KGen Power Corporation

Report to Shareholders

for

Quarter Ended September 30, 2009

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

Investor Relations
713-979-1990

TABLE OF CONTENTS

		Page No.
PART I—FINANCIAL INFORMATION		
Number 1	— Unaudited Condensed Consolidated Financial Statements and Notes	3
Number 2	— Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Number 3	— Quantitative and Qualitative Disclosures about Market Risk	25
PART II—OTHER INFORMATION		
Number 1A	— Risk Factors and Forward-Looking Statements	25

PART I—FINANCIAL INFORMATION

Number 1. Unaudited Condensed Consolidated Financial Statements and Notes

KGen Power Corporation

Condensed Consolidated Balance Sheets

(in thousands, except per share amounts)

	September 30, 2009 (unaudited)	June 30, 2009
Assets		
Current assets:		
Cash and cash equivalents	**$ 65,206**	$ 40,663
Restricted cash and cash equivalents	**32,943**	32,943
Accounts receivable	**13,508**	22,815
Spare parts inventories	**8,397**	7,232
Prepaid expenses and other current assets	**179**	1,336
Total current assets	**120,233**	104,989
Property, plant, and equipment	**706,781**	705,711
Less: accumulated depreciation	**63,626**	57,501
Net property, plant, and equipment	**643,155**	648,210
Contract-based intangibles (net of $28,162 and $25,498 of accumulated amortization, respectively)	**55,380**	58,044
Deferred charge	**2,777**	2,769
Deferred financing fees (net of $2,361 and $2,138 of accumulated amortization, respectively)	**3,903**	4,126
Other noncurrent assets	**325**	325
Total assets	**$ 825,773**	$ 818,463
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable and accrued liabilities	**$ 13,646**	$ 19,078
Current portion of long-term debt	**2,000**	2,000
Total current liabilities	**15,646**	21,078
Long-term debt	**202,500**	203,000
Contract-based intangibles (net of $3,940 and $3,604 of accumulated amortization, respectively)	**16,228**	16,564
Other noncurrent liabilities	**3,709**	4,119
Commitments and contingencies (Note 6)	**—**	—
Stockholders' equity:		
Common stock (par value $.01; 150,000 shares authorized; 55,968 shares issued and outstanding at both September 30, 2009 and June 30, 2009)	**560**	560
Additional paid in capital	**741,977**	741,602
Accumulated deficit	**(154,847)**	(168,460)
Total stockholders' equity	**587,690**	573,702
Total liabilities and stockholders' equity	**$ 825,773**	$ 818,463

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 September 30, 2009	For the Three Months Ended September 30, 2008
Revenues:		
Energy sales	$61,859	$111,769
Capacity sales	26,529	30,849
Total revenues	88,388	142,618
Operating expenses:		
Cost of fuel	48,995	94,896
Operating and maintenance	4,022	20,255
Gas transportation	4,786	4,637
Selling, general, and administrative	2,965	4,384
Depreciation	6,125	6,100
Auxiliary power	2,290	2,609
Insurance	925	842
Total operating expenses	70,108	133,723
Operating income	18,280	8,895
Other income (expenses):		
Interest expense	(3,599)	(3,311)
Taxes, other than income taxes	(999)	(1,290)
Net interest income	—	260
Other	(69)	(1,034)
Total other expenses	(4,667)	(5,375)
Net income before taxes	13,613	3,520
Income tax expense	—	—
Net income after taxes	$13,613	$ 3,520
Net earnings per share—basic and diluted	$ 0.24	$ 0.06
Weighted average shares outstanding—basic	55,968	55,967
Weighted average shares outstanding—diluted	55,968	56,193

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 Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008
Cash flows from operating activities		
Net income	**$13,613**	$ 3,520
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**6,125**	6,100
Amortization of deferred financing fees	**223**	223
Amortization of contract-based intangibles	**2,328**	2,322
Valuation of derivative instruments	**1,584**	1,034
Stock-based compensation	**375**	689
Payments from settlement of derivative instruments	**(1,591)**	(1,020)
Changes in operating assets and liabilities:		
Accounts receivable	**9,307**	16,943
Spare parts inventories	**(1,165)**	(10)
Prepaid expenses and other current assets	**1,157**	944
Deferred charge	**(8)**	(458)
Accounts payable and accrued liabilities	**(6,745)**	(11,289)
Other noncurrent liabilities	**(1)**	(2)
Net cash provided by operating activities	**25,202**	18,996
Cash flows from investing activities		
Purchases of property, plant, and equipment	**(159)**	(329)
Short-term investments	**—**	1,047
Use of restricted cash and cash equivalents	**—**	15,043
Net cash (used in) provided by investing activities	**(159)**	15,761
Cash flows from financing activity		
Repayment of debt	**(500)**	(500)
Net cash used in financing activity	**(500)**	(500)
Increase in cash and cash equivalents	**24,543**	34,257
Cash and cash equivalents at beginning of period	**40,663**	51,493
Cash and cash equivalents at end of period	**$65,206**	$ 85,750
Cash paid for		
Interest	**$ 1,810**	$ 3,086
Noncash transactions		
Grant of shares for Board fees	**$ —**	$ 116

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

KGen Power Corporation

Notes to Unaudited Condensed Consolidated Financial Statements

1. Nature of Business and Significant Accounting Policies

Operations—KGen Power Corporation (the "Company") was incorporated in Delaware on December 4, 2006, which is the date of its inception. The Company owns and operates electric power generation plants and sells electricity and electrical generation capacity in the United States to wholesale purchasers such as retail electric providers, power trading organizations, municipal utilities, electric power cooperatives, and other power generation companies. The portfolio of facilities consists of five operational and fully permitted power plants (the "Plants") located in the southeastern United States with gas turbines having an aggregate capacity of 3,030 megawatts ("MW"). The Plants include four combined-cycle plants (Murray I, Murray II, Hot Spring, and Hinds) and one simple-cycle plant (Sandersville). The Plants were acquired from an affiliate of MatlinPatterson Global Advisors LLC on February 8, 2007.

