KGEN POWER CORPORATION

Report to Shareholders

for

Quarter Ended December 31, 2010

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Number 1. Unaudited Condensed Consolidated Financial Statements and Notes

KGen Power Corporation

Condensed Consolidated Balance Sheets

(in thousands, except per share amounts)

(unaudited)

	December 31, 2010	June 30, 2010
Assets		
Current assets:		
Cash and cash equivalents	**$ 130,323**	$ 48,177
Restricted cash and cash equivalents	**7,443**	7,167
Short-term investments	**4,000**	—
Accounts receivable	**7,986**	26,329
Spare parts inventories	**9,513**	8,009
Prepaid expenses and other current assets	**781**	1,947
Assets held for sale	**—**	63,580
Total current assets	**160,046**	155,209
Property, plant, and equipment	**638,779**	637,344
Less: accumulated depreciation	**84,917**	73,819
Net property, plant, and equipment	**553,862**	563,525
Contract-based intangibles (net of $41,482 and $36,154 of accumulated amortization, respectively)	**42,060**	47,388
Deferred charge	**2,070**	2,575
Deferred financing fees (net of $3,480 and $3,032 of accumulated amortization, respectively)	**2,784**	3,232
Other noncurrent assets	**325**	325
Total assets	**$ 761,147**	$ 772,254
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable and accrued liabilities	**$ 17,968**	$ 20,983
Current portion of long-term debt	**1,393**	2,000
Liabilities associated with assets held for sale	**—**	784
Total current liabilities	**19,361**	23,767
Long-term debt	**132,366**	201,000
Contract-based intangibles (net of $5,015 and $4,370 of accumulated amortization, respectively)	**14,484**	15,129
Other noncurrent liabilities	**1,810**	2,717
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Common stock (par value $.01; 150,000 shares authorized; 56,025 and 55,974 shares issued and outstanding at December 31, 2010 and June 30, 2010, respectively)	**560**	560
Additional paid in capital	**743,303**	742,477
Accumulated deficit	**(150,737)**	(213,396)
Total stockholders' equity	**593,126**	529,641
Total liabilities and stockholders' equity	**$ 761,147**	$ 772,254

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 December 31, 2010	For the Three Months Ended December 31, 2009	For the Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009
Revenues:				
Energy sales	**$ 15,893**	$ 15,556	**$ 116,112**	$ 77,415
Capacity sales	**5,784**	5,849	**34,874**	32,378
Total revenues	**21,677**	21,405	**150,996**	109,793
Operating expenses:				
Cost of fuel	**16,017**	14,174	**96,804**	63,169
Operating and maintenance	**11,051**	7,069	**17,951**	11,091
Gas transportation	**3,454**	3,649	**9,022**	8,434
Selling, general, and administrative	**3,165**	2,983	**6,456**	5,946
Depreciation	**5,546**	6,130	**11,098**	12,255
Auxiliary power	**1,866**	1,892	**4,443**	4,183
Insurance	**590**	856	**1,325**	1,782
Total operating expenses	**41,689**	36,753	**147,099**	106,860
Operating (loss) income	**(20,012)**	(15,348)	**3,897**	2,933
Other (expenses) income:				
Net gain on sale of assets	**11**	—	**64,991**	—
Interest expense	**(1,805)**	(2,589)	**(4,591)**	(6,188)
Taxes, other than income taxes	**(613)**	(964)	**(1,565)**	(1,963)
Other	**(33)**	(51)	**(73)**	(120)
Total other (expenses) income	**(2,440)**	(3,604)	**58,762**	(8,271)
Net (loss) income before taxes	**(22,452)**	(18,952)	**62,659**	(5,338)
Income tax benefit (expense)	**—**	—	**—**	—
Net (loss) income after taxes	**$ (22,452)**	$ (18,952)	**$ 62,659**	$ (5,338)
Net (loss) income per share—basic and diluted	**$ (0.40)**	$ (0.34)	**$ 1.12**	$ (0.10)
Weighted average shares outstanding—basic	**56,017**	55,968	**55,997**	55,968
Weighted average shares outstanding—diluted	**56,017**	55,968	**56,089**	55,968

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 Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009
Cash flows from operating activities		
Net income (loss)	**$ 62,659**	$ (5,338)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Net gain on sale of assets	**(64,991)**	—
Depreciation	**11,098**	12,255
Amortization of deferred financing fees	**448**	447
Amortization of contract-based intangibles	**4,683**	4,657
Valuation of derivative instruments	**1,008**	2,192
Stock-based compensation	**826**	756
Payments from settlement of derivative instruments	**(2,402)**	(3,197)
Changes in operating assets and liabilities:		
Accounts receivable	**18,343**	17,818
Spare parts inventories	**(1,504)**	(1,282)
Prepaid expenses and other current assets	**1,166**	(1,984)
Deferred charge	**505**	(49)
Accounts payable and accrued liabilities	**(2,655)**	(5,367)
Other noncurrent liabilities	**(4)**	(4)
Net cash provided by operating activities	**29,180**	20,904
Cash flows from investing activities		
Purchases of property, plant, and equipment	**(1,304)**	(795)
Sale of assets	**127,787**	—
Short-term investments	**(4,000)**	—
(Investment in) restricted cash and cash equivalents	**(276)**	—
Net cash provided by (used in) investing activities	**122,207**	(795)
Cash flows from financing activity		
Repayment of debt	**(69,241)**	(1,000)
Net cash used in financing activity	**(69,241)**	(1,000)
Increase in cash and cash equivalents	**82,146**	19,109
Cash and cash equivalents at beginning of period	**48,177**	40,663
Cash and cash equivalents at end of period	**$ 130,323**	$ 59,772
Cash paid for		
Interest	**$ 3,135**	$ 3,574
Noncash transactions		
Accounts payable related to purchases of property, plant, and equipment	**$ 131**	$ —

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. As of December 31, 2010, the Company's portfolio of facilities consisted of four operational and fully permitted combined-cycle power plants (Murray I, Murray II, Hot Spring, and Hinds), or (the "Plants"), located in the southeastern United States with gas turbines having an aggregate capacity of 2,390 megawatts ("MW"). On July 9, 2010, the Company completed the sale of its Sandersville power plant, a 640 MW simple-cycle plant (See Note 12). 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 the 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 considered necessary for a fair presentation have been included. The balance sheet as of June 30, 2010 is derived from the June 30, 2010 audited consolidated financial statements. These condensed consolidated financial statements included 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, 2010.

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

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, and KGen Acquisition I LLC, all direct or indirect 100% owned subsidiaries of the Company as of December 31, 2010, 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.

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. Three of the plants operate, and historically the Sandersville power plant operated, 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)

Fair Value of Financial Instruments—The Company's financial instruments consist primarily of cash and cash equivalents, restricted cash and cash equivalents, short-term investments, accounts receivable, accounts payable, debt instruments, and interest rate derivatives. The carrying values of the cash and cash equivalents, restricted cash and cash equivalents, short-term investments, accounts receivable, and accounts payable are representative of their respective fair value due to the short-term nature of these instruments. The carrying value of interest rate derivative instruments represents the fair value, which is based on estimates using standard pricing models that take into account the present value of future cash flows as of the condensed consolidated balance sheet date. Based on the borrowing rates currently available to the Company for bank loans with similar terms and average maturities, the fair value of term debt was $130.9 million and $184.7 million at December 31, 2010 and June 30, 2010, respectively.

