NRG ENERGY, INC.
Form 10-Q
August 04, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended: June 30, 2006 **Commission File Number: 001-15891**

NRG Energy, Inc.
(Exact name of Registrant as specified in its charter)

Delaware	**41-1724239**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
211 Carnegie Center Princeton, New Jersey	**08540**
(Address of principal executive offices)	(Zip Code)

(609) 524-4500
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ **No** o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12 b-2 of the Exchange Act).

Large accelerated filer þ **Accelerated filer o** **Non-accelerated filer** o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o **No þ**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15 (d) of the Securities and Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes þ **No** o

As of August 2, 2006, there were 137,015,810 shares of common stock outstanding, par value $0.01 per share.

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CAUTIONARY STATEMENT REGARDING FORWARD LOOKING INFORMATION

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. The words believes , projects , anticipates , plans , expects intends , estimates and similar expressions are intended to identify forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause NRG Energy, Inc. s actual results, performance and achievements, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statement. These factors, risks and uncertainties include the factors described under Risks Related to NRG Energy, Inc. in Item 1A of NRG Energy, Inc. s 2005 Annual Report on Form 10-K and the following:

General economic conditions, changes in the wholesale power markets and fluctuations in the cost of fuel or other raw materials;

Hazards customary to the power production industry and power generation operations such as fuel and electricity price volatility, unusual weather conditions, catastrophic weather-related or other damage to facilities, unscheduled generation outages, maintenance or repairs, unanticipated changes to fuel supply costs or availability due to higher demand, shortages, transportation problems or other developments, environmental incidents, or electric transmission or gas pipeline system constraints and the possibility that NRG Energy, Inc. may not have adequate insurance to cover losses as a result of such hazards;

The effectiveness of NRG Energy Inc. s risk management policies and procedures, and the ability of NRG Energy, Inc. s counterparties to satisfy their financial commitments;

Counterparties collateral demands and other factors affecting NRG Energy, Inc. s liquidity position and financial condition;

NRG Energy, Inc. s ability to operate its businesses efficiently, manage capital expenditures and costs tightly (including general and administrative expenses), and generate earnings and cash flow from NRG Energy, Inc. s asset-based businesses in relation to the Company debt and other obligations;

NRG Energy, Inc. s potential inability to enter into contracts to sell power and procure fuel on terms and prices acceptable to us;

The liquidity and competitiveness of wholesale markets for energy commodities;

Government regulation, including compliance with regulatory requirements and changes in market rules, rates, tariffs and environmental laws;

Price mitigation strategies and other market structures employed by independent system operators or ISO, or regional transmission organizations that result in a failure to adequately compensate the Company s generation units for all of their costs;

NRG Energy, Inc. s ability to borrow additional funds and access capital markets, as well as NRG Energy, Inc s substantial indebtedness and the possibility that NRG Energy, Inc. may incur additional indebtedness going forward;

Operating and financial restrictions placed on NRG Energy, Inc. contained in the indentures governing NRG Energy Inc. s 7.25% and 7.375% unsecured senior notes due 2014 and 2016, respectively, in NRG Energy, Inc. s senior secured credit facility and in debt and other agreements of certain of the NRG Energy, Inc. subsidiaries and project affiliates generally; and

NRG Energy, Inc. s ability to achieve the objectives of its development programs.

Forward-looking statements speak only as of the date they were made, and NRG Energy, Inc. undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The foregoing review of factors that could cause NRG Energy, Inc. s actual results to differ materially from those contemplated in any forward-looking statements included in this Quarterly Report on Form 10-Q should not be construed as exhaustive.

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GLOSSARY OF TERMS

When the following terms and abbreviations appear in the text of this report, they have the meanings indicated below:

Acquisition	February 2, 2006 acquisition of Texas Genco LLC
Acquisition Agreement	Acquisition Agreement dated September 30, 2005 underlying the February 2, 2006 acquisition of Texas Genco LLC, now referred to as NRG Texas
APB 18	Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*
BTA	Best Technology Available
BTU	British Thermal Unit
CAA	Clean Air Act
CAIR	Clean Air Interstate Rule
Cal ISO	California Independent System Operator.
CDWR	California Department of Water Resources
CL&P	Connecticut Light & Power
DNREC	Delaware Department of Natural Resources and Environmental Control
EFOR	Equivalent Forced Outage Rates considers the equivalent impact that forced de-ratings have in addition to full forced outages
EITF 02-3	Emerging Issues Task Force Issue No. 02-3, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*
EPA	Environmental Protection Agency
ERCOT	Electric Reliability Council of Texas, the Independent System Operator and the regional reliability coordinator of the various electricity systems within Texas
FASB	Financial Accountings Standards Board
FERC	Federal Energy Regulatory Commission
Fresh Start	Reporting requirements as defined by SOP 90-7
ISO	Independent System Operator, also referred to as regional transmission organizations, or RTO
ISO-NE	ISO New England, Inc.
LIBOR	London Inter-Bank Offered Rate
MDE	Maryland Department of the Environment
MWh	Saleable megawatt hours net of internal/parasitic load megawatt-hours
NiMo	Niagara Mohawk Power Corporation
NOx	Nitrogen oxides
NOL	Net operating loss
NQSO	Non-qualified stock option
NYISO	New York Independent System Operator
NYSDEC	New York Department of Environmental Conservation
OCI	Other Comprehensive Income
PJM	PJM Interconnection, LLC
PJM Market	The wholesale and retail electric market operated by PJM primarily in all or parts of Delaware, the District of Columbia, Illinois, Maryland, New Jersey, Ohio, Pennsylvania, Virginia and West Virginia
Powder River Basin, or PRB Coal	Coal produced in the northeastern Wyoming and southeastern Montana, which has low sulfur content
PUCT	Public Utility Commission of Texas
RMR	Reliability must-run

SEC	United States Securities and Exchange Commission
Sellers	Former holders of Texas Genco LLC shares
SFAS	Statement of Financial Accounting Standards issued by the FASB
SFAS 71	SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*
SFAS 109	SFAS No. 109, *Accounting for Income Taxes*
SFAS 123 (R)	SFAS No. 123 (revised 2004), *Share-Based Payment*
SFAS 133	SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*
SFAS 141	SFAS No. 141, *Business Combinations*
SFAS 142	SFAS No. 142, *Goodwill and Other Intangible Assets*
SFAS 143	SFAS No. 143, *Accounting for Asset Retirement Obligations*
SFAS 144	SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*
SO_2	Sulfur dioxide
SOP 90-7	Statement of Position 90-7 *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code*
STP	South Texas Project NRG Texas s nuclear generating facility located in Bay City, TX of which NRG has a 44% ownership interest
NRG Texas	Texas Genco LLC
US	United States of America
USEPA	United States Environmental Protection Agency
US GAAP	Accounting principles generally accepted in the US
WCP	WCP (Generation) Holdings, Inc.

