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INITIATING COVERAGE

BUY (Speculative)

Calpine Generating Company, LLC CalGen Finance Corp.

Issue Size	Publicly-Traded Securities Outstanding	Rate	Maturity	Recent Quote	Current Yield	Call Date	Call Price	Credit Ratings
235.0	First Priority Secured Floating Rate Notes	L+375	1-Apr-09	NA	NA	1-Apr-07	102.5	B1/B+
640.0	Second Priority Secured Floating Rate Notes	L+575	1-Apr-10	98.000	8.48%	1-Apr-08	103.5	B2/B
680.0	Third Priority Secured Floating Rate Notes	L+900	1-Apr-11	95.000	12.17%	NC	NA	B3/CCC+
150.0	Third Priority Secured Notes	11.50%	1-Apr-11	93.000	12.37%	NC	NA	B3/CCC+

Executive Summary

Calpine Generating Company, LLC (CalGen), an indirect subsidiary of Calpine Corporation, owns 14 relatively new and fuel efficient merchant power plants with total baseload capacity of 8,425 megawatts, equal to about one-third of the total for Calpine. Along with its subsidiary, CalGen Finance, CalGen issued \$2.4 billion of First, Second and Third Priority Secured Floating Rate Notes and term loans in a private placement in March 2004 and subsequently registered the Notes with the SEC in October 2004.

Like other merchant power producers, CalGen and its parent Calpine have suffered over the past few years from overcapacity in wholesale electric power generation and rising natural gas prices, which together have caused spark spreads (i.e. the difference between electricity revenue and natural gas costs expressed on a per megawatt basis) to plummet. Although spark spreads have recovered modestly over the past year or so and futures markets suggest that they will increase sharply this summer, it is uncertain whether they will rise enough for CalGen to generate sustained profitability. Nevertheless, the superior fuel efficiency of CalGen's fleet and emerging industry trends, including environmental concerns, could lead to higher utilization rates for CalGen in the years ahead.

We recommend CalGen's First Priority and Second Priority Secured Floating Rate Notes due April 1, 2010 for purchase. The First Priority notes earn interest at LIBOR plus 375 basis points, which would be 6.84%, if reset today. The Second Priority Notes earn LIBOR plus 575 basis points which is 8.84% at current reset rates. The First Priority Notes have first claim on CalGen's operating assets in bankruptcy, while the Second Priority Notes are next in line. A financial covenant requires that the ratio of total outstanding First- and Second-Priority Notes and Term Loans to the company's combined estimated peak generating capacity not exceed \$235 per kilowatt. We believe that the First and Second Priority Notes have excess collateral protection, while the Third Priority Notes are probably just covered by current plant market values. Still, the Third Priority Notes have greater upside potential should spark spreads improve, which is likely for this summer at least, according to electricity and natural gas futures prices. Consequently, we also recommend the Third Priority Notes as a speculative investment.

See further important disclosures on the last page.

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Positives

1. Reasonable debt per MW levels. As of September 30, 2005, Calgen's level of First Priority and Second Priority debt was \$168,000 per megawatt of peak operating capacity, less than the effective prices recorded on several power plant transactions over the past few years. The cost of constructing new gas-fired plants is about \$500,000 or above. If spark spreads rise, the market value cushion of the collateral backing the First and Second Priority Notes will increase, as well.
2. Collateral/covenant protection. The Notes are secured by 13 of CalGen's 14 power plants with total baseload plus peaking capacity of 9,563 megawatts. This, we believe, should provide adequate support for payments of interest and principal on at least the First and Second Priority Notes. Under the indebtedness covenant on the Notes, we estimate that the company can add up to \$650 million of First and Second Priority debt, provided that it remains in compliance with interest coverage and other tests.
3. Fuel efficient fleet. CalGen's fleet has an average heat rate of 7.3 million BTUs/MWh, making it one of the most efficient users of natural gas in the nation. If natural gas and oil prices continue to rise, this will give CalGen an increasing advantage over older, natural gas-plants, which may comprise as much as one-third of the existing nationwide gas-fired capacity of about 210,000 MW. In addition, there is talk that FERC may eventually adopt merit order dispatch rules which would give priority access to transmission to the more efficient power producers.
4. Modern, natural gas-fired plants may gain favor because of environmental concerns and other factors. CalGen's plants are designed to reduce output of nitrogen oxide and several have installed equipment to reduce carbon dioxide emissions. Increasing concerns over SO₂, NO_x and mercury has prompted the EPA to adopt rules to require all coal plant producers to reduce their emissions over the next 10-15 years. Although critics charge that the EPA has relaxed existing requirements under the Clean Air Act, any spending by coal-fired producers to reduce emissions should lead to higher electricity prices and help to raise spark spreads.
5. Possible emerging tightness in electricity supply on the West coast and other markets. State regulators have raised concerns about possible summer shortages in California. In addition, a dry winter in the Northwest has reduced water supplies for hydroelectric power generation. This may help to improve utilization rates and spark spreads for gas-fired producers like CalGen. Futures rates suggest that spark spreads will increase significantly by the summer.
6. Possible additional financial support through Morgan Stanley hedge and subordinated working capital agreement. The index hedge guarantees a minimum aggregate spark spread of \$100 million annually until March 31, 2007. Combined with revenues from capacity sales and tolling agreements from third-parties and Calpine Energy Services (CES), this will help to ensure sufficient operating cash flow to meet interest requirement at least until 2007.

Negatives

1. Rising natural gas costs and flat electricity rates. High natural gas costs and flat electricity prices have kept spark spreads low, putting significant pressure on gas-fired producers. If futures markets are correct, rising electricity prices this summer should alleviate the situation at least temporarily. However, relative operating costs for coal-fired and nuclear plants will have to rise to put gas-fired plants on solid ground.

2. Low capacity utilization levels. A surge in construction of gas-fired plants since 1999 has caused substantial overcapacity, causing utilization rates to fall below 40%. With high natural gas prices, some owners have petitioned regulators to close their older, less efficient gas-fired plants, which could help reduce surplus capacity over time. A decline in new plant construction should help, as well. Even so, barring a dramatic change in industry conditions, the capacity glut is not expected to disappear until the end of the decade.
3. CalGen depends upon Calpine for most of its operations, including sales and marketing, administration, operation and new plant construction. This could make it more difficult and costly for secured creditors to seize their collateral in a bankruptcy to pursue other alternatives, including operating CalGen as a standalone business, should they find it necessary or desirable to do so.
4. A large portion of CalGen's profitability is capacity-based with prices set by regional indexes and does not reflect the actual underlying performance of the merchant plant fleet. Under the Index Based Gas Sale and Power Purchase Agreement, CES pays CalGen for its available capacity at a spark spread determined by reference to various regional indexes for electricity and natural gas prices. At current operating levels, we believe that this will result in payments to CalGen significantly above its current actual performance. Calpine can then recapture this extra payment through dividends from CalGen. In the short-run, this benefits Noteholders. In the long-run, unless Calpine is able to improve its overall operating performance, CalGen could face increasing demands and pressures from its parent.

