# KGen Power Corporation

**Report to Shareholders**

**for**

**Quarter Ended March 31, 2009**

**Four Oaks Place**
**1330 Post Oak Boulevard, Suite 1500**
**Houston, Texas 77056**

Investor Relations
713-979-1990

## TABLE OF CONTENTS

| | | Page No. |
|---|---|---|
| PART I—FINANCIAL INFORMATION | | |
| Number 1 | — Unaudited Condensed Consolidated Financial Statements and Notes | 3 |
| Number 2 | — Management's Discussion and Analysis of Financial Condition and Results of Operations | 15 |
| Number 3 | — Quantitative and Qualitative Disclosures about Market Risk | 32 |
| PART II—OTHER INFORMATION | | |
| Number 1A | — Risk Factors and Forward-Looking Statements | 34 |

## 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 amounts)

| | March 31, 2009 (unaudited) | June 30, 2008 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | **$ 48,125** | $ 51,493 |
| Restricted cash and cash equivalents | **32,866** | 24,325 |
| Short-term investments | **585** | 2,199 |
| Accounts receivable | **5,416** | 36,763 |
| Spare parts inventories | **7,226** | 7,409 |
| Prepaid expenses and other current assets | **1,867** | 1,272 |
| Total current assets | **96,085** | 123,461 |
| Property, plant, and equipment | **705,610** | 704,343 |
| Less: accumulated depreciation | **51,435** | 33,229 |
| Net property, plant, and equipment | **654,175** | 671,114 |
| Contract-based intangibles (net of $22,834 and $14,842 of accumulated amortization, respectively) | **60,708** | 68,700 |
| Deferred charge | **2,739** | 2,101 |
| Deferred financing fees (net of $1,914 and $1,243 of accumulated amortization, respectively) | **4,350** | 5,021 |
| Other noncurrent assets | **325** | 325 |
| Total assets | **$ 818,382** | $ 870,722 |
| **Liabilities and stockholders' equity** | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | **$ 13,992** | $ 37,457 |
| Current portion of long-term debt | **2,000** | 2,000 |
| Total current liabilities | **15,992** | 39,457 |
| Long-term debt | **203,500** | 195,000 |
| Contract-based intangibles (net of $3,269 and $2,243 of accumulated amortization, respectively) | **16,899** | 17,925 |
| Other noncurrent liabilities | **5,670** | 2,535 |
| Commitments and contingencies (Note 6) | **—** | — |
| Stockholders' equity: | | |
| Common stock (par value $.01; 150,000 shares authorized; 55,968 and 55,963 shares issued and outstanding at March 31, 2009 and June 30, 2008, respectively) | **560** | 560 |
| Additional paid in capital | **740,626** | 738,215 |
| Accumulated deficit | **(164,865)** | (122,970) |
| Total stockholders' equity | **576,321** | 615,805 |
| Total liabilities and stockholders' equity | **$ 818,382** | $ 870,722 |

*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, 2009 | For the Three Months Ended March 31, 2008 | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 |
|---|---|---|---|---|
| **Revenues:** | | | | |
| Energy sales | **$ 19,307** | $ 49,269 | **$153,683** | $219,169 |
| Capacity sales | **5,659** | 5,645 | **42,153** | 37,370 |
| Total revenues | **24,966** | 54,914 | **195,836** | 256,539 |
| **Operating expenses:** | | | | |
| Cost of fuel | **18,196** | 46,801 | **130,875** | 188,427 |
| Operating and maintenance | **6,398** | 28,434 | **35,233** | 47,218 |
| Gas transportation | **3,675** | 3,856 | **11,971** | 12,152 |
| Selling, general, and administrative | **4,674** | 5,551 | **12,363** | 16,200 |
| Acquisition contract termination loss | **—** | — | **—** | 37,190 |
| Depreciation | **5,989** | 5,982 | **18,206** | 18,046 |
| Auxiliary power | **1,950** | 1,817 | **6,475** | 6,145 |
| Insurance | **937** | 717 | **2,741** | 2,328 |
| Total operating expenses | **41,819** | 93,158 | **217,864** | 327,706 |
| **Operating loss** | **(16,853)** | (38,244) | **(22,028)** | (71,167) |
| **Other income (expenses):** | | | | |
| Interest expense | **(2,546)** | (4,259) | **(9,668)** | (13,318) |
| Taxes, other than income taxes | **(1,041)** | (1,050) | **(3,238)** | (2,551) |
| Interest income | **(81)** | 769 | **221** | 2,690 |
| Other | **1,097** | (4,872) | **(7,182)** | (11,457) |
| Total other expenses | **(2,571)** | (9,412) | **(19,867)** | (24,636) |
| **Net loss before taxes** | **(19,424)** | (47,656) | **(41,895)** | (95,803) |
| Income tax benefit | **—** | — | **—** | — |
| **Net loss after taxes** | **$(19,424)** | $(47,656) | **$ (41,895)** | $ (95,803) |
| Net loss per share—basic and diluted | **$ (0.35)** | $ (0.85) | **$ (0.75)** | $ (1.71) |
| Weighted average shares outstanding—basic and diluted | **55,967** | 55,951 | **55,967** | 55,948 |

*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, 2009 | For the Nine Months Ended March 31, 2008 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net loss | **$(41,895)** | $(95,803) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation | **18,206** | 18,046 |
| Amortization of deferred financing fees | **671** | 671 |
| Amortization of contract-based intangibles | **6,966** | 6,822 |
| Change in fair value of derivative instruments | **7,177** | 11,772 |
| Stock-based compensation | **2,411** | 3,345 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | **31,347** | 21,022 |
| Spare parts inventories | **183** | (9) |
| Prepaid expenses and other current assets | **(595)** | (1,467) |
| Deferred charge | **(638)** | (1,267) |
| Other noncurrent assets | **—** | 691 |
| Accounts payable and accrued liabilities | **(23,394)** | (4,889) |
| Other noncurrent liabilities | **(5)** | — |
| Net cash provided by (used in) operating activities | **434** | (41,066) |
| **Cash flows from investing activities** | | |
| Purchases of property, plant, and equipment | **(1,267)** | (1,083) |
| Short-term investments | **1,614** | (112) |
| (Investment in) use of restricted cash and cash equivalents | **(8,541)** | 11,082 |
| Net cash (used in) provided by investing activities | **(8,194)** | 9,887 |
| **Cash flows from financing activities** | | |
| Repayment of debt | **(1,500)** | (1,500) |
| Borrowings from working capital revolver | **10,000** | — |
| (Payments) proceeds from settlement of derivative instruments | **(4,108)** | 439 |
| Net cash provided by (used in) financing activities | **4,392** | (1,061) |
| Decrease in cash and cash equivalents | **(3,368)** | (32,240) |
| Cash and cash equivalents at beginning of period | **51,493** | 90,315 |
| Cash and cash equivalents at end of period | **$ 48,125** | $ 58,075 |
| **Cash paid for** | | |
| Interest | **$ 8,985** | $ 12,742 |
| **Noncash transactions** | | |
| Grant of shares for Board fees | **$ 116** | $ — |

*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 its inception. The Company owns and operates electric power generation plants and sells electricity and electrical generation capacity in the United States to wholesale purchasers such as retail electric providers, power trading organizations, municipal utilities, electric power cooperatives, and other power generation companies. The portfolio of facilities consists of five operational and fully permitted power plants (the "Plants") located in the southeastern United States with gas turbines having an aggregate capacity of 3,030 megawatts ("MW"). The Plants include four combined-cycle plants (Murray I, Murray II, Hot Spring, and Hinds) and one simple-cycle plant (Sandersville). The Plants were acquired from an affiliate of MatlinPatterson Global Advisors LLC on February 8, 2007.

*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, 2008 is derived from the June 30, 2008 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, 2008.

*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 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.

*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. 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.

*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 varies with weather conditions. Four of the plants currently 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 typically the months during which the Company seeks to perform scheduled maintenance-related activities.

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

*New Accounting Pronouncements*—In September 2006, the Financial Accounting Standards Board ("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 was effective for the Company on July 1, 2008. The Company evaluated the requirements of SFAS No. 157 and believes the interest rate swap derivatives (See Note 7) are valued using Level 2 fair value measurements. Under SFAS No. 157, instruments valued using Level 2 measurements are valued based on either quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and/or model based valuations whose inputs are observable or whose significant value drivers are observable.

