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

March 31, 2018 and 2017

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 operating thermal plants use natural gas to produce electricity. Our generation capacity is aproximately 100% contracted under PPA's with an average life of approximately 8 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 installed capacity of 555 MW, is the largest privately owned hydroelectric power plant in Peru. On August 25, 2016, the Company declared the COD of the plant, consisting of a six 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. This increased total capacity of CDA to 555 MW.

As part of a strategy to optimize its operations and as both companies shared a common management team and shareholders, 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. Upon effectiveness of the merger, the combined entity would be renamed to Kallpa Generación S.A. On August 16, 2017, Kallpa and CDA effectively merged and CDA become 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 Holdingts LLC, and other newly formed holding companies that are indirectly owned by certain funds managed by I Squared Capital Advisors (US) LLC (collectively, the "Sponsor"). The Sponsor is our controlling shareholder with 74.9% of the Company. The remaining 25.1% is held by Energía del Pacífico. Energía del Pacífico is a member of the Quimpac group, a Peruvian chemical company.

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.

Our Notes

On May 24, 2016, Kallpa 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 (KII) and Kallpa III (KIII) natural gas turbines; (ii) the Kallpa local bonds due 2022; (iii) the syndicated loan; (iv) US$45 million of short-term loans and (v) general corporate purposes. Through this transaction, Kallpa was able to refinance the vast majority 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 former Cerro del Aguila 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.

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 financial statements as of March 31, 2018 and 2017. This is the first set of financial statements where IFRS 9 - Financial Instruments and IFRS 15 - Revenue from Contracts with Customers have been applied, as the Company has initially adopted both from January 1, 2018. As a result, the changes in accounting policies are reflected in the financial statements as of March 31, 2018. Refer to the section Appendixes for further explanation.

For the three-month period ended March 31, 2018 and 2017.

In the following table, columns A and B show the Statement of Profit or Loss and Other Comprehensive Income for March 2018 and 2017 as presented in that set of financial statements. For comparison purposes, we have included column C that shows March 2017 reexpresed as if the IFRS 15 had been applied since January 1, 2017 and column D that shows the percentage change comparing 2018 and 2017.

All of the explanations below are based on columns A, C and D to compare financial results applying same accounting standards.

	Three months ended March 31		***% Change***	***Applying IFRS 15 As of March 31***	***% Change***
	A	**B**		**C**	**D**
In millions of U.S. dollars	**2018**	**2017**		**2017**	
Revenues	134	137	*-2%*	106	*26%*
Cost of sales (excluding depreciation)	(57)	(79)	*-28%*	(48)	*19%*
Depreciation	(13)	(13)	*0%*	(13)	*0%*
Administrative expenses	(4)	(7)	*-43%*	(7)	*-43%*
Other income (expenses), net	1	1	*0%*	1	*0%*
Profit from operating activities	**61**	**39**	***56%***	**39**	***56%***
Finance income	-	-	*0%*	-	*0%*
Finance costs	(13)	(17)	*-24%*	(17)	*-24%*
Net foreign exchange difference	1	2	*-50%*	2	*-50%*
Finance cost, net	**(12)**	**(15)**	***-20%***	**(15)**	***-20%***
Profit before income tax	**49**	**24**	***104%***	**24**	***104%***
Income tax expense	(15)	(5)	*200%*	(5)	*200%*
Profit for the year	**34**	**19**	***79%***	**19**	***79%***

Results of Operations

The Company's net income for the first quarter of 2018 amounted approximately US$34 million compared to US$19 million during the same period in 2017. The Company's results were mainly explained by the following:

Revenues

Revenues increased by US$28 million or 26%, to US$134 million during the first quarter of 2018 from US$106 million during the same period in 2017, due to higher energy and capacity associated with the start in January 2018 of the 202 MW 10-year PPA with distribution companies and the start in April 2017 of the 120 MW 10-year PPA with Southern Copper.

Cost of Sales

Cost of sales increased by US$9 million, or 19%, to US$57 million during the first quarter of 2018 from US$48 million during the same period in 2017, mainly as a result of:

- US$5 million increase in our gas supply expenses, mainly as a result of a 36% increase in the volume of gas used due to the 34% increase in Kallpa's thermal power plants dispatch, to 1,185 GWh during the first quarter of 2018 from 882 GWh during the same period in 2017.

