MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

June 30, 2019 and 2018

KALLPA GENERACIÓN S.A.

US$350,000,000 – 4.875% Senior Notes due 2026
US$650,000,000– 4.125% Senior Notes due 2027

KALLPA GENERACIÓN S.A.

About the Company

We are a Peruvian company focused on the electric power sector, specifically on generation. We own, develop and operate two thermal power plants, Kallpa and Las Flores, and one hydropower plant, Cerro del Aguila ("CDA"), to generate and sell electricity to regulated customers (distribution companies) and unregulated customers under short-term and long-term power purchase agreements ("PPAs") and to the spot market. Our thermal plants use natural gas to produce electricity. Our contracting level under PPAs is aproximately 91%[1] with an average life of approximately 10 years, which reduces the risk related to spot market prices of electricity and fuel.

Our thermal plants have an aggregate capacity of 1,063 MW: (i) Kallpa combined-cycle generation plant in Chilca (45 kms south of Lima) with three natural gas-fired turbines and one steam turbine that have an aggregate capacity of 870 MW; and (ii) Las Flores open cycle natural gas fired turbine plant, with a capacity of 193 MW, also located in Chilca, 3km away from Kallpa's site. The commercial operation date ("COD") of the combined cycle was granted on August 8, 2012 and Las Flores plant acquisition became effective on April 1, 2014.

Our hydropower plant, with an effective capacity of 568 MW, is the largest privately-owned hydroelectric power plant in Peru. On August 25, 2016, CDA's COD was declared. The plant has a 6-kilometer headrace tunnel and a 17-kilometer transmission line with a capacity of 545 MW. On October 27, 2017, COES declared the COD of the 10 MW mini-hydro, built to take advantage of the Mantaro river ecological water flow. On March 28, 2019, after running additional effective capacity tests, COES approved a capacity increase of 13MW, increasing total capacity from 555 MW to 568 MW.

On June 26, 2017, the shareholders and the Board of Directors of each Kallpa and Cerro del Águila, unanimously approved the merger of both companies, with CDA becoming the surviving entity. On August 16, 2017, Kallpa and CDA effectively merged and CDA became the surviving entity. On September 28, 2017 the combined entity was renamed Kallpa Generación S.A.

On November 24, 2017, the Company's former indirect parent company, Inkia Energy Ltd. and one of its subsidiaries, entered into a share purchase agreement in which they sold, effectively on December 31, 2017, substantially all of their Latin American and Caribbean businesses to Nautilus Inkia Holdings LLC ("Inkia"), and other newly formed holding companies that are indirectly owned by certain funds managed by I Squared Capital Advisors (US) LLC and coinvestors (collectively, the "Sponsor"). On April 30, 2018, the Instituto Nacional de Defensa de la Competencia y de la Protección de la Propiedad Intelectual, INDECOPI, the Peruvian antitrust authority, approved the acquisition by the Sponsor of 74.9% of the Company, becoming our controlling shareholder.

On October 16, 2018, Inkia entered into a share purchase agreement with Energía del Pacífico S.A., owner of the remaining 25.1%, to acquire all the shares held by the latter in Samay and the Company. The transaction closed on October 19, 2018. Through this acquisition Inkia became Kallpa's sole shareholder.

After INDECOPI approved the December 2017 acquisition by the Sponsor, the related parties also include Orazul Energy Peru S.A. and Subsidiaries[2] ("OEP"). Since January 1, 2019, as part of a strategy to optimize operations and maximize benefits from having the same shareholders, Kallpa and OEP have integrated and streamlined their management teams, implementing a single management organization, with no legal mergers between the companies.

Kallpa's management has extensive experience in the power generation business. Our executive officers have an average of approximately 15 years of experience in the power generation industry and have previously held senior positions in leading power generation companies, financial institutions and the Peruvian government. Our management team provides in-depth market knowledge and power industry experience, with significant experience in the Peruvian energy industry and government regulators. We believe that this overall level of experience allows our management team to lead the Company in the effective operation and maintenance of our facilities.