Accounting/financial reporting issues

1. Inadequate MD&A disclosure. CalGen should disclose operating metrics, such as available megawatt hours, average spark spreads on merchant sales and natural gas volumes and prices, as well as aggregate fixed-price payments from third-parties and CES on a quarterly basis.
2. Natural gas cost transfer arrangements between CGC and CES represent a potential internal control weakness. If CalGen purchases natural gas from a third party, it is transferred to CES and then repurchased by CalGen before it is theoretically used in its plants.
3. No documentation available for MS Index-based hedge and subordinated working capital facility. Although the company provide some description for these instruments in its S-4, it should have also filed these documents as exhibits.

Business

Calpine Generating Company, LLC is a wholly-owned indirect subsidiary of Calpine Corporation. The company was formed to facilitate stand-alone financing for 14 of Calpine's natural gas-fired power plants. As of December 31, 2004, 13 of the plants were operating and one was under construction. All of the plants use energy efficient combined-cycle combustion turbines to generate power, except for the Zion Energy Center, a peaking facility which utilizes simple-cycle turbines. Data on CGC's power plants is given in the Table 1 below:

Table 1

Calpine Generating Company, LLC

Information on power plants owned

Power Plant	City	State	Date completed	Heat Rate (MMbtu/MWh)	Baseload capacity (MW)	Baseload w/ peaking (MW)	Total 2003 generation (MWh)	Calculated capacity utilization (%)
Morgan	Morgan Cty.	AL	Jan-04	7.19	722	852	95,457	1.28%
Decatur	Decatur	AL	Jun-03	7.41	793	852	429,220	5.75%
Delta	Pittsburgh	CA	Jun-02	7.15	799	882	5,440,349	70.41%
Los Medanos	Pittsburgh	CA	Aug-01	6.90	497	566	3,344,159	67.45%
Pastoria	Kern County	CA	Jun-05	6.98	759	769		
Zion Energy	Zion	IL	Jun-02	10.60		513	74,781	1.66%
Carville	St. Gabriel	LA	Jun-03	7.08	455	531	1,697,994	36.50%
Oneta	Coweta	OK	May-03	7.06	994	994	611,992	7.03%
Columbia	Columbia	SC	Mar-04	6.76	464	641		
Freestone	Fairfield	TX	Jul-02	6.95	1,022	1,022	4,930,706	55.07%
Baytown	Baytown	TX	Jun-02	7.00	742	830	5,045,069	69.39%
Channel	Houston	TX	Apr-02	6.95	527	574	3,144,479	62.54%
Corpus Christi	Corpus Christi	TX	Oct-02	6.78	414	537	1,854,208	39.42%
Goldendale	Goldendale	WA	Aug-04	7.34	237	271		
TOTALS/AVG.				7.30	8,425	9,834	26,668,414	37.34%

Source: Calpine's 2003 Annual Report, Calpine Generating Company's S-4 Amendment No. 1 filing (October 19, 2004), Calpine's web site and Robotti & Company calculations.

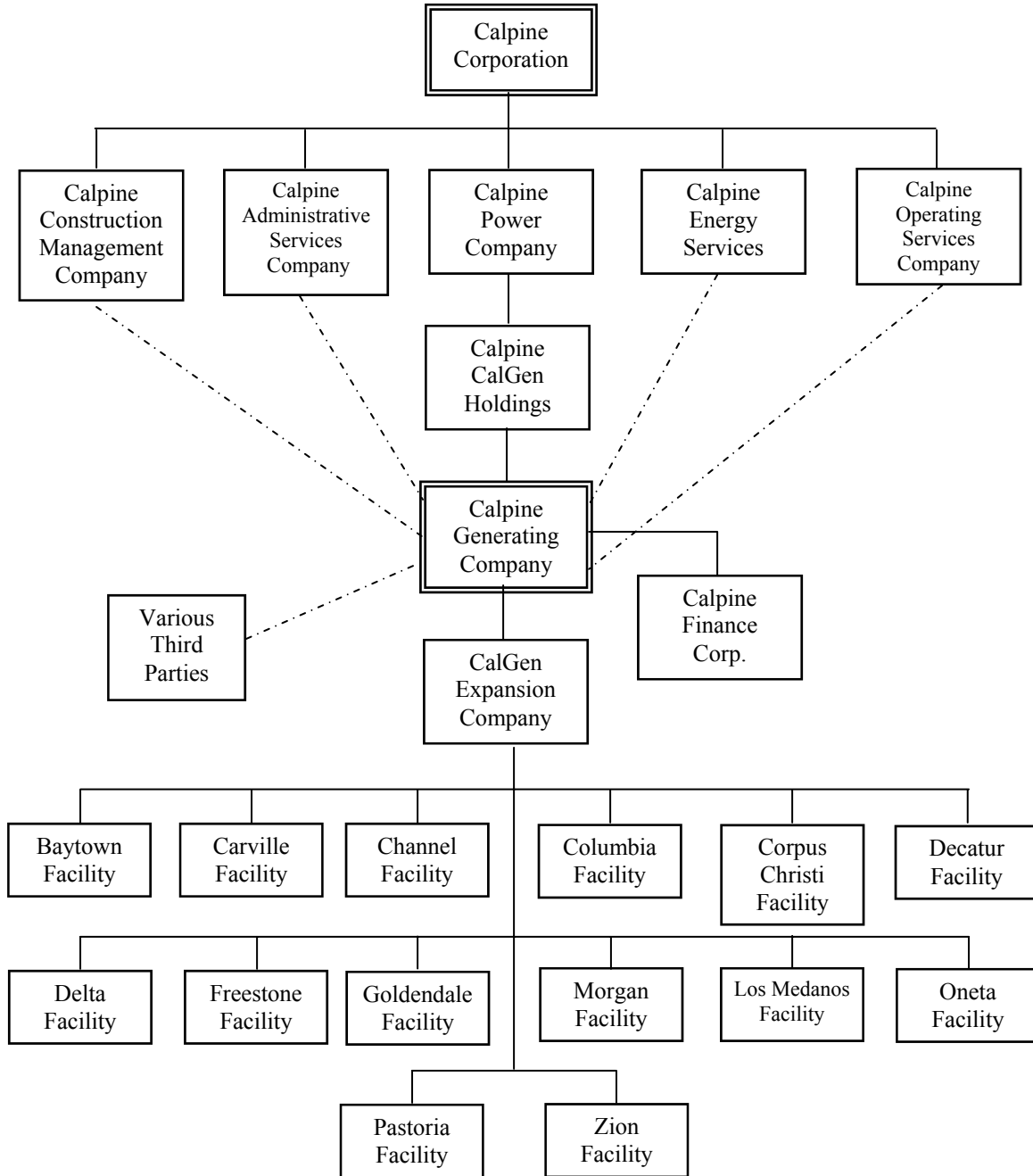
Our estimates of capacity utilization based upon the 2003 operating data suggest that the company's plants in northern California (Delta and Los Medanos) and Texas (Freestone, Baytown and Channel, which serve the Houston market, and to a lesser extent, Corpus Christi) are operating at a sufficiently high rates of capacity to generate reasonable profitability. In its S-4 filing, CalGen notes that there is a higher proportion of gas-fired plants incorporated into the rate base in these two states, which has helped these plants to compete effectively for new business.

