KGen Power Corporation

Report to Shareholders

for

Quarter Ended March 31, 2008

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PART I—FINANCIAL INFORMATION

Number 1. Unaudited Condensed Consolidated Financial Statements and Notes

KGen Power Corporation
Condensed Consolidated Balance Sheets
(in thousands, except per share amount)

	March 31, 2008	June 30, 2007
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$ 58,075	$ 90,315
Restricted cash and cash equivalents	29,123	40,205
Short-term investments	4,352	4,240
Accounts receivable	3,929	24,951
Spare parts inventories	7,083	7,074
Prepaid expenses and other current assets	1,819	1,012
Total current assets	104,381	167,797
Property, plant, and equipment	703,542	702,459
Less: accumulated depreciation	27,210	9,164
Total property, plant, and equipment	676,332	693,295
Contract-based intangibles (net of $12,178 and $4,186 of amortization, respectively)	71,364	79,356
Deferred charge	1,856	589
Deferred financing fees (net of $1,019 and $348 of amortization, respectively)	5,245	5,916
Other noncurrent assets	325	1,814
Total assets	$ 859,503	$948,767
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 1,287	$ 428
Accrued liabilities	16,816	18,161
Current portion of long-term debt	2,000	2,000
Total current liabilities	20,103	20,589
Long-term debt	195,500	197,000
Contract-based intangibles (net of $1,901 and $731 of amortization, respectively)	18,267	19,437
Other noncurrent liabilities	6,350	—
Commitments and contingencies (Note 6)	—	—
Stockholders' equity:		
Common stock (par value $.01; 150,000 shares authorized; 55,951 and 55,945 shares issued and outstanding at March 31, 2008 and June 30, 2007, respectively)	560	559
Additional paid in capital	733,563	730,219
Accumulated deficit	(114,840)	(19,037)
Total stockholders' equity	619,283	711,741
Total liabilities and stockholders' equity	$ 859,503	$948,767

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

KGen Power Corporation

Condensed Consolidated Statements of Operations

(in thousands, except per share amounts)
(unaudited)

	For the Three Months Ended March 31, 2008	For the Nine Months Ended March 31, 2008	For the Three Months Ended March 31, 2007	From December 4, 2006 (Date of Inception) to March 31, 2007
Revenues:				
Energy sales	$ 49,269	$219,169	$ 20,379	$ 20,379
Capacity sales	5,645	37,370	3,285	3,285
Total revenues	54,914	256,539	23,664	23,664
Operating expenses:				
Cost of fuel	46,801	188,427	19,703	19,703
Operating and maintenance	28,434	47,218	3,808	3,808
Gas transportation	3,856	12,152	2,126	2,126
Selling, general, and administrative	5,551	16,200	3,020	3,020
Acquisition contract termination loss (Note 6)	—	37,190	—	—
Depreciation	5,982	18,046	3,215	3,215
Auxiliary power	1,817	6,145	950	950
Insurance	717	2,328	561	561
Total operating expenses	93,158	327,706	33,383	33,383
Operating loss	(38,244)	(71,167)	(9,719)	(9,719)
Other income (expenses):				
Interest expense	(4,259)	(13,318)	(2,528)	(2,528)
Taxes, other than income taxes	(1,050)	(2,551)	(441)	(441)
Interest income	769	2,690	232	232
Other	(4,872)	(11,457)	(323)	(323)
Total other expenses	(9,412)	(24,636)	(3,060)	(3,060)
Net loss before taxes	(47,656)	(95,803)	(12,779)	(12,779)
Income tax benefit	—	—	3,602	3,602
Net loss after taxes	$(47,656)	$(95,803)	$ (9,177)	$ (9,177)
Net loss per share—basic and diluted	$ (0.85)	$ (1.71)	$ (0.17)	$ (0.21)
Weighted average shares outstanding—basic and diluted	55,951	55,948	54,138	42,943

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

KGen Power Corporation

Condensed Consolidated Statements of Cash Flows

(in thousands)
(unaudited)