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 was effective for the Company on July 1, 2008. The requirements of SFAS No. 159 did not have an impact on the Company's consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* ("SFAS No. 161"). SFAS No. 161 establishes improved financial reporting for derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. SFAS No. 161 was effective for the Company on January 1, 2009. The Company evaluated the requirements of SFAS No. 161 and added additional disclosures (See Note 7).

## 2. Property, Plant, and Equipment

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

| | Estimated Useful Life | March 31, 2009 | June 30, 2008 |
|---|---|---|---|
| Land | — | $ 4,201 | $ 4,201 |
| Buildings | 40 years | 28,612 | 28,612 |
| Gas and steam turbines | 30 years | 235,985 | 235,985 |
| Steam 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 | 122,611 |
| Other plant | 3 - 30 years | 208,608 | 207,341 |
| Total property, plant, and equipment | | 705,610 | 704,343 |
| Less: accumulated depreciation | | 51,435 | 33,229 |
| Net property, plant, and equipment | | $654,175 | $671,114 |

### 3. Contract-Based Intangibles

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

| | Term | March 31, 2009 | June 30, 2008 |
|---|---|---|---|
| **Assets** | | | |
| Murray I Georgia Power contract | May 31, 2012 | $25,882 | $31,965 |
| Murray firm transportation contracts | Various | 34,826 | 36,735 |
| Total assets | | $60,708 | $68,700 |
| **Liabilities** | | | |
| Hinds firm transportation contract | March 31, 2012 | $ 160 | $ 220 |
| Murray firm transportation contract | November 30, 2016 | 498 | 546 |
| Hot Spring firm transportation contracts | Various | 16,241 | 17,159 |
| Total liabilities | | $16,899 | $17,925 |

For the three and nine months ended March 31, 2009 and 2008, amortization of contract-based power sales rights and obligations, in both fiscal years, was $2.0 million and $6.1 million, 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, 2009, amortization of contract-based natural gas transportation rights and obligations was $0.3 million and $0.9 million, respectively, and was recorded as an increase of gas transportation expenses on the condensed consolidated statements of operations. For the three and nine months ended March 31, 2008, amortization of contract-based natural gas transportation rights and obligations was $0.3 million and $0.7 million, respectively, and 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, 2009 | June 30, 2008 |
|---|---|---|---|---|
| Term debt | Variable | February 8, 2014 | $195,500 | $197,000 |
| Working capital facility | Variable | February 8, 2012 | 10,000 | $ — |
| Total debt outstanding | | | $205,500 | $197,000 |
| Less: current portion | | | 2,000 | 2,000 |
| Total long-term debt | | | $203,500 | $195,000 |

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

**4. Long-Term Debt (Continued)**

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 3.3% and 6.6% at March 31, 2009 and 2008, respectively.

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 charges a 200 basis point fee for outstanding letters of credit, bears interest at LIBOR plus 200 basis points for outstanding draws, and has a 50 basis point commitment fee for any unused portion. It has a five-year term expiring on February 8, 2012. On March 20, 2009, KGen LLC drew $10.0 million under the working capital facility. The proceeds of the drawdown will be used for working capital purposes. Letters of credit have been issued under the working capital facility as of March 31, 2009 and June 30, 2008 for $8.9 million and $12.5 million, respectively. KGen LLC pays a fee of 191 basis points on the $120.0 million synthetic letter of credit facility. The synthetic letter of credit facility has a seven-year term expiring on February 8, 2014, and as of March 31, 2009, $119.9 million in letters of credit were issued under such facility.

The remaining future minimum principal payments under the term debt and the working capital facility subsequent to March 31, 2009 are as follows (in thousands of dollars):

| | |
|---|---|
| 2009 | $ 500 |
| 2010 | 2,000 |
| 2011 | 2,000 |
| 2012 | 12,000 |
| 2013 | 2,000 |
| Thereafter | 187,000 |
| Total | $205,500 |

The Credit Agreement and related financing documents contain various affirmative and negative covenants, including (a) financial covenants, (b) limitations on KGen LLC's ability to pay dividends, (c) restrictions on the use of available cash for operations, except as required for debt service payments and (d) an event of default in the event of a change in control of KGen.

Under the terms of the Credit Agreement, KGen LLC is 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 $533.1 million at March 31, 2009, of which $37.5 million was restricted net current assets.

**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, 2009 and June 30, 2008, the restricted balance, in accordance with this requirement, was $5.8 million and $7.0 million, respectively.

Additionally, the Security Deposit Agreement requires KGen LLC to reserve quarterly the amount of major maintenance expenditures expected to be incurred during the following 12 months. At March 31,

**5. Restricted Cash and Cash Equivalents (Continued)**

2009 and June 30, 2008, the restricted balance, in accordance with this requirement, was $27.1 million and $17.3 million, respectively.

**6. Commitments and Contingencies**

*Litigation*—The Company is party to various legal and regulatory 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. In October 2008, KGen Hinds LLC entered into a settlement agreement related to the litigation associated with amounts owed in lieu of property taxes for the 2006 and 2007 tax years. Pursuant to this settlement, the Company and the relevant taxing authorities have agreed upon property values for the 2008 through 2010 tax years.

*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 for the year ended June 30, 2008.

*Employee Matters*—The employment of Gerald Lindner, the former Chairman and Chief Executive Officer and Donald Boyd, the former Chief Operating Officer and Executive Vice President, was terminated on May 6, 2008 and May 23, 2008, respectively. Each was a party to an employment and severance agreement that provided for certain termination payments. The Company negotiated separation agreements with each of Mr. Lindner and Mr. Boyd providing for payments and benefits in full settlement of the Company's obligations under their respective employment agreements. Mr. Lindner received a cash payment of approximately $2.7 million in November 2008 pursuant to his separation agreement. Mr. Boyd received a payment of approximately $0.5 million in November 2008 and an additional payment of approximately $0.5 million in January 2009 pursuant to his separation agreement. Mr. Boyd will also receive health benefits for 18 months. In accordance with their employment agreements, all unvested options held by them vested upon their respective termination. Under the settlement agreement terms, these options will remain exercisable until November 2009.

The employment of Richard McLean, the former Chief Executive Officer and Chief Financial Officer appointed on May 27, 2008 as Chief Executive Officer, was terminated on March 12, 2009. Mr. McLean was a party to an employment agreement that provided for certain termination payments. The Company entered into a separation agreement on May 4, 2009 that provides for certain termination payments and benefits in accordance with the Company's obligations under the employment agreement. Mr. McLean will receive cash payments and health benefits totaling approximately $0.5 million, which was accrued as of March 31, 2009. In accordance with his employment agreement, all unvested options held by him vested upon his termination. By their terms, these options will remain exercisable until May 2010. Also in accordance with his employment agreement, Mr. McLean is entitled to additional compensation in the event of a change in control within six months of the separation date indicated above.

**7. Derivatives**

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

**7. Derivatives (Continued)**

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, 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 by KGen LLC was 5.0% at March 31, 2009. On March 31, 2009, the Company and its counterparty amended the swap agreements to reduce the Company's fixed rate payments component and change the basis of the counterparty's floating rate payments.

The Company evaluated the requirements of SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* ("SFAS No. 161") to enhance its current disclosure for derivative instruments in terms of accounting designation.

The short-term portion of the Swaps as of March 31, 2009 and June 30, 2008 was $3.9 million and $2.9 million, respectively, and was recorded in accounts payable and accrued liabilities. The long-term portion of the Swaps as of March 31, 2009 and June 30, 2008 was $5.6 million and $2.5 million, respectively, and was recorded in other noncurrent liabilities. Please refer to the schedule in "Number 3. *Quantitative and Qualitative Disclosures About Market Risk*." for the fair values of derivative instruments.

The Swaps are not accounted for utilizing hedge accounting, they are marked to market with gains and losses shown on the condensed consolidated statements of operations as follows (in thousands of dollars):

| | Location of Gain (Loss) on Derivatives | Gain (Loss) on Derivatives |
|---|---|---|
| For the three months ended March 31, 2009 | Other income (expenses) | $ 1,098 |
| For the three months ended March 31, 2008 | Other income (expenses) | $ (4,981) |
| For the nine months ended March 31, 2009 | Other income (expenses) | $ (7,178) |
| For the nine months ended March 31, 2008 | Other income (expenses) | $(11,773) |

The Company evaluated the requirements of SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157") and believes the Swaps are valued using Level 2 fair value measurements. Under SFAS No. 157, instruments valued using Level 2 measurements are valued based on either quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and/or model-based valuations whose inputs are observable or whose significant value drivers are observable.