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PART I FINANCIAL INFORMATION

Item 1 Condensed Consolidated Financial Statements and Notes

NRG ENERGY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended June 30		Six months ended June 30	
(In millions, except for per share amounts)	**2006**	**2005**	**2006**	**2005**
Operating Revenues				
Revenues from majority-owned operations	$ 1,423	$ 522	$ 2,513	$ 1,070
Operating Costs and Expenses				
Cost of majority-owned operations	746	387	1,447	796
Depreciation and amortization	178	41	297	83
General, administrative and development	83	50	143	97
Corporate relocation charges		1		4
Total operating costs and expenses	1,007	479	1,887	980
Operating Income	416	43	626	90
Other Income (Expense)				
Equity in earnings of unconsolidated affiliates	8	16	29	53
Write downs and gains on sales of equity method investments	14	12	11	12
Other income, net	8	6	88	31
Refinancing expense			(178)	(35)
Interest expense	(152)	(46)	(266)	(98)
Total other expense	(122)	(12)	(316)	(37)
Income From Continuing Operations Before Income Taxes	294	31	310	53
Income Tax Expense	90	8	89	14
Income From Continuing Operations	204	23	221	39
Income/(loss) from discontinued operations, net of income tax expense/(benefit)	(1)	1	8	8
Net Income	203	24	229	47
Dividends for Preferred Shares	13	4	23	8
Income Available for Common Stockholders	$ 190	$ 20	$ 206	$ 39
Weighted Average Number of Common Shares Outstanding Basic	137	87	127	87

Income From Continuing Operations per Weighted Average Common Share Basic	$ 1.39	$ 0.22	$ 1.55	$ 0.35
Income/(loss) From Discontinued Operations per Weighted Average Common Share Basic	(0.01)	0.01	0.06	0.09
Net Income per Weighted Average Common Share Basic	$ 1.38	$ 0.23	$ 1.61	$ 0.44
Weighted Average Number of Common Shares Outstanding Diluted	159	88	148	88
Income From Continuing Operations per Weighted Average Common Share Diluted	$ 1.26	$ 0.21	$ 1.47	$ 0.34
Income/(loss) From Discontinued Operations per Weighted Average Common Share Diluted		0.01	0.05	0.09
Net Income per Weighted Average Common Share Diluted	$ 1.26	$ 0.22	$ 1.52	$ 0.43

See notes to condensed consolidated financial statements.

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NRG ENERGY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(in millions, except shares and par value)	June 30, 2006 (unaudited)	December 31, 2005
ASSETS		
Current Assets		
Cash and cash equivalents	$ 957	$ 493
Restricted cash	58	49
Accounts receivable, less allowance for doubtful accounts of $2 and $2	473	259
Inventory	402	242
Derivative instruments valuation	528	387
Collateral on deposits in support of energy risk management activities	209	438
Prepayments and other current assets	187	188
Current assets held-for-sale		43
Current assets discontinued operations	96	98
Total current assets	2,910	2,197
Property, plant and equipment, net of accumulated depreciation of $668 and $343	11,815	2,620
Other Assets		
Equity investments in affiliates	307	603
Notes receivable, less current portion	480	458
Goodwill	1,462	
Intangible assets, net of accumulated amortization of $131and $79	1,182	257
Nuclear decommissioning trust fund	326	
Derivative instruments valuation	191	18
Funded letter of credit		350
Deferred income taxes	42	26
Other non-current assets	242	124
Intangible assets held-for-sale	66	
Non-current assets discontinued operations	419	813
Total other assets	4,717	2,649
Total Assets	$ 19,442	$ 7,466
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Current portion of long-term debt and capital leases	$ 125	$ 95
Accounts payable	340	247
Derivative instruments valuation	640	679
Accrued expenses and other current liabilities	467	174

Current liabilities discontinued operations		58		162
Total current liabilities		1,630		1,357
Other Liabilities				
Long-term debt and capital leases		7,631		2,410
Nuclear decommissioning reserve		226		
Nuclear decommissioning trust liability		325		
Deferred income taxes		152		129
Derivative instruments valuation		398		56
Out-of-market contracts		2,320		298
Other non-current liabilities		378		170
Non-current liabilities discontinued operations		278		568
Total non-current liabilities		11,708		3,631
Total Liabilities		13,338		4,988
Minority Interest		1		1
3.625% Convertible perpetual preferred stock (at liquidation value, net of issuance costs)		246		246
Commitments and Contingencies				
Stockholders Equity				
Preferred stock (at liquidation value, net of issuance costs)		892		406
Common Stock; $.01 par value; 500,000,000 shares authorized; 136,979,082 and 80,701,888 outstanding		1		1
Additional paid-in capital		4,454		2,431
Retained earnings		374		261
Less treasury stock, at cost 0 and 19,346,788 shares				(663)
Accumulated other comprehensive income/(loss)		136		(205)
Total stockholders equity		5,857		2,231
Total Liabilities and Stockholders Equity	$	19,442	$	7,466

See notes to condensed consolidated financial statements.

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NRG ENERGY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In millions)	**Six months ended June 30 2006**	**2005**
Cash Flows from Operating Activities		
Net income	$ 229	$ 47
Adjustments to reconcile net income to net cash provided by operating activities		
Distributions in excess of equity in earnings of unconsolidated affiliates	(13)	16
Depreciation and amortization	308	96
Amortization of financing costs and debt discount	16	5
Amortization of intangibles and out-of-market contracts	(211)	15
Amortization of unearned equity compensation	9	5
Write-off of deferred financing costs and debt premium	47	(8)
Write down and gains on sale of equity method investments	(11)	(12)
Deferred income taxes	96	(4)
Nuclear decommissioning trust liability	3	
Minority interest		1
Loss on sale of equipment	3	
Unrealized (gains)/losses on derivatives	(114)	82
Gain on legal settlement	(67)	(14)
Gain on sale of discontinued operations	(10)	
Gain on sale of emission allowances	(67)	
Collateral deposit payments in support of energy risk management activities	272	(179)
Cash provided by changes in other working capital, net of acquisition and disposition affects	114	41
Net Cash Provided by Operating Activities	604	91
Cash Flows from Investing Activities		
Acquisition of Texas Genco LLC, net of cash acquired	(4,303)	
Acquisition of WCP, net of cash acquired	(25)	
Decrease/(Increase) in restricted cash and trust funds, net	(9)	26
Decrease in notes receivable	14	93
Investments in nuclear decommissioning trust fund securities	(106)	
Purchases of emission allowances	(78)	
Sales of emission allowances	84	
Proceeds from sale of equipment	1	
Proceeds on sale of investments	86	65
Proceeds on sale of discontinued operations	15	
Proceeds from sales of nuclear decommissioning trust fund securities	103	
Return of capital from equity method investments and projects		1
Capital expenditures	(74)	(37)
Net Cash Provided/(Used) by Investing Activities	(4,292)	148
Cash Flows from Financing Activities		
Payment of dividends to preferred stockholders	(23)	(8)
Funded letter of credit	350	

Issuance of common stock, net of issuance costs	986	
Issuance of preferred shares, net of issuance costs	486	
Deferred debt issuance costs	(164)	(1)
Proceeds from issuance of long-term debt, net	7,175	204
Principal payments on short and long-term debt	(4,662)	(722)
Net Cash Provided/(Used) by Financing Activities	4,148	(527)
Change in Cash from Discontinued Operations	1	(3)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	3	(1)
Net Increase (Decrease) in Cash and Cash Equivalents	464	(292)
Cash and Cash Equivalents at Beginning of Period	493	1,071
Cash and Cash Equivalents at End of Period	$ 957	$ 779

See notes to condensed consolidated financial statements.

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NRG ENERGY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 Basis of Presentation

NRG Energy, Inc., NRG , we , us or the Company , is a wholesale power generation company, primarily engaged the ownership and operation of power generation facilities, the transacting in and trading of fuel and transportation services, and the marketing and trading of energy, capacity and related products in the United States.

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with the Securities and Exchange Commission s regulations for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. The accounting policies NRG follows are set forth in Note 1, *Summary of Significant Accounting Policies,* to the Company s financial statements in its Annual Report on Form 10-K for the year ended December 31, 2005. The following notes should be read in conjunction with such policies and other disclosures in the Form 10-K for the fiscal year ended December 31, 2005. Interim results are not necessarily indicative of results for a full year.

In the opinion of management, the accompanying unaudited interim condensed consolidated financial statements contain all material adjustments (consisting of normal, recurring accruals) necessary to fairly present NRG s consolidated financial position as of June 30, 2006, the results of NRG s operations for the three months and six months ended June 30, 2006 and 2005, and NRG s cash flows for the six months ended June 30, 2006 and 2005. Certain prior-year amounts have been reclassified for comparative purposes.

Use of Estimates

The preparation of consolidated financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions impact the reported amount of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the consolidated financial statements. They also impact the reported amount of net earnings during the reporting period. Actual results could be different from these estimates.

