 2008. The change in fair value of the contracts and all related amounts in connection with settlement are recorded in other in other income and expense. The short-term portion of the Swaps as of June 30, 2008 was $2.9 million, and was recorded in other current liabilities. As of June 30, 2007, the short-term portion of the Swaps was $0.3 million and was recorded in other current assets. The long-term portion of the Swaps as of June 30, 2008 was $2.5 million, and was recorded in other noncurrent liabilities. As of June 30, 2007, the long-term portion of the Swaps was $0.8 million, and was recorded in other noncurrent assets.

11. Share-Based Payments

Effective January 1, 2007, the Company adopted the KGen Power Corporation 2006 Equity Incentive Plan (the "2006 Incentive Plan"). Under the 2006 Incentive Plan, 4,870,568 shares are currently authorized and reserved for equity awards.

On February 8, 2007, options were granted under the 2006 Incentive Plan to purchase 730,585 shares of common stock at an exercise price equal to $14.00 per share. On February 8, 2007, additional options were granted under the 2006 Incentive Plan to purchase 1,704,699 shares of common stock in four equal parts at four different exercise prices: (i) $14.00 per share, (ii) $15.40 per share, (iii) $16.80 per share (iv) $18.20 per share. Options from both grants have a ten-year term and will vest equally over three years from February 8, 2007. On May 28, 2008, options were granted under the KGen Power Corporation Chairman Stock Option Plan to purchase 100,000 shares of common stock at an exercise price equal to $19.50 per share. Options from this grant have a ten-year term and will vest one year from the date of issuance. The Company's policy is to recognize option awards subject to periodic vesting on a straight-line basis over the requisite service period for the entire award. No share-based compensation awards were awarded to employees prior to the February 8, 2007 grants.

11. Share-Based Payments (Continued)

On May 3, 2007, stock awards were granted to non-employee directors of the company. The non-employee director grants consisted of liability awards of common stock totaling $100 thousand per year for each director with the number of shares granted determined by the market price of the Company's stock quarterly and are measured and recognized at fair value through earnings as settled at fair value.

The Company has applied the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R") for the accounting of stock options. SFAS 123R requires that compensation expense be recorded for the options granted under the 2006 Incentive Plan. In general, compensation expense will be determined at the date of grant based on the fair value of the options granted and amortized to compensation expense over the applicable vesting period.

The fair value of each stock option is estimated on the date of grant using a Black-Scholes option pricing model. The weighted average assumptions for the year ended June 30, 2008 and for the period from December 4, 2006 (Date of Inception) to June 30, 2007 are noted in the following table:

	June 30, 2008	June 30, 2007
Risk-free interest rate	4.66%	4.70%
Expected volatility	32.27%	32.37%
Expected term in years	5.99	6.01
Expected dividends	—	—
Fair value (per option)	$5.34	$5.28

The risk-free rates of return were based on the U.S. Treasury yield curve in effect on the date of grant. As the Company has not had publicly traded stock, the expected volatilities were based on the average of the historical volatility of a group of companies that management believes is comparable to KGen Power Corporation. To the extent that the Company had sufficient information to develop reasonable expectations about future exercise patterns, the Company estimated the expected term of awards based on several factors, including vesting schedules, contractual terms, expected post-vesting termination behavior, and various factors surrounding the expected exercise behavior of employees. The "simplified" method for "plain vanilla" options as described in SEC Staff Accounting Bulletin No. 107 was used to estimate the expected term of certain options granted.