On the other hand, CalGen's plants in the Southeast (especially Morgan and Decatur in Alabama and to a lesser extent Carville in Louisiana) are operating at very low capacity levels and are almost certainly losing money. The Southeast is dominated by coal-fired and nuclear power plant generation. Although a lot of gas capacity has been added over the past few years, a lot of it is underutilized. Calpine recently announced a new marketing effort to boost its sales in the Southeast, but it will take time to show results and for excess capacity to be absorbed in that market.

The same can be said for the Oneta facility in Oklahoma, which is operating at low capacity and is also the subject of litigation with Panda Energy, the former owners, who accuse Calpine of stalling in getting the plant up and running. Although the Zion Energy Center is also operating at a very low level, it should be profitable because all of its capacity has been sold to Wisconsin Electric for peaking purposes.

As for the newer plants, the Goldendale facility in Washington state, which is also facing litigation over delays, may fare well this summer due to the shortage of water runoff for hydroelectric power. Columbia has opened in the fast growing South Carolina market and Pastoria will open this summer, serving the Bakersfield market, which has also grown rapidly.

Figure 1
Calpine Generating Company, LLC
 Corporate organization and relationships
 (\$ millions)



Source: Calpine's 2003 Annual Report, Calpine Generating Company's S-4 Amendment No. 1 filing (October 19, 2004)

Organization and Operating Structure. CalGen is an indirect subsidiary of Calpine, which formed its Calpine Finance Corp. subsidiary to facilitate the issuance of the Notes and term loans. Through CalGen Expansion Company, it owns the 14 energy centers, each of which has been set up as a separate subsidiary. CalGen has few employees. All of the services are provided by subsidiaries of Calpine. For

example, Calpine Operating Services Company is responsible for the operations of all of CalGen's plants. Calpine Administrative Services Company provides all administrative services to CalGen. Calpine Construction Management Services Company oversees the construction of all new plants and major upgrades. Finally, with the exception of the sales to steam hosts and certain longer-term capacity purchases or tolling arrangements with third parties, Calpine Energy Services buys all of the power generated by CalGen and also supplies its natural gas.

Regulation. Under the Public Utility Regulatory Policy Act of 1978 (PURPA) and accompanying rules promulgated by the Federal Energy Regulatory Commission (FERC), a domestic electricity generating plant that is a Qualifying Facility (QF) is exempt from federal and state regulation of its financial condition and electric rates. In order to qualify as a QF, a power plant must have a commercial or industrial host that utilizes the thermal energy generated by the plant. Electric utilities and most electric utility holding companies cannot control or own more than 50% of a QF. Under FERC rules, a utility is supposed to purchase electricity generated by a QF at its avoided cost, which is equal to the incremental cost that it would otherwise have had to pay for power generated from its own or other sources. (However, FERC regulations also permit utilities to negotiate rates lower than their avoided costs.) Owners of QFs are exempt from the requirements of the Public Utility Holding Company Act of 1935 (PUHCA). With all of these advantages, maintaining QF status for its power plants is quite important to Calpine and other merchant power producers.

Under the Energy Policy Act of 1992, a power plant whose output is sold entirely for resale (rather than end users) can be qualified as an Exempt Wholesale Generator (EWG). In many cases, this is an acceptable alternative to QF status, as it exempts the EWG from the provisions of (PUHCA). Nevertheless, EWGs are subject to rate approval by FERC and may could become subject to state regulation of thermal energy sales.

Efficiency of CalGen's Fleet. Since the average plant in the portfolio is only about two years old, the efficiency of CalGen's fleet is high. On average, each plant has a heat rate of 7.3 million BTUs per megawatt hour, owing to their use of combined-cycle gas turbines and in many cases, their conversion of excess thermal energy into electricity. Consequently, Calpine's plants have a significant cost advantage over older natural-gas fired plants, which typically utilize single-cycle gas turbines that require 10 million BTUs or more of natural gas to produce one megawatt hour of electricity.

Revenue Generation. CalGen, like all merchant power companies, earns its revenues in essentially two ways: either by (1) selling the power to customers (in spot transactions or under long-term contracts) or (2) selling its generating capacity for a fixed fee under a tolling arrangement.

Power purchase agreements usually specify different rates for "on-peak" and "off-peak" electricity delivery. Higher on-peak charges are typically paid during the 16 busiest hours of the day from Monday through Friday. (In the West, Saturday is also considered an on-peak day.)

The thermal energy that is a byproduct of gas turbine electricity generation is almost always converted into steam which is then either delivered to the industrial or commercial host, which utilizes it in its own manufacturing process or facility, or converted into electricity by a steam turbine and delivered to the host or to the power grid.

Complications of Host Arrangements. A critical task in the site selection process is identifying the host. In order for the plant to attain QF status, the host must be large enough to take a meaningful proportion of its thermal energy output. CalGen must also ensure that the host is strong enough financially to meet its obligations under a long-term contract. Often, Calpine will construct and operate the facility on land owned by the host subject to the terms of a ground lease. At the same time, the plant

must be located in an area where there is sufficient demand for the electricity that it produces. If the host defaults on its obligations, the plant's QF status may be jeopardized. Alternatively, if electricity demand in the region is inadequate, Calgen may have to run the plant inefficiently in order to meet its obligations to the host.

Table 2

Calpine Generating Company, LLC

Steam and electricity customers

	Steam Customer	Electricity Customer
Baytown	Bayer	Bayer
Carville	Cos-Mar Styrene	Entergy
Channel	Lyondell-Citgo	Lyondell-Citgo
Columbia	Eastman Chemical	
	Citgo, Elementis Chromium,	
Corpus Christi	Flint Hills	Citgo, Solutia
Decatur	Solutia	Solutia
Delta	Dow Chemical	
Freestone		
Goldendale		
Los Medanos	USS-Posco, Dow	USS-Posco, Dow
Morgan	BP Amoco	BP Amoco, TVA
Oneta		
Pastoria		
Zion Energy		Wisconsin Electric

Source: Calpine Generating Company, LLC S-4 Amendment No. 1 filing (October 19, 2004)

On December 27, 2003, the host of CalGen's Decatur plant, Solutia, Inc., filed for bankruptcy. Five months later, it rejected its cogeneration agreements with Calgen relating to the sale of steam and supply of electricity. On June 30, 2004, the two parties executed a term sheet with the bankruptcy that preserves the Decatur facility's right to operate on Solutia's property through a continuation of the ground lease but have not yet reached agreement on damages. As a result of the loss of the steam host, CalGen is in jeopardy of losing its QF status on the Decatur plant. Although it will receive a customary waiver from FERC for the time being, it is likely that it will have to reclassify the facility as an EWR.