[1] Estimated for the following 3 years (2019-2021).
[2] OEP subsidiaries include Aguaytia Energy del Peru S.R.L., Termoselva S.R.L., Eteselva S.R.L. and Etenorte S.R.L.

Our Notes

On May 24, 2016, the Company issued senior notes for an aggregate principal amount of US$350 million in the international capital markets under rule 144A Regulation S. These notes accrue interest at a rate of 4.875% payable semi-annually and have final maturity in May 2026. The proceeds from this issuance were used to repay in full the outstanding balance of: (i) the financial lease agreements used to finance the construction of Kallpa II and Kallpa III natural gas turbines; (ii) the Kallpa local bonds due 2022; (iii) the syndicated loan; (iv) short-term loans and (v) general corporate purposes. Through this transaction, Kallpa was able to refinance most of the existing project finance debt that averaged an interest rate above 7% into a 10-year bullet 144A Reg S investment grade bonds rated Baa3 by Moody's and BBB- by Fitch, at a 4.875% interest rate.

On August 16, 2017, the Company issued senior notes for an aggregate principal amount of US$650 million in the international capital markets under rule 144A Regulation S. These notes accrue interest at a rate of 4.125% payable semi-annually and have final maturity in August 2027. The proceeds from this issuance were used to to repay in full the outstanding balance of: (i) syndicated project finance loan, (ii) shareholder loans, (iii) expenses related to the interest rate swap unwind and (iv) general corporate purposes. Through this transaction, the Company was able to refinance the project finance debt used for the construction of the CDA hydropower plant that averaged an interest rate above 7% into a 10-year bullet 144A Reg S investment grade bonds rated Baa3 by Moody's and BBB- by Fitch, at a 4.125% interest rate.

Business development

Kallpa Asset Optimization Project

Kallpa has started an asset optimization program for up to US$165 million that consists of: (i) the conversion to combined cycle of the Las Flores thermal plant, with an 125 MW increase in capacity from 193 MW to approximately 318 MW requiring an investment of US$148 million; and (ii) the upgrade of gas turbines II and III in the Kallpa plant, expected to add approximately 37 MW by improving their technology with the increase of their efficiency and the reduction of their heat rate, with an investment of US$15 million. COD is expected for the first quarter of 2022.

Related to the project:

- On August 6th, 2019, Kallpa signed an On Site Services Contract with Siemens S.A.C. (on shore agreement) and a Foreign Part Supply and Overseas Logistical Support Contract with Siemens Energy Inc (off shore agreement) for (1) maintenance services for all gas turbines, (2) supply of spare parts and replacement units, and (3) the combustion upgrade of Kallpa II, Kallpa III and Las Flores' gas turbines.
- On August 7th, 2019, Kallpa and Siemens S.A.C. signed an engineering, procurement and construction (EPC) contract for a total amount of US$135 million which includes all costs and expenses to complete the construction of the Las Flores combined cycle plant.
- On August 13 th, 2019, Kallpa entered into a financial lease agreement with Banco de Crédito del Perú for US$148 million to finance the construction of the Las Flores combined cycle plant. Under the lease agreement, Kallpa has up to 36 months disbursement period and a 5-year repayment period with quarterly payments until the maturity of the lease. The lease bears a fixed interest rate of 3.65%.

Management's Discussion and Analysis of Financial Conditions and Results of Operations

The following discussion of our financial condition and results of operations should be read in conjunction with our condensed interim financial statements as of June 30, 2019.