	For the Nine Months Ended March 31, 2008	From December 4, 2006 (Date of Inception) to March 31, 2007
Cash flows from operating activities		
Net loss	$(95,803)	$ (9,177)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	18,046	3,215
Deferred income taxes	—	(2,155)
Amortization of deferred financing fees	671	123
Amortization of contract-based intangibles	6,822	1,256
Change in fair value of derivative instruments	11,772	390
Stock compensation expense	3,345	599
Write off of short-term investment	—	35
Changes in operating assets and liabilities:		
Accounts receivable	21,022	(16)
Spare parts inventories	(9)	194
Prepaid expenses	(1,467)	284
Other noncurrent assets	691	—
Deferred charge	(1,267)	(135)
Accounts payable	859	(1,551)
Accrued liabilities	(5,748)	—
Net cash used in operating activities	(41,066)	(6,938)
Cash flows from investing activities		
Purchase of KGLLC, net of cash acquired	—	(773,838)
Purchase of property, plant, and equipment	(1,083)	(76)
Proceeds from settlement of derivative instruments	439	—
Short-term investments	(112)	2,006
Use of (Investment in) restricted cash and cash equivalents	11,082	(24,463)
Net cash provided by (used in) investing activities	10,326	(796,371)
Cash flows from financing activities		
Net proceeds from sale of common stock	—	725,051
Net proceeds from debt borrowings	—	193,809
Repayment of debt	(1,500)	(500)
Net cash (used in) provided by financing activities	(1,500)	918,360
(Decrease) Increase in cash and cash equivalents	(32,240)	115,051
Cash and cash equivalents at beginning of period	90,315	—
Cash and cash equivalents at end of period	$ 58,075	$ 115,051
Cash paid for:		
Income taxes	$ —	$ —
Interest	$ 12,742	$ 2,405

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

KGen Power Corporation

Notes to Unaudited Condensed Consolidated Financial Statements

1. Nature of Business and Significant Accounting Policies

Operations—KGen Power Corporation (the "Company") was incorporated in Delaware on December 4, 2006, which is the date of inception. The Company was formed to acquire, own and operate 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 condensed consolidated financial statements since that date. The Company did not have operations prior to the acquisition of KGLLC. As a result, the period from inception through March 31, 2007 does not reflect a comparable period of operations compared to the period ended March 31, 2008.

Interim Financial Statements—The accompanying condensed consolidated financial statements have been prepared in accordance with the regulations regarding interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted. In the opinion of management, all adjustments (consisting of normal recurring accruals, except as noted in Note 6—Commitments and Contingencies) considered necessary for a fair presentation have been included. The balance sheet at June 30, 2007 is derived from the June 30, 2007 audited consolidated financial statements. These condensed consolidated financial statements included herein should be read in conjunction with the Consolidated Financial Statements and Notes included in the Company's Annual Report for the year ended June 30, 2007.

Use of Estimates—The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Such estimates include the 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.

Principles of Consolidation—The condensed 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, 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.

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

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

the peak summer months, historically have not been profitable for the Company and its predecessors and are the months during which the Company seeks to perform scheduled maintenance-related activities.

2. Property, Plant, and Equipment

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

	Estimated Useful Life	March 31, 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	122,663	122,550
Other plant	3-30 years	206,488	205,518
Total property, plant, and equipment		703,542	702,459
Less: accumulated depreciation		27,210	9,164
Net property, plant, and equipment		$676,332	$693,295

3. Contract-Based Intangibles

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

	Term	March 31, 2008	June 30, 2007
Assets			
Murray I Georgia Power contract	May 31, 2012	$33,994	$40,078
Murray firm transportation contracts	Various	37,370	39,278
Total assets		$71,364	$79,356
Liabilities			
Hinds firm transportation contract	March 31, 2011	$ 240	$ 443
Murray firm transportation contract	November 30, 2016	563	612
Hot Spring firm transportation contracts	Various	17,464	18,382
Total liabilities		$18,267	$19,437

For the three and nine months ended March 31, 2008 and three months ended March 31, 2007, amortization of contract-based power sales rights and obligations was $2.0 million, $6.1 million and $1.2, respectively, and was recorded as a reduction of energy sales on the condensed consolidated statements of operations. For the three and nine months ended March 31, 2008 and the three months ended March 31, 2007, amortization of contract-based natural gas transportation rights and obligations of $0.3 million,

3. Contract-Based Intangibles (Continued)

$0.7 million, and $0.1 million, respectively, was recorded as an increase of gas transportation expenses on the condensed consolidated statements of operations.

4. Long-Term Debt

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

	Interest Rate	Maturity	March 31, 2008	June 30, 2007
Total debt outstanding	Variable	February 8, 2014	$197,500	$199,000
Less: current portion			2,000	2,000
Total long-term debt			$195,500	$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 weighted average interest rate paid for interest was 6.6%, 6.9% and 7.1% for the three and nine months ending March 31, 2008, and the three months ended March 31, 2007, respectively.