CalGen's Revenue Stream. In its S-4 filing, CalGen enumerated the various types of revenues that it receives as follows:

1. The sale of 1,049 MW of electric capacity under tolling arrangements, of which 513 MW relates to the capacity of Zion Energy Center, a peaking facility serving Wisconsin Electric.
2. The sale of steam to third parties under long-term agreements (see Table 2)
3. The sale of reliability must-run capacity to the California Independent System Operator (Payments have been running at \$28.7 million per year.)
4. Sale of 500 megawatts of on-peak capacity from CalGen's western plants to Calpine Energy Services (CES) at a fixed price (\$43.4 million per year) until December 31, 2009.
5. Sale of off-peak, peaking and power augmentation products to CES at a fixed price (\$164.1 million per year). Power augmentation has been sold primarily to the Tennessee Valley Authority from the Morgan Energy Center in Decatur AL.

6. Sale of the remaining on-peak output (net of the third party and CES sales described above) to CES at a floating spot price reflecting the positive difference (but never negative) between the day-ahead prices for power and gas (pursuant to the Index Based Gas Sale and Power Purchase Agreement between CalGen and CES (IBGS&PPA)).
7. Payments to CalGen, if any, from Morgan Stanley Capital Group under a 3-year index hedge equal to the amount that the aggregate spark spread falls below \$50 million in each 6 month period.

In essence, CalGen has sold a small portion of its on-peak and all of its off-peak and peaking generating capacity at fixed rates. It will receive a floating spot price rate from CES for the rest of its on-peak capacity.

The Morgan Stanley index hedge is equivalent to a three-year minimum guaranty on the aggregate spark spread of \$100 million per year. After the expiration of the hedge, Calpine's indirect subsidiary, Calpine CalGen Holdings, will step in under its \$750 million working capital facility that to guarantee a minimum aggregate spark spread of \$184.2 million for the 12-months ending March 28, 2008, rising each year to a minimum guarantee of \$256.8 million in the 12-months ending March 28, 2011. Of course, the ability to finance any significant shortfall will depend upon Calpine's overall financial condition at that time.

It is important to note, therefore, that CalGen has no direct relationship with a substantial majority of its electricity customers. All customer purchases, whether at spot rates or under long-term contracts, are being handled through CES. If CalGen ultimately files for bankruptcy, this arrangement may make it more difficult for its creditors to pursue their own reorganization plan for CalGen should they desire to do so. If secured creditors do not have adequate protection, they can seize their collateral, but unless they make a quick sale to another power producer or utility, they would have to assemble a management team and find new customers in order to maintain CalGen's operations. CES, on the other hand, could in theory at least, fill its electricity delivery requirements from the rest of its fleet or purchase the power on the open market. Consequently, while the concentration of marketing effort under CES can help to promote better plant utilization and efficiency for the entire Calpine network, it also strengthens Calpine's negotiating position in any reorganization plan negotiations.

Spark Spread Sensitivity Analysis. Also in its S-4, Calpine provides a sensitivity analysis highlighting the variability in its 2006 operating cash flow from hypothetical changes in the spark spread as applied to potential merchant sales during on-peak periods. What is unusual about the Index Based Gas Sale and Power Purchase Agreement is that it is not based upon actual sales of electricity by CalGen's plants, but rather the availability of on-peak capacity which can be sold on a merchant basis in the spot markets. CalGen calculates the capacity available for on-peak merchant sales by first subtracting out its existing fixed-price contractual arrangements with third parties and CES. This 7,389 MW of capacity is then multiplied by the total number of on-peak hours in a year to get the total potential annual merchant sales of 32.3 million megawatt hours. We then adjust this total potential megawatt hour figure for the anticipated availability factor of 92%, bringing the adjusted potential to 29.7 million megawatt hours. CES has agreed to pay CalGen the equivalent of the spot spark spread rates using regional benchmark indexes for electricity and natural gas for each of its power plants. Using these figures and the format provided by CalGen in its S-4 filing, we assess the company's spark spread sensitivity in the table below:

Table 3

Calpine Generating Company, LLC

Spark spread sensitivity

(\$ millions)

	Assumed Spark Spreads (\$/MWh)				
	\$5.00	\$10.00	\$15.00	\$20.00	\$25.00
Potential merchant on-peak MWh (mil.)	32.3	32.3	32.3	32.3	32.3
Assumed availability	92%	92%	92%	92%	92%
Assumed merchant on-peak MWh (mil.)	29.7	29.7	29.7	29.7	29.7
Merchant rev. (aggregate spark spread)	148.6	297.2	445.8	594.4	743.0
Third-party agreement revenue	102.0	102.0	102.0	102.0	102.0
CES fixed-price contract revenue	207.5	207.5	207.5	207.5	207.5
Total net revenues	458.1	606.7	755.3	903.9	1,052.5
Fixed O&M payments	170.9	170.9	170.9	170.9	170.9
Variable O&M payments	16.6	16.6	16.6	16.6	16.6
SG&A expenses	1.0	1.0	1.0	1.0	1.0
Total expenses	188.5	188.5	188.5	188.5	188.5
Oper. cash flow bef. major maint.	269.6	418.2	566.8	715.4	864.0
Major maintenance	30.0	30.0	30.0	30.0	30.0
Operating cash flow	239.6	388.2	536.8	685.4	834.0
Pro forma interest expense	224.6	224.6	224.6	224.6	224.6
Oper. cash flow after interest exp.	15.9	164.5	313.1	461.7	610.3
Interest coverage ratio	1.1X	1.7X	2.4X	3.1X	3.7X

Source: Calpine Generating Company, LLC S-4 Amendment No. 1 filing (October 19, 2004) and Robotti & Company estimates

At various assumed spark spreads ranging from \$5 to \$25 per megawatt hour, we calculate that CalGen's aggregate spark spread from on-peak merchant power sales would range from \$149 million to \$743 million. (As a result of the Index Hedge provided by Morgan Stanley Capital Group, the company's minimum annual aggregate spark spread would be \$100 million or about \$3.36 per megawatt hour until March 31, 2007.)