11. Share-Based Payments (Continued)

The following table summarizes incentive stock-based compensation activity for the year ended June 30, 2008 and for the period from December 4, 2006 (Date of Inception) to June 30, 2007:

	Shares Under Option	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding December 4, 2006 (Date of Inception)	—	$ —		
Granted	2,435,284	15.26		
Exercised	—	—		
Forfeited or expired	—	—		
Outstanding June 30, 2007	2,435,284	$15.26	9.61	$ 9,107,980
Vested or expected to vest at June 30, 2007	—	—	—	—
Exercisable at June 30, 2007	—	—	—	—
Outstanding June 30, 2007	2,435,284	$15.26	9.61	$ 9,107,980
Granted	100,000	19.50		
Exercised	—	—		
Forfeited or expired	(13,356)	15.80		
Outstanding June 30, 2008	2,521,928	$15.43	4.18	$10,276,205
Vested or expected to vest at June 30, 2008	2,397,965	15.41	3.95	9,811,303
Exercisable at June 30, 2008	1,778,284	15.17	2.26	7,702,692

Total compensation cost for share-based payment arrangements recognized in income was $8.0 million and $1.8 million, respectively, for the year ended June 30, 2008 and for the period from December 4, 2006 (Date of Inception) to June 30, 2007. For purposes of computing recognized compensation cost, the Company assumed that options related to certain terminated employees were expected to vest (See Note 8). Total income tax benefit recognized for share-based compensation arrangements was $2.7 million and $0.6 million, respectively, for the year ended June 30, 2008 and for the period from December 4, 2006 (Date of Inception) to June 30, 2007. As of June 30, 2008 and 2007, there was $3.5 million and $11.2 million, respectively, of total unrecognized compensation cost related to non-vested options. As of June 30, 2008, the cost is expected to be recognized over a weighted average period of 1.52 years.

12. Income Taxes

The detail of income tax provision (credits) for continuing operations is presented below:

	For the Year Ended June 30, 2008	From December 4, 2006 (Date of Inception) to June 30, 2007
Current	$ —	$ —
Deferred		
Federal	—	(3,602)
State	—	—
Total	$ —	$(3,602)

The Company's provision for income taxes differs from that determined by applying the federal income tax rate (statutory rate) to income from continuing operations before income taxes, as follows (in thousands of dollars):

	For the Year Ended June 30, 2008	From December 4, 2006 (Date of Inception) to June 30, 2007
Statutory rate	35%	35%
Tax at statutory rate	$(36,377)	$(7,923)
Increase (decrease) due to:		
Nondeductible meals and entertainment	15	6
Nondeductible corporate D&O insurance	—	166
State tax benefit	(3,011)	(848)
Return to provision	(215)	
Adjustment to valuation allowance	39,588	4,997
Total provision	$ —	$(3,602)

12. Income Taxes (Continued)

Temporary differences and carryforwards which gave rise to deferred tax assets and liabilities were as follows (in thousands of dollars):

	At June 30, 2008	At June 30, 2007
Deferred tax assets:		
Interest rate derivatives	$ 2,271	$ 228
Contract-based intangible assets	6,180	1,648
Nonqualified stock options expense	3,400	583
Accrued expenses	1,367	—
Net operating loss	41,467	8,586
Net deferred tax assets	54,685	11,045
Deferred tax liabilities:		
Purchase price adjustments	1,556	2,155
Property, plant, and equipment	6,707	2,879
Prepaid expenses	291	—
Contract-based intangible liabilities	1,546	1,014
Net deferred tax liability	10,100	6,048
Valuation allowance	44,585	4,997
Deferred tax asset (liabilities), net	$ —	$ —

At June 30, 2008, the Company had a federal net operating loss carryforward of $107.3 million which will expire in 2027 and 2028. A wholly-owned subsidiary of the Company had an estimated net operating loss carryforward of approximately $115,000, which will expire in 2025 and 2026. The utilization of this carryforward is subject to a Section 382 limitation.

Management has decided that valuation allowances are necessary, as of June 30, 2008 and 2007, as the future tax benefits relating to all deferred income tax assets are not expected to be fully realized when measured against a more likely that not standard.