- US$1 million increase in capacity purchases mainly due to the start of the PPAs stated above and to cover the unused variable part already contracted that reduce the available capacity needed for PPAs.
- US$ 1 million increase in energy purchases required in February due to the incident in gas distribution that generated a gas shortage for 10 days to all thermal generation in Peru, including Kallpa.
- US$1 million increase in operating expenses, explained by diverse variations, mainly including variable regulatory charges that increased due to the higher revenues, among others.
- US$1 million increase in services related to the CDA plant, mainly facilities maintenance that were allocated as operating expenses in 2018 and were considered administrative expenses during 2017.

Depreciation and amortization

Depreciation and amortization remain unchanged in US$13 million for both periods.

Administrative Expenses

General, selling and administrative expenses decreased by US$3 million, or 43%, to US$4 million during the first quarter of 2018 from US$7 million during the same period in 2017, mainly due to a US$2 million reduction in personnel expenses and US$1 million decrease in services that were reallocated from administrative expenses in 2017 to operating expenses in 2018.

Other Income, net

Other income remained unchanged in US$1 million for both periods. This income is mainly related to the Operating Maintenance and Management Services Agreement with Samay.

Finance expenses, net

Finance expenses net decreased by US$3 million, or 20%, to US$12 million for the first quarter of 2018 compared to US$15 million during the same period in 2017, mainly as a result of:

- A US$4 million decrease, or 24%, in finance costs mainly related to the project debt refinancing through the Kallpa's 2027 notes (from more than 7% to 4.125%) and the lower interest expenses of Las Flores financial lease due to the rate reduction obtained in May 2017 (from 7.15% to 5.08%).

These effects were partially offset by:

- A US$1 million decrease, or 50%, in net foreign exchange difference as a result of the 0.4% appreciation of the Peruvian sol against the U.S. dollar during the first quarter of 2018, as compared to the 3.2% appreciation during the same period in 2017.

Taxes on Income

Tax expenses increased by US$10 million, or 10%, to US$15 million during the first quarter of 2018 from US$5 million during the same period in 2017, due to a higher profit before income tax. In addition, the estimated average effective income tax rate changed to 31% in 2018 from 21% in 2017. In 2017, the effective tax rate differed from the current tax rate of 30% mainly due to the effects of translating taxable bases and other permanent items.

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-term and long-term borrowings.

During the first quarter of 2018 and 2017, cash flow generated by operations was primarily used for working capital requirements, investment activities and to service our outstanding interest and debt obligations.

As of March 31, 2018, our cash and cash equivalents amounted US$69 million.

Cash Flow

	Three months ended March 31,		*% Change*
In millions of U.S. dollars	**2018**	**2017**	
Cash from operating activities	67	65	*3*
Income tax paid	(1)	(4)	*(75)*
Net cash from operating activities	**66**	**61**	***8***
Net cash used in investing activities	**(3)**	**(15)**	***(80)***
Net cash used in financing activities	**(41)**	**(41)**	***-***
Net increase (decrease) in cash	**22**	**5**	***340***
Cash and cash equivalent as of January 1	47	58	*(19)*
Effects of variations on exchange difference on held cash	-	-	-
Cash as of March 31	**69**	**63**	***10***

Cash Flows from Operating Activities

Our primary source of operating funds is cash flow generated from our operations. The net cash from operating activities was US$66 million during the first quarter of 2018 and US$61 million during the same period in 2017 or an 8% increase.

The cash provided by operating activities increased by US$2 million, to US$67 million during the first quarter of 2018 from US$65 million during the same period in 2017. This increase was driven by: (i) a US$40 million increase in our collections due to the increase in revenues; and (ii) a US$38 million increase in payments to suppliers and third parties, including US$ 10 million in value added tax payments and a US$7 million payment under protest to the Peruvian tax authority related to import taxes allegedly owed by the Company in connection with imported equipment for the installation and construction of Kallpa III project. For the latest, the corresponding judicial actions were filed in March 2018,

In addition, income tax payments decreased by US$3 million, to US$1 million during the first quarter of 2018 from US$4 million for the same period in 2017, due to the higher tax depreciation in 2018 compared to 2017 that generated a lower taxable base.