The remaining future minimum principal payments for the five fiscal years (years ended June 30) subsequent to March 31, 2008 and thereafter are as follows (in thousands of dollars):

2008	$ 500
2009	2,000
2010	2,000
2011	2,000
2012	2,000
Thereafter	189,000
Total	$197,500

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 to support the collateral requirements at the project level. The working capital facility bears interest at 200 basis points over LIBOR with a 50 basis point commitment fee for any unused portion and has a five-year term. The Company pays a fee of 191 basis points on the outstanding amount of the synthetic letter of credit. The synthetic letter of credit facility has a seven-year term and was fully drawn as of March 31, 2008. No amounts were drawn under the working capital facility as of March 31, 2008 except for $11.5 million of letters of credit that have been issued thereunder.

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

4. Long-Term Debt (Continued)

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 the Company.

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 4-3(e)(3) of the Regulation S-X) of the Company's subsidiaries exceeding 25% of the consolidated net assets of the Company and its subsidiaries. The amount of restricted net assets is $566.9 million at March 31, 2008.

5. Restricted Cash and Cash Equivalents

The Credit Agreement requires KGen LLC to maintain six months of principal and interest payments reserve in cash. At March 31, 2008, the restricted balance, in accordance with this requirement, was $10.2 million.

Additionally, the Security Deposit Agreement requires KGen LLC to maintain in restricted cash an estimated 12 months of major maintenance expenditures as of each quarter end. At March 31, 2008 and 2007, the restricted balance, in accordance with this requirement, was $19.0 million and $15.0 million, respectively.

6. Commitments and Contingencies

Litigation—The Company is party to various legal actions arising in the normal course of business. Matters that are probable of unfavorable outcome to the Company and which can be reasonably estimated are accrued.

Commitments—The Company enters into long-term contractual arrangements for power purchases and capacity sales and to procure fuel and transportation services. There have not been significant changes to these commitments as discussed in Note 8—Commitments in the Notes to Consolidated Financial Statements contained in the Annual Report as of June 30, 2007 except as discussed below related to Complete Energy Holdings, LLC ("CEH").

Complete Energy Acquisition Contract Termination—On June 18, 2007, the Company signed a purchase and sale agreement with affiliates of CEH to acquire 1,859 MW of capacity for $1.3 billion, plus working capital adjustments. On September 19, 2007, the Company informed CEH that it was likely the Company would not complete the CEH acquisition in accordance with the terms of the purchase and sale agreement. As of September 30, 2007, the Company recorded $35.0 million to reflect a reserve required against payment of amounts as a result of not completing the transaction. On October 12, 2007, the Company entered into a termination and mutual release agreement with CEH and certain of its affiliates pursuant to which the Company made the $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 had 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 condensed consolidated statements of operations.

7. Derivatives

The Company accounts for derivative instruments in accordance with the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 137, SFAS No. 138,

7. Derivatives (Continued)

and SFAS No. 149 ("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.

On May 4, 2007, the Company entered into six interest rate swap agreements ("Swaps"). 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 fixed rate payable by the Company under the swaps is 5.160%. The change in fair value of the contracts and all related amounts in connection with settlement are recorded in other income and expense. The short-term portion of the Swaps as of March 31, 2008 was $4.4 million and is recorded in accrued liabilities. The long-term portion of the Swaps as of March 31, 2008 was $6.4 million and is recorded in other noncurrent liabilities.

8. 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 (in thousands, except per share amounts).

	For the Three Months Ended March 31, 2008	For the Nine Months Ended March 31, 2008	For the Three Months Ended March 31, 2007	From December 4, 2006 (Date of Inception) to March 31, 2007
Numerator:				
Net loss	$(47,656)	$(95,803)	$(9,177)	$(9,177)
Denominator:				
Weighted average shares outstanding	55,951	55,948	54,138	42,943
Loss per share—basic:	$ (0.85)	$ (1.71)	$ (0.17)	$ (0.21)
Loss per share—diluted:	$ (0.85)	$ (1.71)	$ (0.17)	$ (0.21)

9. Share-Based Payments

The Company adopted the KGen Power Corporation 2006 Equity Incentive Plan (the "2006 Incentive Plan") as of January 1, 2007 and reserved 4,870,568 shares for equity awards at the time of adoption. The plan provisions allow for grants to be issued with a per share exercise price equal to the fair value of a share of common stock on the date of grant. The original terms of the grants typically do not exceed ten years and will vest over a three-year period assuming continuous employment by the grantee, except under "change in control" provisions, then the grants will vest immediately. 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. Note 11—Share-Based Payments of the Notes to Consolidated Financial Statements

9. Share-Based Payments (Continued)

contained in the Annual Report for the year ended June 30, 2007 should be referred to for additional information regarding the stock-based incentive plans.