Effective July 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109 (“FIN 48”). FIN 48 prescribes a minimum recognition threshold and measurement methodology that a tax position taken or expected to be taken in a tax return is required to meet before being recognized in the financial statements. It also provides guidance for derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company recognizes interest and penalties related to unrecognized tax benefits within the provision for income taxes on continuing operations in the consolidated statements of operations. There were no unrecognized tax benefits as of the date of adoption. There were no unrecognized tax benefits that if recognized would affect the tax rate. There were no interest and penalties recognized as of the date of adoption or for the year ended June 30, 2008.

The Company filed income tax returns in the United States federal jurisdiction and in various states. In all material respects, the Company will not be subject to United States federal, state and local income tax examination by tax authorities for fiscal years ended before June 30, 2007.

13. Related Party Transactions

During the year ended June 30, 2007, the Company issued 308,000 shares to GKL Capital LP in exchange for its member interest in KGLLC. Mr. Gerald Lindner, the former Chairman and Chief Executive Officer of the Company, was the sole general partner of GKL Capital LP. The approximate dollar value of the transaction and the value of Mr. Linder's interest in the transaction was $4.0 million. The $4.0 million value of the shares issued was determined by the market price of the Company's common shares on the date that the acquisition of KGLLC was completed, less applicable placement fees. In May of 2008, Mr. Gerald Lindner's employment with KGen Power Corporation was terminated.

During the year ended June 30, 2007, the Company provided asset management services to KMPAM Holdco LLC, formerly known as KGen Holdco LLC, with respect to certain assets that were held as part of our predecessor's business prior to our acquisition of KGen Partners LCC in February 2007. KMPAM Holdco LLC is controlled by MatlinPatterson Global Advisers LLC. Mr. Ramon Betolaza, who was a director of the Company from May 2007 to May 2008, is a Partner of MatlinPatterson Global Advisers and shares in the profits of such entity. Under the services agreement with KMPAM Holdco LLC, the Company received payments of $50,000 per month plus reimbursement for out-of-pocket expenses in connection with the asset management services. The services agreement was in effect prior to Mr. Betolaza becoming a director of the Company and was terminated in May 2008.

14. Registration of Shares with the Securities and Exchange Commission

On November 9, 2007, the Company filed a registration statement on Form S-1 with the Securities and Exchange Commission, and subsequently amended such statement. The registration statement has not been declared effective. On February 21, 2008, the Company's Board of Directors suspended the process for completion of the registration statement.

15. Subsequent Events

On July 1, 2008, the Company entered into a $14.4 million standby letter of credit that supports the Sandersville PPA.

Number 9. ***Directors, Executive Officers and Corporate Governance***

Directors and Executive Officers

The following table sets forth certain information about the persons currently serving as our directors and executive officers as of June 30, 2008:

Name	Age	Position
Richard A. McLean	47	Chief Executive Officer and Chief Financial Officer
James H. Sweeney	49	Senior Vice President, Energy Management
William R. Marlow	41	General Counsel and Secretary
K. Daniel East	35	Senior Vice President Mergers and Acquisitions and Treasurer
Charles L. Holland	66	Senior Vice President, Operations
W. Kevin Redmond	43	Chief Accounting Officer and Controller
Daniel T. Hudson	42	Chairman of the Board
James P. Jenkins	60	Director
Gerald J. Stalun	49	Director
Jeffrey S. Stein	38	Director
Thomas B. White	52	Director

Executive Officers

Richard A. McLean

Mr. McLean is our Chief Executive Officer and Chief Financial Officer. Mr. McLean joined our predecessor as Treasurer in September 2004. Mr. McLean was a Managing Director in ABN Amro's Energy and Power Group from 2001 to 2004. Responsibilities included M&A and project finance advisory assignments with companies such as ConocoPhillips, ExxonMobil and Chevron. From 1996 to 2001, Mr. McLean worked in Bank of America's Energy and Power group advising and arranging project financings and M&A transactions. Mr. McLean received a BA in administration and an MBA from Sam Houston State.