Interim Financial Statements—The accompanying condensed consolidated financial statements have been prepared in accordance with the regulations regarding interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted. In the opinion of management, all adjustments (consisting of normal recurring accruals, except as noted in Note 6—Commitments and Contingencies) considered necessary for a fair presentation have been included. The balance sheet at June 30, 2009 is derived from the June 30, 2009 audited consolidated financial statements. These condensed consolidated financial statements included herein should be read in conjunction with the Consolidated Financial Statements and Notes included in the Company's Annual Report for the year ended June 30, 2009.

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

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

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

Recently Issued Accounting Standards—In June 2009, the Financial Accounting Standards Board ("FASB") issued FASB Accounting Standards Codification 105 ("FASB ASC") *Generally Accepted*

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

Accounting Principles, which establishes the FASB ASC as the sole source of authoritative generally accepted accounting principles. Pursuant to the provisions of FASB ASC 105, the Company has updated references to GAAP in its financial statements issued for the period ended September 30, 2009. The adoption of FASB ASC 105 did not impact the Company's financial position or results of operations.

In August 2009, FASB ASC 820-10 *Fair Value Measurements and Disclosures* was issued, effective for the Company for interim periods ending December 2009. FASB ASC 820-10 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The Company does not expect the adoption of this guidance to have a material impact on either its financial position or results of operations.

2. Property, Plant, and Equipment

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

	Estimated Useful Life	September 30, 2009	June 30, 2009
Land	—	$ 4,201	$ 4,201
Buildings	40 years	$ 29,382	28,612
Gas and steam turbines	30 years	$236,243	235,985
Steam generators and auxiliaries	30 years	$ 48,954	48,402
Transmission and fuel gas pipelines	30 years	$ 57,390	57,191
Systems and equipment	5-30 years	$124,411	122,616
Other plant	3-30 years	$206,200	208,704
Total property, plant, and equipment		706,781	705,711
Less: accumulated depreciation		63,626	57,501
Net property, plant, and equipment		$643,155	$648,210

3. Contract-Based Intangibles

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

	Term	September 30, 2009	June 30, 2009
Assets			
Murray I Georgia Power contract	May 31, 2012	$21,826	$23,854
Murray firm transportation contracts	Various	33,554	34,190
Total assets		$55,380	$58,044
Liabilities			
Hinds firm transportation contract	March 31, 2012	$ 133	$ 147
Murray firm transportation contract	November 30, 2016	465	481
Hot Spring firm transportation contracts	Various	15,630	15,936
Total liabilities		$16,228	$16,564

3. Contract-Based Intangibles (Continued)

For both of the three months ended September 30, 2009 and 2008, amortization of contract-based power sales rights and obligations, was $2.0 million, and was recorded as a reduction of energy sales on the condensed consolidated statements of operations. For both of the three months ended September 30, 2009 and 2008, amortization of contract-based natural gas transportation rights and obligations was $0.3 million, and was recorded as an increase of gas transportation expenses on the condensed consolidated statements of operations.

4. Long-Term Debt

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

	Interest Rate	Maturity	September 30, 2009	June 30, 2009
Term debt	Variable	February 8, 2014	$194,500	$195,000
Working capital facility	Variable	February 8, 2012	10,000	10,000
Total debt outstanding			204,500	205,000
Less: current portion			2,000	2,000
Total long-term debt			$202,500	$203,000

On February 8, 2007, KGen LLC, a wholly owned subsidiary of the Company, entered into a credit agreement with Morgan Stanley (the "Credit Agreement") and related security deposit agreement (the "Security Deposit Agreement") with Union Bank of California, as collateral agent and The Bank of New York, as depository agent, to provide term debt in the amount of $200.0 million. The term debt bears interest at an adjusted rate based on the London Interbank Offered Rate ("LIBOR") plus 175 basis points, has a term of seven years and requires a $2.0 million principal payment per year made in quarterly installments. KGen LLC's obligations and indebtedness under the Credit Agreement are secured by a security interest in all of the assets and all of the membership interests of KGen LLC and its subsidiaries. The interest rate incurred on the term debt was 2.1% at both September 30, 2009 and June 30, 2009.

KGen LLC also entered into an $80.0 million working capital facility for other liquidity needs and a $120.0 million synthetic letter of credit facility to support the collateral requirements at the project level. The working capital facility charges a 200 basis point fee for outstanding letters of credit, bears interest at LIBOR plus 200 basis points for outstanding draws, and has a 50 basis point commitment fee for any unused portion. It has a five-year term expiring on February 8, 2012. On March 20, 2009, KGen LLC drew $10.0 million under the working capital facility. The proceeds of the drawdown are for working capital purposes. Letters of credit have been issued under the working capital facility at both September 30, 2009 and June 30, 2009 for $8.0 million. KGen LLC pays a fee of 191 basis points on the $120.0 million synthetic letter of credit facility. The synthetic letter of credit facility has a seven-year term expiring on February 8, 2014. At both September 30, 2009 and June 30, 2009, a letter of credit, supporting the power sales contract with GPC, with a current outstanding amount of $100.0 million and $19.9 million of other letters of credit have been issued under such facility.