2. Property, Plant, and Equipment

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

	Estimated Useful Life	December 31, 2010	June 30, 2010
Land	—	$ 3,312	$ 3,312
Buildings	40 years	26,394	26,382
Gas and steam turbines	30 years	182,001	181,733
Steam generators and auxiliaries	30 years	49,112	48,959
Transmission and fuel gas pipelines	30 years	51,098	51,038
Systems and equipment	5-30 years	120,612	120,210
Other plant	3-30 years	206,250	205,710
Total property, plant, and equipment		638,779	637,344
Less: accumulated depreciation		84,917	73,819
Net property, plant, and equipment		$ 553,862	$ 563,525

KGen Power Corporation

Notes to Unaudited Condensed Consolidated Financial Statements

3. Contract-Based Intangibles

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

	Term	Original Cost	Accumulated Amortization	December 31, 2010
Assets				
Murray I Georgia Power contract	May 31, 2012	$ 43,265	$(31,579)	$ 11,686
Murray firm transportation contracts	Various	40,277	(9,903)	30,374
Total assets		$ 83,542	$(41,482)	$ 42,060
Liabilities				
Murray firm transportation contract	November 30, 2016	638	(254)	384
Hot Spring firm transportation contracts	Various	18,861	(4,761)	14,100
Total liabilities		$ 19,499	$ (5,015)	$ 14,484

	Term	Original Cost	Accumulated Amortization	June 30, 2010
Assets				
Murray I Georgia Power contract	May 31, 2012	$ 43,265	$(27,523)	$ 15,742
Murray firm transportation contracts	Various	40,277	(8,631)	31,646
Total assets		$ 83,542	$(36,154)	$ 47,388
Liabilities				
Murray firm transportation contract	November 30, 2016	638	(222)	416
Hot Spring firm transportation contracts	Various	18,861	(4,148)	14,713
Total liabilities		$ 19,499	$ (4,370)	$ 15,129

For both the three months ended December 31, 2010 and 2009, amortization of contract-based power sales rights and obligations was $2.0 million. For both the six months ended December 31, 2010 and 2009, amortization of contract-based power sales rights and obligations was $4.1 million. These amortization amounts were recorded as a reduction of energy sales on the condensed consolidated statements of operations.

For both the three months ended December 31, 2010 and 2009, amortization of contract-based natural gas transportation rights and obligations was $0.3 million. For both the six months ended December 31, 2010 and 2009, amortization of contract-based natural gas transportation rights and obligations was $0.6 million. These amortization amounts were 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	December 31, 2010	June 30, 2010
Term debt	Variable	February 8, 2014	$ 133,759	$ 193,000
Working capital facility	Variable	February 8, 2012	—	10,000
Total debt outstanding			133,759	203,000
Less: current portion			1,393	2,000
Total long-term debt			$ 132,366	$ 201,000

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, N.A., 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 required a $2.0 million principal payment per year made in quarterly installments. KGen LLC’s obligations and indebtedness under the Credit Agreement are secured by a security interest in all of the assets and all of the membership interests of KGen LLC and its subsidiaries. The interest rate on the term debt was 2.1% at both December 31, 2010 and June 30, 2010.

The Credit Agreement includes an $80.0 million working capital facility for 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. KGen LLC pays a fee of 191 basis points on the $120.0 million synthetic letter of credit facility. It has a seven-year term expiring on February 8, 2014. On March 20, 2009, KGen LLC drew $10.0 million under the working capital facility. The proceeds of the drawdown were used for working capital purposes.

On August 18, 2010, the Company prepaid $58.5 million of its outstanding term debt and $10.0 million of its outstanding working capital facility using a portion of the proceeds received from the sale of 100% of the ownership interests in KGen Sandersville LLC, the entity that owned the Sandersville power generation facility (See Note 12). In connection with this prepayment, the Company reduced its principal payment requirement of $2.0 million per year to $1.4 million per year with quarterly installments beginning September 30, 2010. In addition, there were $0.5 million of outstanding letters of credit issued under the working capital facility and $14.4 million of outstanding letters of credit issued under the synthetic letter of credit facility that related to Sandersville and were cancelled following the sale of 100% of the ownership interests in KGen Sandersville LLC.

There were $28.6 million and $14.0 million of outstanding letters of credit issued under the working capital facility as of December 31, 2010 and June 30, 2010, respectively. At both December 31, 2010 and June 30, 2010, a letter of credit, supporting the power sales contract with GPC, in the amount of $80.0 million was outstanding under the synthetic letter of credit facility. There were $14.5 million and $19.9 million of other outstanding letters of credit under the synthetic letter of credit facility as of December 31, 2010 and June 30, 2010, respectively.

4. Long-Term Debt (Continued)

The remaining future minimum principal payments under the term debt and the working capital facility subsequent to December 31, 2010 are as follows (in thousands of dollars):

2011	$ 698
2012	1,393
2013	1,393
2014	130,275
Total	$ 133,759

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. At December 31, 2010, KGen LLC was in compliance with these covenants.

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 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 $536.1 million at December 31, 2010, of which $84.4 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 December 31, 2010 and June 30, 2010, the restricted balance, in accordance with this requirement, was $4.3 million and $4.7 million, respectively.

Additionally, the Security Deposit Agreement requires KGen LLC to reserve, on a quarterly basis, the amount of major maintenance expenditures expected to be incurred during the following 12 months. At December 31, 2010 and June 30, 2010, the restricted balance, in accordance with this requirement, was $3.1 million and $2.5 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.

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 6-Commitments in the Notes to Consolidated Financial Statements contained in the Annual Report for the year ended June 30, 2010.

7. Industrial Development Revenue Bonds

This footnote should be read in conjunction with Note 7—Industrial Development Revenue Bonds of the Notes to the Consolidated Financial Statements contained in the Annual Report for the year ended June 30, 2010. Construction of the Hot Spring, Murray, and Sandersville facilities was financed by various development authorities through the issuance of Industrial Development Revenue Bonds (the "Bonds").

Following the sale of 100% of the ownership interests in KGen Sandersville LLC, the entity that owns the Sandersville power generation facility (See Note 12), the Industrial Development Revenue Bond related to Sandersville was no longer held by the Company. At December 31, 2010, $510.0 million of the Bonds remained outstanding related to the Hot Spring and Murray projects. At June 30, 2010, $775.4 million of the Bonds remained outstanding related to the Hot Spring, Sandersville, and Murray projects.

8. Derivatives and Investments

The Company recognizes all derivatives and investments as either assets or liabilities on the balance sheet and measures 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 purpose 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 December 31, 2010.

The short-term portion of the Swaps as of December 31, 2010 and June 30, 2010 was $3.2 and $3.6 million, respectively, and was recorded in accounts payable and accrued liabilities. The long-term portion of the Swaps as of December 31, 2010 and June 30, 2010 was $1.8 million and $2.7 million, respectively, and was recorded in other noncurrent liabilities.

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	Hierarchy	Gain (Loss) on Derivatives
For the three months ended December 31, 2010	Interest expense	Level II	$ (107)
For the three months ended December 31, 2009	Interest expense	Level II	$ (608)
For the six months ended December 31, 2010.........	Interest expense	Level II	$(1,008)
For the six months ended December 31, 2009.........	Interest expense	Level II	$(2,192)

The Company evaluated the requirements of FASB ASC 820, *Fair Value Measurement and Disclosures* ("FASB ASC 820") and believes the Swaps are valued using Level 2 fair value measurements. Under FASB ASC 820, 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.

8. Derivatives and Investments (Continued)

On December 9, 2010, the Company entered into short-term investments consisting of two cash collateralized letters of credit supported by certificates of deposit. The balance of the short-term investments was $4.0 million as of December 31, 2010. Short-term investment income is shown on the condensed consolidated statements of operations as follows (in thousands of dollars):

	Location of Interest on Short-Term Investments	Hierarchy	Interest on Short-Term Investments
For the three months ended December 31, 2010	Other	Level I	$ —
For the six months ended December 31, 2010........	Other	Level I	$ —

The Company evaluated the requirements of FASB ASC 820 and believes the short-term investments are valued using Level 1 fair value measurements. Under FASB ASC 820, instruments valued using Level 1 measurements are valued based on accessible quoted prices in active markets for identical instruments.

The three levels of the fair value hierarchy are:

Level 1—Unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets and liabilities;

Level 2—Pricing inputs include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and

Level 3—Prices or valuations that require inputs that are both significant to the fair value measurements and unobservable.

9. Net Earnings (Loss) per Share

Basic earnings (loss) per share is calculated by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Due to the net loss for both the three months ended December 31, 2010 and 2009, and for the six months ended December 31, 2009, diluted earnings per share was calculated on the same basis as basic loss per share as the inclusion of any other potential shares outstanding would be anti-dilutive. Therefore, restricted stock units of 92,360 shares for the three months ended December 31, 2010, and 7,466 shares for the three and six months ended December 31, 2009, were not considered in the loss per share calculation.

Due to the net income for the six months ended December 31, 2010, diluted earnings per share was calculated by adjusting the weighted average number of shares of common stock outstanding by the dilutive effect of incremental shares attributable to restricted stock awards in the amounts of 92,360 shares.