To this aggregate spark spread, CalGen adds \$102 million of revenues from third party agreements and \$207.5 million in revenues from its fixed-price contracts with CES. It subtracts estimated total expenses of \$188.5 million, most of which is fixed. This yields operating cash flow before major maintenance expenses and interest expense.

CalGen points out that its projected fixed and variable operating & maintenance payments are based upon historical estimates, which may not hold true going forward.

As a result of these assumptions, the company's pro forma operating cash flow (or EBITDA) before major maintenance costs would range from \$270 million to \$864 million.

CalGen does not include a specific estimate of major costs in its S-4 filing. Instead, it projects \$21.5 million of maintenance capital expenditures for 2005, which includes major maintenance costs. Although it does not break out maintenance expenses on its income statement, it does disclose that payments to turbine manufacturers under long-term service agreements will average about \$50 million per year from 2004 to 2008. (Recently, however, CalGen disclosed that Calpine would replace Siemens and GE, who currently provide service under these contracts, with its own internal maintenance team.) Since its plants are relatively new, the probability of major expenditures due to equipment failure is low; but current maintenance spending of \$21.5 million is far below the annual depreciation run-rate of \$140 million. Facing a liquidity squeeze, it is reasonable to expect that Calpine would reduce spending wherever possible. Hopefully, it is spending enough on maintenance to avoid major problems in the future. For now, I have guessed that major maintenance expenditures will be \$30 million per year going forward.

Since the majority of CalGen's outstanding debt carries floating interest rates, the company's interest expense will likely increase in 2005 and beyond. For the first nine months of 2004, total interest costs incurred (including capitalized interest but excluding interest paid on intercompany debt) were \$162 million, up from \$155 million last year. On an annualized basis, 2004 interest incurred will probably be about \$212 million. However, with 3-month LIBOR currently at 3.09%, CalGen's total pro forma annual interest bill is \$225 million today. (Every 1% increase in LIBOR raises CalGen's annual interest costs by about \$23 million.)

With these assumptions, our analysis shows that CalGen's operating cash flow (after major maintenance and interest costs) would range from \$240 million to \$834 million for spark spreads ranging from \$5 to \$25 per megawatt hour. At the same time, its operating cash flow coverage of interest expense would range from 1.1 times to 3.7 times.

Even so, we estimate that actual utilization of the 14 merchant power plants (making some assumptions about utilization of the three newest plants, including Pastoria, which is scheduled to open this summer) is probably around 60% of capacity. (See Table 8 below.) If so, we believe that CES will pay at least \$50 million more for on-peak merchant sales availability under the IBGS&PPA than it actually would if it paid for the actual on-peak merchant power generated, but it could reduce this difference by earning more than spot rates on electricity or paying less than spot rates for natural gas.

Estimating Current and Future Spark Spreads. Estimates of average spark spreads for a geographically diversified merchant power producer like CalGen are difficult to obtain, because wholesale power prices and even natural gas prices can vary considerably by region and the spread also depends on the heat rate and power production levels of individual plants. Data on wholesale prices and spark spreads are available from a couple of sources on a subscription basis, but we have not utilized those sources in developing our own estimates. Instead, we have chosen to look at the differences in the futures markets between wholesale power prices (at the PJM interconnection's western hub) and natural gas prices (at the Henry Hub). We apply CalGen's average heat rate of 7.3 million BTUs per megawatt hour to calculate forward spark spreads. A summary of results is given in Table 4 below:

Table 4

Forward spark spreads at March 28, 2005

(\$ per megawatt hour)

	Electricity Price/MWh	Natural Gas Cost/mmBTU	CalGen Heat Rate	Natural Gas Cost/MWh	Spark Spread
	(a)	(b)	(c)	(d)=(b)*(c)	(a) - (d)
Apr-05	54.92	6.99	7.3	51.03	3.89
May-05	56.75	7.12	7.3	51.99	4.76
Jun-05	60.92	7.23	7.3	52.79	8.13
Jul-05	74.78	7.32	7.3	53.45	21.33
Aug-05	74.78	7.38	7.3	53.89	20.89
Sep-05	60.32	7.40	7.3	54.03	6.29
Oct-05	57.25	7.43	7.3	54.25	3.00
Nov-05	57.25	7.77	7.3	56.74	0.51
Dec-05	57.25	8.10	7.3	59.14	(1.89)
Jan-06	69.19	8.32	7.3	60.74	8.45
Feb-06	69.19	8.31	7.3	60.63	8.56
Mar-06	63.25	8.16	7.3	59.57	3.68
Apr-06	63.25	6.99	7.3	51.03	12.22
May-06	57.88	6.85	7.3	49.97	7.91
Jun-06	60.06	6.87	7.3	50.15	9.91
Jul-06	72.50	6.90	7.3	50.37	22.13
Aug-06	72.50	6.93	7.3	50.59	21.91
Sep-06	57.75	6.91	7.3	50.41	7.34
Oct-06	55.00	6.93	7.3	50.57	4.43
Nov-06	55.00	7.24	7.3	52.85	2.15
Dec-06	55.00	7.54	7.3	55.01	(0.01)
Jan-07	63.34	7.75	7.3	56.58	6.77
Feb-07	63.34	7.73	7.3	56.39	6.95
Mar-07	60.54	7.55	7.3	55.12	5.43
Apr-07	60.54	6.52	7.3	47.60	12.94
May-07	56.42	6.40	7.3	46.68	9.74

Source: NYMEX PJM is the most active electricity market in the country. Heat rate equals the number of millions of BTUs necessary to produce one megawatt of electricity.

Wholesale power futures for the PJM Western Hub indicate that prices will rise from \$54.92 per megawatt in April 2005 to \$74.78 in July and August, an increase of 36%. Although higher prices are expected during the peak summer months, this year's seasonal increase looks quite high.

Meanwhile, natural gas futures suggest that prices will rise from \$6.99 in April to "only" \$7.38-\$7.40 by summer. Demand for natural gas typically peaks in the winter, which is evident from the increase over near-term futures prices for the December through March contracts, all of which are above \$8 per million BTUs.

Using the average heat rate for CalGen's fleet and the forward prices for electricity and natural gas, we derive a forward spark spread curve, given in the last column in Table 5 above. It suggests that spark spreads will rise significantly over the next few months from \$3.89 per MWh in April to about \$21 per MWh in July and August, before falling back as the cooler weather approaches. On average, without adjusting for seasonal peaks, the forward spark spread curve averages out to less than \$8 per MWh over

the next 12 months. If so, then CalGen's profitability should approach the lower end of the sensitivity analysis, as given in Table 4 above, with operating cash flow of \$360 million and interest coverage of 1.5 times.