The Company also considered the effect of its nonperformance risk in determining the fair value of its liabilities, as required under SFAS No. 157. The consideration of nonperformance risk resulted in an adjustment of $1.2 million for the three months ended March 31, 2009. The adjustment reduced the fair value of the Company's Swap liabilities on the condensed consolidated balance sheets and increased the gain on derivatives on the condensed consolidated statements of operations.

**8. Net 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

**8. Net Loss per Share (Continued)**

basic loss per share as the inclusion of any other potential shares outstanding would be anti-dilutive. Amounts shown below are in thousands, except per share amounts.

| | For the Three Months Ended March 31, 2009 | For the Three Months Ended March 31, 2008 | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 |
|---|---|---|---|---|
| **Numerator:** | | | | |
| Net loss | $(19,424) | $(47,656) | $(41,895) | $(95,803) |
| **Denominator:** | | | | |
| Weighted average shares outstanding—basic and diluted | 55,967 | 55,951 | 55,967 | 55,948 |
| Net loss per share—basic and diluted | $ (0.35) | $ (0.85) | $ (0.75) | $ (1.71) |

**9. Share-Based Payments**

This footnote should be read in conjunction with Note 11—Share-Based Payments of the Notes to Consolidated Financial Statements contained in the Annual Report for the year ended June 30, 2008.

The Company recorded compensation expense of $1.1 million and $2.3 million for the three and nine months ended March 31, 2009, respectively, and $1.1 million and $3.2 million for the three and nine months ended March 31, 2008, respectively, related to stock options outstanding. As of March 31, 2009 and 2008, there was $1.4 million and $8.0 million, respectively, of total unrecognized compensation expense related to unvested options. For the three and nine months ended March 31, 2009 and 2008, no options were granted or exercised.

**10. Income Taxes**

For the three and nine months ended March 31, 2009 and 2008, there were no current or deferred income tax provision (credits) included in the net loss.

**10. Income Taxes (Continued)**

The Company's provision for income taxes differed 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, 2009 | For the Three Months Ended March 31, 2008 | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 |
|---|---|---|---|---|
| Statutory rate | 35% | 35% | 35% | 35% |
| Tax at statutory rate | $ 6,798 | $(16,680) | $(14,663) | $(33,531) |
| Increase (decrease) due to: | | | | |
| Nondeductible meals and entertainment | (4) | 2 | (1) | 14 |
| State tax benefit | (742) | (2,943) | (1,925) | (3,011) |
| Adjustment to valuation allowance | 7,544 | 19,621 | 16,589 | 36,528 |
| Total provision | $ — | $ — | $ — | $ — |

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

| | At March 31, 2009 | At June 30, 2008 |
|---|---|---|
| Deferred tax assets: | | |
| Interest rate derivatives | $ 4,103 | $ 2,271 |
| Contract-based intangible assets | 10,208 | 6,180 |
| Nonqualified stock options expense | 4,657 | 3,400 |
| Accrued expenses | 182 | 1,367 |
| Net operating loss | 58,078 | 41,467 |
| Net deferred tax assets | 77,228 | 54,685 |
| Deferred tax liabilities: | | |
| Property, plant, and equipment | 12,249 | 6,707 |
| Prepaid expenses | 322 | 291 |
| Contract-based intangible liabilities | 3,478 | 3,102 |
| Net deferred tax liability | 16,049 | 10,100 |
| Valuation allowance | 61,179 | 44,585 |
| Deferred tax asset (liabilities), net | $ — | $ — |

At March 31, 2009, the Company had a federal net operating loss carryforward of $150.1 million which will expire between 2027 and 2029. The amount of taxable income that the Company can offset with this carryforward is subject to an annual limitation under Section 382 of the Internal Revenue Code, which is applicable to corporations in certain instances following an ownership change (as such term is defined for income tax purposes).

Management has determined that valuation allowances are necessary as of March 31, 2009 and June 30, 2008, 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 than not standard. There were no unrecognized tax

**10. Income Taxes (Continued)**

benefits that if recognized would affect the tax rate. No interest or penalties were recognized as of March 31, 2009.

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 2005.

**11. 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 had not been declared effective. On February 21, 2008, the Company's Board of Directors suspended the process for completion of the registration statement.

### 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, 2008. Unless the context otherwise requires or indicates, references to "KGen," "Company," "we," "our," and "us" refer to KGen Power Corporation and its subsidiaries. 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 I of our Annual Report for the fiscal year ended June 30, 2008 and "Number 1A. *Risk Factors and Forward-Looking Statements*" of Part II of this Quarterly Report 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. 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. The Plants have 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 on February 8, 2007.

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 Southern Company. The GPC PPA, which continues through May 2012, provides for fixed capacity payments that provide stable cash flow. The Company recognized $5.7 million and $5.6 million related to capacity sales on the GPC PPA for the quarter ended March 31, 2009 and 2008, respectively, and $37.5 million and $37.4 million for the nine months ended March 31, 2009 and 2008, respectively. 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.

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

On October 17, 2008, the Board of Directors announced that the directors and management of the Company, with the assistance of an experienced team at Credit Suisse, had engaged in an extensive process of exploring various strategic alternatives for the Company, with the ultimate goal of maximizing the value of the Company for our shareholders. As part of this process, the Company and Credit Suisse approached many industry participants and financial sponsors regarding their potential interest in a range of transactions, including a purchase of the Company as a whole and an acquisition of one or a combination of our power generating facilities. Despite the difficult mergers and acquisitions and credit markets, the Company received multiple indicative proposals for both the acquisition of the entire Company and acquisitions of individual assets from a combination of strategic and financial bidders. Although the Board was generally pleased with the results of the solicitation, it believes that the Company and its shareholders would realize even greater value, with more certainty of closing, in a more stable financial market in which

potential acquirers would have greater, and more certain, access to capital and financing instruments. Accordingly, the Board determined not to bring the sale process to a conclusion at this time.

The Company will continue to explore and review credible transaction proposals, to the extent that they increase shareholder value, as they are received.

**Recent Events**

*Employee Matters*

The employment of Richard McLean, the former Chief Executive Officer and Chief Financial Officer appointed on May 27, 2008 as Chief Executive Officer, was terminated on March 12, 2009. Mr. McLean was a party to an employment agreement that provided for certain termination payments. The Company entered into a separation agreement on May 4, 2009 that provides for certain termination payments and benefits in accordance with the Company's obligations under the employment agreement. Mr. McLean will receive cash payments and health benefits totaling approximately $0.5 million, which was accrued as of March 31, 2009. In accordance with his employment agreement, all unvested options held by him vested upon his termination. By their terms, these options will remain exercisable until May 2010. Also in accordance with his employment agreement, Mr. McLean is entitled to additional compensation in the event of a change in control within six months of the separation date indicated above.

Thomas B. White was named as Chief Executive Officer, effective March 13, 2009. In connection with his appointment, the Company expects to enter into an employment agreement with Mr. White providing for a two and a half year employment term (subject to renewal) with an annual base salary of $0.4 million, transaction bonuses upon the successful completion of sales of the Company's generation facilities and/or a sale of the Company, and 20,000 restricted stock units. The employment agreement had not been finalized. Mr. White has served on our Board of Directors since April 18, 2008 and will continue his role on the Board.

**Results of Operations**

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 typically seek to perform scheduled maintenance-related activities.