The Company has recorded compensation expense of $1.1 million and $3.2 million for the three and nine months ended March 31, 2008, respectively, related to stock options outstanding. Unrecognized compensation expense at March 31, 2008 for the unvested options was $8.0 million. At March 31, 2008, there were 2,429,445 shares of common stock available under the 2006 Incentive Plan for issuance pursuant to future stock option grants. For the three and nine months ended March 31, 2008, no options were granted or exercised.

10. Income Taxes

The detail of income tax provision (credits) included in the Company's net loss is presented below:

	For the Three Months Ended March 31, 2008	For the Nine Months Ended March 31, 2008	For the Three Months Ended March 31, 2007	From December 4, 2006 (Date of Inception) to March 31, 2007
Current	$—	$—	$ —	$ —
Deferred:				
Federal	—	—	(3,602)	(3,602)
State	—	—	—	—
Total	$—	$—	$(3,602)	$(3,602)

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

	For the Three Months Ended March 31, 2008	For the Nine Months Ended March 31, 2008	For the Three Months Ended March 31, 2007	From December 4, 2006 (Date of Inception) to March 31, 2007
Statutory rate	35%	35%	35%	35%
Tax at statutory rate	$(16,680)	$(33,531)	$(4,473)	$(4,473)
Increase (decrease) due to:				
Nondeductible meals and entertainment	2	14	—	—
State tax benefit	(2,943)	(3,011)	—	—
Adjustment to valuation allowance	19,621	36,528	871	871
Total provision	$ —	$ —	$(3,602)	$(3,602)

10. Income Taxes (Continued)

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

	March 31, 2008	June 30, 2007
Deferred tax assets:		
Interest rate swap derivative	$ 4,131	$ 228
Intangible assets	4,714	1,648
Nonqualified stock options expense	1,823	583
Net operating loss	35,102	7,738
Deferred state tax	3,569	848
Net deferred tax assets	49,339	11,045
Deferred tax liabilities:		
Purchase price adjustments	—	2,155
Property, plant, and equipment	4,263	2,879
Intangible liability	3,625	1,014
Net deferred tax liability	7,888	6,048
Valuation allowance	41,451	4,997
Deferred tax asset (liabilities)—net	$ —	$ —

At March 31, 2008, the Company had a federal net operating loss carryforward of $99.7 million which will expire in 2027 and 2028.

Management has decided that valuation allowances are necessary as of March 31, 2008, as the future tax benefits relating to certain deferred income tax assets are not expected to be fully realized when measured against a more likely than 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 condensed consolidated statements of operations. There were no unrecognized tax benefits as of the date of adoption. There were no unrecognized tax benefits that would affect the tax rate. There were no interest and penalties recognized as of the date of adoption or for the three and nine months ended March 31, 2008.

The Company filed income tax returns in the United States jurisdiction and in various states. In all cases, 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.

11. Registration of Shares with the Securities and Exchange Commission

On November 9, 2007, the Company 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.

Number 2. 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 Condensed Consolidated Financial Statements and the accompanying notes included in this Quarterly Report, as well as our Annual Report for the fiscal year ended June 30, 2007. 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 "Risk Factors" in Number 1A of Part II of our Annual Report for the fiscal year ended June 30, 2007 and Number 1A of Part II of this Quarterly Report regarding certain risk factors relating 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 March 31, 2008, our existing 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.

Four of the Plants 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. In addition to their energy value, the Plants have system stability value to the local utilities operating the transmission grid.

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 62.82% of the Company's 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 12.82%, for a total of 75.64%, of the Company's shares delivered proxies supporting these actions. The removal of

Mr. Lindner, 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 the Company's outstanding shares indicated to the Company their support for their election.

On May 5, 2008, Daniel Hudson was 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. Mr. Hudson will also be granted options in an amount to be determined by the Board.

As strongly recommended by the stockholders of the Company, the Board terminated Mr. Lindner as Chief Executive Officer, effective May 6, 2008. The Company expects to negotiate a severance package with Mr. Lindner based on the severance payments and benefits provided for in his employment agreement with the Company.

Richard McLean, the Chief Financial Officer of the Company, was named as interim Chief Executive Officer. Mr. McLean will also continue his position as Chief Financial Officer.

The biographical information with respect to the current members of the Board follows:

Daniel Hudson

Daniel 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

James P. 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

Gerald J. 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

Jeffrey S. 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

Thomas B. 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.

Exploration of Strategic Alternatives

Beginning in February 2008, representatives of the Company engaged in preliminary discussions with, and received several non-binding indications of interest from, a financial investor in the energy generation business for the purchase of 100% of the outstanding shares of the Company. The last indication of interest received from this investor was for a transaction at $20 per share in cash. This non-binding indication of interest was subject to due diligence and mutually agreeable documentation, but was not condition on the investor's receipt of financing. On April 9, 2008, the Board announced that, based upon these preliminary valuation analyses prepared by management and an outside financial advisor and the nonbinding nature of the $20 indication of interest, the Board was not prepared at that time to recommend the proposed transaction to KGen's shareholders.