For the six-month period ended June 30, 2019 and 2018

	Six months ended June 30		% Change
	A	B	
In millions of U.S. dollars	**2019**	**2018**	
Revenues	281	269	*4%*
Cost of sales (excluding depreciation)	(122)	(115)	*6%*
Depreciation	(25)	(27)	*-7%*
Administrative expenses	(12)	(9)	*33%*
Other income, net	4	2	*100%*
Operating profit	**126**	**120**	***5%***
Finance income	3	-	*100%*
Finance expenses	(28)	(26)	*8%*
Net foreign exchange difference	1	-	*100%*
Finance cost, net	**(24)**	**(26)**	***-8%***
Profit before income tax	**102**	**94**	***9%***
Income tax expense	(49)	(30)	*63%*
Profit for the period	**53**	**64**	***-17%***

Results of Operations

The Company's net income for the six-month period ended June 30, 2019 amounted to US$53 million compared to US$64 million during the same period in 2018. The Company's results were mainly explained by the following:

Revenues

Revenues increased by US$12 million or 4%, to US$281 million during the first six months of 2019, from US$269 million during the same period in 2018, mainly due to higher energy and capacity sales under PPAs from an increase in demand of non-regulated customers. Energy sales increased to 5,103 GWh during the first six months of 2019 from 4,642 GWh during the same period in 2018, mainly explained by (i) higher consumption from the Southern Peru Corporation PPA related to the Toquepala mine expansion (up to 80 MW); and, (ii) the new Tintaya PPA signed in January 2019 (up to 74 MW). This was partially offset by PPA's price decrease of 3% to an average of US$42.5/MWh during the first six months of 2019 from an average of US$43.9/MWh during the same period in 2018, mainly for PPAs with non-regulated customers.

Cost of Sales

Cost of sales increased by US$7 million, or 6%, to US$122 million during the first six months of 2019 from US$115 million during the same period in 2018, mainly as a result of:

- US$10 million increase in energy and capacity purchases in the spot market, explained by net purchases of 1,819 GWh during the first six months of 2019 compared to 361 GWh during the same period in 2018, in connection with higher PPA consumption from non-regulated customers and lower thermal generation mainly due to the programmed major maintenance of the steam turbine (Kallpa IV) between April and May 2019. This was partially offset by lower marginal cost (US$7.4/MWh during the six-month period ended June 30, 2019 compared to US$10.5/MWh in the same period in 2018); partially offset by,

- US$3 million decrease in gas supply expenses, mainly due to the decrease in gas consumption to 12,914,400 MMBTU during the first six months of 2019 from 18,003,728 MMBTU during the first six months of 2018, due to lower thermal generation mainly due to the programmed major maintenance of the steam turbine (Kallpa IV), added to the application of carry forward gas volume from previous year.

Depreciation and amortization

Depreciation and amortization decreased by US$2 million, or 7%, to US$25 million during the first six months of 2019 from US$27 million during the same period in 2018, mainly due to the end of the useful life of certain assets.

Administrative Expenses

General, selling and administrative expenses increased by US$3 million, or 33%, to US$12 million during the first six months of 2019 from US$9 million during the same period in 2018, mainly explained by:

- US$2 million increase in personnel expenses as a result of Kallpa and OEP management integration; which is compensated by an increase in Other income due to the Management Service Agreement with related companies, including OEP.
- US$1 million increase in third-party services, mainly human resourses and regulatory consulting, community services and other minor expenses.

Other Income, net

Other income, net increased by US$2 million, or 100%, to US$4 million during the first six months of 2019 from US$2 million during the same period in 2018, mainly due to the Management Service Agreement with OEP, effective since January 1st, 2019.

Finance cost, net

Finance cost, net decreased by US$2 million, or 8%, to US$24 million during the first six months of 2019 from US$26 million during the same period in 2018, explained by:

- US$3 million increase in finance income, which corresponds to the interest associated to the refund request filed before the Peruvian Tax Authority in connection with the arbitration result related to our Legal Stability Agreement (LSA), which generated a recalculation resulting in lower income tax for 2013.
- US$1 million increase in foreign exchange gain due to the 2.7% devaluation of the Peruvian sol against the U.S. dollar during the six-month period ended June 2019, compared to the 1.0% appreciation during the same period in 2018.