There were no unexercised in-the-money stock options to purchase shares of common stock for the three and six months ended December 31, 2010 and 2009. Unexercised out-of-the-money stock options to purchase a weighted average of 796,297 shares of common stock for both the three and six months ended December 31, 2010 and 1,444,663 shares and 1,969,944 shares of common stock for the three and six months ended December 31, 2009, respectively, were not considered in the earnings (loss) per share calculation as the impact of such inclusion would have been anti-dilutive.

9. Net Earnings (Loss) per Share (Continued)

Amounts shown below are in thousands, except per share amounts.

	For the Three Months Ended December 31, 2010	For the Three Months Ended December 31, 2009	For the Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009
Numerator:				
Net (loss) income	$ (22,452)	$ (18,952)	$ 62,659	$ (5,338)
Denominator:				
Weighted average shares outstanding—basic	56,017	55,968	55,997	55,968
Weighted average shares outstanding—diluted	56,017	55,968	56,089	55,968
Net income (loss) per share—basic and diluted	$ (0.40)	$ (0.34)	$ 1.12	$ (0.10)

10. Share-Based Payments

This footnote should be read in conjunction with Note 9—Share-Based Payments of the Notes to the Consolidated Financial Statements contained in the Annual Report for the year ended June 30, 2010.

The Company recorded compensation expense of zero for both the three and six months ended December 31, 2010, respectively, and $0.4 million and $0.8 million for the three and six months ended December 31, 2009, respectively, related to stock options outstanding. As of December 31, 2010, all options were vested and there was no unrecognized compensation expense remaining on the options. As of December 31, 2009, there was $0.2 million of total unrecognized compensation expense related to unvested options. For the three and six months ended December 30, 2010 and 2009, no options were granted or exercised.

On August 13, 2010, the Board of Directors granted a total of 237,268 restricted stock units (“RSUs”) to senior employees and the Chairman of the Board of Directors pursuant to the KGen Power Corporation 2006 Equity Incentive Plan (“the Plan”). Each RSU will entitle its holder to receive, upon vesting of the RSU, one share of common stock of the Company. Under the terms of the RSU awards, 35,592 RSUs vested immediately upon grant due to the completed sale of 100% of the ownership interests in KGen Sandersville LLC, the entity that owns the Sandersville power generation facility. Of the remaining unvested RSUs, 106,769 will vest upon the consummation of a sale of the Murray I and II power generation facilities; 47,454 will vest upon the consummation of a sale of the Hot Spring power generation facility; and 47,453 will vest upon the consummation of a sale of the Hinds power generation facility. All unvested RSUs will vest upon the consummation of a change in control of the Company.

The Company recorded compensation expense of $0.2 million and $0.6 million for the three and six months ended December 31, 2010, respectively, and $18.0 thousand and $37.0 thousand for the three and six months ended December 31, 2009, respectively, related to the above outstanding RSUs. As of December 31, 2010 and 2009, there was $1.0 million and $0.1 million of total unrecognized compensation expense related to the unvested RSUs.

On October 5, 2010, the Board of Directors granted 15,000 RSUs to the CEO of the company pursuant to the Plan. Each RSU entitled the CEO to receive, upon vesting of the RSU, one share of common stock of the Company. Under the terms of the RSU awards, all 15,000 shares vested immediately upon grant and the Company recorded the full compensation expense of $0.2 million during the three months ended December 31, 2010.

11. Income Taxes

For the three and six months ended December 31, 2010 and 2009, there were no current or deferred income tax provision (benefits) included in the net income (loss).

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

	For the Three Months Ended December 31, 2010	For the Three Months Ended December 31, 2009	For the Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009
Statutory rate	35%	35%	35%	35%
Tax at statutory rate	$ (7,857)	$ (6,633)	$ 21,931	$ (1,868)
Increase (decrease) due to:				
Nondeductible meals and entertainment	5	3	6	5
State tax (benefit) expense	(858)	(694)	2,393	(179)
Adjustment to valuation allowance	8,710	7,324	(24,330)	2,042
Total provision	$ —	$ —	$ —	$ —

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

	December 31, 2010	June 30, 2010
Deferred tax assets:		
Interest rate derivatives	$ 1,931	$ 2,472
Contract-based intangible assets	17,000	15,109
Nonqualified stock options expense	5,695	5,375
Accrued expenses	19	21
Net operating loss	55,734	81,113
Contribution carryforward	—	16
Net deferred tax assets	80,379	104,106
Deferred tax liabilities:		
Property, plant, and equipment	20,126	19,346
Prepaid expenses	186	613
Contract-based intangible liabilities	4,293	4,043
Net deferred tax liability	24,605	24,002
Valuation allowance	55,774	80,104
Deferred tax asset (liabilities), net	$ —	$ —

At December 31, 2010, the Company had a federal net operating loss carryforward of $144.0 million which will expire between 2027 and 2031. The amount of taxable income that the Company can offset with this carryforward is subject to limitations 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).

Based on management's projections of book and taxable income for the year ended June 30, 2011, it was deemed appropriate to release a $24.3 million valuation allowance equal to the projected taxable income for the six months ended December 31, 2010, as a portion of the net operating loss carryforward can now be utilized against such income. There were no unrecognized tax benefits that if recognized would affect the tax rate. No interest or penalties were recognized as of December 31, 2010.

11. Income Taxes (Continued)

The Company filed income tax returns in the United States federal jurisdiction and in various U.S. 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.

12. Net Gain on Sale of Asset

This footnote should be read in conjunction with Note 12—Assets Held for Sale of the Notes to the Consolidated Financial Statements contained in the Annual Report for the year ended June 30, 2010.

The transaction between the Company and AL Sandersville Holdings, LLC, an entity formed by ArcLight Energy Partners Fund III, LP, to purchase 100% of the ownership interests in KGen Sandersville LLC, the entity that owns the Sandersville power generation facility closed on July 9, 2010. A subsidiary of ArcLight Energy Partners Fund IV, LLP, is a shareholder who owns approximately 12% of the Company. The Company received $129.3 million in cash sales proceeds which represents a $130.0 million purchase price less a working capital adjustment. The net gain on the sale was $65.0 million and the Company prepaid $58.5 million of its outstanding term debt and $10.0 million of its outstanding working capital facility using a portion of the proceeds of this sale. In addition, KGen LLC distributed $19.5 million of the cash sales proceeds received to its parent, KGen Power Corporation. The Company expects to use a portion of its existing tax net operating loss (“NOLs”) to offset all of the taxable gain resulting from the sale.

13. Subsequent Events

Murray Purchase & Sale Agreement—On January 31, 2011, the Company’s subsidiary KGen LLC executed a definitive agreement for the sale of the Company’s Murray I and II electric generation facilities to Oglethorpe Power Corporation, a power supply cooperative, for a cash purchase price of $531.3 million, subject to working capital and spare parts inventory adjustments. The transaction will be implemented by means of a sale of 100% of the ownership interests in KGen Murray I and II LLC, the entity that owns the Murray facilities. These facilities, located in Murray County, Georgia, are comprised of two natural gas-fired combined cycle power generation plants with a combined nominal capacity of 1,250 MW. The transaction is conditioned upon the receipt of approval of sale from holders of a majority of the Company’s outstanding shares, approval of the Federal Energy Regulatory Commission, clearance under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, certain third-party consents, and certain other customary closing conditions. The transaction, which is not subject to any financing condition, is expected to close in April 2011. The Company expects to use tax NOLs to offset all but approximately $45.0 million of the taxable gain resulting from the sale. In connection with the closing of the transaction, the Company’s credit, working capital, and synthetic letter of credit facilities will terminate. The Company expects to use approximately $139.0 million of the net proceeds of the sale to repay outstanding debt under these facilities and satisfy related obligations. Under the terms of the transaction agreement, approximately $80.0 million of the purchase price will be placed in escrow for a period of 18 months after closing to secure customary post-closing indemnification obligations. The Board of Directors expects to declare a special dividend to shareholders out of the net proceeds of the sale of KGen Murray I and II LLC. The amount of the dividend will be determined by the Board of Directors after closing of the transaction based on a review of the Company’s on-going cash needs.

Subsequent events were analyzed and considered through February 11, 2011, the date this report was available for issuance.