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. The retention of Credit Suisse is subject to Credit Suisse and the Company reaching agreement of mutually acceptable terms of engagement. On May 6, 2008, the reconstituted Board announced that it is committed to exploring any and all strategic alternatives to maximize the value of the Company.

Results of Operations

The results of operations for the three and nine months ended March 31, 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 three and nine months ended March 31, 2007 of our predecessor, KGLLC, combined with KGen for the period from February 8, 2007 through March 31, 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 a new Credit Facility was entered into.

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 55,476,874 shares at $14.00 per share, which generated net proceeds to us of $722.0 million. Our predessor 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 nine months ended March 31, 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 $972.3 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 redetermined. These revaluations led to signficantly 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 4, *Long Term Debt,* in Notes to Unaudited Condensed 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 9, *Share-Based Payments*, in Notes to Unaudited Condensed 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 Three Months Ended March 31, 2008 compared to the combined period from January 1, 2007 through February 7, 2007 of our Predecessor and February 8, 2007 through March 31, 2007 of KGen.

The following table sets forth our results of operations for the three months ended March 31, 2008, and the results of operations for the combined period from January 1, 2007 through February 7, 2007 of our predecessor and February 8, 2007 through March 31, 2007 of KGen, respectively, which are expressed in thousands of dollars, except per share amounts:

	KGen	Predecessor & KGen		
	For the Three Months Ended March 31, 2008	For the Three Months Ended March 31, 2007	Change	% Change
Revenues:				
Energy sales	$ 49,269	$ 26,857	$ 22,412	83%
Capacity sales	5,645	5,583	62	1%
Total revenues	54,914	32,440	22,474	69%
Operating expenses:				
Cost of fuel	46,801	25,386	21,415	84%
Operating and maintenance	28,434	5,382	23,052	428%
Gas transportation	3,856	3,579	277	8%
Selling, general, and administrative	5,551	3,007	2,544	85%
Acquistion contract termination loss	—	—	—	0%
Depreciation	5,982	4,471	1,511	34%
Auxiliary power	1,817	1,496	321	21%
Insurance	717	942	(225)	(24)%
Total operating expenses	93,158	44,263	48,895	110%
Operating loss	(38,244)	(11,823)	(26,421)	223%
Other income (expenses):				
Interest expense	(4,259)	(7,683)	3,424	(45)%
Taxes, other than income taxes	(1,050)	(1,217)	167	(14)%
Interest income	769	1,745	(976)	(56)%
Other	(4,872)	(102)	(4,770)	4676%
Total other expenses	(9,412)	(7,257)	(2,155)	30%
Net loss before taxes	(47,656)	(19,080)	(28,576)	150%
Income tax benefit	—	3,602	(3,602)	(100)%
Net loss after taxes	$(47,656)	$(15,478)	$(32,178)	208%

Selected Operating and Business Metrics

	KGen	Predecessor & KGen		
	For the Three Months Ended March 31, 2008	For the Three Months Ended March 31, 2007	Change	% Change
Selected Financial and Operating Data				
Total generation (GWh)	779	435	344	79%
Merchant generation (GWh)	721	379	342	90%
Merchant energy gross margin (in thousands)	$3,966	$2,895	$1,071	37%
Merchant energy gross margin/merchant generation ($/MWh)	$ 5.50	$ 7.64	$(2.14)	(28)%
Selected Market Data				
Average on-peak market power price—Entergy ($/MWh)	$63.99	$53.96	$10.03	19%
Average on-peak market power price—Southern ($/MWh)	$62.60	$51.75	$10.85	21%
Average Henry Hub gas price ($/MMbtu)	$ 8.58	$ 7.13	$ 1.45	20%
Selected Weather Data				
Actual CDDs(1)	—	—	—	—
Normal CDDs	—	—	—	—
Actual HDDs(2)	4,621	4,209	412	10%
Normal HDDs	4,899	4,828	71	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 Three Months Ended March 31, 2008	For the Three Months Ended March 31, 2007
	(in thousands)	
Energy sales	$49,269	$26,857
Cost of fuel	46,801	25,386
Energy gross margin	2,468	1,471
Less: Murray I energy sales	2,638	3,033
Add: Murray I fuel	4,136	4,457
Merchant energy gross margin	$ 3,966	$ 2,895

Historical Results of Operations of KGen for the Three Months Ended March 31, 2008 compared to the combined period from January 1, 2007 through February 7, 2007 of our Predecessor and February 8, 2007 through March 31, 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 subject to long-term sales agreements. Our Murray I plant operates under the long-term GPC PPA.