James H. Sweeney

Mr. Sweeney has been our Senior Vice President, Energy Management since our formation and held that position with our predecessor from June 2004. Prior to joining, KGen Mr. Sweeney was employed by American Electric Power as Vice President-M&A and Divestitures from 2002 to 2004, and as Vice President-Latin America from 1998 to 2002. From 1987 to 1998, Mr. Sweeney held various senior positions at LG&E Energy (formerly Hadson & Ultrasystems) including Vice President-Latin American Development. Mr. Sweeney has a BS in electrical engineering from Worcester Polytechnic Institute and an ME in power systems from Rensselaer Polytechnic Institute.

William R. Marlow

Mr. Marlow has been our General Counsel and Secretary since our formation and held that position with our predecessor from March 2005. Mr. Marlow was an attorney at Bracewell & Patterson LLP from 1992 to 2005 where he left as a partner in the Real Estate, Energy, and Finance practice group. Mr. Marlow holds a BBA from the University of Houston and a JD from The University of Texas School of Law.

K. Daniel East

Mr. East is our Senior Vice President Mergers and Acquisitions and Treasurer. Mr. East joined our predecessor as Vice President Strategic Planning and Development in November 2004. Prior to that Mr. East was employed by Dynegy from 1998 to 2004. During that time, Mr. East worked in a number of roles in the Strategy & Planning group including Senior Director, Strategic Market Analysis and Senior Director, Strategy & Planning—Europe. His responsibilities during that period included managing the analysis of M&A transactions, originated structured transactions and the energy commodity markets. Mr. East received a BBA from the University of Houston and an MBA from Rice University.

Charles L. Holland

Mr. Holland is our Senior Vice President, Operations. Mr. Holland joined our predecessor as Vice President, Operations in October 2004. He was previously employed with Duke Energy from 1995 to 2004. Initially in his career with Duke Energy he held the position of Vice President, Asia Pacific, and was responsible for the development of power projects in that region. Immediately prior to joining the Company he was a Managing Director in the North American merchant power business unit with responsibility for managing the plants that the Company acquired from Duke Energy. Prior to 1995, Mr. Holland held a number of officer-level positions with companies involved in the development, design, construction, and operation of power generating facilities. Mr. Holland holds a Bachelor of Science degree in nuclear engineering from North Carolina State University.

W. Kevin Redmond

Mr. Redmond has been our Chief Accounting Officer & Controller since our formation. Mr. Redmond joined our predecessor as Controller in March 2005. He has over 15 years of experience working with energy related companies. He began his career working as an internal auditor for a national printing company. He subsequently joined Ernst and Young, LLP, an international accounting firm and worked primarily in the Energy group focusing on power/energy clients during his four year tenure. Mr. Redmond later joined Tractebel Power, Inc. (aka Suez Energy Generation) and ultimately become Vice President, Controller during his eight-year tenure from 1996 to 2004. He also worked with a local consulting firm, Sirius Solutions, from 2004 to 2005, providing Sarbanes Oxley implementation assistance to energy companies. Mr. Redmond has a BS degree from Texas A&M University and an MBA from University of Houston. He is a licensed Certified Public Accountant.

Directors

Daniel T. Hudson

Mr. Hudson became a director in February of 2008 and was elected Chairman of the Board on. May 5, 2008. Mr. Hudson is a principal owner of Navasota Energy Partners LP and Montgomery Energy Partners LP, as well as Managing Member and CFO of Navasota Holdings Texas Partners LP, a 1,650 MW ERCOT portfolio. He is responsible for M&A, capital formation / management from private equity, third party debt and equity-raising. During 20 years of industry experience, Mr. Hudson has focused on wholesale electric and gas markets. His background includes asset acquisition and divestiture strategies, implementation and financing at Navigant Consulting, Duke Energy North America and NRG Energy. Prior to joining Navigant, Hudson served as Managing Director of Acquisitions and Divestitures for Duke where he led the company's acquisition and divestiture program. Mr. Hudson received a BS in Mechanical Engineering from the University of Minnesota and an MBA from the University of St. Thomas.