These effects were offset by:

- US$2 million increase in finance expenses to US$28 million during the first six months of 2019 from US$26 million during the same period in 2018, mainly explained by the interest expense associated to the recalculation of the income tax for 2016, 2017 and 2018, resulting in higher income tax for such periods, as a consequence of the arbitration result related to our LSA.

Income tax expense

Tax expenses increased by US$19 million, or 63%, to US$49 million during the first six months of 2019 from US$30 million during the same period in 2018. The estimated average effective tax rate for the first six months of 2019 was 48% (32% for the same period in 2018). The increase in the effective tax rate as of June 2019 corresponds primarily to the impact of the arbitration result related to our LSA that generated a recalculation of the income tax of 2016, 2017 and 2018, increasing the income tax expense of the six-month period by US$17 million.

Liquidity and Capital Resources

Our principal cash requirements consist of the following:

- Working capital requirements;
- Debt and interest service; and
- Distribution to our shareholders.

Our principal sources of liquidity have traditionally consisted of the following:

- Cash flows from operating activities; and
- Short and long-term borrowings.

During the first six months of 2019 and 2018, cash flow generated by operations was primarily used for working capital requirements, investment activities, distributions to shareholders and to service our outstanding interest and debt obligations.

As of June 30, 2019, our cash and cash equivalents amounted to US$54 million.

Cash Flow

	Six months ended June 30,		***% Change***
In millions of U.S. dollars	**2019**	**2018**	
Cash from operating activities	121	136	*-11%*
Income tax paid	(2)	(3)	*-33%*
Net cash from operating activities	**119**	**133**	***-11%***
Net cash used in investing activities	**(20)**	**(6)**	***233%***
Net cash used in financing activities	**(96)**	**(79)**	***22%***
Net increase in cash	**3**	**48**	***-94%***
Cash and cash equivalent as of January 1	50	47	*6%*
Effects of variations on exchange difference on held cash	1	-	-
Cash as of June 30	**54**	**95**	***-43%***

Cash Flows from Operating Activities

Our primary source of operating funds is cash flow generated from our operations. The net cash from operating activities decreased by US$14 million, or 11%, to US$119 million during the first six months of 2019 from US$133 million during the same period in 2018.

The cash provided by operating activities decreased by US$15 million, to US$121 million during the first six months of 2019 from US$136 million during the same period in 2018. The decrease was driven by: (i) US$10 million increase in payments to suppliers and third parties, mainly due to the higher purchase of energy and capacity, partially offset by lower gas consumption; and, (ii) US$5 million decrease in our collections mainly explained by invoices collected in the first week of July.

Income tax payment decreased by US$1 million, to US$2 million during the first six months of 2019 in comparison with US$3 million for the same period in 2018 due to the application of income tax credit from previous year.

Cash Flows Used in Investing Activities

Net cash flows used in our investing activities increased by US$14 million or 233% to US$20 million during the first six months of 2019 from US$6 million during the same period in 2018.

During the first six months of 2019, cash from investing activities was mainly used for: (i) US$12 million in payments related to the option agreements signed with distribution companies to extend the contract terms of certain PPAs, recorded as intangibles; (ii) US$3 million in payments related to the programmed major maintenance of the steam turbine (Kallpa IV); (iii) US$3 million in payments related to the long-term service agreement with Siemens and Andritz; and (iv) US$2 million in the acquisition of other property, plant and equipment.

During the first six months of 2018, cash from investing activities was mainly used for: (i) US$4 million in payments related to the long-term service agreement with Siemens; and (ii) US$2 million in the acquisition of other property, plant and equipment.

Cash Flows Used in Financing Activities

Net cash flows used in our financing activities increased by US$17 million or 22% to US$96 million during the first six months of 2019 from US$79 million during the same period in 2018.

During the first six months of 2019, cash from financing activities was mainly used for (i) US$48 million of dividends to shareholders; (ii) US$21 million of capital reduction; (iii) US$24 million of interest service and (iv) US$3 million of debt amortization.