Number 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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 four operational and fully permitted combined-cycle power plants (Murray I, Murray II, Hot Spring and Hinds), located in the southeastern United States with General Electric (GE) 7FA gas turbines. Our combined-cycle Plants have an aggregate capacity of 2,390 MW. On July 9, 2010, we completed the sale of our Sandersville power plant, a 640 MW simple-cycle plant, for which we received $129.3 million in sales proceeds. We acquired our Plants from an affiliate of MatlinPatterson Global Advisors LLC on February 8, 2007.

Three of our four Plants currently operate, and historically the Sandersville power plant operated, 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 $5.2 million and $31.5 million related to capacity sales on the GPC PPA for the three and six months ended December 31, 2010, respectively, and $5.6 million and $31.8 million related to capacity sales on the GPC PPA for the three and six months ended December 31, 2009, respectively.

As part of our strategy, we continue to explore and review credible alternatives that may become available to us to enhance shareholder value. Our management team's compensation package includes incentives payable upon successful facility sales or a change in control transaction.

Recent Events

Murray Purchase & Sale Agreement— On January 31, 2011, we executed a definitive agreement for the sale of our Murray I and II electric generation facilities to Oglethorpe Power Corporation, a power supply cooperative, for a cash purchase price of $531.3 million, subject to working capital and spare parts inventory adjustments. The transaction will be implemented by means of a sale of 100% of the ownership interests in KGen Murray I and II LLC, the entity that owns the Murray facilities. These facilities, located in Murray County, Georgia, are comprised of two natural gas-fired combined cycle power generation plants with a combined nominal capacity of 1,250 MW. The transaction is conditioned upon the receipt of approval of sale from holders of a majority of our outstanding shares, approval of the Federal Energy Regulatory Commission, clearance under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, certain third-party consents, and certain other customary closing conditions. The transaction, which is not subject to any financing condition, is expected to close in April 2011. We expect to use tax net operating losses, or NOLs, to offset all but approximately $45.0 million of the taxable gain resulting from the sale. In connection with the closing of the transaction, our credit, working capital, and synthetic letter of credit facilities will terminate. We expect to use approximately $139.0 million of the net proceeds of the sale to repay outstanding debt under these facilities and satisfy related obligations. Under the terms of the transaction agreement, approximately $80.0 million of the purchase price will be placed in escrow for a period of 18 months after closing to secure customary post-closing indemnification obligations. The Board of Directors expects to declare a special dividend to shareholders out of the net proceeds of the sale of KGen Murray I and II LLC. The amount of the dividend will be determined by the Board of Directors after closing of the transaction based on a review of our on-going cash needs.

Murray Outage—During November and December 2010, an extended outage occurred at our Murray power generation facility to repair the high pressure piping at Murray I and II, the Murray II steam turbine generator rotor, and other related items resulting in costs of approximately $2.7 million. During the outage, we provided replacement power at a cost of approximately $1.5 million from other sources to Georgia Power in accordance with the GPC PPA.

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. The discussion below includes the results from our Sandersville plant, which we sold on July 9, 2010. For the three and six months ended December 31, 2010, KGen Sandersville LLC's adjusted EBITDA, a non-GAAP financial measure, was income of $0.1 million and a loss of $0.1 million, respectively. Accordingly, these results may not be indicative of future results of the Company.

Consolidated Results of Operations of KGen for the Three Months Ended December 31, 2010 compared to the Three Months Ended December 31, 2009.

The following table sets forth our results of operations for the three months ended December 31, 2010 and 2009, expressed in thousands of dollars.

	For the Three Months Ended December 31, 2010	For the Three Months Ended December 31, 2009	Favorable/(Unfavorable) Change	% Change
Revenues:				
Energy sales	$ 15,893	$ 15,556	$ 337	2%
Capacity sales	5,784	5,849	(65)	(1%)
Total revenues	21,677	21,405	272	1%
Operating expenses:				
Cost of fuel	16,017	14,174	(1,843)	(13%)
Operating and maintenance	11,051	7,069	(3,982)	(56%)
Gas transportation	3,454	3,649	195	5%
Selling, general, and administrative	3,165	2,983	(182)	(6%)
Depreciation	5,546	6,130	584	10%
Auxiliary power	1,866	1,892	26	1%
Insurance	590	856	266	31%
Total operating expenses	41,689	36,753	(4,936)	(13%)
Operating loss	(20,012)	(15,348)	(4,664)	(30%)
Other (expenses) income:				
Net gain on sale of assets	11	—	11	100%
Interest expense	(1,805)	(2,589)	784	30%
Taxes, other than income taxes	(613)	(964)	351	36%
Other	(33)	(51)	18	35%
Total other expenses	(2,440)	(3,604)	1,164	32%
Net loss before taxes	(22,452)	(18,952)	(3,500)	(18%)
Income tax benefit	—	—	—	0%
Net loss after taxes	$ (22,452)	$ (18,952)	$ (3,500)	(18%)

Operating and Business Metrics We Use to Analyze the Company's Performance for the Three Months Ended December 31, 2010 and December 31, 2009

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 December 31, 2010 and 2009, to the most directly comparable GAAP measures for those periods. See the reconciliation of net income to adjusted EBITDA on page 21. This presentation may not include all of the disclosure that SEC regulations would require a company that files periodic reports with the SEC to make, 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 consider our Hinds, Hot Spring, and Murray II plants and considered our former Sandersville plant to be merchant plants because they are not selling their energy output and capacity pursuant to long-term sales agreements.

	For the Three Months Ended December 31, 2010	For the Three Months Ended December 31, 2009
Energy sales	$ 15,893	$ 15,556
Less: Cost of fuel	(16,017)	(14,174)
Less: Contracted energy sales	(2,178)	(257)
Add: Contracted cost of fuel	4,441	1,883
Merchant energy margin	2,139	3,008
Capacity sales	5,784	5,849
Less: Contracted capacity sales	(5,175)	(5,659)
Merchant capacity sales	609	190
Merchant margin	$ 2,748	$ 3,198

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 December 31, 2010	For the Three Months Ended December 31, 2009
Energy sales	$ 15,893	$ 15,556
Less: Merchant sales	(13,715)	(15,299)
Contracted energy sales	2,178	257
Less: Contracted cost of fuel	(4,441)	(1,883)
Add: Power sales rights and obligations amortization	2,028	2,028
Adjusted contracted energy margin	(235)	402
Contracted capacity sales	5,175	5,659
Add (Less): Noncash deferred capacity revenue	56	(41)
Adjusted contracted capacity sales	5,231	5,618
Adjusted contracted margin	$ 4,996	$ 6,020

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

	For the Three Months Ended December 31, 2010	For the Three Months Ended December 31, 2009
Merchant margin	$ 2,748	$ 3,198
Adjusted contracted margin	4,996	6,020
Total adjusted margin	$ 7,744	$ 9,218

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) depreciation, (f) director and officer insurance expense captured in adjusted corporate expenses (defined below); and (g) 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 December 31, 2010	For the Three Months Ended December 31, 2009
Total operating expenses	$ 41,689	$ 36,753
Less: Cost of fuel	(16,017)	(14,174)
Less: Major maintenance expense	(1,852)	593
Less: Gas transportation noncash amortization	(313)	(301)
Less: Selling, general, and administrative expense	(3,165)	(2,983)
Less: Depreciation	(5,546)	(6,130)
Less: D&O insurance expense	(42)	(46)
Add: Taxes, other than income taxes	613	964
Adjusted plant expenses	$ 15,367	$ 14,676

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 December 31, 2010	For the Three Months Ended December 31, 2009
Selling, general, and administrative expense	$ 3,165	$ 2,983
Less: Noncash employee options/awards expense	(432)	(381)
Add (Less): Employee severance expense	6	—
Add: D&O insurance expense	42	46
Adjusted corporate expenses	$ 2,781	$ 2,648