Energy gross margin increased $1.0 million to $2.5 million for the three months ended March 31, 2008 compared to the same period in the previous year due to a $1.1 million increase in merchant energy gross margin, or energy gross margin from our merchant plants. The $1.1 million merchant energy gross margin increase resulted from increased merchant generation at a lower implied spark spread, or merchant energy gross margin per MWh of merchant generation. Merchant generation increased by 342 GWh to 721 GWh for the quarter ended March 31, 2008. Implied merchant spark spread decreased by $2.14/MWh, or 28%, to $5.50/MWh for the quarter. The increase in merchant generation and merchant energy gross margin was driven by 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.

Operating expenses, excluding cost of fuel, for the three months ended March 31, 2008 were $46.4 million, compared to $18.9 million for the three months ended March 31, 2007. This $27.5 million increase includes, but is not solely derived from, a $23.1 million increase in operating and maintenance expenses, a $2.5 million increase in selling, general, and administrative expenses , and a $1.5 million increase in depreciation expense. The operating and maintenance expense increase was primarily related to $8.1 million and $13.9 million in additional charges in connection with the scheduled major maintenance outages at the Hot Spring and Murray facilities, respectively, and $0.4 million in unscheduled maintenance expenses at the Hinds facility. The increase in selling, general, and administrative expenses for the three months ended March 31, 2008 primarily related to a $0.5 million increase in noncash option expenses, a $0.6 million increase in an accrual for budgeted bonuses that our predecessor did not accrue, a $0.6 million increase that was created when our predecessor reversed an accrual for 144A legal expenses during the three months ended March 31, 2007 which became part of the acquisition costs upon closing, a $0.2 million increase in health benefit expenses due to a plan change, a $0.2 million increase in costs associated with corporate registration fees, a $0.2 million increase in legal fees associated with the S-1 registration process, and a $0.1 million increase in consulting services to meet additional financial reporting requirements. 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*.

As a result of the foregoing, we incurred an operating loss of $38.2 million for the quarter ended March 31, 2008 compared to an operating loss of $11.8 million in the quarter ended March 31, 2007.

Other expense for the three months ended March 31, 2008 was $9.4 million compared to $7.3 million for the three months ended March 31, 2007. The primary components of other expense were as follows:

- Interest expense for the three months ended March 31, 2008 was $4.3 million as compared to $7.7 million for the same period in 2007. The decrease in interest expense relates to a significant reduction in outstanding debt and interest rates as compared to the same period in the previous period.
- Other expense for the three months ended March 31, 2008 increased $4.8 million when compared to the same period in 2007. The increase in expense at March 31, 2008 primarily related to losses on derivatives associated with our interest rate hedging due to the change of the fair value and the cash settlements on the swaps.

As a result of the foregoing, we incurred a net loss of $47.7 million for the quarter ended March 31, 2008 compared to a net loss of $15.5 million for the quarter ended March 31, 2007.

Consolidated Results of Operations of KGen for the Nine Months Ended March 31, 2008 compared to the combined period from July 1, 2006 through February 7, 2007 of our Predecessor and February 8, 2007 through March 31, 2007 of KGen.

The following table sets forth our results of operations for the nine months ended March 31, 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 March 31, 2007 of KGen, respectively, which are expressed in thousands of dollars, except per share amounts:

	KGen	Predecessor & KGen		
	For the Nine Months Ended March 31, 2008	For the Nine Months Ended March 31, 2007	Change	% Change
Revenues:				
Energy sales	$219,169	$161,459	$ 57,710	36%
Capacity sales	37,370	37,785	(415)	(1)%
Total revenues	256,539	199,244	57,295	29%
Operating expenses:				
Cost of fuel	188,427	134,779	53,648	40%
Operating and maintenance	47,218	15,357	31,861	207%
Gas transportation	12,152	11,800	352	3%
Selling, general, and administrative	16,200	13,456	2,744	20%
Acquistion contract termination loss	37,190	—	37,190	100%
Depreciation	18,046	10,829	7,217	67%
Auxiliary power	6,145	5,137	1,008	20%
Insurance	2,328	2,599	(271)	(10)%
Total operating expenses	327,706	193,957	133,749	69%
Operating income (loss)	(71,167)	5,287	(76,454)	(1446)%
Other income (expenses):				
Net gain on sale of assets	—	110,109	(110,109)	(100)%
Interest expense	(13,318)	(32,759)	19,441	(59)%
Taxes, other than income taxes	(2,551)	(3,547)	996	(28)%
Interest income	2,690	4,066	(1,376)	(34)%
Other	(11,457)	(3,860)	(7,597)	197%
Total other income (expenses)	(24,636)	74,009	(98,645)	(133)%
Net income (loss) before taxes	(95,803)	79,296	(175,099)	(221)%
Income tax benefit (expense)	—	3,602	(3,602)	(100)%
Net income (loss) after taxes	$ (95,803)	$ 82,898	$(178,701)	(216)%