4. Long-Term Debt (Continued)

The remaining future minimum principal payments under the term debt and the working capital facility subsequent to September 30, 2009 are as follows (in thousands of dollars):

2010	1,500
2011	2,000
2012	12,000
2013	2,000
Thereafter	187,000
Total	$204,500

The Credit Agreement and related financing documents contain various affirmative and negative covenants, including (a) financial covenants, (b) limitations on KGen LLC's ability to pay dividends, (c) restrictions on the use of available cash for operations, except as required for debt service payments and (d) an event of default in the event of a change in control of KGen. At September 30, 2009, 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 $546.0 million at September 30, 2009, of which $63.5 million was restricted net current assets.

5. Restricted Cash and Cash Equivalents

The Credit Agreement requires KGen LLC to maintain six months of principal and interest payments reserve in cash. At both September 30, 2009 and June 30, 2009, the restricted balance, in accordance with this requirement, was $5.8 million.

Additionally, the Security Deposit Agreement requires KGen LLC to reserve quarterly the amount of major maintenance expenditures expected to be incurred during the following 12 months. At both September 30, 2009 and June 30, 2009, the restricted balance, in accordance with this requirement, was $27.1 million.

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, 2009.

6. Commitments and Contingencies (Continued)

Sublease—The Company entered into an agreement on September 29, 2009 to sublease approximately 6,318 square feet of corporate office space in exchange for monthly payments of $15,775. The commencement date of the sublease is expected to occur in January 2010, after substantial completion of the sublessor's improvements.

7. Derivatives

The Company recognizes all derivatives 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 September 30, 2009. During the year ended June 30, 2009, the Company and its counterparty amended the swap agreements to reduce the Company's fixed rate payments component and change the basis of the counterparty's floating rate payments.

The short-term portion of the Swaps as of September 30, 2009 and June 30, 2009 was $4.3 million and $3.9 million, respectively, and was recorded in accounts payable and accrued liabilities. The long-term portion of the Swaps as of September 30, 2009 and June 30, 2009 was $3.7 million and $4.1 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	Gain (Loss) on Derivatives
For the three months ended September 30, 2009	Interest expense	$(1,584)
For the three months ended September 30, 2008	Other income (expenses)	$(1,034)

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.

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 quote 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

7. Derivatives (Continued)

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

The Company also considered the effect of its nonperformance risk in determining the fair value of its liabilities, as required under FASB ASC 820. The consideration of nonperformance risk resulted in an adjustment of $0.7 million for the three months ended September 30, 2009. The adjustment reduced the fair value of the Company's Swap liabilities on the condensed consolidated balance sheets and decreased the loss on derivatives on the condensed consolidated statements of operations.

8. Net Earnings per Share

Basic earnings per share is calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. For the three months ended September 30, 2009, diluted earnings per share was computed on the same basis as basic earnings per share as the inclusion of any other potential shares outstanding would be anti-dilutive. For the three months ended September 30, 2008, diluted earnings per share was calculated by adjusting the weighted average number of shares of common stock outstanding by the dilutive effect of unexercised in-the-money stock options, or 225,350 shares. Such inclusion had no significant impact on basic earnings per share for the period. Amounts shown below are in thousands, except per share amounts.

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008
Numerator:		
Net income	$13,613	$ 3,520
Denominator:		
Weighted average shares outstanding—basic	55,968	55,967
Weighted average shares outstanding—diluted	55,968	56,193
Net earnings per share—basic and diluted	$ 0.24	$ 0.06

9. Share-Based Payments

This footnote should be read in conjunction with Note 9—Share-Based Payments of the Notes to Consolidated Financial Statements contained in the Annual Report for the year ended June 30, 2009.

The Company recorded compensation expense of $0.4 million and $0.6 million for the three months ended September 30, 2009 and 2008, respectively, related to stock options and awards outstanding. As of September 30, 2009 and 2008, there was $0.6 million and $2.8 million, respectively, of total unrecognized compensation expense related to unvested options. For the three months ended September 30, 2009 and 2008, no options were granted or exercised.

10. Income Taxes

For both the three months ended September 30, 2009 and 2008, there were no current or deferred income tax provision (benefits) included in the net income.

10. Income Taxes (Continued)

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

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008
Statutory rate	35%	35%
Tax at statutory rate	$ 4,765	$ 1,232
Increase (decrease) due to:		
Nondeductible meals and entertainment	2	—
State tax expense	515	141
Return to provsion		—
Adjustment to valuation allowance	(5,282)	(1,373)
Total provision	$ —	$ —

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

	At September 30, 2009	At June 30, 2009
Deferred tax assets:		
Interest rate derivatives	$ 3,121	$ 3,124
Contract-based intangible assets	12,449	11,329
Nonqualified stock options expense	5,181	5,036
Accrued expenses	258	258
Net operating loss	56,164	60,493
Net deferred tax assets	77,173	80,240
Deferred tax liabilities:		
Property, plant, and equipment	15,477	13,886
Prepaid expenses	44	294
Contract-based intangible liabilities	3,499	3,488
Net deferred tax liability	19,020	17,668
Valuation allowance	58,153	62,572
Deferred tax asset (liabilities), net	$ —	$ —

At September 30, 2009, the Company had a federal net operating loss carryforward of $143.1 million which will expire between 2027 and 2029. The amount of taxable income that the Company can offset with this carryforward is subject to 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).

Management has determined that valuation allowances are necessary as of September 30, 2009 and June 30, 2009, as the future tax benefits relating to all deferred income tax assets are not expected to be fully realized when measured against a more likely than not standard. There were no unrecognized tax

10. Income Taxes (Continued)

benefits that if recognized would affect the tax rate. No interest or penalties were recognized as of September 30, 2009.

The Company filed income tax returns in the United States federal jurisdiction and in various states. In all material respects, the Company will not be subject to United States federal, state and local income tax examination by tax authorities for fiscal years ended before 2005.