Emission Allowances

NRG actively manages its SO_2 emission allowances as well as fuels and accounts for this asset optimization activity related to emission allowances and other fuel commodities under EITF Issue No. 02-3, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*. As such, revenues and costs for these activities are reflected on a net basis in the consolidated statement of operations. Emission allowances allocated for trading are considered to be intangible assets held for sale and are valued at the lower of their weighted average cost or market. In accordance with their classification as intangible assets, purchases and sales of emissions allowances are classified as an investing activity with the corresponding gains and/or losses on the sales recorded as an adjustment to operating activity in the consolidated statement of cash flows.

Goodwill and Intangible Assets

Goodwill is the excess of the purchase price of an acquired business over the fair value of the net assets acquired. NRG accounts for goodwill and other intangibles under the provisions of SFAS 142, *Goodwill and Other Intangible Assets,* and consequently NRG does not amortize goodwill. SFAS 142 requires us to evaluate goodwill and other intangibles for impairment at least annually or more often if events and circumstances such as adverse changes in the business climate, indicate there maybe impairment. Goodwill is impaired if the carrying value of the business exceeds its fair value. Annually, NRG estimates the fair value of the businesses the Company has acquired using estimated future cash flows or other methods to assess fair value. If the estimated fair value of the business is less than its carrying value, an impairment loss is required to be recognized to the extent that the carrying value of goodwill is greater than its fair value. SFAS 142 also requires the amortization of intangible assets with finite lives.

New Accounting Pronouncements

NRG adopted SFAS 123(R) and Staff Accounting Bulletin 107, or SAB 107, on January 1, 2006 under a modified version of prospective application, or the modified prospective method. Under the modified prospective method, NRG applied the provisions of SFAS 123(R) to new awards of stock-based compensation and to awards modified, repurchased, or cancelled after the required effective date. SFAS 123(R) requires that NRG apply a forfeiture rate to existing awards and to calculate the retroactive impact of such application. If material, NRG must recognize in income the cumulative effect of this as a change in accounting principle as of the required effective date. Upon adoption of SFAS 123(R) on January 1, 2006, NRG applied a forfeiture rate to the Company s existing awards and recognized in income approximately $1.1 million (net of tax of $0.8 million) as a reduction to compensation expense for

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the six months ended June 30, 2006. This amount did not materially affect the Company s consolidated financial position, results of operations or statement of cash flows for the six months ended June 30, 2006.

On January 1, 2006, NRG adopted EITF Issue No. 04-6 *Accounting for Stripping Costs Incurred during Production in the Mining Industry*, or EITF 04-6. EITF 04-6 provides that costs incurred to remove overburden and waste material to access coal seams, or stripping costs; during the production phase of a mine are variable production costs that should be included in the costs of the inventory produced during the period that the stripping costs are incurred. EITF 04-6 is effective for the first reporting period in fiscal years beginning after December 15, 2005. MIBRA GmbH, or MIBRAG, in which NRG holds a 50% equity investment, has mining operations which were negatively affected by this pronouncement. As of December 31, 2005, MIBRAG had capitalized costs totaling approximately $185 million (157 million), representing the stripping costs incurred during production as of December 31, 2005. As a result of the Adoption of EITF 04-6, such costs are no longer allowed to be capitalized and in accordance with the new pronouncement, were written off to retained earnings. The adoption of EITF 04-6 did not have a material impact on NRG s consolidated results of operations, but did have a material impact on NRG s consolidated financial position. Following adoption on January 1, 2006, NRG s investment in MIBRAG was reduced by 50% of the above mentioned asset, approximately $93 million after tax, with an offsetting charge to retained earnings.

On January 1, 2006, NRG adopted EITF Issue No. 05-5, *Accounting for Early Retirement or Post-employment Programs with Specific Features (Such As Terms Specified in Altersteilzeit Early Retirement Arrangements)*, or EITF 05-5. EITF 05-5 provides guidance on the accounting for early retirement or post-employment programs with specific features, and specifically the terms of Altersteilzeit early retirement arrangements. The Altersteilzeit (ATZ) arrangement is a voluntary early retirement program in Germany designed to create an incentive for employees, within a certain age group, to transition from employment into retirement before their legal retirement age. If certain criteria are met by the employer, the German government provides to the employer a subsidy for bonuses paid to the employee and the additional contributions paid by the employer into the German government pension scheme under an ATZ arrangement for a maximum of six years. The Task Force reached a consensus that the employer should recognize the government subsidy when it meets the necessary criteria and is entitled to the subsidy. The Task Force also reached a consensus that payments made by the employer relative to the bonus feature and the additional contributions into the German government pension scheme (collectively, the additional compensation) should be accounted for as a post-employment benefit under SFAS No. 112, *Employers Accounting for Post-employment Benefits*, which prescribes that an entity should recognize the additional compensation over the period from the point at which the employee signs the ATZ contract until the end of the active service period. Upon adoption of EITF 05-5 on January 1, 2006, NRG recognized additional equity in earnings of unconsolidated affiliates of approximately $2.1 million, after tax, from the Company s MIBRAG interest. This amount reflects the cumulative effect of the adoption of EITF 05-5, and did not materially affect NRG s consolidated financial position, results of operations or statement of cash flows for the period ending June 30, 2006.

During the first quarter of 2006, the FASB issued SFAS No. 155 *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements Nos. 133 and 140*, or SFAS 155. This statement allows fair value measurement of certain financial instruments, and eliminates certain exemptions from fair value measurement found within SFAS 133. The fair value election would not be available for hybrid instruments with embedded derivative features that are not required to be bifurcated, such as those that are clearly and closely related to the host instrument, or hybrid instruments with an embedded derivative that is eligible for one of FAS 133 s scope exceptions. This statement is effective for all financial instruments acquired, issued, or subject to a re-measurement (new basis) event occurring after the beginning of the first fiscal year that begins after September 15, 2006. NRG does not expect this guidance to materially affect the Company s consolidated financial position, results of operations or statement of cash flows.

In July 2006, the FASB issued FASB Interpretation Number 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*, or FIN 48. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return, including a decision as to whether to file or not to file in a particular jurisdiction. FIN 48 is effective for fiscal years beginning after December 15, 2006. If there are changes in net assets as a result of application of FIN 48 these are to be accounted for as an adjustment to retained earnings. NRG is currently assessing the impact of FIN 48 on its consolidated financial position.

Note 2 Comprehensive Income/(Loss)

	Three months ended June 30		Six months ended June 30	
(In millions)	**2006**	**2005**	**2006**	**2005**
Net Income	$ 203	$ 24	$ 229	$ 47
Unrealized gain/(loss) from derivative activity	57	(4)	304	(86)
Foreign currency translation adjustment	34	(27)	37	(50)
Other comprehensive income/(loss), net of tax	$ 91	$ (31)	$ 341	$ (136)
Comprehensive income/(loss)	$ 294	$ (7)	$ 570	$ (89)

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Accumulated other comprehensive income/ (loss) as of June 30, 2006 was as follows:

(In millions) As of June 30	2006
Accumulated other comprehensive loss as of December 31, 2005	$ (205)
Unrealized gain from derivative activity	304
Foreign currency translation adjustments	37
Accumulated other comprehensive income as of June 30, 2006	$ 136

Note 3 Business Acquisitions and Dispositions

Acquisition of Texas Genco LLC and Related Financing

On February 2, 2006, NRG acquired Texas Genco LLC, pursuant to an Acquisition Agreement, dated September 30, 2005. As such, the results of Texas Genco LLC have been included in the consolidated financial statements since February 2, 2006. The purchase price of approximately $6.2 billion consisted of approximately $4.4 billion in cash, the issuance of approximately 35.4 million shares of NRG s common stock valued at approximately $1.7 billion and acquisition costs of approximately $0.1 billion. This amount is subject to adjustment due to additional acquisition costs. The value of NRG s common stock issued to the Sellers was based on NRG s average stock price immediately before and after the closing date of February 2, 2006. The acquisition also included the assumption of approximately $2.7 billion of Texas Genco LLC debt. Texas Genco LLC is now a wholly-owned subsidiary of NRG, and is being managed and accounted for as a new business segment referred to as NRG Texas.