It should be noted, however, that forward rates for two zones in California (NP15 and SP15) indicate that electricity prices will rise from just under \$57 per megawatt hour in April to about \$85 this summer and then ease to about \$75 for the foreseeable future. This suggests that on-peak spark spreads in California will average about \$20 per megawatt hour over the next 21 months. We suspect that activity on the NP15 and SP15 contracts is not nearly as strong as for PJM, which raises questions about whether these forward prices are truly representative of market expectations. Nevertheless, if the futures markets are correct, it suggests that profitability should improve significantly for both CalGen and Calpine in the months ahead.

Table 5

Calpine Generating Company, LLC

Consolidated capitalization at September 30, 2004

	30-Sep-04
Debt Outstanding	
Revolving Credit Facility	36.5
First Priority Secured Floating Rate Notes	235.0
First Priority Secured Term Loans	600.0
Second Priority Secured Floating Rate Notes	631.3
Second Priority Secured Term Loans	98.6
Third Priority Secured Floating Rate Notes	680.0
Third Priority Secured Notes	150.0
Notes payable	2.3
Total debt	2,433.7
Members' equity	4,074.7
Total capitalization	6,508.4
Debt-to-total capitalization	37.4%
EBITDA (ttm)	313.6
Interest incurred (ttm) (excl. rel. party int. exp.)	125.7
Interest coverage	2.5
Pro forma interest expense	224.6
Interest coverage	1.4
Capital spending (ttm)	338.8
Projected 2005 capital spending	
Completion of Pastoria Energy Center	99.8
Construction-related costs for Columbia, Goldendale and Morgan	32.9
Maintenance capital expenditures	21.5
	154.2

Source: CalGen's 2004 Third Quarter 10-Q and Robotti and Company estimates

Consolidated Capitalization and Interest Coverage. CalGen is the successor to Calpine Construction Finance Company II. It was formed to facilitate the refinancing of certain bank loans. In March 2004, the company issued \$2.4 billion of first, second and third priority secured floating rate notes and term loans in a private placement in March 2004. The offering was subsequently registered with the SEC in October 2004. CalGen's consolidated capitalization at September 30, 2004 is given in the table below:

Prior to this offering, Calpine had advanced funds to CalGen in the form of subordinated debt to cover construction and operating costs. It converted this debt into equity concurrent with the March 2004 offering.

At September 30, 2004, CalGen had \$2.434 billion of total debt outstanding and its debt-to-total capitalization ratio was 37.4%. We estimate that the company's EBITDA on a trailing 12 month basis was \$313.6 million and total interest incurred (including capitalized interest but excluding interest paid on parent company debt) was \$125.7 million. On a pro forma basis, however, at current levels of LIBOR, we estimate that total interest incurred would be about \$225 million annually with interest coverage of 1.4 times. Every 100 basis point increase in LIBOR adds about \$23 million to the company's annual interest expense.

Going forward, the full year performance for three power plants (Columbia, Goldendale and Pastoria) is not reflected in the trailing 12 month EBITDA results. Based upon the actual and expected completion dates, the formula for on-peak merchant power sales as specified in the IBGS&PPA and our estimate of the company's current spark spread of \$8 per megawatt hour, we estimate that these plants would add \$47 million to EBITDA on a full year basis. (Our calculations are given in the table below.) Thus, our pro forma estimate for ongoing EBITDA for the company as a whole is \$360 million. Any improvement above this figure would have to come from an increase in spark spreads, replacement of existing fixed-price contracts at higher rates or subsequent acquisitions/completions of power plants.

Table 6

Calpine Generating Company, LLC

Calculation of additional potential EBITDA from newer power plants

Facility	Completion Date	Total Baseload & Peaking (MW)	Annual On-Peak Hours (000s)	Pct. of Annual Generation Not Included in TTM Results	Potential Merchant MWh (000s)
(a)	(b)	(c)	(d)	(e)	(c)*(d)*(e)
Columbia	March 2004	641	4.205	50.0%	1,347
Goldendale	August 2004	271	4.205	62.5%	712
Pastoria	June 2005	769	4.906	100.0%	3,773
Totals					5,833
Estimated spark spread (\$/MWh):					X \$8
Estimated additional EBITDA contribution (\$ millions)					\$46.7

Source: Calpine Generating Company, LLC S-4 Amendment No. 1 filing (October 19, 2004) and Robotti & Company estimates

The indenture for the Notes give noteholders a security interest in 13 of the 14 CalGen power plants, each of which operates as a separate subsidiary. Besides the security interests, the Notes are also guaranteed by all of CalGen's power plant subsidiaries. Only the Goldendale facility is excluded from the collateral pool and guarantees. That plant apparently is pledged to secure other obligations of Calpine. The indenture for the Notes requires that Goldendale be included in the collateral pool if and when it is

released by Calpine's creditors. At June 30, 2004, the Goldendale facility accounted for 4.7% of CalGen's total assets (or about \$313 million) and 2.8% of its peak generating capacity (or 271 MW).

From the noteholders' perspective, the strongest financial covenant in the indenture requires that the ratio of the total amount of First and Second Priority Notes to the total peak capacity of facilities (in MW) not exceed \$235 per megawatt. Surprisingly, this calculation appears to include the Goldendale facility, which is excluded from the collateral pool. Accordingly, our calculation of the current values of debt per megawatt, based upon the September 30, 2004 financial figures, is given in the table below:

Table 7

Calpine Generating Company, LLC

Calculation of debt outstanding at September 30, 2004 per megawatt of peak capacity (\$000s/MW)

Debt category	Debt Outstanding (\$ millions)	Cumulative Debt Outstanding (\$ millions)	Debt Per Megawatt of Peak Capacity (\$000s)	Debt Per MW of Peak Cap. for Secured Facilities (\$000s)
First Priority debt	871.5	871.5	88.6	91.1
Second Priority debt	729.9	1,602.4	162.9	167.6
Third Priority debt	830.0	2,431.4	247.2	254.3
Other debt	2.3	2,433.7	247.5	254.5

Source: Calpine Generating Company, LLC S-4 Amendment No. 1 filing (October 19, 2004), Calgen's 2004 third quarter 10-Q and Robotti & Company estimates. Debt per megawatt of peak capacity is calculated based on total peak capacity of 9,834 megawatts. Debt per megawatt of peak capacity for secured facilities is calculated based on total peak capacity for secured facilities of 9,563 megawatts.

Based upon the undepreciated book value of property, plant and equipment, CalGen's facilities have an original cost (including construction in progress) of \$6.59 billion or \$670,500 per megawatt of peak capacity (based upon total capacity of 9,834 megawatts) as of September 30, 2004. The company has also disclosed that it will spend another \$130 million to complete the construction of the Pastoria facility and upgrades to the Columbia, Goldendale and Morgan facilities which will add another \$13,000 or so to the total original cost per MW of the fleet.