11. Subsequent Events

On September 23, 2009, KGen Hot Spring LLC, a 100% owned subsidiary of the Company, self-reported to the SERC Reliability Corporation ("SERC"), that it failed to document certain maintenance and testing items which may constitute a violation of a North American Electric Reliability Corporation ("NERC") reliability standard. Subsequent to this reporting, SERC conducted its regularly scheduled audit of all of the Company's facilities and found a separate possible violation by KGen Hot Spring LLC of the reliability standards. In the event that it is determined that there has been a violation of the reliability standards, KGen Hot Spring LLC may be subject to penalties. The ultimate outcome of these matters remains uncertain, but the Company does not believe an unfavorable outcome would result in a material impact to its consolidated financial statements. No loss contingency is accrued, however should such financial penalties be imposed on us, it is our estimate any such penalties would be in the range of $0 to $250,000.

On October 16, 2009, the Company notified Duke Energy Generation Services ("DEGS") that it was exercising its rights to terminate the operating and maintenance agreements between DEGS and KGen Hinds LLC, KGen Hot Spring LLC, and KGen Sandersville LLC, all 100% owned subsidiaries of the Company. The terminations will become effective 120 days after notification, and the Company will be required to pay DEGS approximately $420,000. In connection with such terminations, KGen Hinds LLC, KGen Hot Spring LLC, and KGen Sandersville LLC executed new operating agreements with NAES Corporation ("NAES"), a third party operations and maintenance provider that will replace DEGS as the service provider for such facilities.

Subsequent events were analyzed and considered through November 13, 2009, the issuance date of the report.

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

The following discussion is intended to assist you in understanding our business and the results of operations together with our present financial condition. This section should be read in conjunction with our Condensed Consolidated Financial Statements and the accompanying notes included in this Quarterly Report, as well as our Annual Report for the fiscal year ended June 30, 2009. Unless the context otherwise requires or indicates, references to "KGen," "Company," "we," "our," and "us" refer to KGen Power Corporation and its subsidiaries. Statements in our discussion may be forward-looking. These forward-looking statements involve risk and uncertainties. We caution that a number of factors could cause future results to differ materially from our expectations. Please see "Number 1A. *Risk Factors*" of Part I of our Annual Report for the fiscal year ended June 30, 2009 and "Number 1A. *Risk Factors and Forward-Looking Statements*" of Part II of this Quarterly Report regarding certain risk factors related to the Company.

Business Overview

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

Four of the Plants currently operate as merchant power providers. The remaining plant, the Murray I combined cycle plant, benefits from a fixed price long-term power purchase agreement, or the GPC PPA, for all of its 630 MW of capacity with Georgia Power, a subsidiary of Southern Company. The GPC PPA, which continues through May 2012, provides for fixed capacity payments that provide stable cash flow. The Company recognized $26.2 million related to capacity sales on the GPC PPA for both the three months ended September 30, 2009 and 2008. On June 6, 2008, the Sandersville simple cycle plant entered into a power purchase agreement, or the Sandersville PPA, for a unit contingent 250 to 280 MW of capacity and associated energy with Southern Power Company. The Sandersville PPA commences on June 1, 2011 and continues through December 31, 2015.

As part of our strategy, we continue to explore and review credible alternatives that may become available to us to enhance shareholder value.

Recent Events

On September 23, 2009, KGen Hot Spring LLC, a 100% owned subsidiary of the Company, self-reported to the SERC Reliability Corporation, or SERC, that it failed to document certain maintenance and testing items which may constitute a violation of a North American Electric Reliability Corporation, or NERC, reliability standard. Subsequent to this reporting, SERC conducted its regularly scheduled audit of all of the Company's facilities and found a separate possible violation by KGen Hot Spring LLC of the reliability standards. In the event that it is determined that there has been a violation of the reliability standards, KGen Hot Spring LLC may be subject to penalties. The ultimate outcome of these matters remains uncertain, but the Company does not believe an unfavorable outcome would result in a material impact to its consolidated financial statements. No loss contingency is accrued, however should such financial penalties be imposed on us, it is our estimate any such penalties would be in the range of $0 to $250,000.

On October 16, 2009, the Company notified Duke Energy Generation Services, or DEGS, that it was exercising its rights to terminate the operating and maintenance agreements between DEGS and KGen

Hinds LLC, KGen Hot Spring LLC, and KGen Sandersville LLC, all 100% owned subsidiaries of the Company. The terminations will become effective 120 days after notification, and the Company will be required to pay DEGS approximately $420,000. In connection with such terminations, KGen Hinds LLC, KGen Hot Spring LLC, and KGen Sandersville LLC executed new operating agreements with NAES Corporation, or NAES, a third party operations and maintenance provider that will replace DEGS as the service provider for such facilities. Under our NAES agreements, we expect savings of approximately $3.8 million over the five year term of the agreements. The agreements may be terminated for convenience with no fee for such termination after the first year.

On October 16, 2009, the Company changed its principal independent accountants from Ernst & Young LLP to Deloitte and Touche LLP. There were no disagreements with Ernst & Young LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements if not resolved to the satisfaction of Ernst & Young LLP, would have caused them to make reference thereto in Ernst & Young LLP's reports on the financial statements of the Company for such fiscal years. In addition, during that period, there were no "reportable events" (as defined in Item 304(a)(1)(v) of Regulation S-K). The decision to change the Company's principal independent accountants was made by the Board of Directors primarily for the purpose of reducing the Company's accounting expenses.

Results of Operations

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

Consolidated Results of Operations of KGen for the Three Months Ended September 30, 2009 compared to the Three Months Ended September 30, 2008.