The acquisition of Texas Genco LLC and related financing activities were funded at closing with a combination of (i) cash proceeds received upon the issuance and sale in a public offering of 20,855,057 shares of NRG s common stock at a price of $48.75 per share; (ii) cash proceeds received upon the issuance and sale of $1.2 billion aggregate principal amount of 7.25% Senior Notes due 2014 and $2.4 billion aggregate principal amount of 7.375% Senior Notes due 2016; (iii) cash proceeds received upon the issuance and sale in a public offering of 2,000,000 shares of mandatory convertible preferred stock at a price of $250 per share; (iv) funds borrowed under a new senior secured credit facility consisting of a $3.6 billion term loan facility, a $1.0 billion revolving credit facility and a $1.0 billion synthetic letter of credit facility; and (v) cash on hand.

NRG Texas is the second-largest generation company in the ERCOT market and the largest owner of power plants in Houston. NRG Texas currently operates 48 operating generation units at nine power generation plants, including an undivided 44% interest in two nuclear generation units at STP. The aggregate net generation capacity at NRG Texas is 10,776 MW, which includes 5,296 MW of low marginal cost solid fuel and nuclear powered baseload plants. Similar to the rest of NRG, NRG Texas is a wholesale power generator whose principal business is selling electric wholesale power produced by power plants to wholesale purchasers such as retail electric providers, power trading organizations and other power generation companies.

The acquisition of Texas Genco LLC was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on the estimated fair value of such assets and liabilities as of February 2, 2006. Since it is difficult to estimate an allocation of the purchase price without completed asset appraisals, NRG has made a preliminary allocation. The excess of the purchase price over the fair value of the net tangible and identified intangible assets acquired is goodwill. The allocation of the purchase price may be adjusted if additional information on known contingencies existing at the date of acquisition becomes available within one year after the acquisition, and longer for certain income tax items. Changes in the allocation between the preliminary assessed goodwill and plant or other intangibles would result in a change in non-cash amortization expense.

The preliminary purchase price allocation is still subject to change due to additional acquisition costs. Certain asset sales, including the sale of the Webster Electric Generating Station that closed on April 7, 2006, were included as part of the working capital adjustments which were finalized on May 5, 2006.

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The following table summarizes the preliminary fair value of the assets acquired and liabilities assumed at the date of the acquisition. For purposes of acquisition costs, NRG has estimated acquisition costs of approximately $129 million, thereby, increasing the total purchase price to approximately $6.2 billion.

(In millions) As of February 2,	**2006**
Assets	
Current and non-current assets	$ 830
Coal inventory	33
In-market contracts	
Power contracts	39
Water contracts	64
Coal contracts	100
Nuclear fuel contracts	48
SO_2 emission allowances	530
NOx emission allowances	320
Property, plant and equipment	9,348
Deferred tax asset	1,560
Goodwill	1,462
Total assets acquired	14,334
Liabilities	
Current and non-current liabilities	872
Pension and post-retirement liability	213
Out-of-market contracts:	
Coal	150
Gas swaps	472
Power contracts	2,100
Deferred tax liability	1,560
Long term debt	2,735
Total liabilities assumed	8,102
Net assets acquired	$ 6,232

The value of goodwill is still subject to change as the Company is still in the process of valuing all assets and liabilities acquired. NRG is also in the process of valuing the tax basis of the assets and liabilities acquired which will affect the deferred tax balances. Any changes to the fair value assessments and tax basis values will affect the final balance of goodwill.

The following table summarizes the change in the value of goodwill during the three month period ended June 30, 2006:

(In millions)	
Goodwill balance at March 31, 2006	$ 2,748
Increase in fixed assets per valuation	(918)
Net decrease in intangibles and other contracts per valuation	256

Adjustment to deferred tax assets and liabilities		(624)
Impact to goodwill due to changes in valuation		(1,286)
Goodwill balance at June 30, 2006	$	1,462

The changes in value for fixed assets, identifiable intangibles and deferred taxes are due to several factors, including the following:

Changes in the forecasted projected price of electricity, coal and emission allowances;

The tax basis of the assets and liabilities acquired is more accurate, but still subject to revision; and

More precise information with respect to identifiable tangible and intangibles assets.

Currently, NRG has valued goodwill at approximately $1.5 billion. NRG s preliminary appraisal of Property, Plant and Equipment increased its fair value, compared to Texas Genco LLC s historical cost, by approximately $5.7 billion. If the remaining goodwill balance is indicative of a further increase in value of depreciable property plant and equipment, depreciation expense for the three months and six months ended June 30, 2006 would increase by approximately $21 million and $35 million, respectively, reducing income from continuing operations before tax for the three and six months ended June 30, 2006 to approximately $273 million and $275 million, respectively.

Acquisition of Remaining 50% interest in WCP

On December 27, 2005, NRG entered into purchase and sale agreements for projects co-owned with Dynegy, Inc and these agreements were consummated on March 31, 2006. NRG acquired Dynegy s 50% ownership interest in WCP (Generation) Holdings, Inc., or WCP, and became the sole owner of WCP s 1,808 MW of generation capacity in Southern California. In addition, NRG sold to Dynegy its 50% ownership interest in Rocky Road Power LLC, or Rocky Road, a 330 MW gas-fueled, simple cycle peaking plant located in Dundee, Illinois. In 2005, NRG wrote down the Company s investment in Rocky Road by approximately $20 million to reflect the sale price of $45 million. NRG paid Dynegy a net purchase price of $160 million at closing.

Prior to the purchase, NRG had an existing investment in WCP accounted for as an unconsolidated equity method investment. The book value of NRG s investment prior to the purchase was approximately $159 million. The acquisition of the remaining 50% interest in WCP was accounted for as a step acquisition as the Company s original equity investment was initiated in a prior period. The purchase price of each acquisition is determined separately per the consideration given at the date of each transaction, and therefore the purchase price allocation is determined separately based on the fair value of the percentage of net assets acquired at the date of each transaction.

NRG s consolidated balance sheet as of June 30, 2006 assumes that the consideration paid below the historical book value of net assets acquired is related to the reduction in fair value of WCP s fixed assets. Once the WCP asset appraisals are final, the purchase price allocation may change significantly from the amounts included herein based on the results of appraisals, changes in forecasted prices and an analysis of the income tax effect of the acquisition.

The following summarizes the preliminary purchase price and allocation impact of the WCP acquisition as of March 31, 2006:

(In millions) As of March 31,	**2006**
Current assets	$ 296
Property, plant and equipment	81
Intangible assets	15
Current liabilities	(25)
Non-current liabilities	(3)
Total Equity	$ 364

Supplemental Pro Forma Information

The following supplemental pro forma information represents the results of operations as if NRG, NRG Texas and WCP had combined at the beginning of the respective reporting periods.

(In millions)	**Three months ended June 30 2005**	**Six months ended June 30 2006**	**Six months ended June 30 2005**
Operating revenues	$ 1,134	$ 2,771	$ 2,351
Net income/(loss)	125	(97)	188
Earnings/(loss) per share Basic	0.99	(0.91)	1.47
Earnings/(loss) per share Diluted	0.98	(0.91)	1.46
Weighted average number of shares outstanding Basic	122.4	133.6	122.4
Weighted average number of shares outstanding Diluted	123.1	133.6	123.1

The pro forma net loss for the six months ended June 30, 2006 reflects the following nonrecurring expenses incurred by Texas Genco LLC before February 2, 2006:

(In millions)	
Equity compensation costs incurred due to immediate vesting of equity compensation awards under change of control provisions	$ 271
Professional fees and other acquisition-related costs	61
Total	$ 332

Other Business Events

Padoma On July 14, 2006, NRG announced the completion of the acquisition of privately-held Padoma Wind Power LLC, or Padoma, a wind farm developer, whose principals have developed, financed, built and operated more than 40 wind farms in the U.S. and Europe. Padoma will maintain its headquarters in La Jolla, California and will operate as a subsidiary of NRG.