Selected Operating and Business Metrics

	KGen	Predecessor & KGen		
	For the Nine Months Ended March 31, 2008	For the Nine Months Ended March 31, 2007	Change	% Change
Selected Financial and Operating Data				
Total generation (GWh)	3,526	2,610	916	35%
Merchant generation (GWh)	2,785	2,137	648	30%
Merchant energy gross margin (in thousands)	$32,148	$26,024	$6,124	24%
Merchant energy gross margin/merchant generation ($/MWh)	$ 11.54	$ 12.18	$(0.63)	(5)%
Selected Market Data				
Average on-peak market power price—Entergy ($/MWh)	$ 57.78	$ 54.12	$ 3.66	7%
Average on-peak market power price—Southern ($/MWh)	$ 58.36	$ 52.70	$ 5.66	11%
Average Henry Hub gas price ($/MMbtu)	$ 7.22	$ 6.60	$ 0.62	9%
Selected Weather Data				
Actual CDDs(1)	4,760	4,310	450	10%
Normal CDDs	3,761	3,762	(1)	0%
Actual HDDs(2)	7,116	6,925	191	3%
Normal HDDs	7,985	7,915	70	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 Nine Months Ended March 31, 2008	For the Nine Months Ended March 31, 2007
	(in thousands)	
Energy sales	$219,169	$161,459
Cost of fuel	188,427	134,779
Energy gross margin	30,742	26,680
Less: Murray I energy sales	40,250	29,477
Add: Murray I fuel	41,656	28,821
Merchant energy gross margin	$ 32,148	$ 26,024

Historical Results of Operations for the Nine Months ended March 31, 2008 compared to the combined period from July 1, 2006 through February 7, 2007 of our Predecessor and February 8, 2007 through March 31, 2007 of KGen.

Energy gross margin increased $4.1 million to $30.7 million for the nine months ended March 31, 2008 compared to the same period in the previous year due to a $6.1 million increase in merchant energy gross margin offset by a $2.0 million decrease in energy gross margin from our Murray I plant. The $6.1 million merchant energy gross margin increase resulted from increased merchant generation at a lower implied spark spread for the nine month period. Merchant generation increased by 648 GWh, or 30%, to 2,785 GWh for the nine months ended March 31, 2008. Implied merchant spark spread decreased by $0.63/MWh, or 5%, to $11.54/MWh for the nine months ended March 31, 2008. This decrease in the 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 $2.0 million decrease in energy gross margin from the Murray I plant resulted, in part, from increased amortization expense due to the revaluation of the intangible contracts from the KGLLC acquisition. Net amortization expense increased to $6.1 million for the nine months ended March 31, 2008 as compared to $2.8 million for the nine months ended March 31, 2007. Excluding noncash amortization expense, energy gross margin for our Murray I plant increased $1.3 million during the period.

Operating expenses, excluding cost of fuel, for the nine months ended March 31, 2008 were $139.3 million, compared to $59.2 million for the nine months ended March 31, 2007. This $80.1 million increase includes, but is not solely derived from, a $31.9 million increase in operating and maintenance expenses, a $2.7 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 $7.2 million increase in depreciation expense, and a $1.0 million increase in auxiliary power. The operating and maintenance expense increase was primarily related to $15.7 million and $14.2 million in charges in connection with the scheduled major maintenance outages at the Hot Spring and Murray facilities, respectively, and $1.3 million in unscheduled maintenance expenses at the Hinds facility. The increase in selling, general, and administrative expenses for the nine months ended March 31, 2008 primarily related to a $2.6 million increase in noncash option expenses. 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 nine months ended March 31, 2008 of $1.0 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 $71.2 million for the nine months ended March 31, 2008 compared to an operating income of $5.3 million for the nine months ended March 31, 2007.

Other income (expense) was a $24.6 million expense and $74.0 million of income for the nine months ended March 31, 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 nine months ended March 31, 2008 was $13.3 million as compared to $32.8 million for the same period 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 nine months ended March 31, 2008 and 2007 was $11.5 million and $3.9 million, respectively. The expense at March 31, 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 March 31, 2007 represented $0.5 million of losses on derivatives, $2.4 million due to potential state tax liabilities relating to the assets that were sold, and $0.9 million of letter of credit fees.