***Consolidated Results of Operations of KGen for the Three Months Ended March 31, 2009 compared to the Three Months Ended March 31, 2008.***

The following table sets forth our results of operations for the three months ended March 31, 2009 and 2008, expressed in thousands of dollars.

| | For the Three Months Ended March 31, 2009 | For the Three Months Ended March 31, 2008 | Favorable/ (Unfavorable) | |
|---|---|---|---|---|
| | | | Change | % Change |
| **Revenues:** | | | | |
| Energy sales | $ 19,307 | $ 49,269 | $(29,962) | (61)% |
| Capacity sales | 5,659 | 5,645 | 14 | 0% |
| Total revenues | 24,966 | 54,914 | (29,948) | (55)% |
| **Operating expenses:** | | | | |
| Cost of fuel | 18,196 | 46,801 | 28,605 | 61% |
| Operating and maintenance | 6,398 | 28,434 | 22,036 | 77% |
| Gas transportation | 3,675 | 3,856 | 181 | 5% |
| Selling, general, and administrative | 4,674 | 5,551 | 877 | 16% |
| Depreciation | 5,989 | 5,982 | (7) | (0)% |
| Auxiliary power | 1,950 | 1,817 | (133) | (7)% |
| Insurance | 937 | 717 | (220) | (31)% |
| Total operating expenses | 41,819 | 93,158 | 51,339 | 55% |
| **Operating loss** | (16,853) | (38,244) | 21,391 | 56% |
| **Other income (expenses):** | | | | |
| Interest expense | (2,546) | (4,259) | 1,713 | 40% |
| Taxes, other than income taxes | (1,041) | (1,050) | 9 | 1% |
| Interest income | (81) | 769 | (850) | (111)% |
| Other | 1,097 | (4,872) | 5,969 | 123% |
| Total other expenses | (2,571) | (9,412) | 6,841 | 73% |
| **Net loss before taxes** | (19,424) | (47,656) | 28,232 | 59% |
| Income tax benefit | — | — | — | 0% |
| **Net loss after taxes** | $(19,424) | $(47,656) | $ 28,232 | 59% |

**Operating and Business Metrics We Use to Analyze the Company's Performance for the Three Months Ended March 31, 2009 and March 31, 2008**

In addition to the foregoing results of operations presented in accordance with GAAP, we utilize various non-GAAP operating and business metrics to analyze the Company's performance. We believe these metrics provide useful insight into the Company's performance, assist us in identifying trends in our business, and better allow us to compare our performance to others in our industry. We describe below these various non-GAAP metrics and provide a reconciliation of these metrics for the three months ended March 31, 2009 and 2008, respectively, to the most directly comparable GAAP measures for those periods. See the reconciliation of net loss to adjusted EBITDA on page 22. This presentation may not include all of the disclosure that SEC regulations require with respect to non-GAAP financial measures.

*Merchant Margin, Adjusted Contracted Margin, and Total Adjusted Margin*

We separate merchant margin and adjusted contracted margin because the distinction helps us analyze the certainty of future cash flows of the Company and the underlying commodity value of the Company's assets.

Merchant margin is equal to the sum of merchant energy margin and merchant capacity sales. Merchant energy margin is defined as energy sales less the related cost of fuel pursuant to arrangements having an original delivery term of less than one year. Merchant capacity sales is defined as capacity sales pursuant to arrangements having an original delivery term of less than one year. We currently consider Hinds, Hot Spring, Murray II and Sandersville to be merchant plants because they are currently not selling their energy output and capacity pursuant to long-term sales agreements.

| | For the Three Months Ended March 31, 2009 | For the Three Months Ended March 31, 2008 |
|---|---|---|
| | (in thousands) | |
| Energy sales | $ 19,307 | $ 49,269 |
| *Less:* Cost of fuel | (18,196) | (46,801) |
| *Less:* Contracted energy sales | (4,495) | (2,638) |
| *Add:* Contracted cost of fuel | 6,045 | 4,136 |
| **Merchant energy margin** | 2,661 | 3,966 |
| Capacity sales | 5,659 | 5,645 |
| *Less:* Contracted capacity sales | (5,659) | (5,645) |
| **Merchant capacity sales** | — | — |
| **Merchant margin** | $ 2,661 | $ 3,966 |

Adjusted contracted margin is equal to the sum of adjusted contracted energy margin and adjusted contracted capacity sales. Adjusted contracted energy margin is defined as energy sales less the related cost of fuel pursuant to arrangements having an original delivery term of one year or greater adjusted to remove the income effects of noncash amortization of contract-based intangibles. Adjusted contracted capacity sales is defined as capacity sales pursuant to arrangements having an original delivery term of one year or greater adjusted to remove the income effects of noncash deferred capacity revenue to levelize the capacity sales over the term of the agreement as required by GAAP. We believe that the foregoing adjustments are helpful in understanding the commercial results of our contractual arrangements without

the impact of noncash accounting adjustments. We currently consider Murray I to be contracted, because it is selling its energy output and capacity pursuant to the long-term GPC PPA.

| | For the Three Months Ended March 31, 2009 | For the Three Months Ended March 31, 2008 |
|---|---|---|
| | (in thousands) | |
| Energy sales | $ 19,307 | $ 49,269 |
| *Less:* Merchant sales | (14,812) | (46,631) |
| **Contracted energy sales** | 4,495 | 2,638 |
| *Less:* Contracted cost of fuel | (6,045) | (4,136) |
| *Add:* Power sales rights and obligations amortization | 2,028 | 2,028 |
| **Adjusted contracted energy margin** | 478 | 530 |
| Contracted capacity sales | 5,659 | 5,645 |
| *Less:* Noncash deferred capacity revenue | (41) | (138) |
| **Adjusted contracted capacity sales** | $ 5,618 | $ 5,507 |
| **Adjusted contracted margin** | $ 6,096 | $ 6,037 |

Total adjusted margin is equal to the sum of merchant margin and adjusted contracted margin.

| | For the Three Months Ended March 31, 2009 | For the Three Months Ended March 31, 2008 |
|---|---|---|
| | (in thousands) | |
| Merchant margin | $2,661 | $ 3,966 |
| Adjusted contracted margin | 6,096 | 6,037 |
| **Total adjusted margin** | $8,757 | $10,003 |

*Adjusted Plant Expense and Adjusted Corporate Expense*

Adjusted plant expenses is defined as total operating expenses adjusted for the removal of (a) cost of fuel captured in merchant energy margin and adjusted contracted energy margin, (b) major maintenance expense, (c) the income effects of noncash amortization of contract-based intangibles of gas transportation expense, (d) all selling, general, and administrative expense, part of which is captured in adjusted corporate expenses (defined below), (e) any nonrecurring items such as an acquisition contract termination loss, (f) depreciation, (g) director and officer insurance expense captured in adjusted corporate expenses

(defined below); and the addition of taxes, other than income taxes, as it largely represents plant property taxes and payments in lieu of taxes.

| | For the Three Months Ended March 31, 2009 | For the Three Months Ended March 31, 2008 |
|---|---|---|
| | (in thousands) | |
| Total operating expenses | $ 41,819 | $ 93,158 |
| *Less:* Cost of fuel | (18,196) | (46,801) |
| *Less:* Major maintenance expense | (755) | (22,001) |
| *Less:* Gas transportation noncash amortization | (294) | (284) |
| *Less:* Selling, general and administrative expense | (4,674) | (5,551) |
| *Less:* Depreciation | (5,989) | (5,982) |
| *Less:* D&O insurance expense | (99) | (75) |
| *Add:* Taxes, other than income taxes | 1,041 | 1,050 |
| **Adjusted plant expenses** | $ 12,853 | $ 13,514 |

Adjusted corporate expenses is defined as selling, general, and administrative expense adjusted for (a) the removal of noncash stock compensation expense and reorganization items such as employee severance and (b) the addition of director and officer insurance expense.

| | For the Three Months Ended March 31, 2009 | For the Three Months Ended March 31, 2008 |
|---|---|---|
| | (in thousands) | |
| Selling, general, and administrative expense | $ 4,674 | $ 5,551 |
| *Less:* Noncash employee options/shares expense | (1,115) | (1,068) |
| *Less:* Employee severance expense | (460) | — |
| *Add:* D&O insurance expense | 99 | 75 |
| **Adjusted corporate expenses** | $ 3,198 | $ 4,558 |

*Adjusted Plant EBITDA and Adjusted EBITDA:*

Adjusted plant EBITDA is defined as total adjusted margin less adjusted plant expenses. Adjusted EBITDA is defined as adjusted plant EBITDA less adjusted corporate expenses.