The following table sets forth our results of operations for the three months ended September 30, 2009 and 2008, expressed in thousands of dollars:

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008	Favorable/ (Unfavorable) Change	% Change
Revenues:				
Energy sales	$61,859	$111,769	$(49,910)	(45)%
Capacity sales	26,529	30,849	(4,320)	(14)%
Total revenues	88,388	142,618	(54,230)	(38)%
Operating expenses:				
Cost of fuel	48,995	94,896	45,901	48%
Operating and maintenance	4,022	20,255	16,233	80%
Gas transportation	4,786	4,637	(149)	(3)%
Selling, general, and administrative	2,965	4,384	1,419	32%
Depreciation	6,125	6,100	(25)	(0)%
Auxiliary power	2,290	2,609	319	12%
Insurance	925	842	(83)	(10)%
Total operating expenses	70,108	133,723	63,615	48%
Operating income	18,280	8,895	9,385	106%
Other income (expenses):				
Interest expense	(3,599)	(3,311)	(288)	(9)%
Taxes, other than income taxes	(999)	(1,290)	291	23%
Net interest income	—	260	(260)	(100)%
Other	(69)	(1,034)	965	93%
Total other expenses	(4,667)	(5,375)	708	13%
Net income before taxes	13,613	3,520	10,093	287%
Income tax expense	—	—	—	0%
Net income after taxes	$13,613	$ 3,520	$ 10,093	287%

Operating and Business Metrics We Use to Analyze the Company's Performance for the Three Months Ended September 30, 2009 and September 30, 2008

In addition to the foregoing results of operations presented in accordance with GAAP, we utilize various non-GAAP operating and business metrics to analyze the Company's performance. We believe these metrics provide useful insight into the Company's performance, assist us in identifying trends in our business, and better allow us to compare our performance to others in our industry. We describe below these various non-GAAP metrics and provide a reconciliation of these metrics for the three months ended September 30, 2009 and 2008, to the most directly comparable GAAP measures for those periods. See the reconciliation of net income to adjusted EBITDA on page 19. This presentation may not include all of the disclosure that SEC regulations require with respect to non-GAAP financial measures.

Merchant Margin, Adjusted Contracted Margin, and Total Adjusted Margin

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

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

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008
Energy sales	$ 61,859	$111,769
Less: Cost of fuel	(48,995)	(94,896)
Less: Contracted energy sales	(12,914)	(30,488)
Add: Contracted cost of fuel	11,234	27,641
Merchant energy margin	11,184	14,026
Capacity sales	26,529	30,849
Less: Contracted capacity sales	(26,223)	(26,158)
Merchant capacity sales	$ 306	$ 4,691
Merchant margin	$ 11,490	$ 18,717

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 September 30, 2009	For the Three Months Ended September 30, 2008
Energy sales	$ 61,859	$111,769
Less: Merchant sales	(48,945)	(81,281)
Contracted energy sales	12,914	30,488
Less: Contracted cost of fuel	(11,234)	(27,641)
Add: Power sales rights and obligations amortization	2,028	2,028
Adjusted contracted energy margin	3,708	4,875
Contracted capacity sales	26,223	26,158
Less: Noncash deferred capacity revenue	(8)	(459)
Adjusted contracted capacity sales	$ 26,215	$ 25,699
Adjusted contracted margin	$ 29,923	$ 30,574

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

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008
Merchant margin	$11,490	$18,717
Adjusted contracted margin	29,923	30,574
Total adjusted margin	$41,413	$49,291

Adjusted Plant Expense and Adjusted Corporate Expense

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

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008
Total operating expenses	$ 70,108	$133,723
Less: Cost of fuel	(48,995)	(94,896)
Less: Major maintenance expense	402	(15,628)
Less: Gas transportation noncash amortization	(301)	(294)
Less: Selling, general and administrative expense	(2,965)	(4,384)
Less: Depreciation	(6,125)	(6,100)
Less: D&O insurance expense	(46)	(101)
Add: Taxes, other than income taxes	999	1,290
Adjusted plant expenses	$ 13,077	$ 13,610

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

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008
Selling, general and administrative expense	$2,965	$4,384
Less: Noncash employee options/awards expense	(375)	(573)
Less: Employee severance expense	(1)	—
Add: D&O insurance expense	46	101
Adjusted corporate expenses	$2,635	$3,912

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 September 30, 2009	For the Three Months Ended September 30, 2008	Favorable/ (Unfavorable)	
			Change	% Change
Merchant energy margin	$11,184	$14,026	$(2,842)	(20)%
Merchant capacity sales	306	4,691	(4,385)	(93)%
Merchant margin	11,490	18,717	(7,227)	(39)%
Adjusted contracted energy margin	3,708	4,875	(1,167)	(24)%
Adjusted contracted capacity sales	26,215	25,699	516	2%
Adjusted contracted margin	29,923	30,574	(651)	(2)%
Total adjusted margin	41,413	49,291	(7,878)	(16)%
Adjusted plant expenses	13,077	13,610	533	4%
Adjusted plant EBITDA	28,336	35,681	(7,345)	(21)%
Adjusted corporate expenses	2,635	3,912	1,277	33%
Adjusted EBITDA	$25,701	$31,769	$(6,068)	(19)%

Selected Operating and Business Metrics

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008	Favorable/ (Unfavorable)	
			Change	% Change
Selected Financial and Operating Data				
Total generation (GWh)	1,880	1,266	614	48%
Merchant generation (GWh)	1,491	913	578	63%
Merchant margin/merchant generation ($/MWh)	$ 7.71	$20.50	$(12.79)	(62)%

Selected Market and Weather Data

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008	Change	% Change
Selected Market Data(1)				
Average on-peak market power price— Entergy ($/MWh)	$28.78	$71.59	$(42.81)	(60)%
Average on-peak market power price— Southern ($/MWh)	$31.34	$78.00	$(46.66)	(60)%
Average Henry Hub gas price ($/MMbtu)	$ 3.15	$ 9.15	$ (6.00)	(66)%
Selected Weather Data				
Actual CDDs(2)	3,592	3,773	(181)	(5)%
Normal CDDs	3,699	3,699	—	0%

Notes:

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

(2) CDD, or cooling degree days, represents the number of degrees that the mean temperature for a particular day is above 65 degrees Fahrenheit. The CDDs are then accumulated for a given period.