Gladstone On June 8, 2006, NRG announced the sale of the Company s 37.5% equity interest in the Gladstone power station, or Gladstone, and its associated 100% owned NRG Gladstone Operating Services to Transfield Services, an Australia-based provider of operations, maintenance, ownership and asset management services for a purchase price of approximately $174 million (AU$239 million) subject to customary purchase price adjustments, plus assumption of NRG s share of Gladstone s unconsolidated debt and cash of approximately $56 million (AU$ 77 million) and approximately $26 million (AU$35 million), respectively. After tax cash proceeds are expected to be in excess of $171 million (AU$ 234 million). NRG is seeking to close the transaction during the fourth quarter of 2006, but considerable uncertainty remains over NRG s ability to satisfy certain conditions particularly the securing of certain consents and waivers from the other owners of the project. As a result, NRG Gladstone Operating Services has not been classified as discontinued operations.

Flinders On June 1, 2006, NRG entered into a sale and purchase agreement to sell its 100% owned Flinders power station and related assets or Flinders, located near Port Augusta, Australia to Babcock & Brown Power Pty, a subsidiary of Babcock & Brown, a global investment and advisory firm, for a purchase price of approximately $231 million (AU$317 million), subject to customary purchase price adjustments, plus the assumption of approximately $174 million (AU$238 million) of non-recourse debt obligations and approximately $31 million (AU$42 million) in cash. The sale is subject to customary approvals, including third party approvals. NRG anticipates closing the transaction during the third quarter of 2006.

Audrain On March 29, 2006, NRG completed the sale of the Audrain generating station, a gas-fired peaking facility in Vandalia, Missouri, to AmerenUE, a subsidiary of Ameren Corporation. The purchase price was $115 million, subject to customary purchase price adjustments, plus AmerenUE s assumption of $240 million of non-recourse capital lease obligations and assignment of a $240 million note receivable. Of the $115 million in cash proceeds, approximately $20 million was paid to NRG. The sale process removed approximately $412 million of assets and liabilities. Of this amount, $355 million remained on NRG s balance sheet as of December 31, 2005, categorized as discontinued operations.

As further discussed in Note 4 below, the activities of Flinders and Audrain have been classified as discontinued operations.

Note 4 Discontinued Operations

NRG has classified certain business operations, and gains/(losses) recognized on sale, as discontinued operations for businesses that were sold or have met the required criteria for such classification. The financial results for all of these businesses have been accounted for as discontinued operations. Accordingly, current period operating results and prior periods have been restated to report the operations as discontinued.

Statement of Financial Accounting Standards No. 144, or SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* requires that discontinued operations be valued on an asset-by-asset basis at the lower of carrying amount or fair value less costs to sell. In applying those provisions, NRG s management considered cash flow analysis and offers related to the assets and businesses. This amount is included in income/(loss) from discontinued operations, net of income taxes in the accompanying condensed consolidated statements of operations. In accordance with SFAS No. 144, assets held for sale will not be depreciated commencing with their classification as such.

The assets and liabilities reported in the balance sheet as of December 31, 2005 as discontinued operations represent disposed operations of entities discussed in Note 3. Total cash proceeds received were approximately $115 million for both the three and six months ended June 30, 2006. There were no cash proceeds received for the three and six months ended 2005. A gain on the sale of Audrain of approximately $10 million was recognized for the three and six months ended of June 30, 2006. There were no gain or loss on the sale of discontinued operations for the three and six months ended June 30, 2005.

For the three and six months ended June 30, 2006, discontinued operations consisted of activity related to Flinders and Audrain as noted above. For the three and six months ended June 30, 2005, discontinued operations consisted of activity related to Flinders, Audrain and NRG McClain.

Summarized results of operations of discontinued operations were as follows:

(In millions)	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
Operating revenues	$ 57	$ 63	$ 111	$ 116
Pre-tax income/(loss) from operations of discontinued operations	(3)	2	(3)	7
Income/(loss) from discontinued operations, net of income taxes	(1)	1	8	8

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Note 5 Write Downs and Gains/(Losses) on Sales of Equity Method Investments

Write downs and gains/(losses) on sales of equity method investments recorded in the condensed consolidated statement of operations include the following:

(In millions)	Three months ended June 30 2006	Three months ended June 30 2005	Six months ended June 30 2006	Six months ended June 30 2005
Latin American funds or SLAP	$ 3	$	$ 3	$
James River			(3)	
Cadillac	11		11	
Enfield		12		12
Total write downs and gains on sales of equity method investments	$ 14	$ 12	$ 11	$ 12

SLAP On June 30, 2006, NRG, through its wholly-owned entities NRG Caymans-C and NRG Caymans-P completed the sale of its remaining interests in various Latin American power funds to a subsidiary of Australia Post. Total proceeds received were approximately $22.6 million and a pre-tax gain of approximately $2.9 million was recognized in the second quarter of 2006.

James River On May 15, 2006, NRG completed the sale of Capistrano Cogeneration Company, a subsidiary of NRG which owned a 50% interest in James River to Cogentrix. The proceeds from the sale were approximately $8 million. During the first quarter of 2006, NRG wrote down the value of its equity investment in James River by approximately $3 million. The sale resulted in no gain or loss to NRG.

Cadillac On January 1, 2006, NRG sold its 49.5% interest in a 38MW biomass fuel generation facility located in Cadillac, Michigan, along with its right to receive Production Tax Credits, or PTCs, through 2009 to Lakes Renewable LLC. In consideration, NRG received an up-front payment of $0.3 million, approximately $4 million in a note receivable and a promissory note equal to the value of its share in future PTCs earned through 2009. The sale was contingent on the receipt of a favorable private letter ruling from the IRS and accordingly, all consideration was to be held in escrow. On April 13, 2006, NRG sold its remaining 0.5% share in Cadillac along with its interest in the notes receivable and promissory note to Delta Power for approximately $11 million, resulting in a pre-tax gain of approximately $11 million.

Note 6 Investments Accounted for by the Equity Method

As of December 31, 2005, NRG had a 50% interest in both MIBRAG and WCP, which were considered significant, as defined by applicable SEC regulations. As discussed in Note 3, NRG acquired the remaining 50% interest in WCP on March 31, 2006 and no longer qualified for accounting per the equity method. As of June 30, 2006, the only equity investment which was considered significant was NRG s 50% interest in MIBRAG.

MIBRAG Summarized Financial Information

For the three and six months ended June 30, 2006, NRG recorded equity earnings for MIBRAG of $2 million and $14 million, respectively. For the three months ended June 30, 2005 NRG recorded equity earnings for MIBRAG of a loss of $1 million but recorded a gain of $8 million for the six months ended June 30, 2005. The following table summarizes the results of operations for MIBRAG, including interests owned by NRG and other parties for the periods shown below:

Results of Operations (in millions)	Three months ended June 30 2006	Three months ended June 30 2005	Six months ended June 30 2006	Six months ended June 30 2005
Operating revenues	$ 105	$ 92	$ 214	$ 204

Operating income	9	4	39	26
Net income	5		29	16

As discussed in Note 1, NRG adopted EITF 04-6 as of January 1, 2006, which negatively affected NRG s equity investment in MIBRAG. As of December 31, 2005, MIBRAG had an asset which totaled approximately $185 million (157 million), this represented stripping costs incurred during mining operations, net of depreciation. Per the guidance of EITF 04-6, upon its adoption, the value of such stripping cost is to be eliminated with an offsetting charge to retained earnings. As such, NRG s investment in MIBRAG has been reduced by 50% of the above mentioned asset, approximately $93 million after tax, with an offsetting charge to retained earnings.