During the first six months of 2018, cash from financing activities was mainly used for (i) US$27 million of dividends to shareholders; (ii) US$26 million of capital reduction; (iii) US$24 million of interest service; and (iv) US$2 million of debt amortization.

For the three-month period ended June 30, 2019 and 2018

	Three months ended June 30		% Change
	A	B	
In millions of U.S. dollars	**2019**	**2018**	
Revenues	144	135	*7%*
Cost of sales (excluding depreciation)	(63)	(58)	*9%*
Depreciation	(12)	(14)	*-14%*
Administrative expenses	(7)	(5)	*40%*
Other income, net	2	1	*100%*
Operating profit	**64**	**59**	***8%***
Finance income	-	-	*0%*
Finance expenses	(13)	(13)	*0%*
Net foreign exchange difference	1	(1)	*-200%*
Finance cost, net	**(12)**	**(14)**	***-14%***
Profit before income tax	**52**	**45**	***16%***
Income tax expense	(16)	(15)	*7%*
Profit for the period	**36**	**30**	***20%***

Results of Operations

The Company's net income for the three-month period ended June 30, 2019 amounted to US$36 million compared to US$30 million during the same period in 2018. The Company's results were mainly explained by the following:

Revenues

Revenues increased by US$9 million or 7%, to US$144 million during the second quarter of 2019, from US$135 million during the same period in 2018, mainly due to higher energy and capacity sales under PPAs from an increase in the demand of non-regulated customers. Energy sales increased to 2,570 GWh during the second quarter of 2019 from 2,326 GWh during the same period in 2018, mainly explained by (i) higher consumption from the Southern Peru Corporation PPA related to the Toquepala mine expansion (up to 80 MW) and (ii) the new Tintaya PPA (up to 74 MW). This was partially offset by lower sales in the spot market due to lower thermal generation mainly due to the programmed major maintenance of the steam turbine (Kallpa IV) between April and May 2019.

Cost of Sales

Cost of sales increased by US$5 million, or 9%, to US$63 million during the second quarter of 2019 from US$58 million during the same period in 2018, mainly as a result of:

- US$6 million increase in energy and capacity purchases in the spot market explained by net purchases of 906 GWh during the second quarter of 2019 compared to 279 GWh during the same period in 2018 in connection with higher PPA consumption from customers and lower thermal generation mainly due to the programmed major maintenance of the steam turbine (Kallpa IV) between April and May 2019, added to a higher marginal cost (US$8.2/MWh during the second quarter of 2019 compared to US$8.0/MWh in the same period in 2018); partially offset by

- US$1 million decrease in our gas supply expenses, mainly due to the decrease in gas consumption to 6,278,738 MMBTU during the second quarter of 2019 from 8,892,242 MMBTU during the second quarter of 2018, related to lower thermal generation in connection with the programmed major maintenance of the steam turbine (Kallpa IV) between April and May 2019.

Depreciation and amortization

Depreciation and amortization decreased by US$2 million, or 14%, to US$12 million during the second quarter of 2019 from US$14 million during the same period in 2018, mainly due to the end of the useful life of certain assets.

Administrative Expenses

General, selling and administrative expenses increased by US$2 million, or 40%, to US$7 million during the second quarter of 2019 from US$5 million during the same period in 2018, mainly explained by:

- US$1 million increase in personnel expenses as a result of Kallpa and OEP management integration; which is compensated by an increase in Other income related to the Management Service Agreement with related companies, including OEP.
- US$1 million increase in third-party services mainly human resourses and regulatory consulting, community services and other minor expenses.

Other Income, net

Other income, net increased by US$1 million, or 100%, to US$2 million during the second quarter of 2019 from US$1 million during the same period in 2018, mainly due to the Management Service Agreement with OEP.

Finance cost, net

Finance cost, net decreased by US$2 million, or 14%, to US$12 million during the second quarter of 2019 from US$14 million during the same period in 2018, mainly due to a variation of US$2 million in the net foreign exchange.