Historical Results of Operations of KGen for the Three Months Ended September 30, 2009 compared to the Three Months Ended September 30, 2008.

Total adjusted margin decreased $7.9 million, or 16%, to $41.4 million for the three months ended September 30, 2009 compared to the same period in the previous year as a result of a $7.2 million decrease in merchant margin and a $0.7 million decrease in adjusted contracted margin. The $41.4 million in total adjusted margin was comprised of $11.5 million in merchant margin and $29.9 million in adjusted contracted margin.

Merchant margin decreased $7.2 million, or 39%, to $11.5 million for the three months ended September 30, 2009. The $7.2 million decrease was made up of a $2.8 million decrease in merchant energy margin and a $4.4 million decrease in merchant capacity sales. The $2.8 million decrease in merchant energy margin related primarily to the significant decrease in natural gas prices, as evidenced by the 66% decrease in the average Henry Hub gas price from $9.15 per MMbtu to $3.15 per MMbtu for the three months ended September 30, 2009 as compared to the previous year. In our markets, merchant energy margins are in part a function of natural gas prices and the market heat rates. Thus, lower gas prices at the same level of market heat rates will yield lower merchant energy margins. There was an increase in merchant generation of 63% from 913 GWh to 1,491 GWh which was a result of additional "must run" and 24 hour monthly block sales as compared to the three months ended September 30, 2008. We believe that lower natural gas prices were in part a factor in the increased monthly sales opportunities for our plants and that such prices enabled our combined-cycle plants to displace more expensive generation sources in the market. The $4.4 million decrease in merchant capacity sales was attributable to lower priced merchant capacity sales during the three months ended September 30, 2009 compared to the June through September 2008 time period. Despite the increase in generation for the three months ended September 30, 2009 when compared to the previous year, the implied merchant spark spread, or merchant margin divided by merchant generation, decreased from $20.50 per MWh to $7.71 per MWh, largely due to the decrease in merchant capacity sales and the effects of lower gas prices.

Adjusted contracted margin decreased $0.7 million, or 2%, to $29.9 million for the three months ended September 30, 2009, which was comprised of $3.7 million in adjusted contracted energy margin and $26.2 million in adjusted contracted capacity sales. The $0.7 million decrease was made up of a $1.2 million decrease in the adjusted contracted energy margin offset by a $0.5 million increase in the adjusted contracted capacity sales. The $1.2 million decrease in adjusted contracted energy margin was largely attributable to lower revenues from the GPC PPA as a result of lower natural gas prices also offset by ~~in~~ the reduction of costs of replacement power purchased in connection with the GPC PPA for the three months ended September 30, 2009 as compared to the previous year. The $0.5 million increase in adjusted contracted capacity sales was a result of the escalation of the pricing in the GPC PPA.

Adjusted plant expenses decreased by $0.5 million, or 4%, to $13.1 million for the three months ended September 30, 2009. The decrease was primarily related to a $0.3 million decrease in auxiliary power and a $0.3 million decrease in taxes other than income taxes for the three months ended September 30, 2009 compared to the same period in the previous year.

As a result of the foregoing changes in total adjusted margin and adjusted plant expenses, adjusted plant EBITDA decreased by $7.3 million to $28.3 million for the three months ended September 30, 2009.

Adjusted corporate expenses decreased by $1.3 million, or 33%, to $2.6 million for the three months ended September 30, 2009. This decrease was primarily related to a $0.2 million decrease in noncash employee options expense, $0.3 million decrease in payroll expenses, a $0.5 million decrease in legal and professional service expenses, and a $0.5 million decrease in Fortis marketing fees.

As a result of the foregoing, adjusted EBITDA decreased by $6.1 million to $25.7 million for the three months ended September 30, 2009.

GAAP to Non-GAAP Adjusted EBITDA Reconciliation

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

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008
Net income after taxes	$13,613	$ 3,520
Add: Interest expense	3,599	3,311
Less: Net interest income	—	(260)
Add: Depreciation	6,125	6,100
Add: Power sales rights and obligations amortization	2,028	2,028
Add: Gas transportation noncash amortization	301	294
Less: Noncash deferred capacity revenue	(8)	(459)
Add: Other expenses	69	1,034
EBITDA	25,727	15,568
Add: Major maintenance expense	(402)	15,628
Add: Noncash employee options/awards expense	375	573
Add: Employee severance expense	1	—
Adjusted EBITDA	25,701	31,769
Add: Selling, general and administrative expense	2,965	4,384
Less: Noncash employee options/awards expense	(375)	(573)
Less: Employee severance expense	(1)	—
Add: D&O insurance expense	46	101
Adjusted plant EBITDA	$28,336	$35,681

The following describes changes to specified financial measures of our performance. As indicated above, in calculating our adjusted EBITDA, we make adjustments to our net income after taxes using these financial measures for the three months ended September 30, 2009 compared to the three months ended September 30, 2008.

- Interest expense for the three months ended September 30, 2009 was $3.6 million compared to $3.3 million for the same period in 2008. In order to more accurately reflect our financing costs for the three months ended September 30, 2009, we have elected to move losses on derivatives from the other expense line and reflect them in the interest expense line of our condensed consolidated statement of operations. The $0.3 million increase was made up of $1.6 million in losses on derivatives associated with our interest rate hedging due to cash payments on our Swaps, offset by a $1.3 million decrease in interest expense due to a reduction in interest rates and outstanding debt compared to the same period in the previous year.