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 December 31, 2010	For the Three Months Ended December 31, 2009	Favorable/Unfavorable) Change	% Change
Merchant energy margin	$ 2,139	$ 3,008	$ (869)	(29%)
Merchant capacity sales	609	190	419	221%
Merchant margin	2,748	3,198	(450)	(14%)
Adjusted contracted energy margin	(235)	402	(637)	(158%)
Adjusted contracted capacity sales	5,231	5,618	(387)	(7%)
Adjusted contracted margin	4,996	6,020	(1,024)	(17%)
Total adjusted margin	7,744	9,218	(1,474)	(16%)
Adjusted plant expenses	15,367	14,676	(691)	(5%)
Adjusted plant EBITDA	(7,623)	(5,458)	(2,165)	(40%)
Adjusted corporate expenses	2,781	2,648	(133)	(5%)
Adjusted EBITDA	$ (10,404)	$ (8,106)	$ (2,298)	(28%)

Selected Operating and Business Metrics

	For the Three Months Ended December 31, 2010	For the Three Months Ended December 31, 2009	Favorable/(Unfavorable) Change	% Change
Selected Financial and Operating Data				
Total generation (GWh)	561	476	85	18%
Merchant generation (GWh)	409	420	(11)	(3%)
Merchant margin/merchant generation ($/MWh)	$ 6.72	$ 7.61	$ (0.89)	(12%)

Selected Market and Weather Data

	For the Three Months Ended December 31, 2010	For the Three Months Ended December 31, 2009	Change	% Change
Selected Market Data(1)				
Average on-peak market power price— Entergy ($/MWh)	$ 32.35	$ 34.08	$ (1.73)	(5%)
Average on-peak market power price— Southern ($/MWh)	$ 36.26	$ 36.75	$ (0.49)	(1%)
Average Henry Hub gas price ($/MMbtu)	$ 3.78	$ 4.26	$ (0.48)	(11%)
Selected Weather Data				
Actual CDDs(2)	208	119	89	75%
Normal CDDs	62	62	—	0%
Actual HDDs(3)	3,269	3,067	202	7%
Normal HDDs	3,087	3,087	—	0%

Notes:

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

(2) CDD, or cooling degree days, represents the number of degrees during April through October 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 December 31, 2010 compared to the Three Months Ended December 31, 2009.

Total adjusted margin decreased $1.5 million, or 16%, to $7.7 million for the three months ended December 31, 2010 compared to the same period in the previous year as a result of a $0.5 million decrease in merchant margin and a $1.0 million decrease in adjusted contracted margin. The $7.7 million in total adjusted margin was comprised of $2.7 million in merchant margin and $5.0 million in adjusted contracted margin.

Merchant margin decreased $0.5 million, or 14%, to $2.7 million for the three months ended December 31, 2010. The $0.5 million decrease was made up of a $0.9 million decrease in merchant energy margin offset by a $0.4 million increase in merchant capacity sales. The $0.9 million decrease in merchant energy margin related primarily to a decrease in natural gas prices, as evidenced by an 11% decrease in the average Henry Hub gas price from $4.26 per MMbtu to $3.78 per MMbtu for the three months ended December 31, 2010 as compared to the previous year, limited pipeline flexibility on CenterPoint which affected Hot Spring in October 2010, and the extended outage at the Murray II power generation facility. Merchant generation decreased by 3% from 420 GWh to 409 GWh for the three months ended December 31, 2010 as compared to the previous year. The implied merchant spark spread, or merchant margin divided by merchant generation, decreased from $7.61 per MWh to $6.72 per MWh, due to the effects of lower market gas prices.

Adjusted contracted margin decreased $1.0 million, or 17%, to $5.0 million for the three months ended December 31, 2010, which was comprised of $5.2 million in adjusted contracted capacity sales offset by a negative adjusted contracted energy margin of $0.2 million. The $1.0 million decrease was made up of a $0.4 million decrease in the adjusted contracted capacity sales and a $0.6 million decrease in the adjusted contracted energy margin. During November and December 2010, an extended outage occurred at our Murray power generation facility to repair the high pressure piping at Murray I and II, the Murray II steam turbine generator rotor, and other related items resulting in costs of approximately $2.7 million. During the outage, we provided replacement power at a cost of approximately $1.5 million from other sources to Georgia Power in accordance with the GPC PPA. The cost of the replacement power negatively impacted our adjusted contracted capacity sales by $0.5 million and our adjusted contracted energy margin by $1.0 million.

Adjusted plant expenses increased by $0.7 million, or 5%, to $15.4 million for the three months ended December 31, 2010. The increase related primarily to a $1.5 million increase in operating and maintenance expenses caused by additional unscheduled maintenance at the Murray facilities offset by a $0.2 million decrease in gas transportation and a $0.3 million decrease in insurance expense.

As a result of the foregoing changes in total adjusted margin and adjusted plant expenses, adjusted plant EBITDA decreased by $2.2 million to $7.6 million for the three months ended December 31, 2010.

Adjusted corporate expenses increased by $0.1 million, or 5%, to $2.8 million for the three months ended December 31, 2010.

As a result of the foregoing, adjusted EBITDA decreased by $2.3 million to $10.4 million for the three months ended December 31, 2010.

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 nonrecurring expenses). Adjusted plant EBITDA is equal to total adjusted EBITDA less certain corporate expenses.

	For the Three Months Ended December 31, 2010	**For the Three Months Ended December 31, 2009**
Net loss after taxes	$ (22,452)	$ (18,952)
Add: Interest expense	1,805	2,589
Add: Depreciation	5,546	6,130
Add: Power sales rights and obligations amortization	2,028	2,028
Add: Gas transportation noncash amortization	313	301
Add (Less): Noncash deferred capacity revenue	56	(41)
Add: Other expenses	33	51
EBITDA	(12,671)	(7,894)
Less: Net gain on sale of assets	(11)	—
Add (Less): Major maintenance expense	1,852	(593)
Add: Noncash employee options/awards expense	432	381
Add(Less): Employee severance expense	(6)	—
Adjusted EBITDA	(10,404)	(8,106)
Add: Selling, general, and administrative expense	3,165	2,983
Less: Noncash employee options/awards expense	(432)	(381)
Add (Less): Employee severance expense	6	—
Add: D&O insurance expense	42	46
Adjusted plant EBITDA	$ (7,623)	$ (5,458)

The following describes changes to specified financial measures of our performance. As indicated above, in calculating our adjusted EBITDA, we made adjustments to our net loss after taxes using these financial measures for the three months ended December 31, 2010 compared to the three months ended December 31, 2009.

- Interest expense for the three months ended December 31, 2010 was $1.8 million compared to $2.6 million for the same period in 2009. The $0.8 million decrease was primarily made up of a $0.3 million decrease due to lower outstanding debt amounts and $0.5 million in losses on derivatives associated with our interest rate hedging and cash payments on our interest rate swap agreements, or Swaps.

- Depreciation was $5.6 million and $6.1 million for the three months ended December 31, 2010 and 2009, respectively.

- 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, which represents the levelization of capacity sales over the GPC PPA term, of $0.1 million of expense and $41.0 thousand of revenue for the three months ended December 31, 2010 and 2009, respectively, was recorded as capacity sales.

- Other expense for the three months ended December 31, 2010 and 2009 was $33.0 thousand and $51.0 thousand, respectively.

- Net gain on sale of assets was $11.0 thousand and zero for the three months ended December 31, 2010 and 2009, respectively. The net gain on sale of assets is related to the sale of the Sandersville facility on July 9, 2010.

- Major maintenance expense consisted of $1.9 million of expense and $0.6 million of income for the three months ended December 31, 2010 and 2009, respectively. The $1.9 million expense was related to $1.3 million of major maintenance performed at the Murray II facility, $0.4 million at the Hinds facility, and $0.2 million at the Hot Spring facility. The $0.6 million of income for the three months ended December 31, 2009 related to a credit from GE for repair work at Murray I.

- Noncash employee options/awards expense for both the three months ended December 31, 2010 and 2009 was $0.4 million, and was recorded as an increase of selling, general, and administrative expense.

- Selling, general, and administrative expense was $3.2 million and $3.0 million for the three months ended December 31, 2010 and 2009, respectively.

Consolidated Results of Operations of KGen for the Six Months Ended December 31, 2010 compared to the Six Months Ended December 31, 2009.

The following table sets forth our results of operations for the six months ended December 31, 2010 and 2009, expressed in thousands of dollars.