Cash Flows Used in Investing Activities

Net cash flows used in our investing activities decreased by 80% to US$3 million during the first quarter of 2018 from US$15 million during the same period in 2017.

During the first quarter of 2018, cash from investing activities was mainly used for quarterly payments of the long-term service maintenance agreement with Siemens.

During the first quarter of 2017, cash from investing activities was mainly used for (i) US$3 million in payments related to the major maintenance of KIII; (ii) US$ 11 million in payments related to the construction of the CDA plant and (iii) quarterly payments of the long-term service maintenance agreement with Siemens.

Cash Flows Used in Financing Activities

Net cash flows used in our financing activities remained unchanged, US$41 million for both periods.

During first quarter of 2018, Kallpa's main uses were (i) US$26 million of capital reduction; and (ii) US$15 million of interest service.

During first quarter of 2017, Kallpa's main uses were (i) US$25 million for dividends to our shareholders; (ii) US$11 million of interest service; and (iii) US$5 million of principal payments.

Appendixes

Changes in IFRS and effects in Financial Statements

Financial Statements as of March 31, 2018 is the first set of financial statements where IFRS 9 - Financial Instruments and IFRS 15 - Revenue from Contracts with Customers have been applied, as the Company has initially adopted both from January 1, 2018. As a result, the changes in accounting policies are reflected in the financial statements as of March 31, 2018.

Effect of IFRS 9 application: IFRS 9 sets out requirements for recognizing and measuring financial sets, financial liabilities and some contracts to buy or sell non-financial items. IFRS 9 requires that entities must recognize a gain or loss at the date of modification when a financial liability measured at amortized cost is modified. By using the previous accounting standard in place, IAS 39, as a result of the refinancing with Kallpa's notes due 2026 certain refinancing expenses were considered as transaction costs and therefore, the difference between the original and modified cash flows was amortized over the remaining term of the modified liability by re-calculating the effective interest rate, with no recognition of a gain or loss at the date of modification. With the new standard applied at balance sheet date, the carrying amount of said liabilities increase by the amount of US$13,752 thousand.

Impact on the condensed interim statement of financial position as of January 1, 2018:

In thousands of US dollars	**Impact of adopting IFRS 9 at January 1, 2018**
Increase financial liabilities	13,752
Decrease deferred tax liabilities	4,057
Decrease retained earnings	9,695

Effect of IFRS 15 application: IFRS establishes a comprehensive framework for determining whether, how much and when revenue is recognized. Under IFRS 15, revenue is recognized when a customer obtains control of the goods or services. Up to December 31, 2017, the Company presented the main and secondary transmission toll payments as cost of services and the reimbursement as revenue as per the industry's general use. However, the transmission services are provided by a transmission entity and Kallpa merely pays for the use of the transmission lines, but there is no separate performance obligation. From January 1, 2018, the transmission costs are presented as net expenses in the cost of sales. Thus, the change affects presentation of line items in the statement of profit or loss, decreasing revenue and costs of sales for the same amount (US$ 31 million) but **with no effect in the gross or net profit**. In addition, there is no impact on the Company's condensed interim statement of cash flows.

For additional information, refer to Note 2D in the financial statements as of March 2018.

EBITDA reconciliation from operating income

	Three months ended March 31, 2018	Three months ended March 31, 2017
	(in millions of U.S. dollars)	
Operating income	61	39
Depreciation and amortization	13	13
Total EBITDA	**US$74**	**US$52**

Material Indebtedness

	Outstanding Principal Amount as of March 31, 2018 (US$ millions)	Interest Rate	Final Maturity	Amortization
Long-term debt:				
Secured:				
Las Flores financial lease.............	80	5.08%	October 2023	Quarterly principal payments to maturity
Unsecured:				
4.875% Senior Notes due 2026	342	4.875%	May 2026	Principal due at maturity with semi-annual interest payments.
4.125% Senior Notes due 2027	642	4.125%	August 2027	
Total	**US$1,064**			

Note: values net of transaction costs