| | For the Three Months Ended March 31, 2009 | For the Three Months Ended March 31, 2008 | Favorable/ (Unfavorable) | |
|---|---|---|---|---|
| | | | Change | % Change |
| | | (in thousands) | | |
| Merchant energy margin | $ 2,661 | $ 3,966 | $(1,305) | (33)% |
| Merchant capacity sales | — | — | — | 0% |
| **Merchant margin** | 2,661 | 3,966 | (1,305) | (33)% |
| Adjusted contracted energy margin | 478 | 530 | (52) | (10)% |
| Adjusted contracted capacity sales | 5,618 | 5,507 | 111 | 2% |
| **Adjusted contracted margin** | 6,096 | 6,037 | 59 | 1% |
| **Total adjusted margin** | 8,757 | 10,003 | (1,246) | (12)% |
| Adjusted plant expenses | 12,853 | 13,514 | 661 | 5% |
| **Adjusted plant EBITDA** | (4,096) | (3,511) | (585) | (17)% |
| Adjusted corporate expenses | 3,198 | 4,558 | 1,360 | 30% |
| **Adjusted EBITDA** | $(7,294) | $(8,069) | $ 775 | 10% |

*Selected Operating and Business Metrics*

| | For the Three Months Ended March 31, 2009 | For the Three Months Ended March 31, 2008 | Favorable/ (Unfavorable) | |
|---|---|---|---|---|
| | | | Change | % Change |
| Total generation (GWh) | 574 | 779 | (205) | (26)% |
| Merchant generation (GWh) | 436 | 721 | (285) | (40)% |
| Merchant margin/merchant generation ($/MWh) | $6.10 | $5.50 | $0.60 | 11% |

*Selected Market and Weather Data*

| | For the Three Months Ended March 31, 2009 | For the Three Months Ended March 31, 2008 | Change | % Change |
|---|---|---|---|---|
| **Selected Market Data**(1) | | | | |
| Average on-peak market power price— Entergy ($/MWh) | $35.79 | $63.99 | $(28.20) | (44)% |
| Average on-peak market power price— Southern ($/MWh) | $39.40 | $62.60 | $(23.20) | (37)% |
| Average Henry Hub gas price ($/MMbtu) | $ 4.58 | $ 8.58 | $ (4.00) | (47)% |
| **Selected Weather Data** | | | | |
| Actual CDDs(2) | — | — | — | 0% |
| Normal CDDs | — | — | — | 0% |
| Actual HDDs(3) | 4,304 | 4,621 | (317) | (7)% |
| Normal HDDs | 4,828 | 4,874 | (46) | (1)% |

Notes:

(1) Data from Platt's Megawatt Daily and Gas Daily publications.

(2) CDD, or cooling degree days, 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.

(3) HDD, or heating degree days, 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.

***Historical Results of Operations of KGen for the Three Months Ended March 31, 2009 compared to the Three Months Ended March 31, 2008.***

Total adjusted margin decreased $1.2 million to $8.8 million for the three months ended March 31, 2009 compared to the same period in the previous year as a result of a $1.3 million decrease in merchant energy margin partially offset by a $0.1 million increase in adjusted contracted margin. The $1.3 million decrease in merchant energy margin resulted principally from decreased merchant generation. Merchant generation decreased by 285 GWh, or 40%, to 436 GWh for the quarter ended March 31, 2009 and implied merchant spark spread increased by $0.60/MWh, or 11%, to $6.10/MWh for the quarter ended March 31, 2009.

Adjusted contracted margin increased $0.1 million to $6.1 million for the three months ended March 31, 2009 compared to the same period in the previous year due to a $0.1 million increase in adjusted contracted capacity sales as a result of the escalation of the pricing in the GPC PPA. Adjusted contracted energy margin was down by $0.1 million as a result of a $0.3 million decrease in availability bonus related

to the GPC PPA, offset by higher dispatch. Murray I generation increased 80 GWh, or 138%, to 138 GWh for the three months ended March 31, 2009.

Adjusted plant expenses decreased by $0.7 million, or 5%, to $12.9 million for the three months ended March 31, 2009. The decrease is associated with a reduction in outage costs compared to the prior period. As a result of the foregoing, adjusted plant EBITDA decreased by $0.6 million to negative $4.1 million for the three months ended March 31, 2009.

Adjusted corporate expenses decreased by $1.4 million, or 30%, to $3.2 million for the three months ended March 31, 2009. This decrease is primarily related to a $0.8 million decrease in payroll expense and a $0.5 million decrease in legal and professional services.

As a result of the foregoing adjusted EBITDA increased by $0.8 million to negative $7.3 million for the three months ended March 31, 2009.

**GAAP to Non-GAAP Adjusted EBITDA Reconciliation**

Following is an alternative calculation of adjusted EBITDA and adjusted plant EBITDA starting from net loss after taxes. EBITDA is equal to net loss after taxes adjusted for interest expenses, income taxes, depreciation, and amortization. Adjusted EBITDA is equal to EBITDA minus certain other items (such as major maintenance and other non-recurring expenses). Adjusted plant EBITDA is equal to total adjusted EBITDA less certain corporate expenses.

| | For the Three Months Ended March 31, 2009 | For the Three Months Ended March 31, 2008 |
|---|---|---|
| | (in thousands) | |
| Net loss after taxes | $(19,424) | $(47,656) |
| *Add*: Interest expense | 2,546 | 4,259 |
| *Less*: Interest income | 81 | (769) |
| *Add*: Depreciation | 5,989 | 5,982 |
| *Add*: Power sales rights and obligations amortization | 2,028 | 2,028 |
| *Add*: Gas transportation noncash amortization | 294 | 284 |
| *Less*: Noncash deferred capacity revenue | (41) | (138) |
| *Add*: Other (income) expenses | (1,097) | 4,872 |
| **EBITDA** | (9,624) | (31,138) |
| *Add*: Major maintenance expense | 755 | 22,001 |
| *Add*: Noncash employee options/shares expense | 1,115 | 1,068 |
| *Add*: Employee severance expense | 460 | — |
| **Adjusted EBITDA** | (7,294) | (8,069) |
| *Add*: Selling, general and administrative expense | 4,674 | 5,551 |
| *Less*: Noncash employee options/shares expense | (1,115) | (1,068) |
| *Less*: Employee severance expense | (460) | — |
| *Add*: D&O insurance expense | 99 | 75 |
| **Adjusted plant EBITDA** | $ (4,096) | $ (3,511) |

The following describes changes to specified financial measures of our performance. As indicated above, in calculating our adjusted EBITDA, we make adjustments to our net loss after taxes using these

financial measures for the three months ended March 31, 2009 compared to the three months ended March 31, 2008.

- Interest expense for the three months ended March 31, 2009 was $2.5 million compared to $4.3 million for the same period in 2008. The decrease in interest expense related to a reduction in interest rates and outstanding debt compared to the same period in the previous year.
- Interest income for the three months ended March 31, 2009 and 2008 was an expense of $81,000 and income of $0.8 million, respectively. The decrease from interest income to expense related to lower interest rates, lower average cash balances, and higher banking fees compared to the same period in the previous year.
- Depreciation was $6.0 million for the three months ended March 31, 2009 and the same period in the prior year.
- Amortization of contract-based power sales rights and obligations, for both three month periods, was $2.0 million and was recorded as a reduction of energy sales.
- Amortization of contract-based natural gas transportation rights and obligations, for both three month periods, was $0.3 million and was recorded as an increase of gas transportation expense.
- Noncash deferred capacity revenue of $41,000 and $0.1 million was recorded as capacity sales for the three months ended March 31, 2009 and 2008, respectively.
- Other income (expense) for the three months ended March 31, 2009 and 2008 was income of $1.1 million and expense of $4.9 million, respectively, and primarily related to losses on derivatives associated with our interest rate hedging due to the change in the fair value and the cash settlements on our Swaps. A portion of the favorable variance is related to the swap agreement restructuring during the quarter, which lowered the ongoing fixed rate within the swap contracts.
- Major maintenance expense was $0.8 million and $22.0 million for the three months ended March 31, 2009 and 2008, respectively.
- Noncash stock compensation expense, for both three month periods, was $1.1 million and was recorded as an increase of selling, general, and administrative expense.
- Selling, general, and administrative expense included $0.5 million in severance expense for the three months ended March 31, 2009.