	For the Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009	Favorable/(Unfavorable) Change	% Change
Revenues:				
Energy sales	$ 116,122	$ 77,415	$ 38,707	50%
Capacity sales	34,874	32,378	2,496	8%
Total revenues	150,996	109,793	41,203	38%
Operating expenses:				
Cost of fuel	96,804	63,169	(33,635)	(53%)
Operating and maintenance	17,951	11,091	(6,860)	(62%)
Gas transportation	9,022	8,434	(588)	(7%)
Selling, general, and administrative	6,456	5,946	(510)	(9%)
Depreciation	11,098	12,255	1,157	9%
Auxiliary power	4,443	4,183	(260)	(6%)
Insurance	1,325	1,782	457	26%
Total operating expenses	147,099	106,860	(40,239)	(38%)
Operating income	3,897	2,933	964	33%
Other income (expenses):				
Net gain on sale of assets	64,991	—	64,991	100%
Interest expense	(4,591)	(6,188)	1,597	26%
Taxes, other than income taxes	(1,565)	(1,963)	398	20%
Other	(73)	(120)	47	39%
Total other income (expenses)	58,762	(8,271)	67,033	810%
Net income (loss) before taxes	62,659	(5,338)	67,997	1274%
Income tax (expense) benefit	—	—	—	0%
Net income (loss) after taxes	$ 62,659	$ (5,338)	$ 67,997	1274%

Operating and Business Metrics We Use to Analyze the Company's Performance for the Six Months Ended December 31, 2010 and December 31, 2009

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 six months ended December 31, 2010 and 2009, to the most directly comparable GAAP measures for those periods. See the reconciliation of net income to adjusted EBITDA on page 27. This presentation may not include all of the disclosure that SEC regulations would require a company that files periodic reports with the SEC to make, 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 consider our Hinds, Hot Spring, and Murray II plants and considered our former Sandersville plant to be merchant plants because they are not selling their energy output and capacity pursuant to long-term sales agreements.

	For the Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009
Energy sales	$ 116,122	$ 77,415
Less: Cost of fuel	(96,804)	(63,169)
Less: Contracted energy sales	(26,157)	(13,171)
Add: Contracted cost of fuel	26,938	13,116
Merchant energy margin	20,099	14,191
Capacity sales	34,874	32,378
Less: Contracted capacity sales	(31,465)	(31,882)
Merchant capacity sales	3,409	496
Merchant margin	$ 23,508	$ 14,687

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 Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009
Energy sales	$ 116,122	$ 77,415
Less: Merchant sales	(89,965)	(64,244)
Contracted energy sales	26,157	13,171
Less: Contracted cost of fuel	(26,938)	(13,116)
Add: Power sales rights and obligations amortization	4,056	4,056
Adjusted contracted energy margin	3,275	4,111
Contracted capacity sales	31,465	31,882
Add (Less): Noncash deferred capacity revenue	505	(49)
Adjusted contracted capacity sales	31,970	31,833
Adjusted contracted margin	$ 35,245	$ 35,944

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

	For the Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009
Merchant margin	$ 23,508	$ 14,687
Adjusted contracted margin	35,245	35,944
Total adjusted margin	$ 58,753	$ 50,631

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) depreciation, (f) director and officer insurance expense captured in adjusted corporate expenses (defined below); and (g) the addition of taxes, other than income taxes, as it largely represents plant property taxes and payments in lieu of taxes.

	For the Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009
Total operating expenses	$ 147,099	$106,860
Less: Cost of fuel	(96,804)	(63,169)
Less: Major maintenance expense	(3,542)	995
Less: Gas transportation noncash amortization	(628)	(601)
Less: Selling, general, and administrative expense	(6,456)	(5,946)
Less: Depreciation	(11,098)	(12,255)
Less: D&O insurance expense	(85)	(92)
Add: Taxes, other than income taxes	1,565	1,963
Adjusted plant expenses	$ 30,051	$ 27,755

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, (b) any nonrecurring items such as expenses associated with plant sales and (c) the addition of director and officer insurance expense.

	For the Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009
Selling, general, and administrative expense	$ 6,456	$ 5,946
Less: Noncash employee options/awards expense	(827)	(756)
Add (Less): Employee severance expense	6	(1)
Less: Sale of plant expense	(5)	—
Add: D&O insurance expense	85	92
Adjusted corporate expenses	$ 5,715	$ 5,281

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 Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009	Favorable/Unfavorable) Change	% Change
Merchant energy margin	$ 20,099	$ 14,191	$ 5,908	42%
Merchant capacity sales	3,409	496	2,913	587%
Merchant margin	23,508	14,687	8,821	60%
Adjusted contracted energy margin	3,275	4,111	(836)	(20%)
Adjusted contracted capacity sales	31,970	31,833	137	0%
Adjusted contracted margin	35,245	35,944	(699)	(2%)
Total adjusted margin	58,753	50,631	8,122	16%
Adjusted plant expenses	30,051	27,755	(2,296)	(8%)
Adjusted plant EBITDA	28,702	22,876	5,826	25%
Adjusted corporate expenses	5,715	5,281	(434)	(8%)
Adjusted EBITDA	$ 22,987	$ 17,595	$ 5,392	31%

Selected Operating and Business Metrics

	For the Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009	Favorable/(Unfavorable) Change	% Change
Selected Financial and Operating Data				
Total generation (GWh)......................................	2,843	2,356	487	21%
Merchant generation (GWh)	2,076	1,911	165	9%
Merchant margin/merchant generation ($/MWh)	$ 11.32	$ 7.69	$ 3.63	47%

Selected Market and Weather Data

	For the Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009	Change	% Change
Selected Market Data(1)				
Average on-peak market power price— Entergy ($/MWh)	$ 38.02	$ 31.43	$ 6.59	21%
Average on-peak market power price— Southern ($/MWh)..	$ 41.09	$ 34.04	$ 7.05	21%
Average Henry Hub gas price ($/MMbtu)...........	$ 4.03	$ 3.71	$ 0.32	9%
Selected Weather Data				
Actual CDDs(2)..	4,917	3,710	1,207	33%
Normal CDDs..	3,760	3,760	—	0%
Actual HDDs(3)..	3,269	3,067	202	7%
Normal HDDs...	3,087	3,087	—	0%

Notes:

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

(2) CDD, or cooling degree days, represents the number of degrees during April through October 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 Six Months Ended December 31, 2010 compared to the Six Months Ended December 31, 2009.

Total adjusted margin increased $8.1 million, or 16%, to $58.8 million for the six months ended December 31, 2010 compared to the same period in the previous year as a result of an $8.8 million increase in merchant margin and a $0.7 million decrease in adjusted contracted margin. The $58.8 million in total adjusted margin was comprised of $23.5 million in merchant margin and $35.3 million in adjusted contracted margin.

Merchant margin increased $8.8 million, or 60%, to $23.5 million for the six months ended December 31, 2010. The $8.8 million increase was made up of a $5.9 million increase in merchant energy margin and a $2.9 million increase in merchant capacity sales. The $5.9 million increase in merchant energy margin related primarily to warmer weather and an increase in natural gas prices, as evidenced by a 33% increase in CDDs and a 9% increase in the average Henry Hub gas price from $3.71 per MMbtu to $4.03 per MMbtu for the six months ended December 31, 2010 as compared to the previous year. Merchant generation increased by 9% from 1,911GWh to 2,076 GWh for the six months ended December 31, 2010 as compared to the previous year. The implied merchant spark spread, or merchant margin divided by merchant generation, increased from $7.69 per MWh to $11.32 per MWh, largely due to the increase in merchant capacity sales, warmer weather, and the effects of higher market gas prices. Merchant margin was also impacted by operational issues associated with the Hot Spring facility's inlet chiller system. These issues are scheduled to be repaired at the facility's spring 2011 outage and we expect to file an insurance claim in connection herewith.

Adjusted contracted margin decreased $0.7 million, or 2%, to $35.2 million for the six months ended December 31, 2010, which was comprised of $3.2 million in adjusted contracted energy margin and $32.0 million in adjusted contracted capacity sales. The $0.7 million decrease was made up of a $0.8 million decrease in the adjusted contracted energy margin offset by a $0.1 million increase in the adjusted contracted capacity sales. The $0.1 million increase in adjusted contracted capacity sales was a result of the escalation of the pricing in the GPC PPA. During November and December 2010, an extended outage occurred at our Murray power generation facility to repair the high pressure piping at Murray I and II, the Murray II steam turbine generator rotor, and other related items resulting in costs of approximately $2.7 million. During the outage, we provided replacement power at a cost of approximately $1.5 million from other sources to Georgia Power in accordance with the GPC PPA. The cost of the replacement power negatively impacted our adjusted contracted capacity sales by $0.5 million and our adjusted contracted energy margin by $1.0 million.