As a result of the foregoing, we incurred a net loss of $95.8 million for the nine months ended March 31, 2008 compared to a net income of $82.9 million for the nine months ended March 31, 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. Our liquidity is comprised of the following at March 31, 2008 (in thousands of dollars):

Unrestricted cash and cash equivalents	$ 58,075
Working capital revolver (net of letters of credit issued thereunder)	68,500
Total	$126,575

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 March 31, 2008 we had approximately $68.5 million available under the revolving working capital portion of our Credit Facility for activities related to our current facilities and cash on hand of $58.1 million, of which $42.1 million is not subject to the lien of the Credit Agreement. Management believes that these amounts and cash flows from operations will be adequate to finance 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 Murray I plant, 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. The $80.0 million Working Capital Facility bears interest at LIBOR plus 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 outstanding 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 $42.1 million at March 31, 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 March 31, 2008, we were in compliance with the covenants contained within our Credit Facility.

Capital Expenditures and Major Maintenance

We do not anticipate material capital expenditures related to the plants through the remainder of the fiscal year. Total capital expenditures for the three and nine months ended March 31, 2008 were $0.4 million and $1.1 million, respectively.

We incur costs for major maintenance on the Plants which is expensed in the period incurred. We do not expect to incur any further major maintenance expenditures in the remaining three months of fiscal 2008. Major maintenance was performed at Hot Spring in the second quarter of fiscal 2008 and at Murray I and Hot Spring in the third quarter of fiscal 2008.

Cash Flow Analysis

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

	For the Nine Months Ended March 31, 2008	From December 4, 2006 (Date of Inception) to March 31, 2007
Statement of Cash Flow Data:		
Cash flows provided by (used in):		
Operating activities	$(41,066)	$ (6,938)
Investing activities	10,326	(796,371)
Financing activities	(1,500)	918,360
Decrease in cash and cash equivalents	(32,240)	115,051
Cash and cash equivalents at beginning of period	90,315	—
Cash and cash equivalents at end of period	58,075	115,051

Cash Flows from Operating Activities. Our cash flows used in operations were $41.0 million for the nine months ended March 31, 2008, primarily related to our net loss of $95.8 million which included $37.2 million of expenses related to the CEH transaction, offset somewhat by collections on accounts receivable. We also incurred $12.7 million of cash interest in such period based on our outstanding credit facility.

Cash Flows from Investing Activities. Our cash flows provided by investing activities for the nine months ended March 31, 2008 were $10.3 million and primarily related to the use of restricted cash requirements for major maintenance. We also incurred $1.1 million in property, plant, and equipment

additions, $0.8 million related to general plant additions, and the remaining $0.3 million related to leasehold improvements to the corporate office space.

Cash Flows from Financing Activities. Our cash flows used in financing activities for the nine months ended March 31, 2008 was $1.5 million and represented the quarterly principal payments of long term debt as required by the Credit Facility.

Number 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

Our primary market risk is the potential impact of changes in interest rates on our variable rate borrowings. The terms of our 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 in order to mitigate the risk associated with the variable rate borrowings.

Our interest rate swap agreements 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 $198.0 million with an average fixed rate payable to KGen under the swaps of 5.160%. The following is a summary of the swaps:

	Maturity Date	Notional Amount	Fair Value at March 31, 2008	Fixed Rate
		(in millions)		
Contract #1	3-31-2008	$33.0	$ —	5.250%
Contract #2	3-31-2009	$33.0	$ (890,358)	5.172%
Contract #3	3-31-2010	$33.0	$(1,781,421)	5.113%
Contract #4	3-31-2011	$33.0	$(2,345,264)	5.115%
Contract #5	3-31-2012	$33.0	$(2,728,882)	5.138%
Contract #6	3-31-2013	$33.0	$(3,008,301)	5.169%

As of March 31, 2008, the majoritiy 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 counterparties to the interest rate swaps or caps, however our counterparties are major financial institutions and we consider such risk of loss to be minimal.

PART II—OTHER INFORMATION

Number 1A. Risk Factors and Forward-Looking Statements

Risk Factors

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, the reconstituted Board announced that it is committed to exploring any and all strategic alternatives to maximize the value of the Company. As this exploration is in its early stages, we are uncertain as to what strategic alternatives may be available to us or whether we will elect to pursue any such strategic alternatives.

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 partners.

Please refer to Number 1A of our Annual Report for the year ended June 30, 2007 for additional risk factors.

Forward-Looking Statements

Except for historical information, 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, the volatility of our stock price, and current competitive conditions. 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 the discussion above and in our Annual Report for the fiscal year ended June 30, 2007 "Risk Factors."