***Consolidated Results of Operations of KGen for the Nine Months Ended March 31, 2009 compared to the Nine Months Ended March 31, 2008.***

The following table sets forth our results of operations for the nine months ended March 31, 2009 and 2008, expressed in thousands of dollars.

| | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 | Favorable/(Unfavorable) | |
|---|---|---|---|---|
| | | | Change | % Change |
| **Revenues:** | | | | |
| Energy sales | $153,683 | $219,169 | $ (65,486) | (30)% |
| Capacity sales | 42,153 | 37,370 | 4,783 | 13% |
| Total revenues | 195,836 | 256,539 | (60,703) | (24)% |
| **Operating expenses:** | | | | |
| Cost of fuel | 130,875 | 188,427 | 57,552 | 31% |
| Operating and maintenance | 35,233 | 47,218 | 11,985 | 25% |
| Gas transportation | 11,971 | 12,152 | 181 | 1% |
| Selling, general, and administrative | 12,363 | 16,200 | 3,837 | 24% |
| Acquisition contract termination loss | — | 37,190 | 37,190 | 100% |
| Depreciation | 18,206 | 18,046 | (160) | (1)% |
| Auxiliary power | 6,475 | 6,145 | (330) | (5)% |
| Insurance | 2,741 | 2,328 | (413) | (18)% |
| Total operating expenses | 217,864 | 327,706 | 109,842 | 34% |
| **Operating loss** | (22,028) | (71,167) | 49,139 | 69% |
| **Other income (expenses):** | | | | |
| Interest expense | (9,668) | (13,318) | 3,650 | 27% |
| Taxes, other than income taxes | (3,238) | (2,551) | (687) | (27)% |
| Interest income | 221 | 2,690 | (2,469) | (92)% |
| Other | (7,182) | (11,457) | 4,275 | 37% |
| Total other expenses | (19,867) | (24,636) | 4,769 | 19% |
| **Net loss before taxes** | (41,895) | (95,803) | 53,908 | 56% |
| Income tax benefit | — | — | — | 0% |
| **Net loss after taxes** | $ (41,895) | $ (95,803) | $ 53,908 | 56% |

**Operating and Business Metrics We Use to Analyze the Company's Performance for the Nine Months Ended March 31, 2009 and March 31, 2008**

As indicated above, in addition to the foregoing results of operations presented in accordance with GAAP, we utilize various non-GAAP operating and business metrics to analyze the Company's performance. We believe these metrics provide useful insight into the Company's performance, assist us in identifying trends in our business, and better allow us to compare our performance to others in our industry. We describe below these various non-GAAP metrics and provide a reconciliation of these metrics for the nine months ended March 31, 2009 and 2008, respectively, to the most directly comparable GAAP measures for those periods. See the reconciliation of net loss to adjusted EBITDA on page 29. This presentation may not include all of the disclosure that SEC regulations require with respect to non-GAAP financial measures.

*Merchant Margin, Adjusted Contracted Margin, and Total Adjusted Margin*

We separate merchant margin and adjusted contracted margin because the distinction helps us analyze the certainty of future cash flows of the Company and the underlying commodity value of the Company's assets.

Merchant margin is equal to the sum of merchant energy margin and merchant capacity sales. Merchant energy margin is defined as energy sales less the related cost of fuel pursuant to arrangements having an original delivery term of less than one year. Merchant capacity sales is defined as capacity sales pursuant to arrangements having an original delivery term of less than one year. We currently consider Hinds, Hot Spring, Murray II and Sandersville to be merchant plants because they are currently not selling their energy output and capacity pursuant to long-term sales agreements.

| | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 |
|---|---|---|
| | (in thousands) | |
| Energy sales | $ 153,683 | $ 219,169 |
| *Less:* Cost of fuel | (130,875) | (188,427) |
| *Less:* Contracted energy sales | (33,438) | (40,250) |
| *Add:* Contracted cost of fuel | 33,716 | 41,656 |
| **Merchant energy margin** | 23,086 | 32,148 |
| Capacity sales | 42,153 | 37,370 |
| *Less:* Contracted capacity sales | (37,462) | (37,370) |
| **Merchant capacity sales** | $ 4,691 | $ — |
| **Merchant margin** | $ 27,777 | $ 32,148 |

Adjusted contracted margin is equal to the sum of adjusted contracted energy margin and adjusted contracted capacity sales. Adjusted contracted energy margin is defined as energy sales less the related cost of fuel pursuant to arrangements having an original delivery term of one year or greater adjusted to remove the income effects of noncash amortization of contract-based intangibles. Adjusted contracted capacity sales is defined as capacity sales pursuant to arrangements having an original delivery term of one year or greater adjusted to remove the income effects of noncash deferred capacity revenue to levelize the capacity sales over the term of the agreement as required by GAAP. We believe that the foregoing adjustments are helpful in understanding the commercial results of our contractual arrangements without the impact of noncash accounting adjustments. We currently consider Murray I to be contracted, because it is selling its energy output and capacity pursuant to the long-term GPC PPA.

| | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 |
|---|---|---|
| | (in thousands) | |
| Energy sales | $ 153,683 | $ 219,169 |
| *Less:* Merchant sales | (120,245) | (178,919) |
| **Contracted energy sales** | 33,438 | 40,250 |
| *Less:* Contracted cost of fuel | (33,716) | (41,656) |
| *Add:* Power sales rights and obligations amortization | 6,084 | 6,084 |
| **Adjusted contracted energy margin** | 5,806 | 4,678 |
| Contracted capacity sales | 37,462 | 37,370 |
| *Less:* Noncash deferred capacity revenue | (638) | (1,267) |
| **Adjusted contracted capacity sales** | $ 36,824 | $ 36,103 |
| **Adjusted contracted margin** | $ 42,630 | $ 40,781 |

Total adjusted margin is equal to the sum of merchant margin and adjusted contracted margin.

| | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 |
|---|---|---|
| | (in thousands) | |
| Merchant margin | $27,777 | $32,148 |
| Adjusted contracted margin | 42,630 | 40,781 |
| **Total adjusted margin** | $70,407 | $72,929 |

*Adjusted Plant Expense and Adjusted Corporate Expense*

Adjusted plant expenses is defined as total operating expenses adjusted for the removal of (a) cost of fuel captured in merchant energy margin and adjusted contracted energy margin, (b) major maintenance expense, (c) the income effects of noncash amortization of contract-based intangibles of gas transportation expense, (d) all selling, general, and administrative expense, part of which is captured in adjusted corporate expenses (defined below), (e) any nonrecurring items such as an acquisition contract termination loss, (f) depreciation, (g) director and officer insurance expense captured in adjusted corporate expenses (defined below); and the addition of taxes, other than income taxes, as it largely represents plant property taxes and payments in lieu of taxes.

| | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 |
|---|---|---|
| | (in thousands) | |
| Total operating expenses | $ 217,864 | $ 327,706 |
| *Less:* Cost of fuel | (130,875) | (188,427) |
| *Less:* Major maintenance expense | (19,368) | (30,667) |
| *Less:* Gas transportation noncash amortization | (882) | (738) |
| *Less:* Selling, general and administrative expense | (12,363) | (16,200) |
| *Less:* Acquisition contract termination loss | — | (37,190) |
| *Less:* Depreciation | (18,206) | (18,046) |
| *Less:* D&O insurance expense | (302) | (167) |
| *Add:* Taxes, other than income taxes | 3,238 | 2,551 |
| **Adjusted plant expenses** | $ 39,106 | $ 38,822 |

Adjusted corporate expenses is defined as selling, general, and administrative expense adjusted for (a) the removal of noncash stock compensation expense and reorganization items such as employee severance and (b) the addition of director and officer insurance expense.

| | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 |
|---|---|---|
| | (in thousands) | |
| Selling, general, and administrative expense | $12,363 | $16,200 |
| *Less:* Noncash employee options/shares expense | (2,294) | (3,228) |
| *Less:* Employee severance expense | (460) | — |
| *Add:* D&O insurance expense | 302 | 167 |
| **Adjusted corporate expenses** | $ 9,911 | $13,139 |

*Adjusted Plant EBITDA and Adjusted EBITDA:*

Adjusted plant EBITDA is defined as total adjusted margin less adjusted plant expenses. Adjusted EBITDA is defined as adjusted plant EBITDA less adjusted corporate expenses.

| | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 | Favorable/ (Unfavorable) | |
|---|---|---|---|---|
| | | | Change | % Change |
| | | (in thousands) | | |
| Merchant energy margin | $23,086 | $32,148 | $(9,062) | (28)% |
| Merchant capacity sales | 4,691 | — | 4,691 | 100% |
| **Merchant margin** | 27,777 | 32,148 | (4,371) | (14)% |
| Adjusted contracted energy margin | 5,806 | 4,678 | 1,128 | 24% |
| Adjusted contracted capacity sales | 36,824 | 36,103 | 721 | 2% |
| **Adjusted contracted margin** | 42,630 | 40,781 | 1,849 | 5% |
| **Total adjusted margin** | 70,407 | 72,929 | (2,522) | (3)% |
| Adjusted plant expenses | 39,106 | 38,822 | (284) | (1)% |
| **Adjusted plant EBITDA** | 31,301 | 34,107 | (2,806) | (8)% |
| Adjusted corporate expenses | 9,911 | 13,139 | 3,228 | 25% |
| **Adjusted EBITDA** | $21,390 | $20,968 | $ 422 | 2% |

***Selected Operating and Business Metrics***

| | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 | Favorable/ (Unfavorable) | |
|---|---|---|---|---|
| | | | Change | % Change |
| **Selected Financial and Operating Data** | | | | |
| Total generation (GWh) | 2,324 | 3,526 | (1,202) | (34)% |
| Merchant generation (GWh) | 1,833 | 2,785 | (952) | (34)% |
| Merchant margin/merchant generation ($/MWh) | $15.15 | $11.54 | $ 3.61 | 31% |

*Selected Market and Weather Data*

| | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 | Change | % Change |
|---|---|---|---|---|
| **Selected Market Data**(1) | | | | |
| Average on-peak market power price— Entergy ($/MWh) | $50.77 | $57.78 | $(7.01) | (12)% |
| Average on-peak market power price— Southern ($/MWh) | $55.65 | $58.36 | $(2.71) | (5)% |
| Average Henry Hub gas price ($/MMbtu) | $ 6.70 | $ 7.22 | $(0.52) | (7)% |
| **Selected Weather Data** | | | | |
| Actual CDDs(2) | 3,974 | 4,760 | (786) | (17)% |
| Normal CDDs | 3,761 | 3,761 | — | 0% |
| Actual HDDs(3) | 7,363 | 7,116 | 247 | 3% |
| Normal HDDs | 7,915 | 7,985 | (70) | (1)% |

Notes:

(1) Data from Platt's Megawatt Daily and Gas Daily publications.

(2) CDD, or cooling degree days, 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.

(3) HDD, or heating degree days, 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.

***Historical Results of Operations of KGen for the Nine Months Ended March 31, 2009 compared to the Nine Months Ended March 31, 2008.***

Total adjusted margin decreased by $2.5 million to $70.4 million for the nine months ended March 31, 2009 compared to the same period in the previous year as a result of a $4.4 million decrease in merchant margin partially offset by a $1.8 million increase in adjusted contracted margin. The $70.4 million in total adjusted margin was comprised of $27.8 million in merchant margin and $42.6 million in adjusted contracted margin.

The $4.4 million decrease in merchant margin related to cooler weather during the summer months, as evidenced by a 17% decrease in cooling degree days, when compared to the previous year. There was also a corresponding decrease in merchant generation of 34% during the nine months ended March 31, 2009. The implied merchant spark spread, or merchant margin divided by merchant generation, increased $3.61 per MWh to $15.15 per MWh for the nine months ended March 31, 2009 compared to the same period in the previous year.

Adjusted contracted margin increased by $1.8 million, to $42.6 million, for the nine months ended March 31, 2009, which was comprised of $36.8 million in adjusted contracted capacity sales and $5.8 million in adjusted contracted energy margin. The $1.1 million increase in adjusted contracted energy margin was largely attributable to a reduction in replacement energy during the nine months ended March 31, 2009, when compared to the previous year. From time to time, KGen has replaced energy scheduled from Murray I under the GPC PPA with energy from Murray II, Sandersville, or third-party sources. The cost of such replacement energy is accounted for as a reduction of energy sales at Murray I. When KGen utilizes replacement energy from Murray II or Sandersville, such replacement energy is also accounted for as energy sales at market prices for such Plant. The $0.7 million increase in adjusted contracted capacity sales was a result of the escalation of the pricing in the GPC PPA.

Adjusted plant expenses increased by $0.3 million, or 1%, to $39.1 million for the nine months ended March 31, 2009. As a result of the foregoing, adjusted plant EBITDA decreased by $2.8 million to $31.3 million for the nine months ended March 31, 2009.

Adjusted corporate expenses decreased by $3.2 million, or 25%, to $9.9 million for the nine months ended March 31, 2009. This decrease is primarily related to a $2.2 million decrease in payroll expense and a $1.0 million decrease in legal and professional services.

As a result of the foregoing, adjusted EBITDA increased by $0.4 million to $21.4 million for the nine months ended March 31, 2009.

**GAAP to Non-GAAP Adjusted EBITDA Reconciliation**

Following is an alternative calculation of adjusted EBITDA and adjusted plant EBITDA starting from net loss after taxes. EBITDA is equal to net loss after taxes adjusted for interest expenses, income taxes, depreciation, and amortization. Adjusted EBITDA is equal to EBITDA minus certain other items (such as major maintenance and other non-recurring expenses). Adjusted plant EBITDA is equal to total adjusted EBITDA less certain corporate expenses.

| | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 |
|---|---|---|
| | (in thousands) | |
| Net loss after taxes | $(41,895) | $(95,803) |
| *Add*: Interest expense | 9,668 | 13,318 |
| *Less*: Interest income | (221) | (2,690) |
| *Add*: Depreciation | 18,206 | 18,046 |
| *Add*: Power sales rights and obligations amortization | 6,084 | 6,084 |
| *Add*: Gas transportation noncash amortization | 882 | 738 |
| *Less*: Noncash deferred capacity revenue | (638) | (1,267) |
| *Add*: Acquisition contract termination loss | — | 37,190 |
| *Add*: Other expenses | 7,182 | 11,457 |
| **EBITDA** | (732) | (12,927) |
| *Add*: Major maintenance expense | 19,368 | 30,667 |
| *Add*: Noncash employee options/shares expense | 2,294 | 3,228 |
| *Add*: Employee severance expense | 460 | — |
| **Adjusted EBITDA** | 21,390 | 20,968 |
| *Add*: Selling, general and administrative expense | 12,363 | 16,200 |
| *Less*: Noncash employee options/shares expense | (2,294) | (3,228) |
| *Less*: Employee severance expense | (460) | — |
| *Add*: D&O insurance expense | 302 | 167 |
| **Adjusted plant EBITDA** | $ 31,301 | $ 34,107 |

The following describes changes to specified financial measures of our performance. As indicated above, in calculating our adjusted EBITDA, we make adjustments to our net loss after taxes using these financial measures for the nine months ended March 31, 2009 compared to the nine months ended March 31, 2008.

- Interest expense for the nine months ended March 31, 2009 was $9.7 million compared to $13.3 million for the same period in 2008. The decrease in interest expense related to a reduction in interest rates and outstanding debt compared to the same period in the previous year.

- Interest income for the nine months ended March 31, 2009 was $0.2 million compared to $2.7 million for the same period in 2008. The decrease in interest income related to lower interest rates, lower average cash balances, and higher banking fees compared to the same period in the previous year.
- Depreciation was $18.2 million and $18.0 million for the nine months ended March 31, 2009 and 2008, respectively.
- Amortization of contract-based power sales rights and obligations, for both nine month periods, was $6.1 million and was recorded as a reduction of energy sales.
- Amortization of contract-based natural gas transportation rights and obligations was $0.9 million and $0.7 million for the nine months ended March 31, 2009 and 2008, respectively and was recorded as an increase of gas transportation expense.
- Noncash deferred capacity revenue of $0.6 million and $1.3 million was recorded as capacity sales for the nine months ended March 31, 2009 and 2008, respectively.
- There was an acquisition contract termination loss of $37.2 million during the nine months ended March 31, 2008, associated with the termination of the proposed acquisition of Complete Energy Holdings, LLC.
- Other expense for the nine months ended March 31, 2009 and 2008 was $7.2 million and $11.5 million, respectively, and primarily related to losses on derivatives associated with our interest rate hedging due to the change in the fair value and the cash settlements on our swaps.
- Major maintenance expense was $19.4 million and $30.7 million for the nine months ended March 31, 2009 and 2008, respectively.
- Noncash stock compensation expense was $2.3 million and $3.2 million for the nine months ended March 31, 2009 and 2008, respectively, and was recorded as an increase of selling, general, and administrative expense.
- Selling, general, and administrative expense included $0.5 million in severance expense for the nine months ended March 31, 2009.