Adjusted plant expenses increased by $2.3 million, or 8%, to $30.1 million for the six months ended December 31, 2010. The increase related primarily to a $2.3 million increase in operating and maintenance expenses caused by additional unscheduled maintenance at the Murray facilities and an increase in gas transportation of $0.7 million offset by a $0.3 million decrease in insurance expense.

As a result of the foregoing changes in total adjusted margin and adjusted plant expenses, adjusted plant EBITDA increased by $5.8 million to $28.7 million for the six months ended December 31, 2010.

Adjusted corporate expenses increased by $0.4 million, or 8%, to $5.7 million for the six months ended December 31, 2010. The increase primarily related to an increase in commercial marketing fees associated with the increase in merchant sales for the six months ended December 31, 2010 compared to the six months ended December 31, 2009.

As a result of the foregoing, adjusted EBITDA increased by $5.4 million to $23.0 million for the six months ended December 31, 2010.

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 income (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 nonrecurring expenses). Adjusted plant EBITDA is equal to total adjusted EBITDA less certain corporate expenses.

	For the Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009
Net income (loss) after taxes	$ 62,659	$ (5,338)
Add: Interest expense	4,591	6,188
Add: Depreciation	11,098	12,255
Add: Power sales rights and obligations amortization	4,056	4,056
Add: Gas transportation noncash amortization	628	601
Add (Less): Noncash deferred capacity revenue	505	(49)
Add: Other expenses	73	120
EBITDA	83,610	17,833
Less: Net gain on sale of assets	(64,991)	—
Add (Less): Major maintenance expense	3,542	(995)
Add: Noncash employee options/awards expense	827	756
Add (Less): Employee severance expense	(6)	1
Add: Sale of plant expense	5	—
Adjusted EBITDA	22,987	17,595
Add: Selling, general, and administrative expense	6,456	5,946
Less: Noncash employee options/awards expense	(827)	(756)
Add (Less): Employee severance expense	6	(1)
Less: Sale of plant expense	(5)	—
Add: D&O insurance expense	85	92
Adjusted plant EBITDA	$ 28,702	$ 22,876

The following describes changes to specified financial measures of our performance. As indicated above, in calculating our adjusted EBITDA, we made adjustments to our net income after taxes using these financial measures for the six months ended December 31, 2010 compared to the six months ended December 31, 2009.

- Interest expense for the six months ended December 31, 2010 was $4.6 million compared to $6.2 million for the same period in 2009. The $1.6 million decrease was made up of a $0.4 million decrease due to lower outstanding debt amounts compared to the same period in the previous year, and $1.2 million in losses on derivatives associated with our interest rate hedging and cash payments on our Swaps.

- Depreciation was $11.1 million and $12.3 million for the six months ended December 31, 2010 and 2009, respectively.

- Amortization of contract-based power sales rights and obligations, for both six month periods, was $4.1 million and was recorded as a reduction of energy sales.

- Amortization of contract-based natural gas transportation rights and obligations, for both six month periods, was $0.6 million and was recorded as an increase of gas transportation expense.

- Noncash deferred capacity revenue, which represents the levelization of capacity sales over the GPC PPA term, of $0.5 million of expense and $49.0 thousand of revenue for the six months ended December 31, 2010 and 2009, respectively, was recorded as capacity sales.

- Other expense for both six month periods was $0.1 million.

- Net gain on sale of assets was $65.0 million and zero for the six months ended December 31, 2010 and 2009, respectively. The net gain on sale of assets is related to the sale of the Sandersville facility on July 9, 2010.

- Major maintenance expense consisted of $3.5 million of expense and $1.0 million of income for the six months ended December 31, 2010 and 2009, respectively. The $3.5 million expense primarily related to a $1.7 million payment to GE as a result of restructuring the long-term service agreements with GE, $1.3 million of major maintenance performed at the Murray II facility, $0.4 million performed at the Hinds facility, and $0.2 million performed at the Hot Spring facility. The $1.0 million of income for the six months ended December 31, 2009 related to a credit from GE for repair work at Murray I.

- Noncash employee options/awards expense for both six month periods was $0.8 million, and was recorded as an increase of selling, general, and administrative expense.

- Sale of plant expenses for the six months ended December 31, 2010 and 2009 were $5.0 thousand and zero, respectively, and were recorded as an increase of selling, general, and administrative expense.

- Selling, general, and administrative expense was $6.5 million and $6.0 million for the six months ended December 31, 2010 and 2009, respectively. The increase was primarily related to $0.4 million in commercial marketing fees associated with the increase in merchant sales.

Liquidity and Capital Resources

Liquidity Position

Historically, our cash on hand, cash flow provided by operations, and cash available under our Credit Facility satisfied our liquidity needs with respect to our current portfolio of assets. Our liquidity was comprised of the following at December 31, 2010 (in thousands of dollars):

Unrestricted cash and cash equivalents	$ 130,323
Working capital revolver and synthetic letter of credit facility (net of letters of credit issued thereunder)	76,936
Total	$ 207,259

Historically, our principal sources of funds were cash flows from operations and borrowings under our Credit Facility. Our principal use of funds consisted of operating expenditures, payments of principal and interest on our Credit Facility, and capital expenditures. On December 31, 2010, we had $76.9 million available under our Credit Facility, of which $51.4 million was under the working capital revolver and $25.5 million was under the synthetic letter of credit facility, for activities related to our plants. We had unrestricted cash on hand of $130.3 million, of which $42.3 million was cash at the parent level and not subject to the lien of the Credit Agreement at December 31, 2010. Similarly, $27.9 million was the balance at the parent level not subject to the Credit Agreement at June 30, 2010. The increase at the parent level relates to a $19.5 million cash distribution made by KGen LLC to its parent KGen Power Corporation upon receipt of the Sandersville cash sales proceeds.

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 in 2007 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 to be used for working capital purposes.

On August 18, 2010, the Company prepaid $58.5 million of its outstanding term debt and $10.0 million of its outstanding working capital facility using a portion of the proceeds received from the sale of 100% of the ownership interests in KGen Sandersville LLC, the entity that owned the Sandersville power generation facility (See Note 12). In connection with this prepayment, the Company reduced its principal payment requirement of $2.0 million per year to $1.4 million per year with quarterly installments beginning September 30, 2010. KGen LLC distributed $19.5 million of the cash sales proceeds received to its parent, KGen Power Corporation. In addition, there were $0.5 million of outstanding letters of credit issued under the working capital facility and $14.4 million of outstanding letters of credit issued under the Collateral Credit Facility that related to Sandersville and were cancelled following the sale of 100% of the ownership interests in KGen Sandersville LLC.

Total letters of credit outstanding under the Working Capital Facility were $28.6 million as of December 31, 2010. Total letters of credit issued under the Collateral Credit Facility were $94.5 million as of December 31, 2010.

In connection with the closing of the sale of KGen Murray I and II LLC, KGen LLC will be required to repay all outstanding debt under the Credit Facility, and the Working Capital Facility and Collateral Credit Facility will terminate. We will likely be unable to replace these facilities on terms that are as favorable to us as the Working Capital Facility and the Collateral Credit Facility, if at all. If we are unable to replace these facilities, after closing, our principal sources of funds will be cash flows from our remaining operations (all of which are expected be free cash flow negative for the foreseeable future) and cash-on-hand, including remaining net proceeds from KGen Murray I and II LLC. Our principal use of funds will consist of operating expenditures and capital expenditures for our remaining operations.

We will receive aggregate consideration of $531.3 million in cash in connection with the closing of the sale of KGen Murray I and II LLC, subject to increase or decrease based on potential purchase price adjustments for working capital and spare parts inventory. We expect that the net proceeds we will receive as a result of the sale will be approximately $507.9 million, after giving effect to taxes, transaction fees, and expenses and cash bonuses we are required to pay in connection with the sale. The final net proceeds we will receive will vary based on final purchase price adjustments, the amount of taxes payable on the gain from the sale, and the amount of transaction fees and expenses.