Income tax expense

Tax expenses increased by US$1 million, or 7%, to US$16 million during the second quarter of 2019 from US$15 million during the same period in 2018, mainly due to a higher taxable income. The estimated average effective annual tax rate for the second quarter of 2019 is 31% (33% for the same period in 2018).

Appendixes

EBITDA reconciliation from operating income

In millions of U.S. dollars	Six months ended June 30, 2019	Six months ended June 30, 2018	Three months ended June 30, 2019	Three months ended June 30, 2018
Operating profit	126	120	64	59
Depreciation[3]	26	27	13	14
Total EBITDA	**US$152**	**US$147**	**US$77**	**US$73**

Material Indebtedness

In millions of U.S. dollars	**Outstanding Principal Amount as of Jun. 30, 2019**	**Nominal Interest Rate**	**Final Maturity**	**Amortization**
Long-term debt:				
Unsecured:				
4.125% Senior Notes due 2027	643	4.13%	Aug-2027	Principal due at maturity with semi-annual interest payments
4.875% Senior Notes due 2026	343	4.88%	May-2026	Principal due at maturity with semi-annual interest payments
Secured:				
Las Flores financial lease	71	5.08%	Oct-2023	Quarterly principal payments to maturity
Total	**US$1,057**			

Note: Values net of transaction costs

[3] Includes depreciation classified as Administrative expenses in our financial statements.

Changes in IFRS and effects in Financial Statements

Financial Statements as of June 30, 2019 were prepared applying IFRS 16 – Leases, as the Company has adopted from January 1, 2019.

IFRS 16 introduces a single, on-balance sheet accounting model for lessees. As a result, the Company, as a lessee, has recognized right of use of assets representing its rights to use the underlying assets and lease liabilities representing its obligation to make lease payments.

For additional information, refer to Note 2D in the Unaudited Condensed Interim Financial Statements as of June 2019.

Arbitration procedure related to the termination of Kallpa's Legal Stability Agreement

On November 16, 2010, the Company and the Peruvian State (through Proinversion) executed a Legal Stability Agreement ("LSA").

On December 27, 2016, the Company informed Proinversion of its resignation to the tax stability granted under the LSA.

On February 7, 2018, the Peruvian State indicated that the LSA was terminated by force of law, as from November 17, 2011, since the Company did not comply with a formal matter related to the issuance of shares in connection to a capital contribution.

On October 26, 2018, the Company filed an arbitration requesting:

a) That the LSA was not terminated on November 17, 2011 but on December 27, 2016, date on which Kallpa informed the Peruvian State of its resignation to the legal stability granted under the LSA.
b) That the Peruvian State is obliged to reimburse Kallpa all amounts paid due to the higher tax obligations imposed according to the stabilized tax regime, in the event the Arbitration Panel rules that the LSA was terminated on November 17, 2011 instead of December 26, 2016.

On December 28, 2018, as part of the defense strategy, the Company filed a refund request before SUNAT for income tax paid in excess for fiscal year 2013.

In relation to the arbitration proceeding, Proinversion accepted Company's request to arbitrate. The arbitral tribunal was set-up and the Company filed its arbitral claim on February 11, 2019. Proinversion responded such request and the oral hearing took place on March 1, 2019. The arbitration award, issued on April 1, 2019, concluded that the LSA was terminated on November 17, 2011 and that, the Peruvian State is not obliged to reimburse the Company for amounts paid while the agreement was inforce. In this sense, the Company is entitled to any refund generated by a recalculation of income tax in the fiscal years from 2013 to 2018.

In the opinion of Company's management and its legal advisors it is more likely than not that the Company will obtain a refund of US$ 10,609 thousand, included interests, corresponding only to the 2013 refund request filed. Therefore, Kallpa has recorded US$ 8,041 thousand as income tax receivable. In addition, the Company has recognized an income tax liability of US$ 6,935 thousand corresponding to the years 2016, 2017 and 2018.

For additional information, refer to Note 17 in the Unaudited Condensed Interim Financial Statements as of June 2019.