- Interest income was zero and $0.3 million for the three months ended September 30, 2009 and 2008, respectively. The decrease in interest income related to lower interest rates, lower average cash balances, and higher banking fees compared to the same period in the previous year.
- Depreciation was $6.1 million for both three month periods.
- Amortization of contract-based power sales rights and obligations, for both three month periods, was $2.0 million and was recorded as a reduction of energy sales.
- Amortization of contract-based natural gas transportation rights and obligations, for both three month periods, was $0.3 million and was recorded as an increase of gas transportation expense.
- Noncash deferred capacity revenue of approximately $8,000 and $0.5 million was recorded as capacity sales for the three months ended September 30, 2009 and 2008, respectively.
- Other expense for the three months ended September 30, 2009 and 2008 was $0.1 million and $1.0 million, respectively. The $0.1 million related to various financing fees and the $1.0 million related to losses on derivatives associated with our interest rate hedging due to cash payments on our Swaps. For the three months ended September 30, 2009, the losses on derivatives were moved to the interest expense line of our condensed consolidated statement of operations.
- Major maintenance consisted of income of $0.4 million and expense of $15.6 million for the three months ended September 30, 2009 and 2008, respectively. The $0.4 million income related to a credit from GE for repair work at Murray I. The $15.6 million expense primarily related to scheduled major maintenance outages at Murray II.
- Noncash employee options/awards expense for the three months ended September 30, 2009 and 2008 was $0.4 million and $0.6 million, respectively, and was recorded as an increase of selling, general, and administrative expense.
- Selling, general, and administrative expense was $3.0 million and $4.4 million for the three months ended September 30, 2009 and 2008, respectively. This decrease was primarily related to a $0.5 million decrease in legal and professional service expenses, and a $0.5 million decrease in Fortis marketing fees, a $0.3 million decrease in payroll expenses, and a $0.2 million decrease in noncash employee options/awards expense.

Liquidity and Capital Resources

Liquidity Position

We expect that cash on hand, cash flow provided by operations, and cash available under our Credit Facility will satisfy our short-term liquidity needs with respect to our current portfolio of working capital assets over the next 12 months. Our liquidity was comprised of the following at September 30, 2009 (in thousands of dollars):

Unrestricted cash and cash equivalents	$ 65,206
Working capital revolver and synthetic letter of credit facility (net of letters of credit issued and cash draws thereunder)	62,126
Total	$127,332

Our principal sources of funds are cash flows from operations and borrowings under our Credit Facility. Our principal use of funds consists of operating expenditures, payments of principal and interest on our Credit Facility, and capital expenditures. On September 30, 2009, we had $62.1 million available under our Credit Facility, of which $62.0 million was under the working capital revolver and $0.1 million was under the synthetic letter of credit facility, for activities related to our plants. We had cash on hand of

$65.2 million, of which $31.0 million was cash at the parent level and not subject to the lien of the Credit Agreement at September 30, 2009. Similarly, $32.0 million was the balance at the parent level not subject to the credit agreement at June 30, 2009. Management believes that cash on hand, amounts available under our Credit Facility, and cash flows from operations will be adequate to finance capital expenditures and other liquidity commitments over the next 12 months.

Debt and Credit Facility

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

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

Borrowings under the Term Loan Facility were made 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. The proceeds of the drawdown are for working capital purposes. Total letters of credits issued under the Working Capital Facility were $8.0 million as of September 30, 2009. Total letters of credit issued under the Collateral Credit Facility were $119.9 million as of September 30, 2009.

Interest Rate. Borrowings under the Credit Facility bear interest at a spread above LIBOR-based loans. The $200.0 million Term Loan Facility bears interest at LIBOR plus 175 basis points. Please refer to "Number 3. *Quantitative and Qualitative Disclosures About Market Risk*." 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 $31.0 million at September 30, 2009 that was held at our parent company level.

The Credit Facility and related financing documents contain various affirmative and negative covenants, including (a) financial covenants, (b) limitations on KGen LLC's ability to pay dividends, (c) restrictions on the use of available cash for operations, except as required for debt service payments and, (d) an event of default in the event of a change in control of KGen. At September 30, 2009, we were in compliance with the covenants contained within our Credit Facility.

Capital Expenditures and Major Maintenance

Total capital expenditures for the three months ended September 30, 2009 and 2008 were $1.1 million and $0.3 million, respectively.

Major maintenance was income of $0.4 million and expense of $15.6 million for the three months ended September 30, 2009 and 2008, respectively. The $0.4 million income related to a credit from GE for repair work at Murray I. The $15.6 million expense primarily related to scheduled major maintenance outages at Murray II.

We incur costs for major maintenance on the Plants which is expensed in the period incurred. We expect to incur major maintenance expense of $22.1 million for the remainder of fiscal 2010.

Cash Flow Analysis

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

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008
Statement of Cash Flow Data:		
Cash flows provided by (used in):		
Operating activities	$25,202	$18,996
Investing activities	(159)	15,761
Financing activity	(500)	(500)
Increase in cash and cash equivalents	24,543	34,257
Cash and cash equivalents at beginning of period	40,663	51,493
Cash and cash equivalents at end of period	$65,206	$85,750

Cash Flows from Operating Activities. Our cash flows from operations were $25.2 million for the three months ended September 30, 2009, primarily related to net income of $13.6 million, depreciation expense of $6.1 million, amortization expense of $2.3 million, valuation of derivative instruments of $1.6 million, collections of accounts receivable of $9.3 million, and an increase in prepaid expenses and other current assets of $1.2 million which was offset primarily by payments from settlement of derivatives instruments of $1.6 million, a decrease in spare parts inventories of $1.2 million, and a decrease in accounts payable and accrued liabilities of $6.7 million. We also incurred $1.8 million of cash interest during the period under our outstanding Credit Facility.