James P. Jenkins

Mr. Jenkins became a director on May 2, 2008. Mr. Jenkins is a Managing Director, Transaction Development at King Street Capital Management, L.L.C. In this capacity, Mr. Jenkins utilizes his senior restructuring and investment banking skills in assisting the investing team particularly in special situations, distressed and event-driven investments and investment opportunities being considered. Mr. Jenkins

joined King Street in April 2007 after five years at Mellon HBV Alternative Strategies, where he was a Portfolio Manager and head of the distressed investing group. At Mellon HBV, Mr. Jenkins served on several official and unofficial creditor or equity committees, including Adelphia, Advanced Lighting, Delta Air Lines, Impath, Ormet, Outsourcing Services Group, Peregrine Systems and Solutia. Prior to Mellon HBV, Mr. Jenkins spent his entire career in investment banking. He ran the Investment Banking and Capital Markets group at Advest for two years. Prior to that, Mr Jenkins spent12 years at CS First Boston where he was a Managing Director in the Reorganization Group and the Leveraged Finance Group, and where he advised numerous debtors and creditor groups, both in and out of bankruptcy, including AK Steel, CalFed, Charter Companies creditors, Cleveland-Cliffs, GlenFed, Harvard Industries, Imo Industries, LTV creditors, Mcorp, Midway Airlines, Presidio Oil, Spreckels Industries and Terex. Previously, Mr. Jenkins spent 12 years at Lehman Brothers in general corporate finance, sovereign debt restructuring and corporate reorganization. Mr. Jenkins was formerly a director of several companies, including Frederick's of Hollywood, Interboro Insurance Company (Chairman), Outsourcing Services Group, Peregrine Systems (Chairman), The Robbins Company (Chairman) and Telespectrum Worldwide. Mr. Jenkins received both a BA in English in 1970 and an MBA in 1972 from Stanford University.

Gerald J. Stalun

Mr. Stalun became a director on May 5, 2008. Mr. Stalun is a Managing Director and the global head of power at The TCW Group, Inc's Energy & Infrastructure Group (TCW EIG). TCW EIG currently has approximately $7 billion of energy and infrastructure investments under management. Mr. Stalun has more than 20 years experience in the global power business, most recently as Head of Asset Based Investments for Arcapita, a leading private equity firm active in the sector. Previous positions in the industry include SVP of GE Financial Services, Managing Director and Executive Vice President of Duke Capital Partners and Managing Director and Co-Head of Power Project Finance for Bank of America. He has an MBA from the University of Chicago, is a Certified Public Accountant and attended the University of Illinois as an undergraduate. Previous board memberships include Bosque Power and Falcon Gas Storage.

Jeffrey S. Stein

Mr. Stein became a director on May 2, 2008. Mr. Stein is a Founder and Principal of Durham Asset Management L.L.C. an asset management firm with approximately $1.5 billion in assets under management. Since 2003, Mr. Stein has served as the Co-Director of Research at Durham responsible for the identification, evaluation and management of investments for the various Durham portfolios. In addition, Mr. Stein is responsible for managing Durham's substantial investments in the energy, merchant power and utility industries. From 1997 to 2003 Mr. Stein was a Director at The Delaware Bay Company, Inc., a boutique research and investment banking firm focused on the distressed debt and special situations asset classes, where he was responsible for identifying and evaluating distressed investment opportunities in the energy, financial services, merchant power, retail, real estate and utility industries. Mr. Stein began his career in 1991 at Shearson Lehman Brothers in the Capital Preservation & Restructuring Group where he was responsible for providing fundamental research and investment recommendations for public and private real estate limited partnerships. Mr. Stein received a B.A. in Economics from Brandeis University and an M.B.A. in Finance and Accounting from New York University. Mr. Stein also serves as a director on the board of Granite Ridge Energy, LLC.