Note 7 Accounting for Derivative Instruments and Hedging Activities

SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* or SFAS 133, as amended, requires us to recognize all derivative instruments on the balance sheet as either assets or liabilities and measure them at fair value each reporting period. If certain conditions are met, NRG may be able to designate the Company s derivatives as cash flow hedges and defer the effective

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portion of the change in fair value of the derivatives in OCI and subsequently recognize in earnings when the hedged items impact income. The ineffective portion of a cash flow hedge is immediately recognized in income.

For derivatives designated as hedges of the fair value of assets or liabilities, the changes in fair value of both the derivative and the hedged item are recorded in current earnings. The ineffective portion of a hedging derivative instrument s change in fair value will be immediately recognized in earnings.

For derivatives that are neither designated as cash flow hedges nor qualify for hedge accounting treatment, the changes in the fair value will be immediately recognized in earnings. Under the guidelines established by SFAS 133, as amended, certain derivative instruments may qualify for the normal purchase and sale exception and are therefore exempt from fair value accounting treatment. SFAS 133 applies to NRG s energy related commodity contracts, interest rate swaps and foreign exchange contracts.

As the Company engages principally in the trading and marketing of its generation assets, most of NRG s commercial activities qualify for hedge accounting under the requirements of SFAS 133. In order to so qualify, the physical generation and sale of electricity must be highly probable at inception of the trade and throughout the period it is held, as is the case with the Company s base-load coal plants. For this reason, trades in support of the Company s peaking units will not generally qualify for hedge accounting treatment and any changes in fair value are likely to be reflected on a mark-to-market basis in the statement of operations. The majority of trades in support of the Company s base-load coal units will normally qualify for hedge accounting treatment and any fair value movements will be reflected in the balance sheets as part of OCI.

Derivative Impact to Accumulated Other Comprehensive Income

The following table summarizes the effects of SFAS 133 on NRG s OCI balance attributable to hedged derivatives for the three months ended June 30, 2006:

(In millions)	**Energy Commodities**	**Interest Rate**	**Total**
Accumulated OCI balance at March 31, 2006	$ 3	$ 48	$ 51
Realized from OCI during the period:			
Due to realization of previously deferred amounts	20	(1)	19
Mark-to-market of hedge contracts (net of tax)	6	32	38
Accumulated OCI balance at June 30, 2006	$ 29	$ 79	$ 108
Gains/(Losses) expected to be realized from OCI during the next 12 months	$ (16)	$ 2	$ (14)

The following table summarizes the effects of SFAS 133 on NRG s OCI balance attributable to hedged derivatives for the six months ended June 30, 2006:

(In millions)	**Energy Commodities**	**Interest Rate**	**Total**
Accumulated OCI balance at December 31, 2005	$ (204)	$ 8	$ (196)
Realized from OCI during the period:			
Due to realization of previously deferred amounts	11	(3)	8
Mark-to-market of hedge contracts (net of tax)	222	74	296
Accumulated OCI balance at June 30, 2006	$ 29	$ 79	$ 108

The following table summarizes the effects of SFAS 133 on NRG s OCI balance attributable to hedged derivatives for the three months ended June 30, 2005:

(In millions)	**Energy Commodities**	**Interest Rate**	**Total**
Accumulated OCI balance at March 31, 2005	$ (88)	$ 13	$ (75)
Realized from OCI during the period:			
Due to realization of previously deferred amounts	1		1
Mark-to-market of hedge contracts (net of tax)	10	(15)	(5)
Accumulated OCI balance at June 30, 2005	$ (77)	$ (2)	$ (79)

The following table summarizes the effects of SFAS 133 on NRG s OCI balance attributable to hedged derivatives for the six months ended June 30, 2005:

(In millions)	**Energy Commodities**	**Interest Rate**	**Total**
Accumulated OCI balance at December 31, 2004	$ 5	$ 2	$ 7
Realized from OCI during the period:			
Due to realization of previously deferred amounts	(2)	1	(1)
Mark-to-market of hedge contracts (net of tax)	(80)	(5)	(85)
Accumulated OCI balance at June 30, 2005	$ (77)	$ (2)	$ (79)

Losses of $19 million and $8 million were reclassified from OCI to current period earnings during the three and six months ended June 30, 2006, respectively, compared to a loss of $1 million and a gain of $1 million during the three and six months ended June 30, 2005, respectively, due to the unwinding of previously deferred amounts. These amounts are recorded on the same line in the statement of operations in which the hedged items are recorded. Also during the three and six months ended June 30, 2006, the Company recorded gains in OCI of approximately $38 million and $296 million, respectively, compared to losses of $6 million and $85 million for the three and six months ended June 30, 2005, respectively, related to changes in the fair values of derivatives accounted for as hedges. The net balance in OCI relating to SFAS 133 as of June 30, 2006 was an unrecognized gain of approximately $108 million. Over the next 12 months it is expected that $14 million of net losses recorded in OCI at June 30, 2006, will be recognized in earnings.

Derivative Impact to the Statement of Operations

The following table summarizes the pre-tax effects of non-hedge derivatives and derivative activities that do not qualify as hedges on NRG s statement of operations for the three months ended June 30, 2006:

(In millions)	Energy Commodities	Interest Rate	Total
Revenue from majority-owned subsidiaries	$ 67	$	$ 67
Equity in earnings of unconsolidated subsidiaries			
Cost of operations			
Interest Expense			
Total statement of operations impact before tax	$ 67	$	$ 67

With the reclassification of Flinders as a discontinued operation, previously designated cash flow hedges were no longer effective beyond the expected date of sale and thus the deferred gain previously recorded in OCI of approximately $11 million was recognized as a derivative gain for the three months ended June 30, 2006, and is included in income from discontinued operations.

The following table summarizes the pre-tax effects of non-hedge derivatives and derivative activities that do not qualify as hedges on NRG s statement of operations for the six months ended June 30, 2006:

(In millions)	Energy Commodities	Interest Rate	Total
Revenue from majority-owned subsidiaries	$ 117	$	$ 117
Equity in earnings of unconsolidated subsidiaries			
Cost of operations			
Interest expense		3	3
Total statement of operations impact before tax	$ 117	$ (3)	$ 114

With the reclassification of Flinders as a discontinued operation, previously designated cash flow hedges were no longer effective beyond the expected date of sale and thus the deferred gain previously recorded in OCI of approximately $11 million was recognized as a derivative gain for the six months ended June 30, 2006, and is included in income from discontinued operations.

The following table summarizes the pre-tax effects of non-hedge derivatives and derivative activities that do not qualify as hedges on NRG s statement of operations for the three months ended June 30, 2005:

(In millions)	Energy Commodities	Interest Rate	Total
Revenue from majority-owned subsidiaries	$	$	$
Equity in earnings of unconsolidated subsidiaries			
Cost of operations	3		3
Interest expense			
Total statement of operations impact before tax	$ (3)	$	$ (3)

The following table summarizes the pre-tax effects of non-hedge derivatives and derivative activities that do not qualify as hedges on NRG s statement of operations for the six months ended June 30, 2005:

(In millions)	Energy Commodities	Interest Rate	Total
Revenue from majority-owned subsidiaries	$ (86)	$	$ (86)
Equity in earnings of unconsolidated subsidiaries	12		12
Cost of operations	1		1
Interest expense			
Total statement of operations impact before tax	$ (75)	$	$ (75)

Energy Related Commodities

As part of NRG s risk management activities, NRG manages the commodity price risk associated with the Company s competitive supply activities and the price risk associated with power sales from NRG s electric generation facilities. In doing so, the Company may enter into a variety of derivative and non-derivative instruments, including the following:

- Forward contracts, which commit NRG to purchase or sell energy commodities in the future.
- Futures contracts, which are exchange-traded standardized commitments to purchase or sell a commodity or financial instrument.
- Swap agreements, which require payments to or from counter-parties based upon the differential between two prices for a predetermined contractual (notional) quantity.
- Option contracts, which convey the right to buy or sell a commodity, financial instrument, or index at a predetermined price.