**Liquidity and Capital Resources**

***Liquidity Position***

We expect that cash on hand, cash flow provided by operations, and cash available under our Credit Facility will satisfy our short-term liquidity needs with respect to our current portfolio of working capital assets over the next 12 months. Our liquidity was comprised of the following at March 31, 2009 (in thousands of dollars):

| | |
|---|---|
| Unrestricted cash and cash equivalents | $ 48,125 |
| Working capital revolver and synthetic letter of credit facility (net of letters of credit issued and cash draws thereunder) | 61,166 |
| Total | $109,291 |

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, 2009, we had $61.2 million available under our Credit Facility, of which $61.1 million was under the working capital revolver and $0.1 million was under the synthetic letter of credit facility, for activities related to our plants. We had cash on hand of $48.1 million, of which $32.4 million was cash at the parent level and not subject to the lien of the Credit

Agreement at March 31, 2009. Similarly, $40.5 million was the balance at the parent level not subject to the credit agreement at June 30, 2008. Management believes that cash on hand, amounts available under our Credit Facility, and cash flows from operations will be adequate to finance capital expenditures and other liquidity commitments over the next 12 months.

***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;
- an $80.0 million working capital facility for letters of credit and other liquidity needs, or 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.

On March 20, 2009, KGen LLC drew $10.0 million under the working capital facility and is to be used for working capital purposes.

*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 3. *Quantitative and Qualitative Disclosures About Market Risk*." The outstanding balance under 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 undrawn letters of credit under the Working Capital Facility and a 191 basis point fee on the $120.0 million 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 $32.4 million at March 31, 2009 that was held at our parent company level.

The Credit Facility and related financing documents contain various affirmative and negative covenants, including (a) financial covenants, (b) limitations on KGen LLC's ability to pay dividends, (c) restrictions on the use of available cash for operations, except as required for debt service payments and, (d) an event of default in the event of a change in control of KGen. At March 31, 2009, we were in compliance with the covenants contained within our Credit Facility.

On December 2, 2008, Moody's Investors Service downgraded KGen's debt rating to B1 citing continuing weakness in the merchant energy markets and placed the company under review. On April 23, 2009, Moody's completed their review and affirmed its B1 rating and revised its outlook to negative. We continue to believe that the Moody's rating will not have a material adverse financial impact on us.

*Capital Expenditures and Major Maintenance*

Total capital expenditures for the three and nine months ended March 31, 2009 were $0.2 million and $1.3 million, respectively. 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. Major maintenance expenses include overhauls and replacements of major components of our power plants. Historically, the Company only included expenses of major maintenance associated with periodic hot gas path inspections in major maintenance that it reported. In order to provide a better picture of total major maintenance costs, we have modified the classification of major maintenance expenses to include other expenses consistent with the foregoing definition. The revised classification has no net impact on our financial results as it moves expenses from the routine operating category to the major maintenance category. For example, during the nine months ended March 31, 2009 under our modified methodology, our major maintenance expenses totaled $19.4 million, under our previous methodology $16.7 million would have been presented in the major maintenance category and $2.7 million as an operating expense.

*Cash Flow Analysis*

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

| | For the Nine Months Ended March 31, 2009 | For the Nine Months Ended March 31, 2008 |
|---|---|---|
| **Statement of Cash Flow Data:** | | |
| Cash flows provided by (used in): | | |
| Operating activities | $ 434 | $(41,066) |
| Investing activities | (8,194) | 9,887 |
| Financing activities | 4,392 | (1,061) |
| Decrease in cash and cash equivalents | (3,368) | (32,240) |
| Cash and cash equivalents at beginning of period | 51,493 | 90,315 |
| Cash and cash equivalents at end of period | $48,125 | $ 58,075 |

*Cash Flows from Operating Activities.* Our cash flows from operations were $0.4 million for the nine months ended March 31, 2009, primarily related to collections of accounts receivable of $31.3 million, depreciation expense of $18.2 million, change in fair value of derivative instruments of $7.2 million, amortization expense of $7.0 million, and stock-based compensation of $2.4 million, which was offset primarily by a net loss of $41.9 million and a decrease in accounts payable of $23.4 million. We also incurred $9.0 million of cash interest during the period under our outstanding Credit Facility.

*Cash Flows from Investing Activities.* Our cash flows used in investing activities for the nine months ended March 31, 2009 were $8.2 million and primarily related to the investment in restricted cash requirements for major maintenance.

*Cash Flows from Financing Activities.* Our cash flows from financing activities for the nine months ended March 31, 2009 were $4.4 million and represented borrowings from our working capital facility of $10.0 million, $1.5 million in quarterly principal payments of long-term debt as required by the Credit Facility and cash settlements on our Swaps of $4.1 million.

**Number 3. 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 Credit Facility require us to maintain interest hedge arrangements on at least fifty percent of our outstanding term debt balance 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.

KGen LLC has four current interest rate swap agreements, or Swaps. These Swaps are intended to hedge the risk associated with variable interest rates. For each of the 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 as of March 31, 2009 is $132.0 million with an average interest rate payable by KGen LLC of 5.0%. The following is a summary of the Swaps:

| | Maturity Date | Notional Amount | March 31, 2009 | | June 30, 2008 | |
|---|---|---|---|---|---|---|
| | | | Fair Value | Fixed Rate | Fair Value | Fixed Rate |
| | | (in millions) | (in thousands) | | (in thousands) | |
| Contract #1 | Expired | $ — | $ — | — | $ — | — |
| Contract #2 | Expired | $ — | $ — | — | $ (493) | 5.2% |
| Contract #3 | 3-31-2010 | $33.0 | $ (944) | 4.9% | $ (942) | 5.1% |
| Contract #4 | 3-31-2011 | $33.0 | $(2,176) | 5.0% | $(1,184) | 5.1% |
| Contract #5 | 3-31-2012 | $33.0 | $(2,922) | 5.0% | $(1,340) | 5.1% |
| Contract #6 | 3-31-2013 | $33.0 | $(3,488) | 5.1% | $(1,480) | 5.2% |

As of March 31, 2009, the majority of our outstanding variable rate debt has been converted to a fixed rate through the Swaps. We are exposed to credit related losses in the event of non-performance by the counterparty to the 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. On March 31, 2009, the Company and its counterparty amended the swap agreements to reduce the Company's fixed rate payments component and change the basis of the counterparty's floating rate payments.

## PART II—OTHER INFORMATION

### Number 1A. Risk Factors and Forward-Looking Statements

*Risk Factors*

The following risk factors below update Part I. "Number 1A. *Risk Factors*" of our Annual Report for the year ended June 30, 2008.

***Demand for electricity from our plants may decline due to difficult economic conditions in the southeastern United States.***

A sustained decline in economic conditions in the southeastern United States where our Plants are located may lead to sustained lower demand for electricity from our merchant facilities, which may have a material adverse effect on our financial condition and results of operations.

***Fortis, our energy management service provider, was nationalized by the Belgian government in October 2008 as a result of recent credit market turmoil and as a result, our contractual relationship could suffer and we could be subject to a material adverse effect on our financial condition and results of operations.***

Fortis' energy marketing and trading operation is our energy management service provider. We utilize Fortis' credit through back-to-back sales of merchant power and capacity to our ultimate customers which are netted against the corresponding gas purchases.

As credit markets deteriorated globally in September and October 2008, the Belgian government nationalized Fortis and agreed to sell most of its operations, including the energy marketing operations that service us, to BNP Paribas. The sale of these operations to BNP Paribas was accepted by a shareholder vote in April 2009. We continue to monitor the status of this transaction. As of this date, our business relations with Fortis have not been materially and adversely impacted. Fortis has the right to terminate its agreements with us at its convenience in accordance with the terms of our agreements with Fortis. If our contractual relationships with Fortis were to change significantly or terminate as a result of a Fortis sale or for any other reason, it may have a material and adverse impact on our financial condition and results of operations. However, based upon discussion with potential alternative providers, we believe that multiple options for a replacement energy management service provider are available to KGen, if required.

*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, the volatility of our stock price, 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 the discussion above and the "Cautionary Statement concerning Forward-Looking Statements" and Part I. "Number 1A. *Risk Factors*" in our Annual Report for the fiscal year ended June 30, 2008.