It is fair to say that current market values for gas-fired plants are well below CalGen's original construction cost and also the \$500,000 per MW that is widely quoted as the cost of building a typical new gas-fired generating plant. Several recent transactions indicated a range of current potential values for existing plants:

1. On March 17, 2005, Entergy agreed to purchase the Attala Power Plant from Central Mississippi Generating Company, LLC, which had taken the plant in foreclosure. Entergy will pay \$88 million to acquire the 480 megawatt, natural gas-fired, combined cycle facility or about \$183,000 per megawatt. It will spend \$20 million to upgrade the plant and \$3 million in transaction costs, bringing the total cost to \$111 million or \$231,000 per megawatt.
2. In August 2004, Duke Energy completed the sale of eight of its merchant power plants with total capacity of 5,325 megawatts for \$975 million or \$183,000 per megawatt. The consideration consisted of \$425 million in cash, a \$50 million note receivable and \$500 million in tax benefits. We estimate that these plants were previously carried on Duke's books at about \$495,000 per megawatt.

3. In December 2004, Teco Energy sold its interest in the Frontera Power Station, a 477 megawatt facility located in McAllen Texas for \$134 million or \$280,900 per megawatt. The Frontera facility operates within the Electric Reliability Council of Texas (ERCOT) market, where most merchant power generators are able to earn reasonable spark spreads. As a result, we would expect power plant values to be higher there than in other markets with capacity gluts, such as the South.

At this time, we do not have sufficient data to provide a current market value assessment for CalGen's fleet with great confidence. Nevertheless, with more than half the company's capacity represented by mature plants in markets with favorable operating conditions (i.e. higher capacity utilization, even with suboptimal spark spreads), we roughly estimate that current value of the fleet at \$235,000-\$270,000 per megawatt. This puts a value of \$280,000-\$350,000 per megawatt on the existing California and Texas plants and \$150,000-\$210,000 per megawatt on everything else. Clearly, these values are affected by current spark spreads, so that if and when spark spreads rise, we would expect that valuations would too. Even if spark spreads do not improve, high replacement costs should help to establish a floor for plant market values.

The remaining covenants offer only a modest amount of protection. CalGen must maintain EBITDA coverage of interest expense of at least 1.05 times at the end of every quarter. Although the indebtedness covenant does provide some financial tests, if the company seeks to borrow to finance asset acquisitions, there is a carve-out on the credit facilities of \$900 million in aggregate, which is well above the current outstanding \$200 million revolving credit facility, which would allow the company to borrow more on a first priority secured basis. Likewise, CalGen is not required to retain any earnings in the business above its ongoing operational requirements. (Although we believe that the provisions of the IBGS&PPA produce higher revenues and profits for CalGen than it is producing through its actual sales of capacity and electric power, the company can immediately dividend any surplus back to its parent company.)

All of the Priority Notes are non-recourse to CalGen, but also have a pledge of the stock of CalGen as part of the collateral pool. As a result, noteholders will not have an unsecured claim against the company or its subsidiaries as is customary if the value of their collateral falls short of their claims. Instead, they will then own all of the equity of CalGen, which is likely to be worthless. In effect, after noteholders receive the value of their security, unsecured creditors will then have claim to any remaining CalGen assets. In our view, this adds significantly to the downside risk facing holders of the Third Priority Notes.

On balance, therefore, we believe that the First and Second Priority Notes offer an attractive floating rate return combined with good downside protection based upon the value of the collateral, even in the currently depressed market environment for merchant power assets. Our rough valuation suggests that the Third Priority Notes are covered by current collateral value, but they lack meaningful covenant protection to ensure that their claim to that value will be realized. Even so, at current yields in excess of 12%, the Third Priority Notes have significantly greater upside than the First and Second Priority Notes, should spark spreads rise. Futures markets suggest that spark spreads will rise sharply this summer, but it will take time before we know whether this improvement will be sustained in the fall and beyond.

Table 8

Calpine Generating Company, LLC

Estimate of current capacity utilization of the merchant power fleet

Region	Total Baseload Capacity (MW)	Less Contract Capacity (MW)	Nominal Capacity Available (MW)	Total On-Peak Hours	Potential Merchant MWh (000s)
	(a)	(b)	(c) (a) - (b)	(d)	(e) (c)*(d)/1000
West	2,292	532	1,760	4,906	8,635
ERCOT	2,705	385	2,320	4,205	9,756
Southeast	2,434	119	2,315	4,205	9,735
Other	994	-	994	4,205	4,180
	8,425	1,036	7,389		32,305

Region	2003 MWh Generated + Pro Forma	Less MWh Due to Contracts	Pro Forma Merchant Total MWh	Pro Forma Merchant On-Peak MWh Generated	Pro Forma Capacity Utilization
	(f)	(g) (b)*(d)/1000	(h) (f) - (g)	(i) (h) * % on-peak	(j) (i) / (e)
West	13,102	2,610	10,492	7,631	88.4%
ERCOT	14,974	1,619	13,355	8,616	88.3%
Southeast	3,907	500	3,407	2,198	22.6%
Other	612	-	612	612	14.6%
	32,595	4,729	27,866	19,057	59.0%

	West	Elsewhere
On-peak hours per week	96	80
Off-peak hours per week	72	88
Total	168	168
On-peak/Off-peak usage intensity	2.0	2.0
On-peak MW generation (% total)	72.7%	64.5%
Off-peak MW generation (% total)	27.3%	35.5%

Source: Calpine Generating Company, LLC S-4 Amendment No. 1 filing (October 19, 2004) and Robotti and Company estimates
Notes:

(a) Figures taken from Table 1.

(b) Contract capacity sold as disclosed in CalGen's S-4 was 1,049 MW to third parties (less 513 MW for Zion's peakers) and 500 MW to CES.

(c) Figures as reported in CalGen's S-4 p.49

(d) In West, on peak hours = 16 hours per day times 6 days per week; elsewhere, peak hours – 16 hours per day times 5 days per week. CalGen adjusts the figures for NERC-designated holidays.

(f) 2003 megawatt hours generated for each plant then in operation as reported by Calpine in its 10-K. We assume a 30% utilization rate for the Columbia facility (which opened March 2004) a 40% utilization for the Goldendale facility (which was opened August 2004) and a 50% utilization for the Pastoria facility (which will be opened in the summer of 2005).