Thomas B. White

Mr. White became a director on April 18, 2008. Since 2006, Mr. White has been employed as a director by Stark Investments, a multi-strategy asset management firm with over $14 billion in assets under management. At Stark, Mr. White has been responsible for the identification, evaluation, and closing on private equity type investments in physical energy assets and businesses, as well as supporting continuing asset management activities for investments made by Stark through the energy asset team and investment employed through other asset strategies including risk arbitrage and commodity hedging structures. From 2002 to 2006, Mr. White was employed by Marathon Capital, LLC, a boutique investment banking firm

focusing on the power generation and renewable energy markets, where he was an officer and Managing Director from 2003 to 2006. At Marathon, Mr. White was the principal executive responsible for banking, origination and marketing activities which included the sourcing, evaluation, and closing of non-recourse financing structures for renewable and conventional energy assets and for managing financial consulting efforts with corporate clients in the acquisition and divesture of energy assets and portfolios in these markets. From 1996 to 2002, Mr. White was employed by Duke Energy, where he was senior director, Development, for Duke Energy North America from 2001 to 2002 and Vice President, Industrial Services, for DukeSolutions, Inc. for 1997 to 2001. Mr. White received his Bachelor of Sciences in Mechanical Engineering from the University of Illinois and is a Registered Professional Engineer in the State of Illinois. From 2004 to 2007, Mr. White was a Registered Representative and held Series 7 and Series 63 Licenses.

Code of Ethics

We have adopted a code of conduct for each of our employees to follow. Our management insists on integrity, honesty and ethical behavior in the workplace and therefore, we requested that each employee affirm, via a written statement, that they are not aware of any code of conduct violation.

Number 10. ***Certain Relationships and Related Transactions, and Director Independence***

Transactions with Related Persons

Set forth below is a description of certain transactions entered into between our company and our executive officers, directors and 5% stockholders.

The Company issued 308,000 shares to GKL Capital LP in exchange for its member interest in KGLLC. Mr. Lindner, our previous Chairman and Chief Executive Officer, is the sole general partner of GKL Capital LP. The approximate dollar value of the transaction and the value of Mr. Linder's interest in the transaction was $4.0 million. The $4.0 million value of the shares issued was determined by the market price of the Company's common shares on the date that the acquisition of KGLLC was completed, less applicable placement fees.

The Company provided asset management services to KMPAM Holdco LLC, formerly known as KGen Holdco LLC, with respect to certain assets that were held as part of our business prior to our acquisition of KGen Partners LLC from KMPAM Holdco LLC in February 2007. KMPAM Holdco LLC is controlled by MatlinPatterson Global Advisers LLC. Ramon Betolaza, a former director of the Company, is a Partner of MatlinPatterson Global Advisers and shares in the profits of such entity. Under the services agreement with KMPAM Holdco LLC, the Company received payments of $50,000 per month plus reimbursement for out-of-pocket expenses in connection with the asset management services. The services agreement was terminated effective May 31, 2008.

Independence of Directors

The Company has affirmatively determined that no member of the Board of Directors has a relationship which, in the opinion of the Company, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director of the Company. Based on this determination, the Board of Directors considers all of its members to be "independent."

In making this determination, the Company was aware that in 2006, Navasota Energy, of which Mr. Hudson is a Managing Member and Chief Financial Officer, purchased turbines for an aggregate of $59.0 million from a subsidiary of KGLLC. These purchases occurred prior to the existence of the Company and its acquisition of KGLLC, and the relevant subsidiary was no longer a subsidiary at the time of the Company's acquisition of KGLLC. Accordingly, the Company did not believe that this transaction would interfere with Mr. Hudson's exercise of independent judgment in carrying out his responsibilities as a director of the Company.