The objectives for entering into such hedges include:

- Fixing the price for a portion of anticipated future electricity sales at a level that provides an acceptable return on the Company s electric generation operations.
- Fixing the price of a portion of anticipated fuel purchases for the operation of NRG s power plants.
- Fixing the price of a portion of anticipated energy purchases to supply NRG s load-serving customers.

Ineffectiveness will result from a difference in the relative price movements between a financial transaction and the underlying physical pricing point. If this difference is large enough, it will cause an entity to discontinue the use of hedge accounting. During the three and six months ended June 30, 2006, NRG s pre-tax earnings were affected by an unrealized gain of $44 million and $36 million, respectively, due to the ineffectiveness associated with financial forward contracted electric sales.

For the three and six months ended June 30, 2006, NRG s pre-tax earnings were affected by an unrealized gain of $67 million and $117 million, respectively, associated with changes in the fair value of energy related derivative instruments not accounted for as hedges in accordance with SFAS 133. For the three and six months ended June 30, 2005, NRG s pre-tax earnings were affected by unrealized losses of $3 million and $75 million, respectively, associated with changes in the fair value of energy-related derivative instruments not accounted for as hedges in accordance with SFAS No. 133.

For the three and six months ended June 30, 2006, NRG reclassified losses of $20 million and $11 million, from OCI to current period earnings. For the three and six months ended June 30, 2005, NRG reclassified losses of $1 million and gains of $2 million, respectively, from OCI to current period earnings on energy-related derivative instruments accounted for as hedges.

At June 30, 2006, NRG had hedge and non-hedge energy related commodity contracts extending through December 31, 2026.

Interest Rates

NRG is exposed to changes in interest rates through the Company s issuance of variable rate and fixed rate debt. In order to manage this interest rate risk, NRG entered into interest-rate swap agreements. In January 2006, in anticipation of the New Senior Credit Facility, NRG entered into a series of forward starting interest rate swaps intended to hedge the variability in cash flows associated with this debt issuance. These transactions were designated as cash flow hedges with any gains/(losses) deferred on the balance sheet in OCI. In February 2006, with the completion of the sale of the Senior Notes, the Company designated fixed-to-floating interest rate swap as a hedge of fair value changes in the Senior Notes. This interest rate swap was previously designated as a hedge of NRG s 8% Second Priority Notes which were effectively replaced by the Senior Notes. For the three months ended June 30, 2006, NRG did not recognize any ineffectiveness associated with this hedging relationship. For the six months ended

June 30, 2006, NRG recognized $3 million in ineffectiveness associated with this hedging relationship. NRG does not foresee any ineffectiveness of this hedging relationship in the future.

As of June 30, 2006, all of NRG s interest rate swap arrangements had been designated as either cash flow or fair value hedges.

For the three and six months ended June 30, 2006, NRG reclassified $1 million and $3 million, respectively, from OCI to current period earnings and expects to reclassify approximately $2 million of deferred gains to earnings during the next twelve months associated with interest rate swaps accounted for as hedges.

At June 30, 2006, NRG had interest rate derivative instruments extending through June 2019.

Foreign Currency Exchange Rates

To preserve the U.S. dollar value of projected foreign currency cash flows, NRG may hedge, or protect those cash flows if appropriate using available foreign currency hedging instruments. In connection with the sale of Flinders as discussed in Note 3, NRG purchased an option to protect against any negative adverse affects from the exchange rate related to the proceeds from the sale. As of June 30, 2006, the results of any outstanding foreign currency exchange contracts were immaterial to NRG s financial results.

Note 8 Long-Term Debt

Cash Tender Offer and Consent Solicitation

On December 15, 2005, NRG commenced a cash tender offer and consent solicitation for any and all outstanding $1.1 billion aggregate principal amount of the Company s 8% Second Priority Notes. On that date, NRG also commenced a cash tender offer and consent solicitation for any and all outstanding $1.1 billion aggregate principal amount of Texas Genco and Texas Genco Financing Corp. s 6.875% senior notes due 2014, or the Texas Genco Notes. The offer to purchase the 8% Second Priority Notes and the Texas Genco Notes was part of NRG s previously announced financing plan in connection with the acquisition of Texas Genco LLC. As of February 2, 2006, NRG had received valid tenders from holders in aggregate principal amount of the 8% Second Priority Notes, representing approximately 99.96% of the outstanding 8% Second Priority Notes, and had received valid tenders from holders of the $1.1 billion in aggregate principal amount of the Texas Genco Notes, representing 100% of the outstanding Texas Genco Notes. The purchase price for the 8% Second Priority Notes of approximately $1.2 billion was paid by NRG on February 2, 2006 and included $0.1 billion prepayment penalty which was recorded in debt refinancing expense in the consolidated income statement. The purchase price for the Texas Genco Notes of approximately $1.2 billion was paid by NRG on February 3, 2006 and included $0.1 billion prepayment penalty which was recorded as an acquisition cost for the acquisition of NRG Texas.

New Senior Credit Facility

On February 2, 2006, NRG also entered into a new senior secured credit facility, or the New Senior Credit Facility, with a syndicate of financial institutions, including Morgan Stanley Senior Funding, Inc., as administrative agent, Morgan Stanley & Co., Inc., as collateral agent, and Morgan Stanley Senior Funding, Inc. and Citigroup Global Markets Inc. as joint lead book-runners, joint lead arrangers and co-documentation agents providing for up to an aggregate amount of $5.575 billion. The New Senior Credit Facility consisted of a $3.575 billion senior first priority secured term loan facility or the Term Loan Facility, a $1.0 billion senior first priority secured revolving credit facility, or the Revolving Credit Facility, and a $1.0 billion senior first priority secured synthetic letter of credit facility, or the Letter of Credit Facility. The New Senior Credit Facility replaced NRG s then existing senior secured credit facility. The Term Loan Facility will mature on February 1, 2013 and will amortize in 27 consecutive equal quarterly installments of 0.25% of the original principal amount of the Term Loan Facility, beginning June 30, 2006, with the balance payable on the seventh anniversary thereof. The full amount of the Revolving Credit Facility will mature on February 2, 2011. The Letter of Credit Facility will mature on February 1, 2013 and no amortization will be required in respect thereof. As of June 30, 2006, NRG had $3.6 billion outstanding under the Company s Term Loan Facility. As of June 30, 2006, NRG had issued $884 million under the Company s Letter of Credit Facility and $154 million in letters of credit under the Company s Revolving Credit Facility.

On January 31, 2006, NRG used proceeds from the issuance of common stock and cash on hand to repay the $446 million outstanding principal balance of NRG s senior secured term loan facility, along with accrued but unpaid interest of approximately $2 million, and terminated the facility. On February 2, 2006, NRG used proceeds from the new debt financing to pay accrued but unpaid fees on the Company s revolving credit facility and funded letter of credit, and terminated those facilities.

The New Senior Credit Facility is guaranteed by substantially all of NRG s existing and future direct and indirect subsidiaries, with certain customary or agreed-upon exceptions for unrestricted foreign subsidiaries, project subsidiaries and certain other subsidiaries. The capital stock of substantially all of NRG s subsidiaries, with certain exceptions for unrestricted subsidiaries, foreign subsidiaries and project subsidiaries, has been pledged for the benefit of the New Senior Credit Facility lenders.

The New Senior Credit Facility is also secured by first-priority perfected security interests in substantially all of the property and assets owned or acquired by NRG and its subsidiaries, other than certain limited exceptions. These exceptions include assets such as the assets of certain unrestricted subsidiaries, equity interests in certain of the Company s project affiliates that have non-recourse debt financing, and voting equity interests in excess of 66% of the total outstanding voting equity interest of certain of NRG s foreign subsidiaries.