(g) Pro forma on-peak generation is calculated by applying an assumed on peak generation percentage of 72.7% for the West and 64.5% elsewhere to the Pro forma Merchant Totals (h). On-peak percentage calculated in table immediately above. For West, it equals (96 on-peak hours times 2.0 on-peak/off-peak usage intensity) divided by (96 on peak hours times 2.0 on-peak/off-peak usage plus 72 off-peak hours)

Table 9

Calpine Generating Company, LLC

Interim results for the quarter and nine months ended September 30, 2004

	3 Months 30-Sep-04	3 Months 30-Sep-03	Percent Change	9 Months 30-Sep-04	9 Months 30-Sep-03	Percent Change
Revenue:						
Revenue - related party	438,695	251,333	74.5%	959,663	621,763	54.3%
Revenue - other	123,641	126,309	-2.1%	344,394	289,811	18.8%
Mark-to-market activities	(574)	-		(2,495)		
Total revenue	561,762	377,642	48.8%	1,301,562	911,574	42.8%
Cost of revenue						
Fuel expense - related party	385,059	238,563	61.4%	887,364	602,612	47.3%
Fuel expense - other	288	321	-10.3%	211	4,721	-95.5%
Plant operating expense	38,502	32,145	19.8%	137,795	107,636	28.0%
Depreciation expense	39,224	33,943	15.6%	110,960	87,342	27.0%
Total cost of revenue	463,073	304,972	51.8%	1,136,330	802,311	41.6%
Gross profit	98,689	72,670	35.8%	165,232	109,263	51.2%
General and admin. expense	2,201	1,674	31.5%	9,236	3,890	137.4%
Income from operations	96,488	70,996	35.9%	155,996	105,373	48.0%
Interest expense - related party	-	73,840	-100.0%	72,173	181,586	-60.3%
Interest expense - other	41,175	17,149	140.1%	110,814	42,138	163.0%
Interest income	(444)	(1,248)	-64.4%	(1,939)	(1,381)	40.4%
Other expense (income)	751	(85)	-983.5%	336	53	534.0%
Income before taxes	55,006	(18,660)	-394.8%	(25,388)	(117,023)	-78.3%
Income taxes	-	-				
Income bef. acct. change	55,006	(18,660)	-394.8%	(25,388)	(117,023)	-78.3%
Change in accounting principle	-	(241)	-100.0%		(241)	-100.0%
Net income	55,006	(18,901)	-391.0%	(25,388)	(117,264)	-78.3%
EBITDA	135,712	104,939	29.3%	266,956	192,715	38.5%
Depreciation & amortization	39,224	33,943	15.6%	110,960	87,342	27.1%
Capital expenditures	60,628	76,387	-20.6%	262,426	364,958	-28.1%
Interest expense – related party		73,840	nmf	72,173	181,586	-60.3%
Interest expense – other	41,175	17,149	140.1%	110,814	42,138	163.0%
Capitalized interest	8,700	30,300	-71.3%	51,100	112,500	-54.6%
Total interest incurred	49,875	121,289	-58.9%	234,087	336,224	-30.4%
Interest coverage	2.7	0.9		1.1	0.6	
Total int. incur. less rel. party	47,875	47,449	0.9%	161,194	154,638	4.2%
Adjusted interest coverage	2.7	2.2		1.6	1.2	

Source: Calpine Generating Company, LLC third quarter 2004 10-Q

Table 10

Calpine Generating Company, LLC

Income statement for the years ended December 31, 2001 – 2003

(\$000s)

	12 Months 31-Dec-03	12 Months 31-Dec-02	12 Months 31-Dec-01
Revenue:			
Revenue - related party	779,162	388,586	18,343
Revenue - other	380,214	155,407	23,343
Total revenue	1,159,376	543,993	41,686
Cost of revenue			
Fuel expense - related party	765,457	282,500	13,404
Fuel expense - other	4,751	6,394	160
Plant operating expense	144,031	80,834	9,988
Depreciation expense	121,008	59,907	6,888
Total cost of revenue	1,035,247	429,635	30,440
Gross profit	124,129	114,358	11,246
General and administrative expense	5,811	3,779	582
Equipment cancellation & impairment		115,121	
Income from operations	118,318	(4,542)	10,664
Interest expense - related party	255,687	111,304	10,487
Interest expense - other	57,004	33,320	5,151
Interest income	(2,061)	(537)	(145)
Other expense (income)	203	1,515	2,642
Minority interest			(26)
Income before taxes	(192,515)	(150,144)	(7,445)
Income taxes			
Income before discontinued operations	(192,515)	(150,144)	(7,445)
Change in accounting principle	(241)		
Net income	(192,756)	(150,144)	(7,445)
EBITDA (adj. to include equip. cancel. chg.)	239,326	170,486	17,552
Depreciation & amortization	121,008	59,907	6,888
Equipment cancellation charge		115,121	
Capital expenditures	441,345	1,678,874	2,711,348
Interest expense – related party	255,687	111,304	10,487
Interest expense – other	57,004	33,320	5,151,
Capitalized interest	123,600	236,400	197,700
Total interest incurred	436,291	381,024	213,338
Interest coverage	0.5	0.4	0.1
Total int. incur. less rel. party	180,604	269,720	202,851
Adjusted interest coverage	1.3	0.6	0.1

Source: Calpine Generating Company, LLC S-4 Amendment No. 1 filing (October 19, 2004)

Table 11

Calpine Generating Company, LLC

Balance sheets at December 31, 2002 and 2003 and September 30, 2004

(\$000s)

	30-Sep-04	31-Dec-03	31-Dec-02
Current assets			
Cash and cash equivalents	97,751	39,598	25,643
Restricted cash		152,290	9,490
Accounts receivable from others, net	51,282	68,905	45,273
Accounts receivable from related party	43,355		
Inventories	17,624	13,301	9,748
Other current assets	58,778	29,444	19,816
Current derivative assets	11,372		
Total current assets	280,162	303,538	109,970
PP&E, net	6,295,431	6,314,166	6,164,211
Deferred financing costs	53,817	17,775	29,717
Other assets	48,908	44,289	10,729
Equipment for future use			24,790
Note receivable - net of current portion	19,476		
Long-term derivative assets	31,133		
Total assets	6,728,927	6,679,768	6,339,417
LIABILITIES AND EQUITY			
Current liabilities			
Accounts payable to others	102,684	113,947	183,216
Accounts payable to related parties	28,916	22,131	29,369
Accrued interest payable	73,269		
Other current liabilities	2,914	4,938	1,545
Notes payable	168	154	133
Credit agreement		2,200,358	
Total current liabilities	207,951	2,341,528	214,263
Notes payable, net of current portion	2,109	2,285	2,453
Priority notes and term loans	2,394,870		
Credit agreement	36,500		2,313,605
Subordinated parent debt		4,615,276	3,910,761
Other liabilities	12,750	3,651	
Total liabilities	2,654,180	6,962,740	6,441,082
Commitments and contingencies			
Stockholders' equity	4,074,747	(282,972)	(101,665)
Total liabilities and equity	6,728,927	6,679,768	6,339,417

Source: Calpine Generating Company, LLC S-4 Amendment No. 1 filing (October 19, 2004) and 2004 Third Quarter 10-Q

Further Disclosures

Analyst Certification

I, Stephen Percoco, hereby certify that the views expressed in this research report accurately reflect my personal views. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation related to the specific recommendations or views contained in this research report.

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