Cash Flows from Investing Activities. Our cash flows used in investing activities for the three months ended September 30, 2009 were $0.2 million and related to purchases of property, plant, and equipment.

Cash Flows from Financing Activity. Our cash flows used in financing activity for the three months ended September 30, 2009 were $0.5 million and represented $0.5 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. The terms of our Credit Facility require us to maintain interest hedge arrangements through the third anniversary of the closing date of our Credit Facility on at least fifty percent of our outstanding term debt balance to reduce our exposure to market risk from changes in the interest rate. As a result, we have entered into interest rate swaps in order to mitigate the risk associated with the variable rate borrowings.

KGen LLC has four current interest rate swap agreements, or Swaps. These Swaps are intended to hedge the risk associated with variable interest rates. For each of the Swaps, the Company has historically paid its counterparty the equivalent of a fixed interest payment on a predetermined notional value, and we received the equivalent of a floating interest payment based on three-month LIBOR rate calculated on the same notional value. These payments were made on a quarterly basis. During the year ended June 30, 2009, the Company and its counterparty amended the Swaps to reduce the Company's fixed rate payment component and change the basis of the counterparty's floating rate payments. We now 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 September 30, 2009 was $132.0 million with an average interest rate payable by KGen LLC of 5.0%. The following is a summary of the Swaps:

	Maturity Date	Notional Amount	September 30, 2009		June 30, 2009	
			Fair Value	Fixed Rate	Fair Value	Fixed Rate
		(in millions)	(in thousands)		(in thousands)	
Contract #1	Expired	$ —	$ —		$ —	
Contract #2	Expired	$ —	$ —		$ —	
Contract #3	3-31-2010	$33.0	$ (641)	4.9%	$ (922)	4.9%
Contract #4	3-31-2011	$33.0	$(1,757)	5.0%	$(1,869)	5.0%
Contract #5	3-31-2012	$33.0	$(2,572)	5.0%	$(2,455)	5.0%
Contract #6	3-31-2013	$33.0	$(3,046)	5.1%	$(2,778)	5.1%

As of September 30, 2009, the majority of our exposure to variation in interest costs associated with our debt due to changes in the LIBOR rate has been hedged 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.

PART II—OTHER INFORMATION

Number 1A. Risk Factors and Forward-Looking Statements

Risk Factors

The following risk factor below updates Part I. "Number 1A. *Risk Factors*" of our Annual Report for the year ended June 30, 2009 as a result of executing new agreements with NAES.

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

We currently have few employees of our own and are dependent on contractual arrangements with third parties for the operation and maintenance of our Plants. Currently all of our Plants are operated by

DEGS under operating and maintenance agreements. Upon termination of the applicable agreements with DEGS, NAES will operate our Hinds, Hot Spring and Sandersville Plants, In addition, GEI provides maintenance services to our combined-cycle plants under LTSAs. Fortis acts as commercial marketer for the power produced by four of the Plants other than the Murray I plant. Procurement of fuel for the Plants, except for sales under the GPC PPA for Murray I and natural gas supply from Sequent for Murray I, is provided by Fortis. Currently, Fortis and Sequent provide significant credit to us which allows us to transact without providing additional financial collateral. In the event that their credit policies toward us change or these agreements terminate, we may be unable to obtain an agreement with another energy service provider on similarly favorable terms and this could have a significant impact on our ability to procure fuel and meet our power generation targets. While we believe that such contractual arrangements allow us to leverage our management team and have allowed us to operate more effectively and efficiently, in the event we have a significant disagreement with DEGS, NAES, GEI, Sequent or Fortis that interrupts one of their services or one of these providers experiences financial difficulties that adversely affect their ability to provide services, our results of operations, financial condition and cash flows may be adversely affected. In this regard, DEGS and Fortis both have the right to terminate their agreements with us at their convenience. In addition, although we seek to align our interests contractually, there may be conflicts of interest and one of these parties may take actions that are not in our best interests. We do not have the internal operating capability to perform the services that we outsource, and to develop such capabilities would be time consuming and expensive. However, based upon discussions with potential alternative providers, we believe that multiple options for a replacement energy management service provider and a replacement operations and maintenance service provider are available to KGen. However, we cannot be certain that these providers will deliver their services to us on the same terms as our current providers.

It is our intent that Fortis passes through the actual price of power and costs of fuel that it receives from its counterparties through mirroring back-to-back transactions and not make any additional revenues by inserting an additional margin on these transactions. However, not all transactions are totally transparent (particularly when sales or purchases are made to and from Fortis' own trading book), and although we have the ultimate authority for all transactions, the possibility exists that our future sales margins may be materially reduced by Fortis' pricing.

Forward-Looking Statements

The discussion in this report contains certain forward-looking statements that involve risks and uncertainties. We have based these forward-looking statements on our current expectations and assumptions about future events. In some cases, you can identify forward-looking statements by terminology, such as "may," "should," "could," "predict," "potential," "continue," "expect," "anticipate," "future," "intend," "plan," "believe," "estimate," "forecast" and similar expressions (or the negative of such expressions.) Forward-looking statements include statements concerning known and unknown risks, uncertainties and other important factors that could cause actual results, performance or achievements of KGen and its subsidiaries to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Forward-looking statements are based on our beliefs as well as assumptions based on information currently available to us, including financial and operational information, the volatility of our stock price, current competitive conditions, and anticipated demand for electricity. As a result, these statements are subject to various risks and uncertainties. For a discussion of material risks and uncertainties that the Company faces, see the discussion above and the "Cautionary Statement concerning Forward-Looking Statements" and Part I. "Number 1A. *Risk Factors*" in our Annual Report for the fiscal year ended June 30, 2009.