We will use approximately $139.0 million of net proceeds from the sale to repay all of the outstanding debt under the Credit Facility and the related Swaps. Under the terms of the agreement for the sale of Murray I and II LLC, approximately $80.0 million of the purchase price will be placed in escrow for a period of 18 months after closing to secure our post-closing indemnification obligations. The Board of Directors expects to declare a special dividend to stockholders out of the net proceeds of the sale of KGen Murray I and II LLC. The amount of the dividend will be determined by the Board of Directors after closing of the sale based on its review of the Company's on-going cash needs.

Interest Rate. Borrowings under the Credit Facility bear interest at a spread above LIBOR-based loans. The $200.0 million Term Loan Facility bears interest at LIBOR plus 175 basis points. Please refer to "Number 7. *Quantitative and Qualitative Disclosures About Market Risk*." Amounts borrowed under the $80.0 million Working Capital Facility bear 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, a 200 basis point fee on drawn 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 $42.3 million at December 31, 2010 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 December 31, 2010, we were in compliance with the covenants contained within our Credit Facility.

On February 2, 2011, Standard & Poor's Rating Service affirmed a BB- rating on our Credit Facility and revised their outlook to positive.

Capital Expenditures and Major Maintenance

Total capital expenditures for the three and six months ended December 31, 2010 were $1.1 and $1.4 million, respectively. Total capital expenditures for the three and six months ended December 31, 2009 were $0.4 million and $1.4 million, respectively.

Major maintenance was an expense of $1.9 million and income of $0.6 million for the three months ended December 31, 2010 and 2009, respectively. The $1.9 million expense was related to $1.3 million of major maintenance performed at the Murray II facility, $0.4 million at the Hinds facility, and $0.2 million at the Hot Spring facility. The $0.6 million of income for the three months ended December 31, 2009 related to a credit from GE for repair work at Murray I. Major maintenance was an expense of $3.5 million and income of $1.0 million for the six months ended December 31, 2010 and 2009. The $3.5 million expense primarily related to a $1.7 million payment to GE as a result of restructuring the long-term service agreements with GE, $1.3 million of major maintenance performed at the Murray II facility, $0.4 million performed at the Hinds facility, and $0.2 million performed at the Hot Spring facility. The $1.0 million of income for the six months ended December 31, 2009 related to a credit from GE for repair work at Murray I.

The timing of major maintenance expenditures is uncertain and can be delayed or accelerated depending on many factors including plant utilization, unexpected plant shut-downs for other reasons, and unanticipated dispatch schedules. We budget anticipated major maintenance costs by using our estimate of future anticipated run time at each facility. This schedule can change based upon changes to actual run time.

We incur costs for major maintenance on the Plants which are expensed in the period incurred. We expect to incur major maintenance expenses of $2.7 million for the remainder of fiscal 2011.

Cash Flow Analysis

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

	For the Six Months Ended December 31, 2010	For the Six Months Ended December 31, 2009
Statements of Cash Flows Data:		
Cash flows provided by (used in):		
Operating activities	$ 29,180	$ 20,904
Investing activities	122,207	(795)
Financing activity	(69,241)	(1,000)
Increase in cash and cash equivalents	82,146	19,109
Cash and cash equivalents at beginning of period	48,177	40,663
Cash and cash equivalents at end of period	$ 130,323	$ 59,772

Cash Flows from Operating Activities. Our cash flows provided by operations were $29.2 million for the six months ended December 31, 2010, primarily related to a net income of $62.7 million, depreciation expense of $11.1 million, amortization expense of $5.1 million, valuation of derivative instruments of $1.0 million, stock-based compensation of $0.8 million, an increase in accounts receivable of $18.3 million, an increase in prepaid expenses and other current assets of $1.2 million, and an increase in deferred charge of $0.5 million, which was offset primarily by a net gain on sale of assets of $65.0 million, payments from settlement of derivative instruments of $2.4 million, a $1.5 million decrease in spare parts inventories, and a decrease in accounts payable and accrued liabilities of $2.7 million. We also incurred $3.1 million of cash interest during the period under our outstanding Credit Facility.

Cash Flows from Investing Activities. Our cash flows provided by investing activities for the six months ended December 31, 2010 were $122.2 million and related to a sale of assets of $127.8 million, offset by purchases of $4.0 million in short-term investments, $1.3 million in purchases of property, plant, and equipment, and $0.3 million use of restricted cash and cash equivalents.

Cash Flows from Financing Activity. Our cash flows used in financing activity for the six months ended December 31, 2010 were $69.2 million and represented a prepayment of $58.5 million of the outstanding term debt and $10.0 million of the outstanding working capital facility as well as $0.7 million in principal payments of long-term debt as required by the Credit Facility.

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. Prior to February 7, 2010, the terms of our Credit Facility required 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 entered into interest rate swaps in order to mitigate the risk associated with the variable rate borrowings.

KGen LLC has three 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 a one-month LIBOR rate calculated on the same notional value. These payments are made on a monthly 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 December 31, 2010 was $99.0 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	December 31, 2010		June 30, 2010	
			Fair Value	Fixed Rate	Fair Value	Fixed Rate
		(in millions)	(in thousands)		(in thousands)	
Contract #1	Expired	$ —	$ —	—	$ —	—
Contract #2	Expired	—	—	—	—	—
Contract #3	Expired	—	—	—	—	—
Contract #4	3-31-2011	33.0	(376)	5.0%	(998)	5.0%
Contract #5	3-31-2012	33.0	(1,704)	5.0%	(2,212)	5.0%
Contract #6	3-31-2013	$ 33.0	$ (2,870)	5.1%	$ (3,135)	5.1%

As of December 31, 2010, 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.

PART II-OTHER INFORMATION

Number 1A. Risk Factors and Forward-Looking Statements

Risk Factors

Please refer to Number 1A of our Annual Report for the year ended June 30, 2010.

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 Power Corporation and its subsidiaries to differ materially from any future results, performance or achievements expressed or implied by such forward looking statements. Forward looking statements are based on our beliefs as well as assumptions based on information currently available to us, including financial and operational information, current competitive conditions, and anticipated demand for electricity. As a result, these statements are subject to various risks and uncertainties. These risks and uncertainties are discussed above, and in the “Cautionary Statement concerning Forward Statements” and Part I. “Number 1A. Risk Factors” in our Annual Report for the fiscal year ended June 30, 2010 and also include risks of the following:

- the occurrence of any event, change, or other circumstances that could give rise to the termination of the agreement for the sale of KGen Murray I and II LLC, including a termination of that agreement under circumstances that could require us to pay a termination fee of up to $20 million;
- our inability to complete the sale transaction due to the failure to satisfy conditions to completion of the transaction, including receipt of stockholder or required regulatory approvals;
- the failure of the transaction to close for any other reason;
- we will likely be unable to replace our Working Capital Facility or the Collateral Credit Facility on terms that are as favorable to us as the terms of those facilities, if at all;
- the possibility that we may be required to make indemnification payments to Oglethorpe out of, or in excess of, the $80.0 million of the purchase price that will be placed into escrow to secure post-closing indemnification obligations;
- the potential difficulties in the retention of executive management and other key employees after the closing of the sale transaction;
- limitations on our ability to utilize our NOLs to offset taxable gain from the sale transaction;
- our remaining power generation plants (after the sale of KGen Murray I and II LLC) are expected to be free cash flow negative for the foreseeable future and we may not generate sufficient cash or otherwise have sufficient liquidity to operate those plants;
- the announcement and consummation of the sale transaction may make it more difficult for us to sell our remaining facilities; and
- the amount of the costs, fees, expenses, and other charges related to the sale transaction.

Number 2. Submission of Matters to a Vote of Security Holders

On December 13, 2010, we held our annual meeting of shareholders. At the meeting, the following proposals were voted upon and approved:

Election of Directors

	For	Against	Abstain	Broker Non-Votes
Nominees				
Daniel T. Hudson	47,255,681	45,000	2,043,412	667,254
James P. Jenkins	46,947,681	353,000	2,043,412	667,254
Gerald J. Stalun	46,947,681	353,000	2,043,412	667,254
Thomas B. White	47,255,681	45,000	2,043,412	667,254

Other Matters

	For	Against	Abstain	Broker Non-Votes
Ratify Deloitte & Touche LLP as the Independent, Registered Public Accountants	47,657,462	310,473	2,043,412	—