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The New Senior Credit Facility contains customary covenants, which among other things require NRG to meet certain financial tests, including minimum interest coverage ratio and a maximum leverage ratio on a consolidated basis, and limit NRG s ability to:

- incur indebtedness and liens and enter into sale and lease-back transactions;
- make investments, loans and advances;
- engage in mergers, acquisitions, consolidations and asset sales;
- pay dividends and other restricted payments;
- enter into transactions with affiliates;
- engage in business activities and hedging transactions;
- make capital expenditures;
- make debt payments; and
- make certain changes to the terms of material indebtedness.

NRG however has the option to prepay the New Senior Credit Facility in whole or in part at any time.

In anticipation of the New Senior Credit Facility, in January 2006, NRG entered into a series of interest rate swaps. These interest rate swaps became effective on February 15, 2006 and are intended to hedge the risks associated with floating interest rates. For each of the interest rate swaps, the Company pays its counterparty the equivalent of a fixed interest payment on a predetermined notional value, and NRG receives quarterly the equivalent of a floating interest payment based on 3-month LIBOR calculated on the same notional value. All interest rate swap payments by NRG and its counterparties are made quarterly, and LIBOR is determined in advance of each interest period. 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 these swaps is $2.15 billion.

The notional amounts and maturities of each tranche of these swaps are as follows:

Period of swap	**Notional Value**	**Maturity**
1-year	$120 million	March 31, 2007
2-year	$140 million	March 31, 2008
3-year	$150 million	March 31, 2009
4-year	$190 million	March 31, 2010
5-year	$1.55 billion	March 31, 2011

Senior Notes

On February 2, 2006, NRG completed the sale of (i) $1.2 billion aggregate principal amount of 7.25% senior notes due 2014, or 7.25% Senior Notes, and (ii) $2.4 billion aggregate principal amount of 7.375% senior notes due 2016, or 7.375% Senior Notes, collectively called the Senior Notes. The Senior Notes were issued under an Indenture, dated

February 2, 2006, or the Indenture, between NRG and Law Debenture Trust Company of New York, as trustee, or the Trustee, as supplemented by a First Supplemental Indenture, dated February 2, 2006, between NRG, the Guarantors named therein and the Trustee, relating to the 7.25% Senior Notes, and as supplemented by a Second Supplemental Indenture, dated February 2, 2006, between NRG, the Guarantors named therein and the Trustee, relating to the 7.375% Senior Notes. On March 14, 2006, NRG executed a Third Supplemental Indenture and a Fourth Supplemental Indenture, whereby the recently acquired NRG Texas subsidiaries were added as Guarantors. On April 28, 2006, NRG executed a Fifth Supplemental Indenture and a Sixth Supplemental Indenture, whereby the WCP subsidiaries were added as Guarantors. The Indentures and the form of notes provide, among other things, that the Senior Notes will be senior unsecured obligations of NRG.

Interest is payable on the Senior Notes on February 1 and August 1 of each year beginning on August 1, 2006 until their maturity dates February 1, 2014 for the 7.25% Senior Notes and February 1, 2016 for the 7.375% Senior Notes. As of June 30, 2006, NRG had $3.6 billion in principal outstanding under the Company s Senior Notes.

At any time prior to February 1, 2009, NRG may redeem up to 35% of the aggregate principal amount of the series of Senior Notes with the net proceeds of certain equity offerings, at a redemption price of 107.25% of the principal amount, in the case of the 7.25% Senior Notes, and 107.375% of the principal amount, in the case of the 7.375% Senior Notes. In addition, NRG may redeem the 7.25% Notes and 7.375% Notes at the redemption prices expressed as a percentage of the principal amount redeemed set forth below, plus accrued and unpaid interest on the notes redeemed.

Prior to February 1, 2010 for the 7.25% Senior Notes or the First Applicable 7.25% Redemption Date, NRG may redeem all or a portion of the 7.25% Notes at a price equal to 100% of the principal amount plus a premium and accrued interest. The premium is the greater of (i) 1% of the principal amount of the note, or (ii) the excess of the principal amount of the note over the following: the present value of 103.625% of the note, plus interest payments due on the Note from the date of redemption through the First Applicable 7.25% Redemption Date, discounted at a Treasury rate plus 0.50%.

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The following table sets forth the premium upon redemption for the 7.25% Senior Notes.

Redemption Period	Premium as defined above
Prior to February 1, 2010	
February 1, 2010 to February 1, 2011	103.625%
February 1, 2011 to February 1, 2012	101.813%
February 1, 2012 and thereafter	100.000%

Prior to February 1, 2011 for the 7.375% Senior Notes or the First Applicable 7.375% Redemption Date, NRG may redeem all or a portion of the 7.375% Notes at a price equal to 100% of the principal amount plus a premium and accrued interest. The premium is the greater of (i) 1% of the principal amount of the note, or (ii) the excess of the principal amount of the note over the following: the present value of 103.688% of the note, plus interest payments due on the Note from the date of redemption through the First Applicable 7.375% Redemption Date, discounted at a Treasury rate plus 0.50%.

The following table sets forth the premium upon redemption for the 7.375% notes.

Redemption Period	Premium as defined above
Prior to February 1, 2011	
February 1, 2011 to February 1, 2012	103.688%
February 1, 2012 to February 1, 2013	102.458%
February 1, 2013 to February 1, 2014	101.229%
February 1, 2014 and thereafter	100.000%

The Indentures provide for customary events of default which include, among others, nonpayment of principal or interest; breach of other agreements in the Indentures; defaults in failure to pay certain other indebtedness; the rendering of judgments to pay certain amounts of money against NRG and its subsidiaries; the failure of certain guarantees to be enforceable; and certain events of bankruptcy or insolvency. Generally, if an event of default occurs, the Trustee or the Holders of at least 25% in principal amount of the then outstanding series of Senior Notes may declare all of the Senior Notes of such series to be due and payable immediately.

The terms of the Indentures, among other things, limit NRG s ability and certain of its subsidiaries ability to:

- make restricted payments;
- restrict dividends or other payments of subsidiaries;
- incur additional debt;
- engage in transactions with affiliates;
- create liens on assets;
- engage in sale and leaseback transactions; and
- consolidate, merge or transfer all or substantially all of NRG and its subsidiaries assets.

Debt of Discontinued Operations

As discussed in Note 3, NRG entered into a sale and purchase agreement on June 1, 2006 for the sale of Flinders to Babcock & Brown Power Pty. The sale of Flinders includes the assumption of $174 million (AU$238 million) of non-recourse debt obligations, subject to customary purchase price adjustments.

On March 29, 2006, NRG completed the sale of the Audrain Generating Station to AmerenUE, a subsidiary of Ameren Corporation. Included in the purchase was Ameren s assumption of $240 million of non-recourse capital lease obligations and assignment of a $240 million note receivable.

NRG Promissory Note

On June 5, 2006 NRG repaid the principal and interest at maturity on its outstanding $10 million note payable with Xcel Energy.

Note 9 Changes in Capital Structure

As of June 30, 2006, NRG had 10,000,000 authorized preferred shares, 2,670,000 of which have been issued and are outstanding. The outstanding preferred shares are comprised of: 420,000 of 4% Preferred Stock, 250,000 of 3.625% Preferred Stock and 2,000,000 5.75% Preferred Stock.

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5.75% Preferred Stock

On February 2, 2006, NRG completed the issuance of 2,000,000 shares of 5.75% mandatory convertible preferred stock, or the 5.75% Preferred Stock, at an offering price of $250 per share for total net proceeds after deducting offering expenses and underwriting discounts of approximately $486 million. Dividends on the 5.75% Preferred Stock are $14.375 per share per year, and are due and payable on a quarterly basis beginning on March 15, 2006. The 5.75% Preferred Stock will automatically convert into common stock on March 16, 2009, or the Conversion Date, at a rate that is dependent upon the applicable market value of NRG s common stock. If the applicable market value of NRG common stock is $60.45 a share or higher at the Conversion Date, then the 5.75% Preferred Stock is convertibl